Social Security Needs "Unemployment Insurance"

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You've been hearing it for years. Social Security is going to crash and burn -- in 2037 if not sooner, unless we do something different. And that "different" always seems to be some version of "cut benefits," "raise the retirement age," or in some other way penalize the good-faith beneficiaries of that excellent pension system -- both those totally dependent on Social Security, and those whose additional 401(k)s were trashed by Wall Street. But it doesn't have to be that way.

Let's get one thing straight first. The problem is not the Social Security system or its level of benefits. The problem is the irresponsible management of the economy. Social Security is becoming the victim of unacceptable levels of unemployment, and what it needs functionally is unemployment insurance.

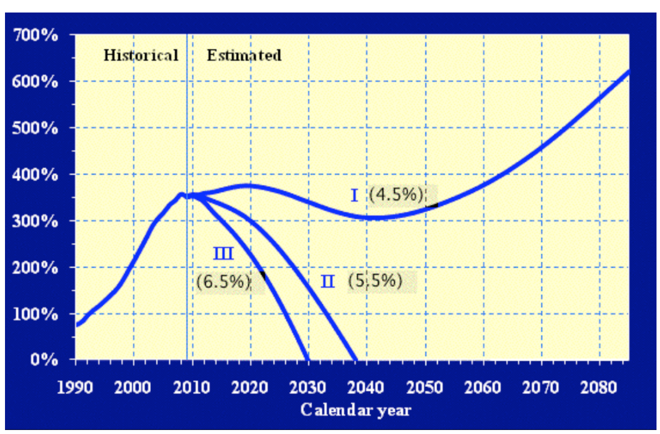
Unemployment insurance? That's right. There is a very strong connection between the unemployment rate and the net amount of money going into Social Security's Trust Fund. And the Social Security Trustees have acknowledged for years, in their annual reports, that if the unemployment rate were to average 4.5% (which they declare to be unlikely), the Trust Fund would remain solvent -- and, in fact, increase -- throughout their 75-year projection.

So, if each year, the Trust Fund were to receive "unemployment compensation" to make up the difference between its actual net income and what that income would be at 4.5% unemployment, it would have no problems with solvency.

Two charts make this clear. The first is of the Trustees' three 75-year projections of the Trust Fund's assets from their 2010 annual report, each of which makes different economic assumptions. We've added the assumed unemployment rate to each. Projection II (5.5% unemployment) is the only one we hear about in public discourse. Projection I (4.5% unemployment) shows what a difference a small change in unemployment can make.

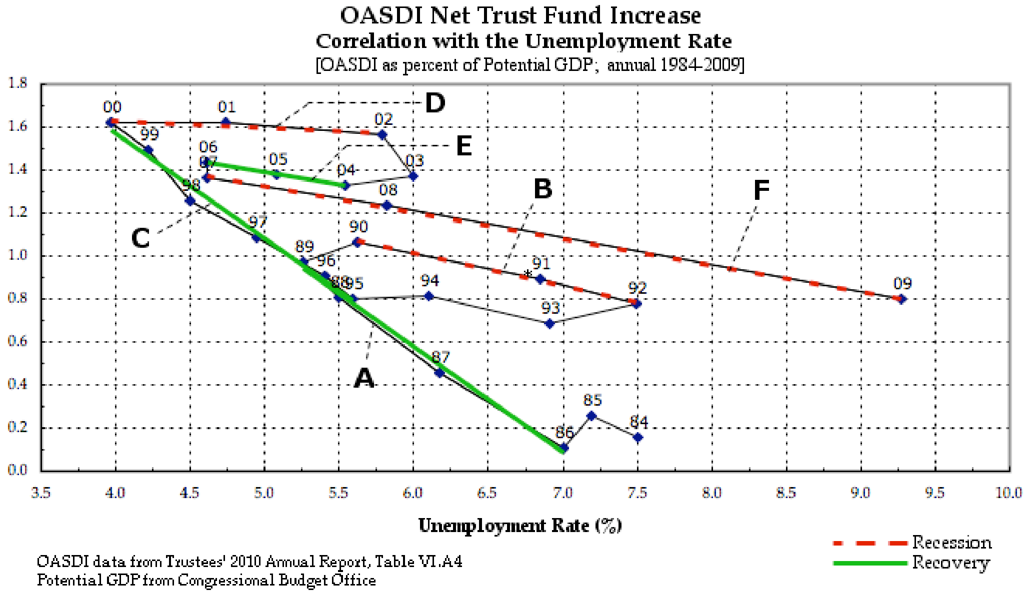
Figure 1

(SS annual report, 2010; unemployment assumptions added)



The second chart shows the close relationship between the net increase each year in the Trust Fund, and the unemployment rate for that year:

Figure 2



The relationship is clearly different during different periods (marked A-F), but within those periods, the relationship is extremely close, as seen by how closely the colored regression lines (green during recovery, red-dash during increasing unemployment) fit the data. The slope of these lines tells us how much income the Trust Fund is losing for each percent of unemployment. (For a more detailed, technical description of this chart and its underlying data and methodology, see http://iea-macro-economics.org/ss_unemp_correlations_intro.html.)

This data makes it possible to determine the total loss each year attributable to unemployment in excess of 4.5%. An unemployment compensation model would specify that an amount of money equal to that unemployment-induced loss be transferred from the general budget to the Trust Fund -- or vice versa, if unemployment dropped below 4.5%. Additional research is needed on the underlying reasons for the close-but-different relationships, and what happens during intervening periods. During such periods, the amounts transferred would be estimates based on this research, to be corrected as new relationships become clear.

Such transfers would play the same "automatic stabilizer" role that normal unemployment compensation and other safety-net programs play in the economy and in the federal budget. But what kind of money are we talking about?

Consider the most recent period for which data is available (2007-2009). Each percent of unemployment caused a roughly $17 billion loss. 2010's average unemployment rate was 9.6%, or 5.1% above the 4.5% base line we're using. This would indicate an "unemployment compensation" transfer of about $85 billion. This is real money, but less than we spend on the Afghanistan War, a tenth of the "defense" budget, and a fraction of the extended Bush tax cuts.

What this does is take the problem out of the realm of the vague beneficiary-punishment proposals currently on the table and put it functionally and squarely where it belongs -- the tradeoff against military spending and tax cuts for the rich.

Online: http://iea-macro-economics.org/ss_unemp_correlations_op-ed.html