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ECONOMIC VIEW

Who Wins in a New Social Security?

By EDUARDO PORTER

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SOCIAL SECURITY may have done more to help the poor than any other government program in American history. Established in 1935 with the explicit objective of protecting the elderly from poverty, it has relied on a heavily skewed benefit formula that pays lower-income workers a higher share of their wages than those at the top of the earnings ladder.

The results? According to government figures, old-age poverty has dropped from about 50 percent in the 1930's to around 10 percent today. Most of the credit goes to Social Security.

Yet as President Bush sets out to reconstruct Social Security, by allowing workers to divert some of their payroll taxes into personal accounts, crucial questions remain unanswered: Would a new system retain the traditional approach of redistributing income from the more affluent to those in need? Or should personal accounts - framed by Mr. Bush as a step toward an "ownership society" - usher in a system in which workers keep what they actually save?

The president argues that workers can get a better return on their payroll taxes if they invest them themselves. Regardless of the truth of that assertion, Social Security has not been a simple retirement savings plan but an instrument of social policy, using part of the taxes paid by some groups to shore up the benefits of others.

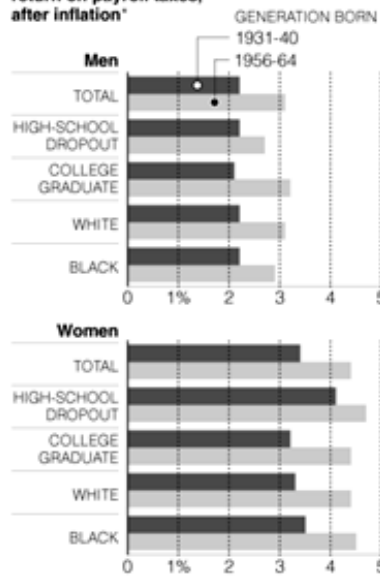
Any changes made to the system will inevitably shift this distributional mix, and that troubles some members of Congress. "Social Security is a central strand in our social safety net," said Senator Gordon H. Smith, Republican of Oregon, the chairman of the Senate Special Committee on Aging. "I believe its progressive nature has to be preserved," he said, adding that he would hold his vote "in abeyance" until "we address these progressive issues."

Social Security uses taxes from the rich to bolster the

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Differences in mortality rates and in benefit schedules mean that some groups get a better deal than others from Social Security, achieving a higher implicit rate of return on their payroll taxes.

Social Security's annual return on payroll taxes, after inflation*



*Assumes households share payroll taxes and benefits

Source: Lee Cohen, C. Eugene Steuerle and Adam Carasso, "Social Security Redistribution by Education, Race and Income: How Much and Why"

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retirement income of the poor through a benefit scale that now replaces about 60 percent of preretirement earnings for low-income workers but only 30 percent for the workers in the highest earning band.

But the program has a multitude of other objectives, moving money every which way. An essential reason for the decline in old-age poverty, for example, is that older generations - which paid lower payroll taxes - have received transfers from younger generations, who have paid higher taxes to get the same or even lower levels of benefits.

Social Security aims to protect women who stay out of the work force to raise children, offering spousal and survivor benefits that depend on the earnings of the working spouse. And the program's disability insurance favors workers in tougher jobs, mainly at the lower end of the income spectrum.

Social Security's income redistribution includes some unintended quirks. Survivor benefits are regressive, favoring people whose spouses were high earners. And the nation's changing demographics have created a patchwork of winners and losers that, to some extent, has overridden the system's original purpose of favoring the poor.

That's because Social Security is more generous to people who have more time to collect benefits, like women, who are expected to live three years longer than men, on average, after retirement, and whites, who, after reaching 65, are expected to live a year and a half longer than blacks.

Calculations by C. Eugene Steuerle and Adam Carasso of the Urban Institute offer this contrast: A 65-year-old single man who retires this year after a career in which he earned an average of \$36,500 a year, in 2005 dollars, will get \$164,000 in retirement benefits over the rest of his life, on average, based on his expected life span of 81.1 years. That is about \$8,000 less than he would receive if he invested his payroll taxes at a 2 percent rate of return, after inflation.

But a single woman with a similar earnings profile can expect to receive \$206,000 - or \$28,000 more than she would get by investing the contributions at the same 2 percent rate, merely because she is likely to live longer.

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