



Is Social Security Wealth?

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By most measures, wealth inequality has been rising in recent years. This rise has become important in the political debate as the rising share of the top 1% or 10% is being used to justify changes in the tax code. The diminishing measured wealth share of the middle class is depicted as being especially egregious. Before we begin to find ways to correct the problem we must first question if any of these measures of inequality require action.

Wealth or net worth is defined as the sum of a family's assets less any liabilities. The assets are typically identified as the market value of assets to which the holder of the assets has a legal claim. Such assets include the market value of a family's home less the outstanding mortgage amount. The assets also include the value of proprietorships and partnerships, financial instruments such as stocks and bonds held outside of retirement accounts, as well as the value of defined contribution retirement accounts and the accrued value of defined benefit pensions.

Given the current debate of entitlement reform, it is noteworthy that accrued Social Security and Medicare benefits are excluded from these inequality measures. This exclusion is based on the fact that individuals do not have a legal claim to receive those benefits. By the same logic, some wealth measures exclude accrued pensions and other retirement benefits payable to federal civilian and military personnel because receipt of those benefits rely on current and future tax funding rather than private market financial assets.

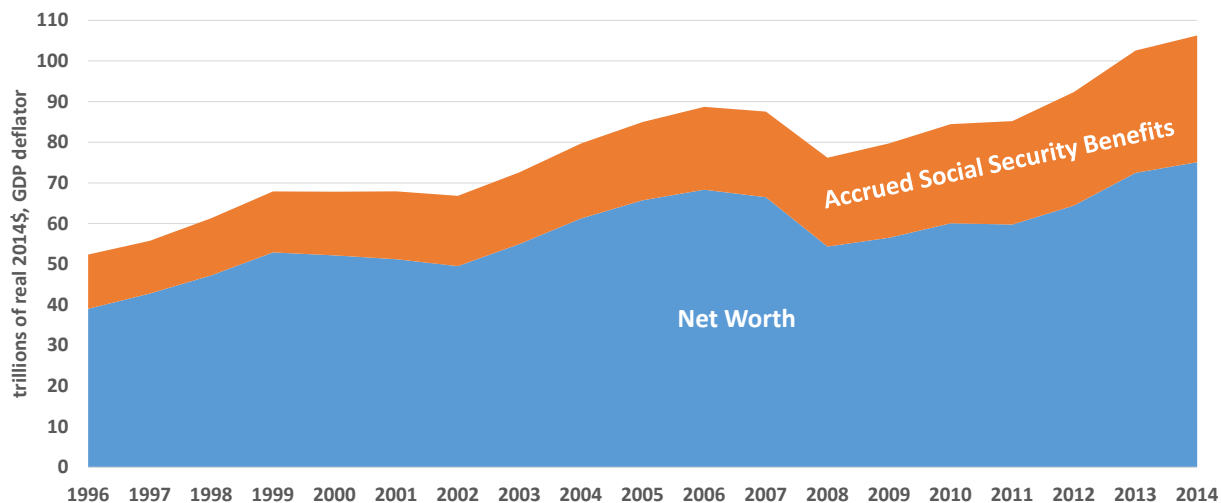
The legal claim criteria that relies on an enforceable property right denies the role of the long history of entitlement payments. Moreover, there are few reforms of these programs in the offing that will result in major changes in the level of future payments for current beneficiaries. As a result, any discussion of wealth inequality must account for the role of elderly entitlements on the changing wealth distribution.

But are these future flows im-

portant? Here that answer is a resounding yes! Accrued Social Security benefits are substantial. As of 2014, the Social Security Actuaries estimated that accrued benefits for both current retirees and workers was \$31 trillion. To put this in perspective, an adjusted measure of the net worth of all households and nonprofit organizations, from the Federal Reserve's Flow of Funds accounts, was \$75 trillion in 2013. Thus, accrued Social Security benefits were over 40% of the size of a conventional measure of wealth.

Any policy proposals aimed at reducing wealth inequality must account for elderly entitlement wealth, given the scale of entitlements. This is especially true since the existence of these programs affect private non-entitlement wealth accumulation. Thus, even though they do not meet the formal legal title definition of wealth, the existence of elderly entitlement benefits affects the lifecycle savings behavior of current workers. Since the existence of Social Security and Medi-

Figure 1. Accrued Social Security Benefits and Net Worth



Source: Net Worth from Federal Reserve Flow of Funds, Adjusted Balance Sheet of Households and Nonprofit Organizations. Social Security from Actuarial Note, Number 2014.1, Social Security Administration.

care affects the savings behavior of current participants they are comparable to financial assets and private fully funded pensions that meet the standard definition of wealth.

But, neither Social Security nor Medicare formally exist as liabilities of the federal government or assets of current of future beneficiaries, primarily due to the fact that there is no enforceable property right. One can argue that because Congress can change the programs, and workers do not possess a legal claim to their benefits, including them in households' net worth is incorrect. One can also argue that individuals behave as if they possess a legal claim to the benefits. Families reduce their private wealth accumulation in light of the expected payments from the programs.

Figure 1 depicts accrued Social Security benefits along with net worth from the Federal Reserve's Flow of Funds accounts. The series are reported in 2014\$. The effects of

the recession on net worth is evident in the figure. Between 2007 and 2008 real net worth declined almost \$10 trillion or almost 17%. By the nature of how accrued Social Security benefits are calculated, they actually increased by about 6% between 2007 and 2008. Accrued Social Security benefits have grown as a share of the combined total from 25.5% in 1996 to 29.3% in 2014.

The measures of accrued Social Security benefits used here are drawn from an Actuarial Note published on an annual basis by actuaries with the Social Security Administration. The estimate of accrued benefits is known as the Maximum Transition Cost. The calculation is made for all current participants in the program and is equal to the present value of future accrued Social Security benefits less the Trust Fund offset and the present value of future payroll taxes. For the presentation here, the Trust Fund amounts each year have been added back to

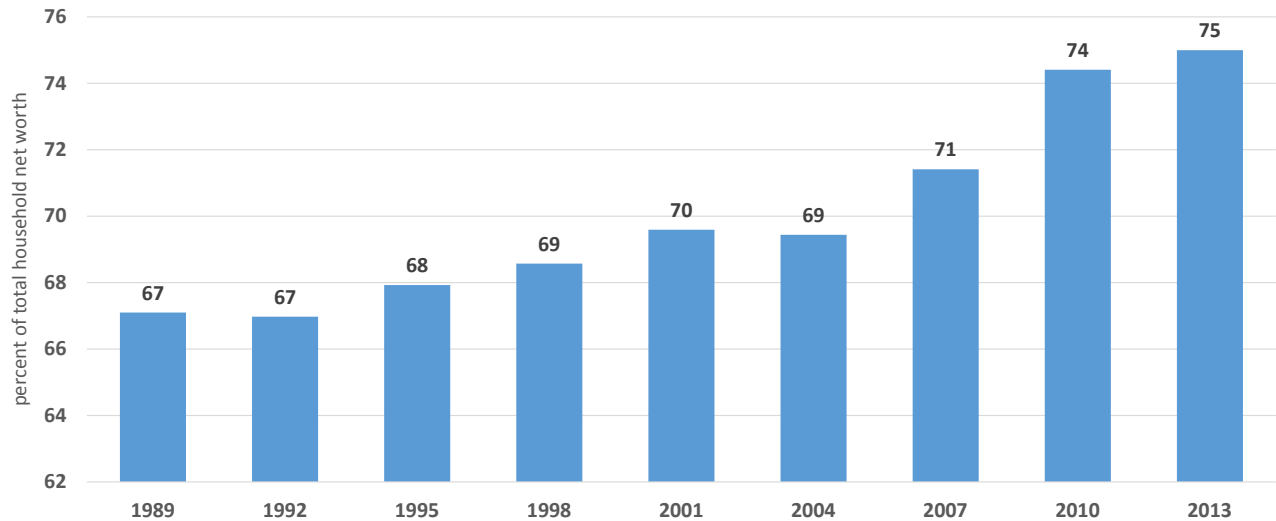
arrive at the participants' total accrued benefits.

The total accrued benefits include those of the currently retired and those of current workers. For current retirees the calculation is simply the present value of their future benefits less benefit taxes. These benefits are likely to be paid in full and they account for about 35% of the total accrued benefits of all participants. For younger workers the calculation adjusts to identify only their accrued benefits up to the date that the calculation is made.

While it is true that Social Security may be reformed in ways that reduce the benefits of younger workers, the accrued benefits of younger workers are limited to past participation and are a fraction of the benefits that they will receive if the program continues in its current form. So, these accrued benefits are a reasonable estimate of workers' current Social Security wealth.

Now back to the question of the

Figure 2. The Top 10% of Families' Share of Net Worth



Source: Survey of Consumer Finances, 2013, Federal Reserve, Table 4

observed increase in wealth disparity and the role of the inclusion of entitlements on wealth disparity. Specifically, how are Social Security benefits distributed across the wealth distribution, and how may they affect our understanding of rising wealth inequality? Figure 2 depicts the share of family wealth held by the top 10 percent of families based on data from the Federal Reserve's Survey of Consumer Finances. From 1989 to 2013 the top 10% of families' share of net worth rose from 67% to 75%.

Two features of the Social Security program contribute to it having an equalizing effect on the wealth distribution. First, above the taxable maximum level of earnings, no additional benefits are accrued. Consequently, Social Security wealth reaches a maximum well before the very top of the distribution of lifetime earnings. Further, the Social Security replacement rate declines as lifetime earnings rise, meaning

that Social Security benefits are much more equally distributed than are lifetime earnings.

For example, for a recent group of new retirees, we estimate that the top 10% of workers in terms of their lifetime earnings accounted for about 16% of the Social Security wealth among new retirees. In contrast, their share of lifetime earnings was almost double this amount. Lifetime earnings are not perfectly correlated with net worth, but this share of Social Security wealth can be used to allocate a portion of total accrued Social Security benefits to the top 10% of families. Once the distribution of Social Security benefits is accounted for, the top 10% of families' share of net worth, including Social Security, grew less rapidly over the last 15 years than is indicated by the measures that exclude Social Security.

There is no doubt that the existence of elderly entitlement programs affect behavior as they were

intended to do. Because of this, any discussion of the distribution of wealth must include Social Security benefits. As we become wealthier as a nation, providing for retirement consumption will require increased non-Social Security wealth because Social Security wealth increases more slowly than income for higher earners. So, it is not surprising that wealth inequality has changed over the years as income has grown. The focus on wealth measures that do not include Social Security and are then used to justify policy interventions may be counter-productive.



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