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Hispanic Americans' Growing Stake in Social Security Reform

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As the national debate intensifies over the best way to save the Social Security system from insolvency, increasing attention is being focused on how the program harms the prospects of a secure retirement for different socioeconomic groups. Hispanics in particular are increasingly concerned. According to a recent Latino Coalition/Hispanic Business Roundtable poll conducted in July 2001, 47 percent of adult Hispanics are not confident that they will receive all of their Social Security benefits when they retire and only 35 percent have \$5,000 or more saved or invested for retirement.[1]

Though today, only 5 percent of the 33 million Hispanic Americans are over the age of 65 and eligible for Social Security (compared with 12 percent of the population nationally), this percentage will change dramatically over the next three decades.[2] Having paid into Social Security over a lifetime of work, many of these Hispanic Americans will find themselves entering retirement at a time when the Trustees of the Social Security fund predict the trust fund will have expired (around 2038).[3]

As a 1998 Heritage Foundation analysis of Social Security's rate of return found, single-income Hispanic families with two children, whose wage earner was born after 1950, can expect a return on their contributions into the program of almost 4 percent. And that expected return declines for subsequent generations. Moreover, a single Hispanic male born in 1975 who earned about \$17,900 in income in 1996 can only expect a return of 1.44 percent.[4]

This is troubling to Hispanic Americans, who as a group have not always found financial stability in retirement. Demographic factors, such as lower lifetime earnings and less participation in private retirement savings vehicles, mean that Hispanics have come to depend more on Social Security for income in their old age. While over time these demographics may change, the potential insolvency of the Social Security trust fund is a concern. Like other groups of Americans, Hispanics would prefer financial security and an opportunity to build wealth that they can pass on to their families. If that same single Hispanic male had invested those same payroll tax dollars in super-safe long-term U.S. Treasury bonds, for example, he would expect a return of at least 2.8 percent—almost twice what he can expect from Social Security.[5]

Hispanics have a growing interest in Social Security reform that increases their personal savings and retirement security but that do not put the decisions in the hands of bureaucrats they do not know. Establishing within Social Security a system that includes personally owned and managed retirement accounts, using a portion of one's payroll tax, would achieve those goals by creating better retirement income, increasing wealth in low- and moderate-income households, and encouraging independence from the government.

Hispanic Americans and Social Security

The Social Security system in America was designed in the 1930s for a vastly different and primarily

industrial workforce. It was intended to provide a safety net against poverty in old age by transferring wealth from higher-income workers to lower-income workers who could not save for retirement. However, those working in less stable and part-time sectors of the economy, such as agriculture, domestic service, and seasonal employment, as well as the self-employed, were excluded from the program.[6] In the decades since Social Security began, many Hispanic Americans have worked in the informal labor force, and as such were unable to contribute to Social Security. The program simply ignored many Americans who needed retirement security the most.

The Social Security system now includes most workers, and Hispanic Americans, though they are still a prominent group in low-wage sectors of the economy, are moving faster up the economic ladder. The poverty rate for Hispanics in America is at an historical low.[7] Roughly 45 percent of Hispanic households now own their own homes.[8] Hispanics are starting businesses in record numbers.[9] And many continue to live in Hispanic communities bound by a common language, religion, and ancestral heritage, contributing to tight-knit families. In particular, their ties to older generations are uncommonly strong. This traditional support for family and community provides an exciting opportunity for Hispanics to build wealth and invest in community development.

The Hispanic population is also growing rapidly, and the percentage of Hispanics aged 19 and under has surpassed the total national share of this age group among non-Hispanic whites in America.[10] (See Table 1.) Hispanic Americans are also living longer; their life expectancy at birth is second only to that of Asian Americans.[11] (See Table 2.) Hispanic workers, who will make up about one-quarter of the working-age population in the middle of this century, will bear enormous financial responsibility for supporting the program's benefits in the decades to come.[12] As today's young Hispanic population enters the workforce and the number of Hispanics age 65 and over grows more rapidly, Hispanic Americans are finding they have a larger stake in the proposals before Congress to reform the ailing Social Security system.

Table 1. Percent of Population in America in 2000

| | |
|---------------------|--|
| Hispanic | |
| Non-Hispanic, White | |

| | |
|---------|--|
| 0 to 19 | |
|---------|--|

| | |
|------|--|
| 39.3 | |
|------|--|

| | |
|------|--|
| 26.3 | |
|------|--|

| | |
|----------|--|
| 20 to 34 | |
|----------|--|

| | |
|------|--|
| 25.6 | |
|------|--|

| | |
|------|--|
| 19.1 | |
|------|--|

| | |
|----------|--|
| 35 to 64 | |
|----------|--|

| | |
|------|--|
| 29.7 | |
|------|--|

| | |
|------|--|
| 40.5 | |
|------|--|

| | |
|-------------|--|
| 65 and over | |
|-------------|--|

| | |
|-----|--|
| 5.3 | |
|-----|--|

| | |
|------|--|
| 14.1 | |
|------|--|

Source: U.S. Census Bureau, Ethnic and Hispanic Branch, Population Division, Current Population Survey, March 2000 at <http://www.census.gov/population/socdemo/hispanic/p20-535/tab01-1.txt>.

Table 2. Life Expectancy at Birth by Race and Ethnicity, 1999

Male

Female

Total Population

74.1

79.8

White

74.7

80.1

Black

68.4

75.1

Native American

72.9

82.0

Asian

80.9

86.5

Hispanic

77.2

83.7

Note: Assumes middle series projections. "Native American" ("American Indian") includes Eskimo and Aleut populations. "Asian" includes Pacific Islander population. Hispanic origin may be of any race and are not included in other categories.

Source: Frederick W. Hollmann, Tammany J. Mulder, and Jeffrey E. Kallan, "Methodology and Assumptions for the Population Projections of the United States: 1999 to 2100," U.S. Census Bureau, Population Division Working Paper No. 38, January 13, 2000.

Unstable Retirement Prospects

When the Social Security Program began in 1935, payroll taxes were set at 2 percent of up to \$3,000 in annual wages—1 percent contributed by the employee and 1 percent by the employer. Today, the combined payroll tax amounts to 12.4 percent of up to \$80,400 in annual wages. The retirement portion of Social Security accounts for 10.6 percent of the payroll taxes. As these Social Security taxes have risen, Americans have had fewer dollars left over for savings.

The Heritage Foundation Center for Data Analysis study found that average-income Hispanic single males born after 1950 can expect no more than a 1.4 percent to 2.3 percent return on their contributions to Social Security.[13] (See Table 3.) While this is better than the return for similar African-Americans born in 1960 (-0.96 percent), for example, it is dismal compared with the return for those who invest in a conservative portfolio of 50 percent equities and 50 percent U.S. Treasury bills (about 4.95 percent).[14]

Insert Table 3. [Insert Table 1, with notes and source, from page 7 of THF Beach/Davis paper CDA 98-02.: Social Security's Rate of Return for Hispanics by year of birth

Factors such as savings habits, familiarity with investments, and financial discipline have much to do with private savings, but data from the Federal Reserve Bank's 1998 Survey of Consumer Finances reveal a strong correlation between family income and assets, with only about 70 percent of families with income under \$10,000 holding some type of asset.[15] (See Table 4.) Non-whites and Hispanic Americans are far less likely than their white counterparts to hold assets.[16] (See Table 5.)

Just over 30 percent of Hispanics age 65 and older receive asset income today, compared with 68 percent of their white counterparts.[17] In fact, fewer than one in five Hispanics age 65 and older are covered by a public or private pension plan other than Social Security, receive annuities, or own an IRA, KEOGH, or 401(k) plan.[18] Absent these types of assets, the opportunities for Hispanics to pass on wealth to their heirs or to use them for community investment and redevelopment are severely limited.

Table 4. Family Income and Percent Holding at Least One Asset, 1998

Percent

< \$10,000

70.6%

\$10,000 to < \$25,000

89.9%

\$25,000 to < \$50,000

97.3%

\$50,000 to < \$100,000

99.8%

> \$100,000

100.0%

Source: Arthur B. Kennickell, Martha Starr-McCluer, and Brian J. Surette, "Recent Changes in U.S. Family Finances: Results from the 1998 Survey of Consumer Finances," Federal Reserve Bulletin, January 2000.

Table 5. Assets by Race and Ethnicity, 1998

White,
Non-Hispanic
Nonwhite or Hispanic

Transaction accounts

94.7

75.8

CDs

17.9

6.4

Savings bonds

22.2

9.2

Bonds

3.7

0.4

Stocks

22.1

9.1

Mutual funds

18.8

8.4

Retirement accounts

53.7

32

Life insurance

32.1

20.8

Other managed assets

7.1

1.7

Other

9.7

8.3

Any financial asset

96.3

81.2

Source: Arthur B. Kennickell, Martha Starr-McCluer, and Brian J. Surette, "Recent Changes in U.S. Family Finances: Results from the 1998 Survey of Consumer Finances," Federal Reserve Bulletin, January 2000.

A Failing System

There is recognition across the political spectrum that the current Social Security system is unsustainable in its current form and that some type of reform is imperative. If left unreformed, the system will be able to pay only out about two-thirds of the benefits it has promised by 2075.[19] According to the federal government's own actuaries, to keep the system solvent could require payroll taxes to climb to an astonishing 20 percent of taxable payroll,[20] in addition to federal and state income taxes, Medicare payroll taxes, and sales taxes.

Such an approach would crowd out private retirement savings even faster and throw more Hispanic workers and retirees, like millions of other Americans, into poverty. Today, the average Hispanic senior's total annual income is just over \$14,000, including almost \$7,600 in Social Security payments,[21] other wages, public assistance, and pensions, interest income. Clearly, reform is needed.

A New Approach

A September 2000 study by the National Bureau of Economic Research (NBER) has revealed that creating a system of private retirement accounts (PRAs) would allow Americans to accrue far better benefits in retirement than would increasing the payroll tax.[22] The study, conducted by NBER economist Martin Feldstein and Harvard University Kennedy School of Government economist Jeffrey Liebman, compared the Social Security program with a 15.4 percent payroll tax rate[23] to two reform

options: (1) a personal retirement account program based on a 9 percent contribution, and (2) a mixed plan that includes a PRA contribution. (See Table 6.)

This important study is based on government data that includes actual lifetime earnings and benefits for individuals born between 1925 and 1929. Its findings demonstrate that both of these reform options could have a significant impact—good or bad—on Hispanics’ financial well being or risk of poverty in old age. Personal retirement accounts, even with modest rates of return, have an enormous potential to boost retirement income and reduce poverty dramatically.

Table 6. Benefit Levels for Hispanics under Two Different Reform Options

Benefits under Current Law

Benefits assuming a 5.5 percent rate of return for the PRA component

Social Security

PRA

Mixed Plan^b

Contribution rate

15.4%^c

9%

15.4%

Married Couples

Benefit Level (\$)

\$5,896

\$9,123

\$6,696

Percent Below Poverty^a

38.7

31.4

33.0

Widowed, Divorced, Never Married*

Benefit Level (\$)

\$7,961

\$18,316

\$11,041

Percent Below Poverty^a

46.8

27.3

40.0

^aThe poverty measure does not include income from public and private sources, such as SSI, other government transfer payments, and assets.

^bThe current Social Security contribution rate is 9.4 percent [under the authors’ assumptions], which does not include a 3 percent contribution to the Disability and Survivors’ fund. It is predicted that payroll tax increases to 15.4 percent will be required to keep the pay-as-you-go retirement component of the program solvent. Instead of assuming a 6 percent payroll tax increase, this plan assumes a 3 percent increase and a 3 percent PRA contribution.

cThis contribution rate is based on the current 9.4 percent payroll tax rate [authors' assumption for this study] plus the required additional 6 percent rate increase to keep the pay-as-you-go retirement component of the program solvent.

Source: Martin Feldstein and Jeffrey Liebman, "The Distributional Effects of an Investment-Based Social Security System," NBER Working Paper No. 7492, revised September 2000.

Private retirement accounts also have the potential to promote intergenerational wealth for all socioeconomic groups. For a 1999 National Bureau of Economic Research study, Federal Reserve Bank of Cleveland economist Jagadeesh Gokhale, Boston University economist Laurence J. Kotlikoff, and economists James Sefton and Martin Weale from the London-based National Institute of Economic and Social Research developed a model to examine such factors that affect intergenerational wealth inequality as skill differences, marriage, death, and progressive income taxation.

Contrary to popular belief, the authors of the 1999 NBER study found that inheritances do not propagate wealth inequality. Rather, as they explain, "Although it may seem counterintuitive, inherited wealth may be more evenly distributed than non-inherited wealth and may reduce overall wealth inequality."^[24] Instead, they found that Social Security is a primary factor in wealth inequality, since it "disproportionately disinherits the lifetime poor."^[25]

The potential benefits of converting the Social Security system into a program where Hispanics, and all workers, can participate in asset accumulation and wealth creation make the effort to reform Social Security—the traditional "third rail" of American politics—more palatable to lawmakers. The impact of their reforms would help not only seniors to find financial security, but also future generations of Americans.

Support for Reform

More than 65 years after the Social Security program was created, and with the original program's basic structure still intact, Hispanic Americans have begun to express their strong support for reforming the federal government's retirement system. A national survey of 1,000 Hispanic adults in July 2001, conducted for the Latino Coalition and the Hispanic Business Roundtable, found that 62 percent favored voluntary personal retirement accounts^[26] when asked:

"Some people have proposed changing the Social Security system so that you can voluntarily put some of the money you now pay in Social Security taxes into a personal retirement account in your own name, like an IRA or a 401(k) program, and invest it as you see fit. While the guaranteed Social Security benefits you get upon retirement would be reduced, you could potentially get higher returns on your personal account and all the money in this account would belong to you. Would you favor or oppose changing the Social Security system in this way?"

This strong support for a privatized approach is consistent with other national surveys.^[27]

There is no reason why Hispanic workers, and all American workers, should be denied the option of diverting a portion of their payroll taxes into a personal retirement account to provide for their retirement and their family's needs in the future. The old bandaid approaches to reforming Social Security—such as increasing the payroll tax or the retirement age—only would bring further harm to the nation's elderly. Proposals that move away from the program's outdated design toward individual ownership and choice will best meet the needs of all American workers, and their families and communities.

Policymakers should carefully consider the benefits of proposals that would allow American workers to:

- Divert a portion of their payroll taxes into personal retirement accounts that they control and own;
- Choose their own age to retire if they can demonstrate financial security; and
- Bequeath their accumulated assets to their heirs, thereby contributing to the well being of future

generations of Americans and communities.

Such reforms would enable Hispanics, and all Americans, to build their own financial security.

Conclusion

Rather than attempting to perpetuate an outdated Social Security system that deprives Hispanics from fully participating in the American dream, lawmakers should pursue reforms that promote private retirement savings and financial independence in old age. All Americans, desire income security and seek an opportunity to build financial stability for their families. All that is needed is political will.

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[1] The Latino Coalition and the Hispanic Business Roundtable, July 24, 2001, at <http://www.hbrt.org/surveys/010724.htm>. See questions #16-20 for Social Security related questions.

[2] U.S. Census Bureau, Ethnic and Hispanic Branch, Population Division, Current Population Survey, March 2000 at <http://www.census.gov/population/socdemo/hispanic/p20-535/tab01-1.txt>.

[3] Board of Trustees, Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, 2001 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, Washington, D.C. Payroll taxes to the OASDI trust fund are predicted to fall short of outlays beginning in 2016.

[4] William W. Beach and Gareth G. Davis, "Social Security's Rate of Return for Hispanic Americans," Heritage Foundation Center for Data Analysis Report, CDA98-02, March 27, 1998, at <http://www.heritage.org/library/cda/cda98-02.html>.

[5] *Ibid.*

[6] Edward D. Berkowitz, *America's Welfare State: From Roosevelt to Reagan* (Baltimore: Johns Hopkins University Press, 1991), p. 25.

[7] Joseph Dalaker and Bernadette D. Proctor, U.S. Census Bureau, Current Population Reports, Series P60-210, *Poverty in the United States: 1999* (Washington, D.C.: U.S. Government Printing Office, 2000). The poverty rate for Hispanics in 1999 had fallen to 22.8 percent, which is not statistically different from the lowest rates recorded between 1972-74 and 1976-79.

[8] U.S. Census Bureau, Ethnic and Hispanic Branch, Population Division, Current Population Survey, March 1999.

[9] U.S. Census Bureau, *Hispanic Economic Census: Survey of Minority-Owned Business Enterprises 1997*, No. EC97CS-4, February 2001.

[10] U.S. Census Bureau, Ethnic and Hispanic Branch, Population Division, Current Population Survey, March 1999.

[11] Frederick W. Hollmann, Tammany J. Mulder, and Jeffrey E. Kallan, "Methodology and Assumptions for the Population Projections of the United States: 1999-2100," U.S. Census Bureau, Population Division Working Paper No. 38, January 13, 2000.

[12]Author's calculations from *ibid.*

[13]Beach and Davis, "Social Security's Rate of Return for Hispanic Americans."

[14]William W. Beach and Gareth G. Davis, "Social Security's Rate of Return," Heritage Foundation Center for Data Analysis Report, CDA98-01, January 15, 1998, at <http://www.heritage.org/library/cda/cda98-01.html>.

[15]Arthur B. Kennickell, Martha Starr-McCluer, and Brian J. Surette, "Recent Changes in U.S. Family Finances: Results from the 1998 Survey of Consumer Finances," Federal Reserve Bulletin, January 2000.

[16]*ibid.*

[17]Social Security Administration, Office of Research, Evaluation and Statistics, "Income of the Population 55 or Older, 1998," Table I.3, March 2000, pp. 8, 10.

[18]Derived from U.S. Census Bureau, "Money Income in the United States: 1999," Current Population Reports, No. P60-209 (Washington, D.C.: U.S. Government Printing Office, 2000), Table 12, p. 57.

[19]See Board of Trustees, 2001 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds.

[20]*ibid.*

[21]U.S. Census Bureau, "Money Income in the United States: 1999," Table 12, p. 57.

[22]Martin Feldstein and Jeffrey Liebman, "The Distributional Effects of an Investment-Based Social Security System," NBER Working Paper No. 7492, September 2000.

[23]This is the estimated required payroll tax rate to fund the pay-as-you-go retirement component of the Social Security program. Disability and Survivor's Insurance benefits are not included in this analysis.

[24]Jagadeesh Gokhale, Laurence J. Kotlikoff, James Sefton, and Martin Weale, "Simulating the Transmission of Wealth Inequality via Bequests," NBER Working Paper No. 7183, June 1999, p. 2.

[25]*ibid.*, p. 1.

[26]The Latino Coalition and the Hispanic Business Roundtable, July 24, 2001. The national survey was conducted in both English and Spanish and has a margin of error of +/- 3.1 percent.

[27]A poll, conducted for the Hispanic Business Round Table, was conducted from January 7 to January 17, 2000. The national survey of 1,000 Hispanic surname households has a margin of error of +/- 3.1 percent. Respondents had the option of taking the survey in Spanish. In this survey, 69 percent of respondents favored diverting a portion of payroll taxes into a personal retirement account. A January 2001 Zogby poll conducted for the Cato Institute found that 68 percent of Hispanic Americans, compared with 70 percent of all respondents, favored PRAs. Another Zogby poll conducted for the Cato Institute in 1999 also found strong support among Hispanics for personal retirement accounts.

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