INTERNATIONAL SOCIAL SECURITY ASSOCIATION

Crisis country case study

United States

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The report was prepared by Alan Wood (International consultant).

Ian Orton was responsible for the project management and was supported by Diane Braunstein, Georgina Harding and Peter Smith from the US Social Security Administration.

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ISSA crisis case study: United States

Summary

From its origins in the United States (US) mortgage market in 2007, the crisis had an immediate and pronounced impact on the country. The federal budget deficit swelled from US-dollar (USD)455 billion to USD1.4 trillion between 2008 and 2009, unemployment more than doubled from 4.6 per cent in 2006 to 10.1 per cent in 2009, and pension funds lost considerable value, registering a -25 per cent return in 2008 according to the Organisation for Economic Co-operation and Development (OECD). Unprecedented levels of unemployment also forced many older workers to draw on their social security benefits, exacerbating the dual challenge of rising expenditures and falling revenue.

In an effort to stimulate the economy, the government signed the USD787 billion American Recovery and Reinvestment Act (ARRA) into law in 2009. Its integrative approach of income tax cuts and increased spending on active labour market policies (ALMPs) and social and health services infrastructure improved economic conditions via stimulating demand and supporting social safety nets. Reportedly, between 2.2 and 2.8 million jobs have been created as a result of ARRA so far and job creation remains a very high policy priority.

Despite mounting debt and weak domestic consumption, the government's crisis response has stabilized the world's largest economy. Consequently it is in a decent position to take advantage of recovery.

Social security institutions covered

The Social Security Administration (SSA) and the Treasury Department. Health and welfare programmes are administered by the Department of Health and Human Services, and unemployment programmes are administered by the Department of Labor.

Overview of the social security system

Under the auspices of President Franklin D. Roosevelt, the first American Social Security Act was enacted in 1935. From modest beginnings, welfare expanded considerably to include health insurance and unemployment assistance by 1965, and health-care reform in 2010. According to the SSA which administers only social security benefits in terms of the amount paid in benefits, their social security programme is the world's largest and constitutes the single largest expenditure in the federal budget, equivalent to 4.4 per cent of US GDP in 2008 (SSA, 2010a).

Key programmes administered by organization:

Social Security Administration (SSA):

- Social Security (Federal Old-Age, Survivor's, and Disability Insurance Funds – (OASDI)): A trust fund worth USD2.4 trillion (in government bonds). The fund pays retirement and survivor's benefits, as well as disability benefits. It is similar to a PAYGO (pay-as-you-go) defined benefit pension plan based on pre-determined criteria and financed by federal payroll taxes;
- Supplemental Security Income (SSI).

Department of Labor:

- Unemployment benefits: Federal tax revenue is used for the administration of unemployment programmes whereas state tax revenue is used for benefits. Most states require minimum earnings and/or weeks of employment (e.g. 15 to 20 weeks) to qualify;
- Workers' compensation.

Department of Health and Human Services:

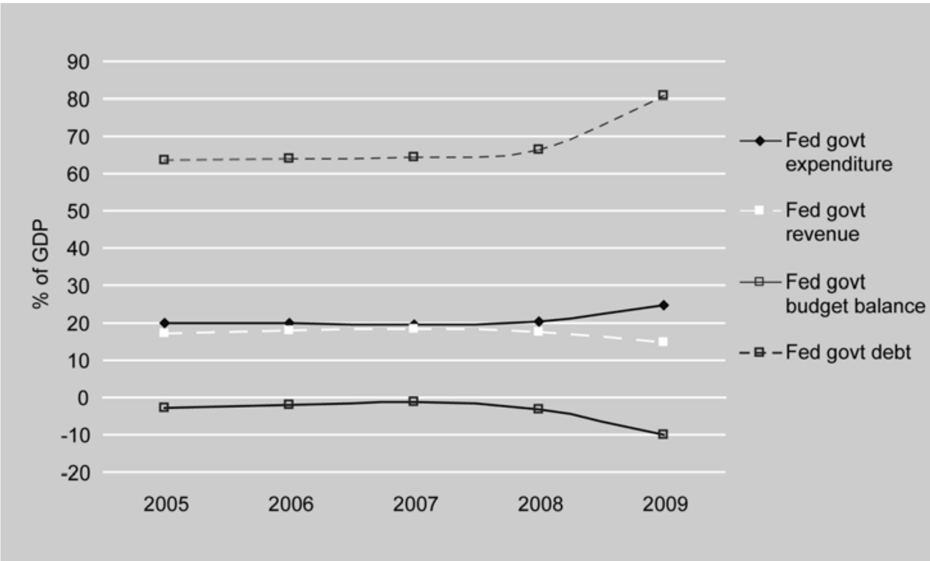
- Temporary assistance for needy families;
- health insurance for the aged and disabled (Medicare): Divided into a hospital insurance programme (funded through payroll taxes) and a supplementary medical insurance programme (financed by insurance premiums and federal contributions);
- grants to states for medical assistance programmes (Medicaid);
- State Children's Health Insurance Program (SCHIP)

Impact of the crisis

Fiscal impact

From US mortgage market origins back in August 2007, the crisis had an immediate and pronounced impact on the country. The growth in the US federal budget deficit was unprecedented, rising from USD455 billion to USD1.4 trillion (9.9 per cent of GDP) between 2008 and 2009 (Department of the Treasury, 2008).

Figure 1: ***US fiscal indicators, 2005–2009 (Per cent of GDP)***

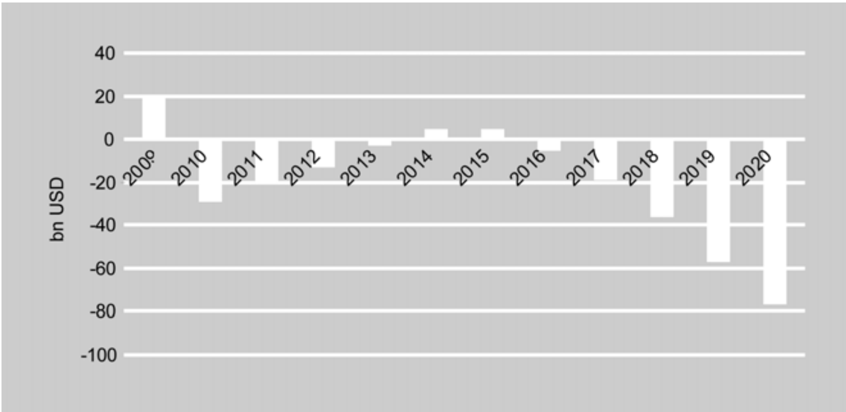


Source: Congressional Budget Office (2009); Office of Management and Budget (2010).

Figure 1 aptly summarizes the financial situation that the US economy experienced – a dual challenge of rising expenditures and falling revenue causing debt to rise and the actuarial balance to worsen.

In turn this has adversely affected the OASDI trust fund. According to the SSA and as seen in figure 2, annual surpluses of tax income over expenditures were expected to rise only briefly in 2009 before declining and turning to cash flow deficits beginning in 2016 that grow as the baby boom generation retires (Congressional Budget Office, 2010).

Figure 2: ***Projections for OASDI surplus or deficit (USD billion)***



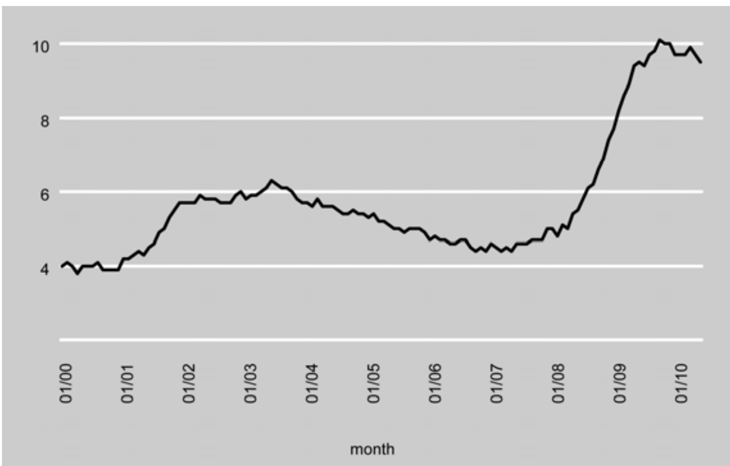
Note: Excluding interest paid.
Source: Office of Management and Budget (2010).

Given the magnitude of this debt, commentators including Chairman of the Federal Reserve Ben Bernanke believe that any economic recovery in 2010 is unlikely to either lower expenditure or lower unemployment substantially.

Labour market impact

The increase in unemployment was far beyond that expected from the decline in output. As seen in figure 3, US unemployment more than doubled from 4.6 per cent 2006 to a peak of 10.1 per cent in 2009.

Figure 3*: US unemployment, 2000–2010*



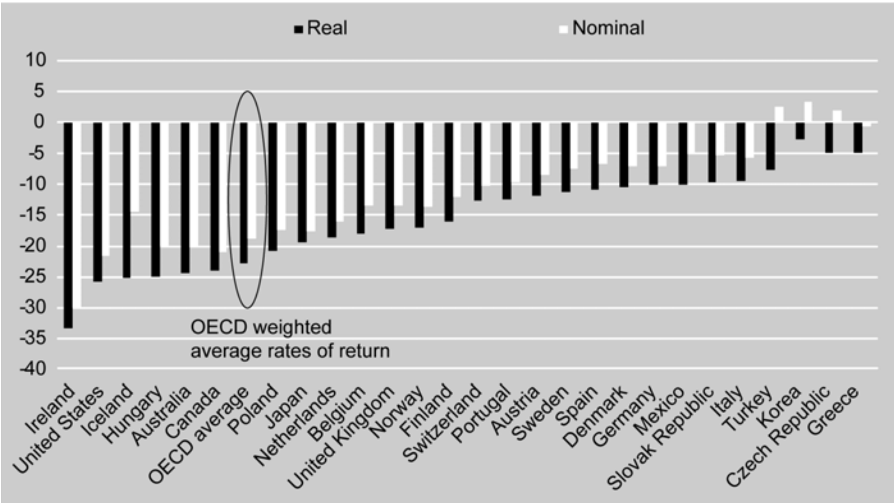
Source: Department of the Treasury (2008).

Despite the return to positive growth in November 2009 (having been negative since January 2008), labour demand (as measured by the employment-to-population ratio) declined 4.5 per cent between June 2007 and June 2010 (Bureau of Economic Analysis, 2010a).

Investment performance

The world largest social security programme also suffered the greatest absolute loss in value in 2008 as a result of market turmoil. Assets in retirement plans fell in value by roughly USD4 trillion, half of which were in defined benefit plans (Pino and Yermo, 2010). Although retirement income provided by defined benefit pension plans is in principle unaffected by changes in investment returns, lower asset prices do reduce funding levels. And worsening funding levels for defined benefit pension plans are a major concern given the link to earnings which has fallen since 2007 (thus lowering contributions and revenue).

Figure 4: ***Pension fund returns, US and OECD countries, 2008 (Per cent)***



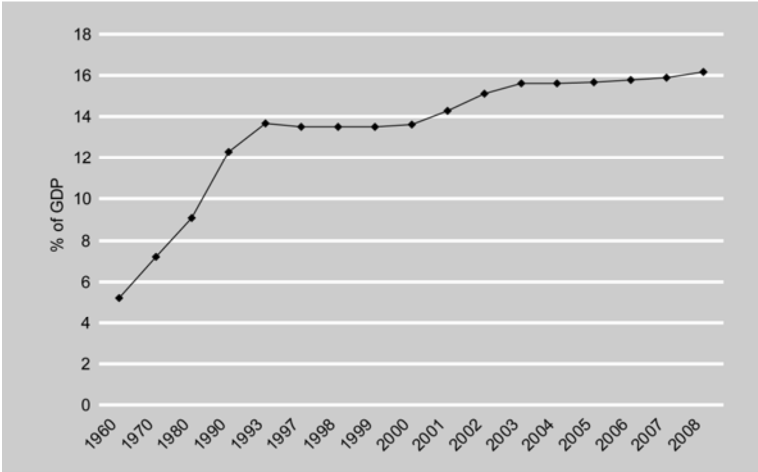
Source: OECD (2008).

As can be seen in figure 4, among OECD countries US pension fund performance (real investment return of -25 per cent) was very poor in 2008. To put this further into perspective, the real rate of return of US pension funds over the last 15 years averaged 4.4 per cent. This has created large funding gaps as pension liabilities will exceed assets, thus jeopardizing current and future benefits. Exacerbating this was a higher than expected increase in the number of retirement applications (20 per cent increase from 2008 and 2009). According to the SSA, many older workers have been forced to draw on their social security benefits due to the high level of unemployment (Keith, 2010).

Health care

The link between employment and health-care cover means that unemployment is a common reason for losing health-care cover. Providing Medicare has become increasingly difficult given higher unemployment, an ageing population and spiralling health-care costs associated with technological improvements.

Figure 5: ***US health-care spending, 1960–2008 (Per cent GDP)***



Source: Centers for Medicare and Medicaid Services (2009).

Despite the fact that at 16 per cent of GDP US health spending was far higher than any OECD country in 2008, the US Census Bureau estimated that approximately 47 million Americans or 15 per cent of the population were without health care in the same year (US Census Bureau, 2010).

Administrative capacity

Despite large and persistent fiscal deficits, it appears that the crisis has not adversely affected the US government's administrative capacity, but in fact enhanced it. The administrative workload has indeed increased, for example the SSA adjudicated over 500,000 more retirement claims in 2009 than in 2008, as well as over 200,000 more initial disability claims, yet greater support was given with the signing into law of the American Recovery and Reinvestment Act (2009) (see section below) (SSA, 2010b). The Act provides the SSA with USD1.09 billion (USD500 million for the replacement of the National Computer Center (NCC) and associated information technology costs, USD90 million to be used to issue payments and USD500 million for the processing of disability and retirement workloads, including information technology acquisition and research in support of such activities (SSA, 2009b).

Responses to the crisis

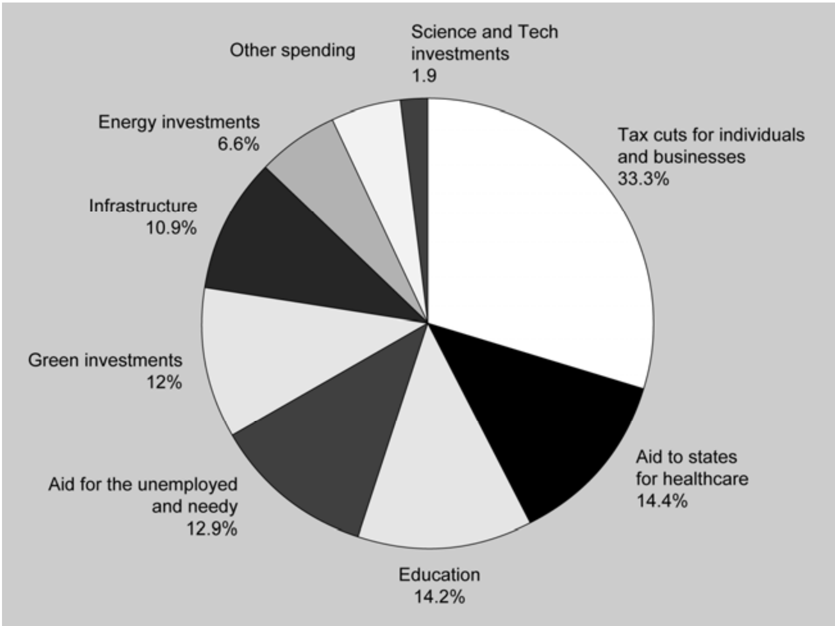
Targeted financial sector support

As global credit markets came to a near standstill in 2008, the government enacted the Emergency Economic Stabilization Act of 2008 (commonly referred to as the Troubled Asset Relief Program or TARP), a law allowing the Treasury to buy up to USD700 billion in troubled assets (e.g. mortgage-based securities). Under considerable pressure, the Treasury announced in November 2008 that TARP funds would no longer be used to purchase troubled assets but for other forms of support such as the Capital Purchase Program (CPP) and the Automotive Industry Financing Program. These measures were pertinent to social security as they helped keep the economy functioning and people in jobs thus helping to maintain contribution income.

Economic stimulus package

In an effort to stimulate major sectors of the economy, President Obama signed the American Recovery and Reinvestment Act (ARRA) into law in February 2009. At 5.6 per cent of 2009 GDP, the package sits in fourth place among the world's largest economic rescue packages (after China, Saudi Arabia and Malaysia). Yet in absolute terms, the US spent USD787 billion which far exceeds that of any other country. This figure includes roughly USD300 billion in tax breaks for individuals and businesses; more than USD250 billion in direct aid to states and individuals; and roughly USD200 billion in public needs such as infrastructure, health care and education (SSA, 2010b).

Figure 6: ***Percentage share of the ARRA***



Source: SSA (2010b).

While the share of overall spending dedicated to social security of 12.9 per cent (see figure 6) seems relatively low, social security plays a significant role. ARRA earmarked roughly USD100 billion to strengthen social protection and improve employment prospects through an integrative approach. That is, social security is complemented by investments to create jobs in areas such as infrastructure and energy by boosting contribution revenue. Moreover, tax cuts increase the spending power of low- and middle-income households.

ARRA includes a plethora of active labour market programmes (ALMPs'):

- Employment Services and Training: Adult Employment and Training, Dislocated Worker Assistance and National Emergency Grants, Health Professions Training Programmes, Job Corps, Native American and Senior Community Service Employment Programmes, Training Grants for Green Jobs and Emerging Industry Sectors, and Youthbuild;
- Employment Subsidies: Work Opportunity Tax Credit, Employee Benefits Security Administration, Salaries and Expenses;
- Unemployment Insurance (UI): extended in duration (33 weeks) and benefit levels (increased by USD25 week) up until the end of 2009.

Though some ALMPs were temporary, a simultaneous increase in social safety net spending occurred, thus having a potentially stronger multiplier effect on output than stand-alone tax cuts.

Social safety net programmes:

- One-time payments of USD250 to individuals who were eligible for Social Security and Supplemental Security Income benefits in any month between November 2008 and January 2009 (International Labour Office (ILO, 2010));
- Food-based programmes (USD20 billion): Aging Services Programs: Congregate Nutrition Services, Home Delivered Nutrition Services, Nutrition Services for Native Americans;
- Community support programmes: Community Health Centres, Community Services Block Grant, Strengthening Communities Fund;
- Family/child-care benefits: Child Care and Development Fund, Childhood Immunization Program, Foster Care, Temporary Assistance for Needy Families;
- Public works: Job creation through infrastructure investments is expected to create 1.25 million jobs.

Of the whole stimulus package, health care received USD147.7 billion, which includes a new USD39 billion temporary health insurance programme for those who have lost jobs (Consolidated Omnibus Budget Reconciliation Act (COBRA)).

Lessons learned

First and foremost, the crisis revealed how highly exposed social security systems such as private pensions were to the performance of a handful of firms (e.g. Lehman Brothers and Fannie and Freddie Mac). The US Government has recognized that a lack of regulation played a significant role in precipitating the crisis. Therefore with the introduction of the "Obama Plan" (formally known as "Financial Regulatory Reform: A New Foundation") in June 2009, the new administration attempted to usher in an era of better regulation and risk management.

On the back of a growing budget deficit, President Obama made the extension of health care a major goal of his presidency. The sheer swiftness, size and boldness of the government's responses demonstrate a renewed emphasis on labour market programmes and social safety nets. The SSA was given the resources to administrate economic recovery and reduce the social impacts of the downturn.

Conclusion

Though the erosion of the financial basis of the PAYGO social security programme can, in large part, be attributed to demographics, the crisis has clearly exacerbated the situation. With the weakening of fund value (e.g. -25 per cent real pension return in 2008), any surplus in the OASDI funds is expected to vanish by 2016 (see figure 2). This will in time harm the aggregate growth rate of the economy.

The social security debate concerns the sustainability of the PAYGO system. The integrative approach of expansionary fiscal polices, such as income tax cuts and increased spending on ALMPs and social and health services infrastructure, have improved economic conditions via stimulating demand and supporting social safety nets. The Council of Economic Advisors (2010) estimates that ARRA is responsible for creating between 2.2 and 2.8 million jobs. Greater job creation is also expected in 2010 as infrastructure projects come to fruition.

True to Keynesian economics, the government is running deficits by increasing government spending and/or cutting taxes in order to stimulate demand during downturns. As the economy pulls out of the downturn the timing of interventions (such as spending cuts and/or raising taxes to stop the economy from overheating) will be increasingly important.

In sum, despite mounting debt harming investor confidence and a poor outlook due to weak domestic consumption, the US remains in a decent and stable position to take advantage of recovery when and if it comes. How well it will be able to deal with a double-dipped recession is beyond the scope of this case study.

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www.issa.int
4 route des Morillons
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