Social insurance is the best way to save — now more than ever

Alicia H. Munnell

Social insurance is the best way to protect people against risks small and large, predictable and unforeseen, routine and calamitous. It provides a framework for broad-based participation, contributions from both the high-paid and low-paid, and a steady source of benefits when the time comes. Given the nation's current challenges, social insurance is needed now more than ever.

At the routine level, it makes less sense than ever for people to save individually for unemployment or retirement. To protect themselves from the risk of being unemployed for an extended period, individuals would have to put aside a large nest egg, at the sacrifice of current consumption, for a contingency that is unlikely to occur for most — pandemics aside. Because of the nation's enormous increase in inequality, the vast majority of Americans simply cannot afford to prepare for such a contingency.

Retirement, in contrast, will occur for most. But in today's low-interest-rate environment, provision for retirement is best addressed through social insurance, not individual saving. When the interest rate adjusted for inflation on government securities is essentially zero, society gains by saving collectively and reaping a return equal to the growth rate of the economy. Social Security has always been a valued mechanism to compel people to undertake saving that they likely would not have done on their own, so that they have a base income on which to rely in retirement. Today, given that economic growth exceeds the rate of return, Social Security is also the most efficient way to save.

In addition to the changing economics, the realization that the country is vulnerable to calamitous events also makes social insurance more valuable than ever. The financial collapse in 2008-09 saw the bursting of the housing bubble and a 50-percent decline in the stock market. As a result, the two major sources of retirement saving other than Social Security were gutted. Moreover, the ensuing recession meant that many older workers lost their jobs and were unable to find new work. Millions were forced to rely on Social Security sooner than planned. It provided a steady base of retirement income for those whose 401(k) plans had taken a beating; it provided assured income for those with disabilities; and it served as a safety net for unemployed older workers, who in large numbers claimed retirement benefits as soon as they became eligible for them at age 62.

The current pandemic and the shutdown of the economy also highlight the value of a social insurance savings program. When virtually all other sources of income suddenly stop, Social Security continues to pay benefits for the retired and those with disabilities and once again acts as a safety net for the older

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unemployed. The steady stream of income not only provides security to individual households but also serves as a source of continued demand to stabilize the economy. On the unemployment front, the pandemic has unfortunately exposed many of the inadequacies of our system of unemployment insurance. But that failure only underscores that we need a comprehensive unemployment insurance program now more than ever.

In an environment where social insurance has demonstrated its worth for both routine and calamitous risks, two conclusions emerge. First, we need more, not less, social insurance. People need a larger base of retirement income when the collapse of financial markets cuts their retirement holdings in half or when prolonged unemployment forces them to consume their nest eggs. And workers need a robust unemployment insurance system to ensure that they have funds to tide them over when jobs dry up. Second, our social insurance programs need to have a firm financial footing. Social Security faces the most egregious and yet manageable shortfall — egregious in the sense that it has been known for decades that costs exceed scheduled revenues and more funding is needed.

The urgency for action has increased as the trust fund assets that are being used to bridge the gap are projected to be depleted in 2035 (or possibly a bit sooner, depending on COVID-19's ultimate economic impact), at which point Social Security will be able to cover only about 75-80 percent of scheduled benefits. Yet the problem is manageable, with the current long-term shortfall equal to roughly one percent of GDP.

We can afford to finance our social insurance programs properly — and we need them now more than ever.

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