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How Hispanics in the U.S. Fare Under the Privatization of Social Security

Avery M. Blank ’08

The privatization of Social Security will harm Hispanics in the United States. Hispanics benefit greatly from the current system of Social Security because it helps people with the following characteristics: those who have (1) lower-than-average income, (2) higher incidence of disability, (3) more children per family, and (4) longer-than-average life expectancies. Unlike other ethnic/racial groups, Hispanics have all four of these characteristics. This suggests that Hispanics benefit the most from the current system and, in turn, that Hispanics would be most affected by changes to the current system. Although there are studies suggesting that Hispanics will benefit from the privatization of Social Security, some of these studies, however, contain major flaws that undermine their conclusions. They neglect to discuss transition costs and stock market risk. They also make incorrect assumptions. Specifically, they assume that Hispanics have financial knowledge and/or experience and Hispanics have similar life expectancies to other population groups. Lastly, these pro-privatization studies consist of methodological flaws.

The immense growth of the Hispanic population in the United States over the last few decades magnifies the impact of the potential privatization of Social Security. Changes to the current Social Security system will not only harm the current Hispanic population, but it will also harm future generations of Hispanics. If the Hispanic population makes poor investment choices, then more people will be worse off, ultimately adding to the poverty crisis in this country. If the current Social Security system cannot be maintained, the government must make sure that the changes will still benefit Hispanics.
minority workers have had in acquiring wealth.” This reasoning, however, is flawed because it assumes that everyone can actually save. For people with less means, it is very difficult to save because the money that they have is needed for basic necessities, undermining any opportunity they might have to save for the future.

The immense growth of the Hispanic population in the United States over the last few decades magnifies the impact of the potential privatization of Social Security. Changes to the current Social Security system will not only harm the current Hispanic population, but it will also harm future generations of Hispanics. If the Hispanic population makes poor investment choices, then more people will be worse off, ultimately adding to the poverty crisis in this country. If the current Social Security system cannot be maintained, the government must make sure that the changes will still benefit Hispanics.

Background: Social Security and Hispanics

Social Security

Social Security in the United States is comprised of several programs that help to do the following: (1) “provide for the material needs of individuals and families,” (2) “protect aged and disabled persons against the expenses of illness that may otherwise use up their savings,” (3) “keep families together,” and (4) “give children the chance to grow up healthy and secure.”

Social Security was developed in response to the 1930s economic crisis. During the Great Depression, there was a tremendous increase in poverty among the elderly. It is believed that more than 50% of the elderly population did not have enough income to be self-supporting. Also, the stock market crash caused banks and businesses to fail and the country’s unemployment rate to rise. To try and meet the nation’s needs, President Franklin D. Roosevelt signed the Social Security Act on August 14, 1935. This act provided benefits to the unemployed and retirees. It also established a system in which workers could contribute to their future benefits by putting earned income into a joint fund that they would access when they retired. In 1950, the enactment of amendments to the Social Security Act increased benefits for those contributing to the Social Security system.

Although factors such as poverty in the elderly and the stock market crash played a major role in the development of Social Security, race at the time, according to Daniel Béland, did not. Race, however, does play a very important role in the current debate over Social Security privatization. Béland believes that race is the face of “identity politics,” a term coined to explain the political action used by people to advance

1 The programs under Social Security include: Retirement insurance, Survivor’s insurance, Disability insurance, Hospital and medical insurance, Prescription Drug Benefit, extra help with Medicare Prescription Drug Costs, Supplementary security income, Special Veterans Benefits, Unemployment insurance, and Public assistance and welfare services.

the interests of members of an oppressed group. Identity politics is something being practiced more and more today. As such, race, as well as other demographic changes (i.e. aging population) indicate an apparent need to change the current system of Social Security. President George Bush believes that Social Security must be strengthened for future generations of Americans. According to The White House publication “Strengthening Social Security for the 21st Century,” the current system will go into bankruptcy. Specifically, the government will be paying out more in Social Security benefits than it will be collecting in just 10 years (2017). Since instituting Social Security, the number of U.S. workers supporting each beneficiary has decreased. In 1950, sixteen workers supported one beneficiary of Social Security. In 2004, only 3.3 workers supported every one beneficiary. Now with the retirement of the baby boomer population, the ratio will only get worse. That is, fewer workers will be paying benefits for an ever-growing population of retirees. If this continues, the benefits of today’s 30-year-old worker will be cut by 27% when he or she reaches the age of retirement. Stated in another way, if the system is not changed, by 2027 the government will have to find an extra $200 billion a year to maintain the current system.5

Privatization. Many people, including the President, believe one of the best ways to curtail the system’s spiral into bankruptcy is via the privatization of Social Security. Privatization would allow people to put their money into private investments, such as the stock market, corporate bonds, and Treasury Bills. The President’s proposal for privatization is based on the assumption that one’s money will yield a higher rate of return if placed into a mix of bonds and equities compared with the current system.6

With the current system, contributors share the risk of paying into the program. Privatization, however, “shifts the risk onto [the] individual.”6 A person is putting their own money into their own account(s). President Bush’s plan would allow workers under the age of 55 to eventually put up to 4% of their payroll taxes (up to $1,000 annually) into a private account. Initially, annual contributions would be capped at $1,000 per year. The cap would gradually rise at a rate of $100 per year.7 But not all individuals are able to take this risk.

Hispanics

This paper uses the term “Hispanic” to mean a Spanish-speaking person of Latin American descent living

in the U.S.\textsuperscript{8} Statistics will help to better understand the Hispanic population as a whole in the U.S. All statistics are based on Hispanics who are U.S. citizens or lawful residents.

**Population.** In 1990, 22.4 million Hispanics lived in the United States.\textsuperscript{9} In 2000, Hispanics numbered 35.4 million. As of July 2006, Hispanics totaled 44.3 million, making up about 15\% of the nation’s population. Between 2000 and 2006, the Hispanic population increased by 25\%.\textsuperscript{10} They make up both the largest and fastest growing minority group in the United States. By the year 2050, it is projected that the Hispanic population will total 102.6 million, making up 24\% of the U.S. population (see Figure 1).\textsuperscript{11}

Just as astonishing are the growth rates of Hispanics at the state-level. Between 1980 and 2000, New York State saw a 6\% population increase in Hispanics. Texas saw an 11\% increase in the Hispanic population, and California saw a 12\% increase.\textsuperscript{12}

One reason the Hispanic population is growing so fast is that its population is young. Data collected by the U.S. Department of Commerce illustrates that Hispanics are the youngest population among the major ethnic/racial groups in the U.S. (see Figure 2). As of 2006, the median age of this ethnic/racial group was 27.4 years. The median age for the population as a whole was 36.4 years.\textsuperscript{13} As a result, there are more Hispanic women in their reproductive years than the rest of the population.

The Pew Hispanic Center conducted a population survey in 2004 and found similar results regarding the median ages. Compared to non-Hispanic Whites, Hispanics have an age distribution that is bottom-heavy, illustrating the youthfulness of this population group (see Figure 3).\textsuperscript{14} As of 2006, 23\% of the total population younger than five years of age was Hispanic.\textsuperscript{15}

While much of the Hispanic population is young, the group also has a longer life expectancy than both Whites and Blacks. Based on 2004 Census data, the Social Security Administration estimates that Hispanic men aged 65 generally live an additional 20 years, compared to approximately 16 years for

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Latinos are people of Latin American descent, so they fall under the term “Hispanic” (“Latino”).


\textsuperscript{11} “Hispanic Americans By the Numbers, From the U.S. Census Bureau,” *Infoplease*.


\textsuperscript{13} “Hispanic Americans By the Numbers, From the U.S. Census Bureau,” *Infoplease*.


\textsuperscript{15} “Hispanic Americans By the Numbers, From the U.S. Census Bureau,” *Infoplease*. 
all other men. Hispanic women aged 65
live an additional 23 years, whereas
women of other groups lived another 20
years (see Figure 4).16

Family. The fertility rate for
Hispanics is higher than the national
average. Currently, the average Hispanic
woman has about 2.8 children. The
national average is 2 children per woman.
There is evidence to suggest that the
fertility rate of Hispanic women will
continue to be above the national average
for years to come.17

In 2006, there were 9.9 million
Hispanic family households, and of those
households 62% contained children
younger than eighteen years of age.18
Because Hispanic women have higher
fertility rates than the rest of
the population, they generally have larger
families than non-Hispanics.19 Data
collected in March of 2002 by the U.S.
Census Bureau tells us that the average
size of an Hispanic family is 3.86,

16 F. Torres-Gil, R. Greenstein, and D. Kamin,
“The Importance of Social Security to the
Hispanic Community,” Center on Budget and Policy
Priorities, June 28, 2005, accessed 10 September
2007 <http://www.cbpp.org/6-28-
05socsec3.htm>.
17 Ibid.
18 “Hispanic Americans By the Numbers, From
the U.S. Census Bureau,” Infoplease.
19 This high fertility rate is culturally driven:
“Hispanics traditionally desire large families and
place great cultural importance on motherhood.
Many Hispanic women believe that bearing large
numbers of children will fulfill their expected
female role and will ensure that they have
someone to care for them and support them
financially in their old age.”
and Son Preference Among Hispanic Women of
Low Socioeconomic Status,” Family Planning
2007 <http://findarticles.com/p/articles/mi_qa3634/i
s_199711/ai_n8759817>.

compared to 3.05 for a non-Hispanic
family. The average number of people
under eighteen in Hispanic families is
1.47, where it is 0.89 for non-Hispanic
families. The average number of people
age eighteen and over in Hispanic
families is 2.39, compared to 2.16 for
non-Hispanic families.20

Education. Hispanics are more
likely to drop out of school and least
likely to complete school. In 2000, the
dropout rate for Hispanics was 28%.
This is higher than both the percentages
for Whites and Blacks (see Figure 5). In
2000, 64% of Hispanics ages 18 to 24
completed secondary schooling,
compar ed to 92% of Whites and 84% of
Blacks.21

Also, less Hispanics complete
college compared to Whites and Blacks.
In 2000, 34% of Whites and 18% of
Blacks ages 25-29 attained at least a
bachelor’s degree (see Figure 6). Only
10% of Hispanics completed a bachelor’s
degree or higher.22

Disability. Data from the U.S.
Census Bureau show that Hispanics, as of
2000, have a higher overall disability rate
than for non-Hispanic Whites.23 Also,

20 “Table AVG2. Average Number of People per
Family Household, by Race and Hispanic Origin,
Marital Status, Age, and Education of
Householder: March 2002,” US Census Bureau,
accessed 30 September 2007
<http://www.census.gov/population/socdemo/h
h-fam/cps2002/tabAVG2.xls>.
21 “Status and Trends in the Education of
Hispanics,” National Center for Education Statistics,
April 2003, accessed 2 October 2007
22 Ibid.
23 “Disability Status: 2000,” US Census Bureau,
2000, accessed 3 October 2007
<http://www.census.gov/mso/www/pres_lib/c2k
_disab_RTF.rtf>.
Hispanics have the highest disability rate for ages 55-64. 24

Employment. With such a large population, Hispanics make up the second largest ethnic or racial group in the labor force behind Whites. Because Hispanics generally have lower levels of education and experience, the majority of Hispanics work low-skill jobs. 25 Compared to Asians, Whites, and Blacks, Hispanics are less likely to work in management and professional occupations (see Figure 7). 26 Consequently, the majority of Hispanics have lower incomes compared to other population groups.

Income. Hispanics do not receive high incomes by working low-skill occupations. In 1996, the median income of Hispanic males was $17,474. This is 78% of what non-Hispanic White males were making ($22,153). The median income of Hispanic females ($8,382) was 62% of the income of non-Hispanic White females ($13,431). 27

In 2002, the median income for Hispanics in jobs covered by Social Security was $22,400. The median income for all covered workers was $28,400. Accordingly, the median income for Hispanic workers covered by Social Security in 2002 was 20% lower than all covered workers. 28

Poverty. As of 2005, 22.5% of Hispanics lived in poverty. Only 8.2% of Whites lived below the poverty level. 29 Social Security, however, has helped many Hispanic elderly escape from poverty. In 2002, the poverty rate for Hispanic elderly with Social Security was 18%, compared to a rate of 51% for those without Social Security. 30

Social Security. Approximately 19.4 million Hispanics in 2005 contributed to the Social Security system, which represents about 93% of Hispanic workers paying into the system. 31 Hispanic elderly depend more on Social Security for their income than any other group. In 1996, approximately 44% of Hispanics aged 65 and older relied on Social Security for 90% or more of their income. Whites only relied on Social Security for 29% of their income. 32 While Hispanics are the most dependent on Social Security, they are also the group that receives the least amount of benefits. In 2003, the average annual benefit

received by elderly Hispanics was about $8,497. Elderly Whites, on the other hand, received an average benefit of about $10,621. The Pew Hispanic Center calculated that in 2005, 16% of Hispanic couples were not receiving benefits. Only 8% of White couples and 11% of Black couples were not receiving benefits.

Literature Review

Pro-privatization
- William W. Beach and Gareth G. Davis for the Heritage Foundation
- Martin Feldstein and Jeffrey B. Liebman

The Heritage report claims that the current Social Security system does not help many socioeconomic groups, including Hispanics. Regarding the current system of Social Security, Beach and Davis believe that (1) its “low rate of return cost Hispanics potential retirement savings,” (2) the current system “also pays a very low rate of return for two-income Hispanic households with children,” and (3) “the rate of return has a damaging impact on communities.”

Beach and Davis argue that Hispanics would fare better under the privatization of Social Security. Specifically, they say that Hispanics would receive a larger rate of return by placing their payroll taxes “in even the most conservative private investments.” They identify compound interest as one of the ways in which Hispanics can receive a greater return rate (in comparison to the current system). The report uses a case scenario to illustrate how compound interest with private accounts can significantly help people, including Hispanics, accumulate wealth. Beach and Davis use “The Heritage Foundation’s Social Security Rate of Return Microsimulation Model to compare the benefits different types of families can expect to receive from the [Old Age and Survivors Insurance (OASI)] with the Social Security taxes they pay during their working lives.”

The Liebman-Feldstein study also argues that Hispanics would receive a larger rate of return with the privatization of Social Security. This study “compares hypothetical benefits under both a ‘pure’ individual account system and a ‘mixed’ system that combines a scaled-back Social Security system with more modest individual accounts to the benefits that the current Social Security system provides.” The study finds that, over time, individuals would have higher benefits with the individual account system.

Anti-privatization
- Fernando Torres-Gil, Robert Greenstein and David Kamin for the Center of Budget and Policy Priorities
- National Council of La Raza

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It has been found that Hispanics receive a higher average rate of return on Social Security contributions. Both the Center on Budget and Policy Priorities and the National Council of La Raza identify the following reasons why Hispanics benefit disproportionately from Social Security compared to any other group because of economic and demographic reasons: Hispanics have (1) lower lifetime earnings, (2) more children per family, (3) a high incidence of disability, and (4) longer life expectancies.

Both sources argue against the privatization of Social Security. Specifically, the Center on Budget and Policy Priorities evaluates past studies that conclude privatization of Social Security to be advantageous for Hispanics (i.e. the Liebman-Feldstein study and Heritage Report). The authors identify improper assumptions the studies make and the flaws in their methodology.

Unlike the Center on Budget and Policy Priorities, the National Council of La Raza also discusses how privatization of Social Security might benefit Hispanics. It says that privatization could “encourage personal saving and self-reliance, give individuals more choices, and allow them a chance to get higher returns on tax contributions in exchange for assuming more risks in the stock market.” Nonetheless, the Council uses information regarding the experience of Hispanics with individual retirement savings to refute the possibility that privatization could help Hispanics. It concludes by identifying the areas that must be addressed for Hispanics to actually benefit from the privatization of Social Security.

**Analysis: Will privatization work for Hispanics?**

**Why Hispanics benefit from current Social Security system**

The purpose of the Social Security system is to “provide for the [basic] needs of individuals and families” and “protect aged and disabled persons against the expenses of illness that may otherwise use up their savings.” The Hispanic population has certain characteristics that match the characteristics of those who would benefit from Social Security. Statistics show that the Hispanic community has (1) lower-than-average income, (2) a high incidence of disability, (3) more children per family, and (4) longer-than-average life expectancies.

**Lower-than-average income.**

Hispanics earn less than the population as a whole. As a result, they cannot contribute a significant amount into the Social Security system. The current system asks all of its participants to

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38 Other important and unique aspects that these sources discuss: The Center of Budget and Policy Priorities report discusses why the elderly within the Hispanic community depend so much more on Social Security than other population groups. It also shows how Social Security helps this particular group within the community overcome poverty. The National Council of La Raza identifies the immense size of the Hispanic population in the U.S. as an important reason why any change to the current Social Security system will affect a great number of people.


contribute a certain percentage of their income. The system redistributes all the money collected among all of the contributors. This is known as the progressive benefit formula. As a result, Hispanics generally receive more money than they initially contributed.\footnote{There are factors than can, in fact, reduce the Hispanics’ high return rate, and they consist of the following: (1) the threshold to qualify for benefits and (2) lower mortality rates and survivor benefits. You must work and contribute into the system for at least ten years to receive Social Security benefits. Hispanic immigrants or Hispanics with a disability may have short work histories, making it difficult to attain the ten year threshold to qualify for benefits. Also, working-age Hispanics tend to have lower mortality rates, which would reduce the amount of survivor’s benefits. Nonetheless, these factors are not strong enough to outweigh the high rate of return. F. Torres-Gil, R. Greenstein & D. Kamin, “The Importance of Social Security to the Hispanic Community,” Center on Budget and Policy Priorities.}

High incidence of disability. Hispanics have a high rate of employment disability. Approximately 17\% of employed Hispanics aged sixteen to sixty-four have a disability (about the same percentage as non-Hispanic Blacks), compared to 10\% of non-Hispanic Whites.\footnote{“The Social Security Program and Reform: a Latino Perspective,” National Council of La Raza, p. 4.} Hispanics with employment disability will start collecting from Social Security before they retire. The more years they collect from the system, the more money they will receive.

More children per family. Social Security provides benefits to children who are dependent on “retired, deceased, or disabled workers.”\footnote{F. Torres-Gil, R. Greenstein & D. Kamin, “The Importance of Social Security to the Hispanic Community,” Center on Budget and Policy Priorities.} Because Hispanics have a relatively high incidence of disability, Hispanic families can collect the benefits paid to their children. Because Hispanics tend to have more children per family, they can collect more benefits from the system.\footnote{Ibid.} More children per family means that the length of time that the family will receive additional benefits is longer (compared to a family, for example, with one child that will lose its additional benefits once that child turns eighteen years of age).

Longer-than-average life expectancies. In general, Hispanics live longer than the other ethnic/racial groups, including Whites and Blacks. A beneficiary of the system continues to receive Social Security benefits until they die. Therefore, Hispanics are receiving benefits for more years than others in the population. The more years they receive benefits, the more money they are collecting. As a result, Hispanics’ longer-than-average life expectancies is also allowing them to collect more money than the amount they put into the system.\footnote{Ibid.}

Data collected by the Social Security Administration tell us that elderly Hispanics depend on Social Security for income. Approximately 51\% of Hispanic beneficiaries receive more than 90\% of their income from Social Security, compared to 34\% of all other beneficiaries (see Figure 8). The Social Security Administration has found that Social Security has helped the elderly in the Hispanic community to combat poverty.\footnote{Ibid.} Based on a 2000 census, 55\% of Hispanic persons age 65 and above
were below the poverty line without Social Security. But with Social Security, only 16% remained below the poverty line. Thus, Social Security helped keep 39% of Hispanic elderly out of poverty (see Figure 9).  

It is also important to discuss the “Hispanic paradox.” In a 2006 article entitled “The Aging Hispanic Population: Prescriptions for Health and Economic Security in Old Age,” Valentine Villa highlights how Hispanics have lower death rates than better-off non-Hispanic whites, even though they have a relatively poor overall socioeconomic status. As a result, they are living longer with disability and poor health. This is another reason why Hispanics depend on Social Security. The current system can provide them with a reliable source of income.

How well does the current Social Security system actually work for Hispanics?

The current Social Security system works well for Hispanics. This paper examines participation levels by Hispanics and the level of Hispanic dependency on the system for income.

Participation. Hispanics have a high participation rate. A large number of Hispanic workers contributed to Social Security in 2005 (discussed in detail in “Background” section). In 2002, 77% of elderly Hispanics (65 years and older) received retirement benefits from Social Security. Hispanics are also more likely to receive disability benefits.

Percentage of Income. The National Council of La Raza maintains that “Social Security is by far the most important source of income for elderly Latinos who receive benefits.” Hispanics in the U.S. received a total of $13 billion in Social Security benefits in 2002. About 75% of a Hispanic beneficiary’s income comes from Social Security. Also, Social Security acts as 40% of the income for Hispanic married couples over age 65 (see Figure 10).

For 31% of elderly Hispanic couples and almost 50% of unmarried elderly Hispanics, Social Security is the only source of income, compared to 11% of elderly White couples and 25% of elderly White singles. This high level of dependency demonstrates how important the current Social Security system is to Hispanics.

How privatization might be beneficial to Hispanics

Privatization can help anyone who participates receive a higher rate of return. For Hispanics, this means that they have the possibility of receiving even more money from Social Security than they are currently. Both the Liebman and Feldstein study and the Heritage Foundation Report have concluded that Hispanics would fare very well under privatized Social Security.

Economists Jeffrey Liebman and Martin Feldstein believe that everyone, including Hispanics, would benefit from

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privatized Social Security because they would receive higher rates of return.\(^5^4\) The 1998 Heritage Foundation Report claims that the current “Social Security system’s rate of return for most Hispanic Americans will be vastly inferior to what they could expect from placing their payroll taxes in even the most conservative private investments.”\(^5^5\)

The 1998 Heritage Report provides a case scenario to show how compound interest with private accounts can significantly help everyone, including Hispanics, accumulate wealth:

An average-income, two-earner couple (both aged 32 years in 1997) with two children can expect to receive about $420,400 in Social Security benefits in return for a lifetime of payroll taxes. By investing these same tax dollars in a portfolio made up of 50 percent U.S. Treasury bonds and 50 percent blue-chip equities, however, this couple could command an estimated $767,100 of after-tax retirement income in 1997 dollars. Even an investment portfolio composed entirely of intermediate and long-term U.S. Treasury bonds outperforms Social Security: By the time of retirement, this couple would generate a lifetime retirement post-tax income of $526,400.

Hence, staying in the Social Security program means that average-income, married Hispanic couples in this age group will bear costs between $106,000 and $346,700 in retirement savings they could have enjoyed if current law had given them the ability to invest their payroll taxes in super-safe U.S. Treasury bonds or in a prudent mix of Treasury bonds and high-grade equities. These dollar differences, depicted in [Figure 11], translate into significant differences in rates of return. Social Security "produces" a 2.17 percent inflation-adjusted rate of return for this couple. If the couple invested its payroll taxes entirely in Treasury bonds, however, they would receive a return rate of 3.17 percent while an even mix of bonds and equities would produce an annualized return of 4.67 percent.

This couple's gains under the mixed portfolio option in [Figure 11] are such that this average-income Hispanic couple could take its retirement savings and convert this amount into an annuity upon retirement that paid exactly the same as Social Security promises to pay--and still have approximately $205,000 left in their accumulated savings at age 67 to bequeath the children. This amount could be used to start a business, pay for education or health care, or, indeed, to seed the retirement security of the next generation.\(^5^6\)

\(^{54}\) F. Torres-Gil, R. Greenstein & D. Kamin, “The Importance of Social Security to the Hispanic Community,” Center on Budget and Policy Priorities.

\(^{55}\) W.W. Beach and G.G. Davis, “Social Security’s Rate of Return for Hispanic Americans,” Heritage Foundation.

\(^{56}\) Ibid., pp. 7-8.
How privatization threatens Hispanics: a critique of pro-privatization studies

Although there are studies suggesting that Hispanics will benefit from the privatization of Social Security, some of these studies, however, contain major flaws that undermine their conclusions. They either neglect to discuss an issue, make incorrect assumptions, or consist of methodological flaws.

Transition costs. The Liebman and Feldstein study and the 1998 Heritage Foundation Report neglect to discuss transition costs. They forget to mention that it costs money to switch from the current system of Social Security to a private account system. The system would have to divert the payroll taxes of its current contributors to private accounts, leaving the current system of Social Security without money to provide its current beneficiaries and those soon to retire. In order to ensure these people continue to receive benefits during the transition, the government would either have to raise the workers payroll taxes or borrow large amounts of money that would eventually have to be paid back. The Liebman and Feldstein study and the Heritage Foundation Report do not take this additional cost into consideration.

The cost of transition from the current system to a private account system would be detrimental to Hispanics because they would have to continue paying into the current system while contributing to their own accounts.

Stock market risk. The other factor that is not considered in both the Liebman and Feldstein study and the Heritage Foundation Report is the risk of the stock market. The nature of the stock market works in such a way that allows “[s]ome people...[to] do better than average,” not all. The stock market is not as reliable of a money source as is the current system of Social Security. It is possible for Hispanics to receive a higher rate of return if they invested in the stock market. But with the risk involved in the stock market, they are just as likely to receive the same rate of return or lower. For Hispanics, it is most likely that they will receive a lower rate of return compared to the current system. This is because the majority of Hispanics lack the financial knowledge that could potentially help them make money in the stock market.

The following section discusses this concept in more detail.

Assumptions. In the argument for privatization being advantageous for Hispanics, there are two major assumptions made: (1) Hispanics have financial knowledge and/or experience, and (2) Hispanics have similar life expectancies to other population groups. Making money from private accounts depends on one’s level of financial expertise. The majority of Hispanics, however, do not have a sufficient level of financial knowledge or experience to make the type of decisions that will yield them a higher rate of return compared to the current system of Social Security.
This is because, compared to other population groups, Hispanics have low levels of education.

A 2002 survey found that more than 35% of Hispanics do not have a bank account. In a survey conducted by the University of Michigan, about 50% of Hispanics said they did not have a regular savings plan. In this same survey, they presented participants with the following statement: “With compound interest, you earn interest on your interest as well as your principal.” Only 60% of Latinos believed this statement to be true, whereas 72% of the other people surveyed said this statement to be true. This illustrates that Hispanics do not know a lot about finance and, thus, would not be always capable of making smart investment decisions that would provide them with a higher rate of return.

Furthermore, the studies do not take into the account that Hispanics have conservative investment strategies. Studies have shown that “people with lower incomes, lower wealth, and members of minorities are more conservative investors and therefore might do less well under a privatized Social Security system.” There is evidence showing that even more affluent minorities avert risks of the stock market. In 1998, a survey found that for households making $50,000 in income, 57% of African Americans invested in the stock market, as compared to 81% of Whites. As a result, the advantage of having a private account can be “offset” by conservative investment strategies. Hispanics, therefore, will probably not even provide themselves with the opportunity of receiving higher rates of return with private accounts because they will not want to place their money into a riskier situation. The 1998 Heritage Report does say that even a very conservative investment approach, like U.S. Treasury bonds, yielded a better return rate than Social Security. But research has shown that the majority of Hispanics lack the necessary knowledge to select and manage even a conservative personal account.

Flaws in methodology. There are a number of methodological flaws in the 1998 Heritage Report that undermine its claim that Hispanics would fare well under private accounts. Two major flaws are as follows. First, the report is not based on statistical analysis of actual Social Security records. Rather, it uses a “representative worker’ or stylized individual case approach.” The problem with this approach is that it “use[s] one case to characterize an entire population.” Second, the report uses an inappropriate measure of life expectancy. Stephen Gross, the Chief Actuary of the U.S. Social Security Administration, states that “the [Heritage] approach consistently overestimates the expected number of years of work and consistently underestimates the expected number of years [of benefits] after reaching retirement age. As a result, it grossly underestimates the expected rates of return.”

62 Ibid.
64 Ibid.
65 Ibid., p. 3.
return from Social Security retirement benefits.\textsuperscript{66} The Heritage Report is not the only one making the assumption that Hispanics, like other minorities, have shorter life expectancies. The book Common Cents, Common Dreams: a Layman’s Guide to Social Security Privatization published in 1998 by the Cato Institute “argue[s] that African Americans should support privatization because of their shorter life expectancy: ‘Social Security is particularly unfair to African-Americans and other minorities. African-Americans can expect to live far fewer years in retirement than can whites because of their lower life expectancy....’\textsuperscript{67} This book suggests that the current Social Security system is unfair to minorities because they have a shorter lifespan. Hispanics, however, do not fit this mold as they have longer-than-average life expectancies. The current Social Security is advantageous to Hispanics for this very reason (among other reasons that have already been discussed).

One could also argue that there is a problem with President Bush’s plan for privatization. His plan says that it will only affect those born after 1950.\textsuperscript{68} Although this plan will spare older workers and current retirees from significant benefit reductions, it will make later generations of Hispanics bear much steeper cuts as a result (see Figure 12).\textsuperscript{69} Because there are so many young Hispanics that will be entering the workforce and then later retiring, a very large number of Hispanics will experience these benefit cuts.\textsuperscript{70} Clearly, this part of President Bush’s plan for privatization does not prove beneficial for the future of this population group.

Partial privatization

In 1997, the government Advisory Council on Social Security presented three plans for partially privatizing Social Security’s Old Age and Survivors Insurance (OASI): (1) Maintenance of Benefits Plan, (2) Individual Accounts Plan, and (3) Personal Security Accounts Plan. The first plan, the Maintenance of Benefits plan, involves placing up to 40% of "OASI Trust Fund reserves in a broad index of the equities market (as opposed to the present practice of investing all reserves in U.S. bonds)."\textsuperscript{71} The Individual Accounts Plan would tax workers an additional 1.6% on their

contributions into Social Security. The government would place this new revenue into an individual account for investment, which would be returned when the contributor retires. The third plan, the Personal Security Accounts plan, requires that 5% of the worker’s payroll tax “be directed to individual accounts and invested in the various financial instruments that are widely available in financial markets.”

The Maintenance of Benefits Plan could potentially help Hispanics by enhancing Social Security returns because it does not involve management by the participants. The Individual Accounts Plan is less likely to benefit Hispanics because even though this plan will add on to the amount of taxes that Hispanics are already putting into the system, they would have to manage their plan. Hispanics would also have to manage their accounts under the Personal Security Accounts Plan, making this plan unfavorable for Hispanics.

The Cato Institute, a supporter of privatization, does not believe partial privatization will work because (1) it is not strong enough to survive economic change, (2) it will hinder the full growth potential of retirement benefits, and (3) it will bring less economic growth.

Policy Recommendations

To ensure the economic wellbeing of Hispanics, Social Security should not be privatized. Hispanics fare very well under the current system because the characteristics of their population group match the characteristics of those that would benefit from the current Social Security system. The majority of Hispanics would not be able to reap the benefits of a privatized system because they lack the necessary financial knowledge and experience. Thus, it is very unlikely that they would receive a higher rate of return with this method.

However, there would be certain features of interest to Hispanics if the system became privatized. First, Hispanics would want to preserve the current system’s progressive benefit formula. Because Hispanics hold low-paying jobs, they do not contribute to the system in proportion to their numbers. Because of the redistributive nature of the current system, they would ultimately receive more than they put in when they retire. Second, Hispanics would want full access to private accounts to retain control of their money. Third, it would be very important that Hispanics receive financial counseling on individual retirement savings. They would need this education to successfully manage their accounts. Fourth, Hispanics would want wealth and ownership guarantee. The National Council of La Raza provides the reasoning behind this last request:

During the payout phase, low-income workers will need to purchase an annuity and account balances will need to be offset against defined-benefits in order to keep the overall system in fiscal balance. Given the likelihood of lower accumulated balances in private accounts for lifelong low-income workers, the likelihood

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72 Ibid.
that they will realize a residual balance that can be bequeathed to heirs is relatively lower than for upper-income workers. In order to ensure equal opportunity among workers within the system to attain ownership, some provisions will need to be developed to ensure a minimum residual balance during the payout phase.

Fifth, Hispanics would want to maintain a universal system. It is important that all participants of the system have the opportunity to receive similar benefits (because it is usually the minority groups that are disadvantaged and receive fewer benefits). The National Council of La Raza discusses three policy options for a privatized Social Security system that might benefit Hispanics: (1) carve-out accounts, (2) add-on accounts, and (3) retirement savings accounts. In order for carve-out accounts to benefit Hispanics, it would not only have to address the five issues addressed above, but it would also have to “shield low-income workers from adverse impacts of revenue-side measures required to maintain solvency.” Unfortunately, this system would probably not work because it “would be enormously expensive to administer, and would likely be the most inefficient means of increasing overall retirement savings.” In addition, the National Council of La Raza says it would be “politically unpalatable” to implement.

Add-on accounts seem like a more realistic and beneficial option for Hispanics. These types of accounts would lie outside the Social Security system and thus would supplement the current system rather than replace it. It could address all of the five concerns listed above without losing the important elements of the current system for Hispanics. Although it is uncertain as to how this option would be financed, it is still a better option for Hispanics than carve-out accounts.

Also, it might benefit Hispanics if there were changes made to retirement savings accounts, such as the 401(k) system. This policy option could also be implemented outside of the Social Security system, which would spare the important aspects of the current system for Hispanics.

Regardless of what policy is actually enacted, Hispanics are looking for and should have a “stronger, solvent system.” They want a system that is expandable to cover more workers, allows for easy access to retirement benefits, and “enhances overall benefits for low-income workers.” They need a system that would help them as low-income workers to better develop their retirement savings.

In short, they need a system that accommodates their characteristics as a population group. For the government to develop a system that would meet the needs of the entire country, it needs to take into account the varying socioeconomic levels of the population as exemplified by Hispanics.

75 Ibid., p. 32.
76 Ibid.
77 Ibid., p. 33.
Appendix

Figure 1.

Percent of the resident U.S. population, by minority race/ethnicity: Selected years 1980 to 2000 and projections to 2050


Figure 2.

Median age of the U.S. population, by race/ethnicity: 2000

<table>
<thead>
<tr>
<th>Race/ethnicity</th>
<th>Age</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>36.9</td>
</tr>
<tr>
<td>White, non-Hispanic</td>
<td>38.6</td>
</tr>
<tr>
<td>Black, non-Hispanic</td>
<td>30.6</td>
</tr>
<tr>
<td>Hispanic</td>
<td>26.6</td>
</tr>
<tr>
<td>Asian/Pacific Islander</td>
<td>24.4</td>
</tr>
<tr>
<td>American Indian/Alaska Native</td>
<td>28.5</td>
</tr>
</tbody>
</table>

Figure 3.

![Age and Gender Distribution of Hispanics and Non-Hispanic Whites](image)


Figure 4.

<table>
<thead>
<tr>
<th>Race/Ethnicity, Sex</th>
<th>Age 22</th>
<th>Age 34</th>
<th>Age 65</th>
</tr>
</thead>
<tbody>
<tr>
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<td></td>
<td></td>
</tr>
<tr>
<td>Both sexes</td>
<td>60.1</td>
<td>48.76</td>
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<tr>
<td>Male</td>
<td>56.99</td>
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<tr>
<td>Female</td>
<td>63.02</td>
<td>51.31</td>
<td>22.85</td>
</tr>
<tr>
<td>White, non-Hispanic</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Both sexes</td>
<td>56.95</td>
<td>45.45</td>
<td>18.29</td>
</tr>
<tr>
<td>Male</td>
<td>54.32</td>
<td>42.98</td>
<td>16.43</td>
</tr>
<tr>
<td>Female</td>
<td>59.5</td>
<td>48.78</td>
<td>19.9</td>
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<tr>
<td>Black, non-Hispanic</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Both sexes</td>
<td>52.66</td>
<td>41.63</td>
<td>17.07</td>
</tr>
<tr>
<td>Male</td>
<td>49.36</td>
<td>38.66</td>
<td>15.12</td>
</tr>
<tr>
<td>Female</td>
<td>55.61</td>
<td>44.23</td>
<td>18.61</td>
</tr>
</tbody>
</table>
Figure 5.
Percent of 16- to 24-year-olds who were high school dropouts, by race/ethnicity: 1972-2000

NOTE: The data presented here represent status dropout rates, which is the percentage of 16- to 24-year-olds who are out of school and who have not earned a high school credential. Another way of calculating dropout rates is the event dropout rate, the percentage of 15- to 24-year-olds who dropped out of grades 10 through 12 in the 12 months preceding the fall of each data collection year. Event dropout rates are not presented here.


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Figure 6.
Percent of 25- to 29-year-olds who have completed college (bachelor’s degree or higher), by race/ethnicity: Selected years 1975 to 2000

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
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<td>23</td>
<td>22</td>
<td>23</td>
<td>25</td>
<td>27</td>
<td>28</td>
<td>27</td>
<td>28</td>
<td>29</td>
</tr>
<tr>
<td>White, non-Hispanic</td>
<td>24</td>
<td>25</td>
<td>24</td>
<td>26</td>
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<td>32</td>
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<td>32</td>
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</tr>
<tr>
<td>Black, non-Hispanic</td>
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<td>13</td>
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<td>15</td>
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<td>16</td>
<td>15</td>
<td>18</td>
</tr>
<tr>
<td>Hispanic</td>
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<td>8</td>
<td>11</td>
<td>8</td>
<td>9</td>
<td>10</td>
<td>11</td>
<td>10</td>
<td>9</td>
<td>10</td>
</tr>
</tbody>
</table>

**Figure 7.**

*Chart 4-6. Blacks and Hispanics are less likely than are whites and Asians to be employed in management and professional occupations*


**NOTE:** Data may not sum to 100 percent due to rounding. **SOURCE:** Bureau of Labor Statistics.
Figure 8.

![Bar chart showing percent of elderly beneficiaries that receive more than 90 percent of income from Social Security.](image)


Figure 9.

<table>
<thead>
<tr>
<th></th>
<th>Hispanics</th>
<th>Blacks</th>
<th>Whites</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Persons age 65+</strong></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Percent below poverty line without SS</td>
<td>55</td>
<td>60</td>
<td>47</td>
</tr>
<tr>
<td>Percent below poverty line with SS</td>
<td>16</td>
<td>21</td>
<td>7</td>
</tr>
<tr>
<td>Percent kept out of poverty by SS</td>
<td>39</td>
<td>39</td>
<td>40</td>
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</tbody>
</table>

### Percent of Aggregate Income from Each Source, 2002

<table>
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<th></th>
<th>Hispanics</th>
<th>Blacks</th>
<th>Whites</th>
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</thead>
<tbody>
<tr>
<td><strong>Married couples age 65+</strong></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Percent of income from:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Social Security</td>
<td>40</td>
<td>37</td>
<td>35</td>
</tr>
<tr>
<td>Employer pensions</td>
<td>15</td>
<td>22</td>
<td>20</td>
</tr>
<tr>
<td>Earnings</td>
<td>35</td>
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<tr>
<td>Assets</td>
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<td>5</td>
<td>13</td>
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<td>0</td>
</tr>
<tr>
<td>Other</td>
<td>2</td>
<td>4</td>
<td>2</td>
</tr>
<tr>
<td><strong>Unmarried men age 65+</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Percent of income from:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Social Security</td>
<td>42</td>
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<td>Employer pensions</td>
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<tr>
<td>Earnings</td>
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<td>24</td>
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<tr>
<td>Assets</td>
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<td>16</td>
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<tr>
<td>Public assistance</td>
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<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Other</td>
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<td>7</td>
<td>3</td>
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<tr>
<td><strong>Unmarried women age 65+</strong></td>
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<tr>
<td>Percent of income from:</td>
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<tr>
<td>Social Security</td>
<td>56</td>
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<td>Employer pensions</td>
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</tr>
<tr>
<td>Assets</td>
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<td>5</td>
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<tr>
<td>Public assistance</td>
<td>8</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>Other</td>
<td>3</td>
<td>2</td>
<td>3</td>
</tr>
</tbody>
</table>


* Employer pensions include Railroad Retirement, government employee pensions, and private pensions or annuities.

** Percents have been rounded up to the next whole numeral when 0.5 or higher.
How an Average Income Two-Earner Hispanic Family Fares in Social Security Compared with Private Investments

1997 Dollars

- $214,904
- $420,406
- $526,447
- $767,082

Legend:
- Lifetime Social Security Taxes
- Lifetime Social Security Benefits
- Post-Tax Lifetime Income from 100% U.S. Treasury Bond Portfolio
- Post-Tax Lifetime Income from 50% U.S. Treasury Bond/50% Equity Portfolio

Note: Each spouse is assumed to earn 69.63 percent of the average wage as defined by the Social Security Administration ($17,911 in wage, salary, and self-employment income in 1996). This is the proportion of the average full-time wage of all full-time workers earned by the average full-time Hispanic worker in 1997. The couple has 2 children and is assumed, upon retirement, to annuitize their savings over 26 years, receiving a real rate of return of 2.0 percent. All values reflect the payment of appropriate federal income taxes. Assumes the couple places contributions in a tax-deferred IRA type account (but with initial contributions not tax-deductible).

Figure 12.

Sliding Scale Benefit Cuts: Benefit Reductions Would Grow Sharply Over Time
(Benefit Reduction for Average Wage Earner Retiring in Year Shown Below)

<table>
<thead>
<tr>
<th>Year</th>
<th>Benefit Reduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>-0.7%</td>
</tr>
<tr>
<td>2035</td>
<td>-11.5%</td>
</tr>
<tr>
<td>2055</td>
<td>-20.6%</td>
</tr>
<tr>
<td>2075</td>
<td>-27.9%</td>
</tr>
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References


