CENTER ON BUDGET AND POLICY PRIORITIES

To: Melanne Verveer
From: Bob and Ellen
Subject: Social Security reform and the impact on women

Date: October 21, 1998

Ellen was recently asked by someone at the White House if we had reviewed some of the materials available on the impact of Social Security reform proposals on women, and if we could pull together a few of the most useful pieces. We thought these materials might be helpful to you as well. Perhaps after the election we might have a chance to chat with you about Social Security and related issues for next year.

We've included the following:

- An excellent three-page piece on how Social Security privatization would affect women by Alicia Munnell, a leading Social Security expert.

- A fact sheet on Social Security and women prepared by the Democratic staff of the House Ways and Means Committee. (Both the Democratic staff director of the full Ways and Means Committee and the Democratic staff director of the Social Security Subcommittee of Ways and Means are women.) The fact sheet is based in part on a fact sheet from the Institute form Women's Policy Research.

- A column on Social Security and women by syndicated columnist Jane Bryant Quinn, and two articles by Social Security expert Edith Fierst, who was a member of the 1994-96 Social Security Advisory Council and is a leading expert on Social Security and women.

- Finally, in the event that you would like more comprehensive background, we are enclosing a 17-page issue brief entitled "Social Security Reform: How Might Women Fare?," prepared by the Public Policy Institute at AARP. This is the single best comprehensive background piece now available on these issues and is largely written as a straight policy analysis, not as an advocacy document.

While these pieces cover a number of issues, one feature of these pieces stands out — *consistent warnings that privatization plans that would shift a portion of payroll tax*

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revenues from the Social Security trust funds to individual accounts would hold particular dangers for women, especially divorced women and widows. The Social Security benefit structure contains a number of unique features highly beneficial to women that individual accounts are unlikely to contain. For example:

- Social Security redistributes benefits toward workers who had below-average earnings over their lives. This is beneficial to women both because they have lower average wages than men and because they spend more years out of the full-time labor force. Private accounts contain no such redistribution.

- Social Security provides benefits that last as long as you live and that are fully adjusted for inflation. This is of greatest value to those with the longest life expectancies. Since women have longer life expectancies than men, these features of Social Security are particularly valuable to them.

  By contrast, funds in individual accounts can run out before an aged person dies if the person lives to a very old age, unless the funds in the account have been used to purchase a private annuity. But private annuities are expensive. Moreover, for a private account of a given size, firms provide *lower* monthly annuity payments to women than to men because women are likely to live longer. This is not true of Social Security.

  In addition, when private firms sell joint annuities to a husband and wife, these annuities provide a *lower* monthly payment than a single annuity does, because joint annuities must pay benefits for a longer number of years (i.e., until both spouses die).

  Finally, most private annuities do not adjust monthly benefits for inflation, so the purchasing power of the monthly payments declines with each passing year. All of these problems primarily affect women.

- Women both earn less than men and tend to invest more conservatively. As a result, they would end up, on average, with significantly smaller private accounts.

- Proposals to shift a portion of the payroll tax to private accounts necessarily entail deeper cuts in Social Security benefits; under such proposals, Social Security benefits must be reduced enough to eliminate the current Social Security shortfall and then reduced further to make up for the loss of the payroll tax revenues being shifted from Social Security to private accounts. For example, proposals to shift two percentage points of the payroll tax to private accounts *double* the financial shortfall in Social Security and greatly enlarge the benefit reductions needed to close the shortfall. Most current proposals of this nature include substantial reductions in spouse benefits, survivors' benefits (which mainly go to widows), and disability benefits as part of their effort to reduce Social Security benefits enough to put Social Security in balance while shifting funds to private accounts at the same time.

- By their nature, private accounts cannot provide the protection to spouses, divorcees, and widows that Social Security does. The funds that a private account can provide to a retiree, his current spouse, and possibly to a former spouse are strictly limited to the money in that account. If money from the account goes to an ex-spouse, less is left for the retiree and his current spouse. It is a zero-sum game.

  This is not true of Social Security. Based on a single retiree's earnings record, Social Security benefits can be paid to the retiree, his current spouse, and all divorced spouses who were married to him at least 10 years and are not currently married. The level of benefits paid to the retiree, his current spouse, and one or more divorced spouses are set by law — these benefit levels do *not* affect each other. Payment of a benefit to one beneficiary does not lower the payments to other beneficiaries.

  It is very likely that replacing a portion of Social Security benefits with private accounts will result in significant reductions in income for elderly women who are divorced. Such women would probably be able to gain access to funds in their ex-spouse's individual account only by going to divorce court. Moreover, the court would be limited in what it could provide a divorced woman from her ex-husband's account by the need to leave adequate funds in the account for the husband and his current spouse.

Why Social Security Privatization Would Hurt Women

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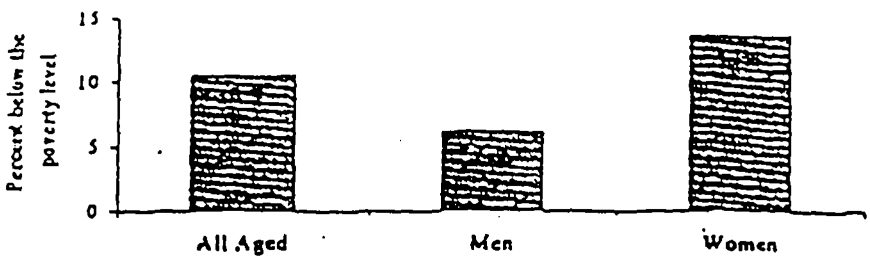
Proposals to replace some or all of the existing Social Security program with a new system of personal retirement accounts would undermine the financial security of older women. Poverty among women over 65 is already twice as severe as among men over 65 (Chart 1). The current Social Security program recognizes this problem, and its benefit structure compensates for two important characteristics of women: They are likely to have earned less than men, and they are likely to live longer. Privatization proposals currently being considered make no provision for these differences, and thus would make the poverty problem for women even worse.

Chart 1. Poverty Status of Persons 65 Years and Older by Sex, 1995

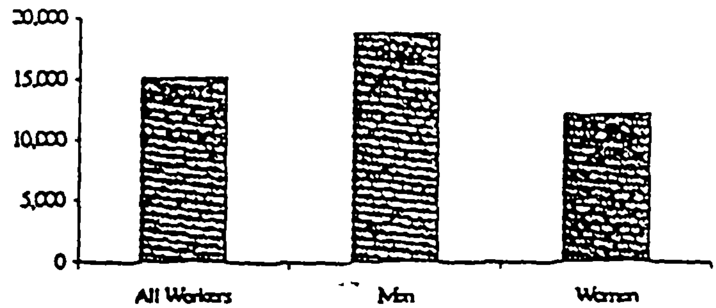


Source: U.S. House of Representatives, Committee on Ways and Means, *1998 Green Book*, May 19, 1998, Table A-6

Although the percentage of working-age women who hold jobs is much higher now than when Social Security was new (60 percent today versus 28 percent in 1940), their careers continue to be different. Women tend to spend fewer years in the workforce than men, since they interrupt their careers to care for young children or elderly parents. For the same reasons, women are also more likely to work at part-time rather than full-time jobs. And even when they work full time, women are likely to be paid less than men. As a result, median earnings for women are far below those for men (Chart 2).

A system relying even in part on personal savings accounts would perpetuate these differences into retirement. Unless special provisions were enacted, a woman's overall retirement benefit would depend on her contributions into her personal account and the earnings on those contributions. Because of lower earnings and less time in the labor force, these contributions and earnings would, on average, produce very low retirement benefits.

Chart 2. Median Earnings of Workers Covered by Social Security, 1994



Source: From the Social Security Administration website, online version of Social Security Bulletin, *Annual Statistical Supplement, 1997*, Table 4.B6, see: http://www.ssa.gov/statistics/supp97/pdf/t4b6.pdf (as of September 8, 1998).

Although Social Security's benefit rules are gender-neutral, they are particularly helpful for women. First, the progressive benefit formula provides proportionately higher benefits for low earners than for high earners. Second, for the woman who spends her career taking care of her family, Social Security provides a retirement benefit equal to 50 percent of her spouse's benefit. Third, for the homemaker who becomes divorced after at least 10 years of marriage, Social Security provides a retirement benefit based on her former spouse's benefits. Fourth, for the older woman whose husband dies, Social Security provides widow's benefits equal to 100 percent of her husband's benefits. Fifth, if a younger widow's children are getting survivors' benefits, she also receives benefits while she is caring for them and not working.

Even with more women in the labor force, these family benefits remain importan.. In 1996 the majority (63 percent) of woman beneficiaries aged 62 and older were receiving wives' or widows' benefits; 37 percent had no earnings history and were entitled only as a wife or widow; and 26 percent had a higher benefit as a wife or widow than as an earner.

In addition to providing benefits to compensate for lower lifetime earnings, Social Security has two features that compensate for the fact that women live longer than men. Life expectancy at age 65 is currently 19.2 years for women compared to 15.6 years for men (Table 1). Because Social Security pays benefits for life, it supports women who outlive their spouses. And because benefits are adjusted annually for changes in the cost of living, their buying power is protected against being eroded by inflation — a protection that increases in importance with every passing year. Without such protection, even a modest 3 percent inflation rate cuts the purchasing power of a $100 benefit to $74 after 10 years and to $55 after 20 years.

Table 1. Life Expectancy at Age 65, for Individuals Reaching 65 in Selected Years, 1997-2025

Life Expectancy (in Years)		
Year	Male	Female
1997	15.6	19.2
2005	16.0	19.5
2015	16.4	19.8
2025	16.8	20.2

Source: *1998 Green Book*, Table 1-53

With personal retirement accounts, on the other hand, benefits are not automatically converted to a lifetime annuity or protected against being diminished by inflation. If individuals receive their money in a lump sum, they risk exhausting their assets before they die — a risk that is compounded by the absence of inflation protection. In theory, annuity and inflation protection could be purchased separately, but private annuities are very expensive to purchase and inflation-adjusted annuities are nonexistent in the United States.

In short, the present Social Security system offers a range of protections — progressive benefits formula, dependents' benefits, lifetime benefits, and inflation adjustments — that are of great importance to women and are not duplicated by any of the proposals to privatize the system. These are established rights, promised by law. Women should be very reluctant to give them up for an untried system that relies on individual investments for even part of their basic retirement income.

SOCIAL SECURITY REFORM AND WOMEN
FACT SHEET

Social Security is very important for women.

Sixty percent of Social Security beneficiaries are women and Social Security is often the only source of retirement income for a majority of these women. Women are heavily reliant on Social Security benefits because of wage and employment discrimination and different patterns of labor force participation. These patterns are not expected to change in the future.

- *Most women do not receive private pensions.* Only 38 percent of women receive employer-provided pension benefits compared to 57 percent of men. This is especially problematic for minority women who are less likely to have employer-provided pension plans than either white men, white women, or nonwhite.

- *Women earn less than men.* Women who work full-time earn less than men who are employed full-time. The average woman college graduate earns little more than the average male high school graduate. Women earn 74 cents for every dollar men earn.

- *Women are more likely to work part-time.* Seventy four percent of men between the ages of 25-44 were employed full-time for all of 1996 compared to 49 percent of women in the same age group.

- *Women are more likely to spend time out of the labor force.* Twenty one percent of women, between the ages of 25-44, were unemployed in 1996 compared to only 7 percent of men. Many of these women are mothers of young children.

- *Women are more likely to live alone in their retirement years.* Retired men, who are more likely to be married, have better financial security upon retirement because they receive two Social Security benefits: one for themselves and one for their wives. Elderly women living alone receive only one benefit.

Plans to privatize Social Security could have an adverse impact on women.

Proposals which reduce Social Security's guaranteed benefits to make way for individual accounts could disproportionately hurt women--making women more vulnerable to the risk of private investments and poverty if expected returns are not realized

- *Private accounts could disadvantage women because they earn less than men.* Because private accounts are based solely on deposits into the accounts (which are strictly proportional to workers' earnings) and on the investment performance of the accounts, women would earn less (even if the market were stable) than their male counterparts from private accounts.

- *Private accounts could adversely impact women because they are more likely to work part-time and spend time out of the labor force.* Private accounts require that individuals work full time for forty years or more in order to receive the expected total value of their accumulated retirement fund. Privatization proposals, therefore, would punish women for taking time off to care for their children and family members.

- *Privatization proposals significantly reduce spousal benefits.* Because women take more time out of the workforce and earn less than men, married women are more reliant on the higher spousal benefits earned by their husbands. Privatization plans propose to cut spousal benefits by one-third, leaving women with a benefit near poverty-level.

- *Private accounts could penalize women for making different investment decisions than men.* Economists have found that women are "risk averse" or less likely to make risky investments. By investing less in riskier assets, women and low wage workers also benefit less from the *potential* rates of return that stocks could generate. Privatization proposals would punish women for making prudent financial decisions!

- *Private accounts could give women smaller retirement checks even if they have the same work history as men.* Annuity companies would adjust women's retirement benefits downward since women live longer than men.

The Social Security benefits that women receive are *guaranteed for life.*

Unlike private individual accounts, Social Security benefits are safe, reliable, and guaranteed for life.

- *Social Security benefits protect against inflation.* The cost-of-living increases built into Social Security provide an important anti-poverty protection for women. Private investments do not protect against inflation or devalued investments.

- *Social Security lasts as long as you live.* Women live an average of 7 years longer than men. Whereas Social Security provides monthly benefits for as long as a retired person lives, private accounts place women in danger of outliving their accumulated funds.

Prepared by the Democratic Staff of the Committee on Ways and Means, August 6, 1998.

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JANE BRYANT QUINN

Women, Be Wary of Social Security Change

In his State of the Union address, President Clinton said he would use any budget surplus first to save the Social Security system.

But women, in particular, need to take a hard look at any "reforms" Congress proposes.

On average, women gain relatively more than men from Social Security today. That's because it favors lower earners and dependents, most of whom are women and children. Some of the reforms would erase this advantage.

Workers like to calculate how much more their money might earn if invested in stocks rather than paid in Social Security taxes. But they often forget that their taxes buy other benefits, too.

For example, when workers die, their spouses and young children are eligible for monthly benefits—so Social Security provides life insurance.

Retirees who had low or spotty earnings during their working years (usually women), and don't get much personally out of Social Security, can collect a higher benefit through their spouse's account. So there's retirement-income insurance, too.

The program includes divorce insurance. The divorced can collect on an ex-spouse's account if the marriage lasted at least 10 years. So a divorced, single woman isn't abandoned financially in old age.

These payments to a former spouse don't take one penny away from the worker or current spouse. Everyone has a safety net.

It even includes inflation insurance. Your check rises annually with the inflation rate.

These would be costly insurance plans if workers had to buy them from private insurers. Without them, dependents and ex-dependents would be at risk.

Many of the reform proposals would cast off or slash the social insurance plans and use part or all of the Social Security tax for some form of mandatory 401(k).

Money would be diverted from your paycheck into a personal account. You could decide where to invest it. Your standard of living in retirement would depend on how large this nest egg grew.

How would life differ for women under these privatization proposals? Each plan is a little different. But the government's General Accounting Office has provided some broad answers in a study requested by Rep. Barbara B. Kennelly (D-Conn.). Said the GAO:

- Benefit payments: Women on average earn less than men, so less money would go into their investment accounts. Social Security helps low earners by raising their benefits a bit. That wouldn't happen in private accounts. Those accounts might yield more for your money than Social Security does, but the gap between men's and women's retirement income would grow.
- Investment returns: Women tend to be more conservative investors than men. If stocks did poorly for a long period of time, their conservatism would pay. But if stocks did well, their cautious investing would leave them even further behind men's retirement incomes.
- Longevity: Women with the same earnings and investments as men could wind up with lower monthly incomes because they tend to live longer. They would have to draw less from their accounts to be sure the money lasted a lifetime.

In the Social Security program, people who had equal incomes get equal monthly benefits for life.

You also could get equal payments from a private plan. The government might decree that, if you bought a lifetime annuity, you would be charged a unisex rate obtained by averaging male and female life spans.

But men wouldn't like that. Their incomes would be lower than if they paid the "male" rate.

- Divorce: None of the plans provide monthly payments to an ex-spouse. My crystal ball sees more impoverished divorcees.

Some reformers would split the investment account at divorce. That helps the unemployed spouse at the worker's expense but has no guarantee that spouse will get the same income that Social Security now pays.

- Spouse protection: When a worker dies today, a spouse can get 100 percent of the worker's monthly Social Security benefit for life.

With private savings, the retired worker can take money as needed, in a lump sum or as a lifetime annuity. So spouses get no income guarantees.

A private investment account might give a spouse more than Social Security pays. It also might give less. That depends on life's tragedies, how the money is invested and how the stock market behaves.

We all need private savings. But dependents, in particular, also need a Social Security guarantee.

ALICE COULD STILL LIVE HERE — WITH SOCIAL SECURITY

By Edith U. Fierst

Recently I watched an old movie, "Alice Doesn't Live Here Any More," a very popular film when it came out in 1974. Readers may remember it as the story of a 35-year old woman whose husband was killed in an accident, leaving her without income. She sold her home and its contents and with her son, Tommy (then perhaps 11 years old), began to travel drearily around the country seeking work. What she found were low-paying and, in some cases, seedy jobs. Eventually she was saved by a new man, played by Kris Kristofferson.

When the movie first came out, it was seen as raising important feminist issues. Was it true that a young woman, unexpectedly widowed, couldn't make it without a man to support her, as the movie suggested? What should women do to avoid a catastrophe like hers?

What I don't remember is any discussion about the Social Security that would have supported Alice if only she had applied. Why didn't she? Obviously it would have spoiled the plot, but its benefits would have made life much better for her and her son, at least until Kris Kristofferson came along. Tommy would have been eligible for monthly payments until he reached 18, or if he was still in school, until he was 20. If he was disabled, he would have been entitled to benefits for life. In addition, Alice would have been eligible to receive benefits for herself as a widowed parent until Tommy reached age 16 or, if he was disabled, until he recovered from his disability.

If Alice's husband had been an average earner, Alice and Tommy were respectively 35 and 11, and this was taking place in 1998, their combined monthly Social Security benefits would be $1,454. (If Alice earned more than $9,120 this year, her benefit would be reduced by half of her earnings above that amount. If she earned more than about $15,000, her benefit would be eliminated, but her son would still get $727 a month.)

When Tommy reached his 16th birthday in 2003, Alice would have to become self-supporting until she reached age 60. But she would then be eligible for a widow's benefit of $1,908 a month.

If Alice were disabled herself, she would be eligible for widow's benefits at age 50 rather than 60. Moreover, Alice could increase her benefits in old age by waiting until normal retirement age — now 65 — before starting to collect her widow's benefit (or by earning enough to qualify for a benefit larger than her widow's benefit).

These Social Security benefits would have enabled Alice to stay in her home rather than sell it and to keep Tommy in his familiar school and neighborhood instead of, as in the movie, leaving him alone in lonely motel rooms while she hunted for jobs and worked. When she was ready to enter the workforce, Social Security would have supported her and Tommy while she trained or looked for work.

Some people argue today that women like Alice would be better off if instead of Social Security, her husband had established a privatized account. A look at the figures shows how unlikely it is that a privatized system would be better for her. Social Security's actuaries estimate that to obtain equivalent income to what Social Security would provide for her and Tommy, she would need to receive a lump sum of about $150,000. If her husband had been three years older than she and had gone to college before entering the workforce, he would have worked for 17 years before his death. If he had average earnings and saved five percent of them in a privatized account, it is highly unlikely his individual account would have accumulated anything close to $150,000. In addition, after his death, the much touted magic of compound interest wouldn't help much because interest is payable only on money that is not spent, and Alice and her son would have begun using the money for their support during the period right after she became a widow.

Recently on a CBS news program, a woman in Galveston, Texas, in a public employment job not covered by Social Security, described the nest egg she had been able to acquire in a privatized account established as an alternative to Social Security. She thought she was better off than under Social Security. But her next egg totaled $85,000, only a little more than *half* the present value of the benefits to which Alice would be entitled. If she became a widow with children — clearly a possibility at the age she appeared to be — or if she became disabled, her nest egg could not offer her anything close to what Social Security would have provided.

To be sure, there are circumstances in which privatization might be better for some individuals, such as those who never marry, have children, or become disabled. They could acquire a significant savings account, provided their investments are well-chosen, and the market does not go down when they are ready to retire. But who can be sure ahead of time he or she will have such a life? Who would risk their security on the guess that they will? Perhaps the same kind of person who does not buy fire insurance because it seems unlikely the house will burn down.

As Americans looking to the future, do we want to abandon or curtail Social Security for privatized accounts in the hope some of us will strike it rich? I'd like to see everyone become rich. But I'm not prepared to sacrifice the guaranteed protection for widows, surviving children, disabled people and people who live until a very old age, among others — as well as people who don't know how to invest wisely — so some of us can grow wealthier. Why not let those who can afford it save more on their own, but keep the vital safety net Social Security provides? None of us knows for sure when we will need it badly.

Edith U. Fierst was a member of the 1994-1996 Advisory Council on Social Security.

WOMEN AND A PRIVATIZED RETIREMENT

By Edith U. Fierst

When I was in my teens, a scandal in our small suburban town shocked the community. A husband of 20 years, father of four children, one of whom was my friend, a man deemed a pillar of society, walked out on his wife to marry another woman. Today a departure like his has become more commonplace, but when I was in high school, it didn't happen. Everyone, including the teenagers talked about it. But one subject we never considered was what the wife would live on as she approached old age in the years to come. She was short and fat, well into her fifties, unlikely to marry again, and a consummate housewife, unequipped to earn a living. Would the husband pay her adequate alimony? Suppose he died and the alimony expired, what would she then do?

Today many people, especially young women planning their lives, ask that question. One important answer is Social Security. Sometimes it is the only answer. Under current law, Social Security pays:

- *A spouse benefit* to a married woman or one divorced after 10 or more years of marriage. This benefit equals the difference between the Social Security benefit she earned herself and an amount equal to *half* of her husband's benefit if it is larger. The spouse benefit is payable while the husband lives.

- *A survivor benefit* to a widow or widower, including one who was divorced after 10 years of marriage. This benefit is the difference between the benefit she earned herself and the *full* amount of the worker's benefit, if it is larger.

Both spouse and survivor benefits are paid from the Social Security trust fund to those eligible. These benefits are guaranteed by law. Such benefits now provide a basic minimum income for millions of elderly women, enabling them to live with self-respect independent of their children. These benefits also provide invaluable peace of mind to younger women who know they can count on these benefits. To the extent Social Security were to be privatized, the financial independence and peace of mind that spouse and survivor benefits now provide to these women could greatly diminish.

Under privatization, payroll taxes would be directed into private individual accounts instead of into the trust fund. Control of the private accounts would vest in the worker who paid the tax. Any payment to the wife would come from payments that would otherwise go the worker, giving him an incentive to resist or limit sharing with her.

This would change the psychology of the financial relationship of the couple. Today no one objects to Social Security payments to a spouse, even if estranged or divorced, since the benefits are paid by the trust fund and *there is no reduction of benefits* *to the retiree himself.* Any woman who has been married 10 years or more is entitled to a spouse or survivor benefit based on marriage. Indeed, the earnings record of a much-married man could be the basis for benefits to several former spouses to whom he was married for 10 or more years, as well as to a current wife to whom he need not have been married that long. (Note: A woman may not collect benefits based on more than one marriage. Her spouse and survivor benefits are based on the earnings of the husband with the highest earnings, except that spouse benefits must be based on the earnings of her current husband if she married him before reaching age 60.)

To the extent benefits were privatized, payments to a spouse could depend on the willingness of the worker to share the funds in his personal account, as well as on the success of his investments. Since any benefits a current or former spouse received would come from his account, a retired worker would have an incentive to resist or limit such sharing. To be sure, under some partial privatization proposals, account owners would be required to purchase survivor annuities for their spouses unless the spouses waive their right to such benefits. Except for such limited requirements, however, privatized benefits would generally be under the unrestricted control of the retired worker, who would have complete freedom over how to spend them.

Payments to a spouse from the privatized portion of Social Security would compete with other uses the owner of the account might find necessary or appropriate. For example, the owner of a privatized account with good intentions might be forced to spend his savings on nursing home care for himself or his spouse. Similarly, the account-holder might buy a small business which later failed, leaving both husband and wife without adequate retirement funds. Or, as in the case of the family I knew in high school, the man might leave for another woman after many years in which his wife thought their marriage was happy, taking his money with him.

What could she do to assure he would help support her in old age, especially if she outlives him? One possibility is to seek assistance from the divorce courts, on the likely assumption that they would divide privatized funds as they now do other marital assets. To assure success, she might conclude she had to act before her husband retired. While divorce courts can award alimony whether the worker is working or retired, there may not be enough funds left after he retires and begins to spend some of the savings in his privatized account for him to be able purchase an adequate survivor annuity for his spouse. For this reason, privatization could even provide an incentive for some women to consider seeking a divorce. I can imagine a woman faced with a terrible dilemma — whether to risk eventual poverty or to act early to gain access to her husband's account before it is spent. Afterwards, it might be too late; there might be too little left for the court to divide.

Even divorce courts would not give women a benefit based on the lifetime earnings of their husbands. Divorce courts generally have jurisdiction to give the wife a share only of what was earned *during* marriage. By contrast, under current law, a wife's Social Security benefits are based on her husband's lifetime earnings, including those earned *before or after* their marriage.

Proponents of privatization sometimes argue that with women working more outside the home, the need for spouse and survivor benefits is diminishing and may soon vanish. The facts are otherwise. The Social Security actuaries estimate that among married women retiring in 2015, approximately 40 percent will continue to qualify for at least a partial spouse benefit.

Moreover, since few women earn as much or more over a lifetime as their husbands do, more than 80 percent of widows will continue to qualify for survivor benefits. As noted above, the benefits equal the husband's entire Social Security benefit. These widows will have earned less at their jobs, perhaps because their attention was divided during the years they were raising children, or because they chose to stay home for extended periods to bring up children, care for elderly parents, or serve in their community. All of these are life-style choices that would be at some risk under privatization.

Another major issue is how to be sure benefits will last a lifetime. The only way is for monthly benefits to be paid for life, as Social Security benefits are. By contrast, most privatization plans allow the retiree access to much or all of his savings at retirement. This means that many people may encounter difficulty spreading their retirement incomes over their and their spouse's lifetimes, whatever their intentions. At age 65, men have an average life expectancy of 15.3 years (to over age 80) and women an average of 19.1 years (to over age 84).

Those who want to protect themselves and their spouses against outliving their benefits could purchase private annuities, but private annuities are expensive. Experience has shown that those who buy them tend to live longer than the average for the population as a whole. Insurance companies and other private purveyors of lifetime annuities charge high prices to compensate for the likelihood of longer lives by their customers and to enable them to earn a profit.

Moreover, unless federal regulations preclude differential charges for annuities by sex, companies will charge women more for annuities or give them lower monthly annuity benefits, since on average women live to older ages than men.

Without annuities, what will keep elderly widows from destitution? Perhaps SSI, welfare for the elderly, which currently supplements the income of the elderly poor. But SSI raises the income of elderly individuals only to $494 a month for those with assets of less than $2,000 (excluding certain items such as a home, a car and prepaid funeral expenses). This is well below the poverty line.

Social Security not only pays a benefit every month for life but also provides an annual cost-of-living supplement to keep up with inflation. Because of the COLA,

A Way to Improve Life for Elderly Widows

One change that has been proposed could make life more secure for elderly widows, who are the poorest component of the elderly population. More than 20 percent of them, including divorced widows, are below the poverty line. This proposal also would give women who have earned their own benefits a greater return for their taxes.

Under the proposal, survivor benefits would be increased from half to three-quarters of the husband and wife's combined benefits. For example, if husband and wife each had earned a benefit of $1,000 a month, under current law the survivor benefit would be $1,000 a month; under this proposal, it would rise to $1,500. If only one partner had worked, the benefit would remain at $1,000.

The beneficiaries of this change would be couples in which both had worked, especially if their earnings had been nearly the same. Researchers at the Social Security Administration estimate that the incomes of about one of every six poor widows who came on the rolls in 1990 would be raised above the poverty level by such a change.

The cost of this modification could be paid for mostly by reducing the spouse benefit from one-half to one-third of the husband's benefit. Of the 40 percent of married women who are expected to qualify for spouse benefits in 2015, many earn more than a third of their husbands' benefits and would keep their worker benefits. Those who did not would still get at least one-third of their husband's benefits. Over time, as women earn higher benefits themselves, such a reduction would affect fewer of them.

Further, most couples in which the wife has earned benefits less than one-third of her husband's are relatively affluent. This is what enabled them to work so little outside the home. The poverty rate among married couples, whether they are of working or retirement age, is less than six percent, while that for widows is more than three times as high.

Social Security never loses its purchasing power. Nothing similar is available in the private market.

The present discussion of privatization has arisen because Social Security is expected to have a shortfall in the 75 years ahead. This shortfall can be solved with modifications in Social Security, such as raising the retirement age modestly, bringing state and local employees under mandatory coverage, and taxing benefits in the same manner as other pension payments are taxed. Such changes are what we should be debating, not proposals that would significantly reduce the security of elderly women.

SOCIAL SECURITY REFORM: HOW MIGHT WOMEN FARE?

Highlights

Trends in female labor force participation rates, female earnings as a percent of male earnings, and women's pension coverage all point to improvements in the economic status of women that have taken place in recent decades. In the years ahead, more women will be receiving Social Security and pension benefits based on their own work histories and, in the aggregate, are likely to have higher real incomes in retirement than women who are retired today.

Despite these positive trends, many millions of women will receive low or no private pension benefits and will remain heavily dependent upon Social Security for retirement-income support. Thus, how Social Security treats women, and how women might fare under various proposals to restore long-term solvency to the Social Security system are matters of critical concern to women.

This issue brief examines the potential impact on women of a number of proposed Social Security reforms. Some of the changes would maintain the system's social insurance principles, while others call for a privatized system that would allow workers to invest all or part of their Social Security contributions in the private market.

Privatization, even partial privatization, poses big risks, especially for persons with limited resources. How the market has performed historically, for example, cannot be counted on to apply to specific groups of workers or to the time that a particular cohort retires. The market does not just go up, and declines can be swift, deep, and prolonged. Low-income women would have less to invest and would be less able than higher-income women to weather market downturns.

Women appear to be more conservative investors than men. Under a privatized system, two investors with identical earnings but different investment philosophies could end up with very different retirement benefits. Women, in such instances, could expect the lower accumulations.

Because Social Security is gender neutral, men and women with identical work histories and earnings can expect identical benefits. In the private market, however, sellers of annuities can take into consideration women's longer life expectancy. Thus, the same accumulation may purchase lower monthly benefits for women than for men.

Social Security provides benefits to the spouses and survivors of workers eligible for Social Security. Not all privatization proposals would require account owners to annuitize their accumulations. This could leave married women and survivors with no assurance of any income from their husbands' retirement investments.

Divorced women are entitled to Social Security benefits based on the earnings of their former husbands, if they had been married for at least ten years. Under some proposed changes to Social Security, such women would apparently have to depend on the vagaries of the divorce court for any share of the accumulations in their husbands' privatized accounts.

Other more modest changes to Social Security have also been proposed, and some of them could adversely affect women. For example, because women's average work histories remain much shorter than men's, they would find it hard to meet an increase in the number of years included in the benefit computation formula or a higher normal retirement age.

Introduction

Women's rising labor force participation rates, increasing earnings, and expanded pension coverage (Tables 1 to 4) point to a brighter old age for millions of women, who at one time could count on little in the way of retirement income beyond a Social Security benefit based on the earnings of their husbands. Growing numbers of women in the future will receive Social Security and private pension benefits as a result of their own work histories, and many will be able to supplement those benefits with income from savings and investments.

Table 1
Labor Force Participation Rates of Women, Selected Ages: 1950-1996 (in percent)

Year	16+	24-34	35-44	45-54	55-64
1950	33.9	34.0	39.1	37.9	27.0
1955	35.7	34.9	41.6	43.8	32.5
1960	37.7	36.0	43.4	49.9	37.2
1965	39.3	38.5	46.1	50.9	41.1
1970	43.3	45.0	51.1	54.4	43.0
1975	46.3	54.9	55.8	54.6	40.9
1980	51.5	65.5	65.5	59.9	41.3
1985	54.5	70.9	71.8	64.4	42.0
1990	57.5	73.6	76.5	71.2	45.3
1995	58.9	74.9	77.2	74.4	49.2
1996	59.3	75.2	77.5	75.4	49.6

Source: U.S. Department of Labor 1985, 1986, 1991, 1996, and 1997.

Despite these developments, the retirement income security of millions of women in the near- and longer-term future is by no means guaranteed.[1] Women with lengthy work careers and jobs with high wages and pension coverage may look forward to a financially secure old age, but even they could find themselves at risk of outliving their assets and watching the value of their private pensions dwindle from even moderate inflation or a stay in a nursing home. Moreover, although women's employment prospects have brightened considerably over the past several decades, their labor force attachment and work experiences have yet to measure up to men's, and it is on work patterns more typical of men that much of the country's retirement-income system is based.

Women are still more likely than men to be out of the labor force at any age, to experience discontinuous work histories, and to be employed part time--all of which have implications for their ability to accrue pension credits and save for retirement.

Table 2
Median Earnings of Full-time Working Women: 1970-1996* (in 1996 dollars)

Year	Number with Earnings (in 000s)	Annual Earnings
1970	25,926	$15,576
1980	34,727	$17,570
1990	42,940	$20,284
1996	46,944	$21,185

*Civilian workers only prior to 1989.
Source: U.S. Census Bureau 1998.

Government efforts to encourage people to assume more responsibility for their own well-being in old age notwithstanding, Social Security will continue to provide much of the

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[1] The same can be said of men, of course. However, as discussed in this paper, older women are, and most likely will remain, more vulnerable financially than men. For this reason, and because the number of vulnerable older women far exceeds the number of vulnerable men, this paper focuses on women.

retirement income on which millions of women depend. Hence, how Social Security treats women, and how women might fare under various proposals designed to restore long-term solvency to the Social Security system, are matters of critical concern to women. This issue brief examines the importance of Social Security to women now and into the 21st century, especially with respect to their continued economic vulnerability. It also addresses issues of benefit adequacy and equity for women and assesses how some of the more prominent proposed changes to the Social Security system might affect them.

Table 3
Female Earnings as Percent of Male Earnings: 1970-1996 (median earnings of full-time workers)

Year	Annual	Weekly
1970	59.4	62.3
1980	60.2	64.4
1990	71.6	71.8
1995	71.4	75.4
1996	73.8	75.0

*Year-round workers.
Source: Institute for Women's Policy Research (IWPR) 1997; U.S. Department of Commerce 1998; U.S. Department of Labor 1988.

Income Security in Old Age

Not only do over 90 percent of women aged 65 or older collect Social Security benefits, but Social Security accounts for over half the income of nonmarried women in this age group and 38 percent of the income of married couples. In fact, Social Security actually contributed more to household income for couples and nonmarried women in 1994 than it did in 1976 (Grad and Foster 1979: Table 28; Grad 1996: Tables I.8 and VII.2). Social Security plays almost as important a role in the financial well-being of nonmarried older men. (See Figure 1.)

Social Security was designed to help protect people against income loss resulting from events--retirement and disability, in particular--over which they have little or no control. While never intended to serve as the sole source of retirement income, it is just that for approximately 2.7 million nonmarried elderly women and nearly three-fourths of a million aged married couples (Grad 1996: Table VI.B.2).

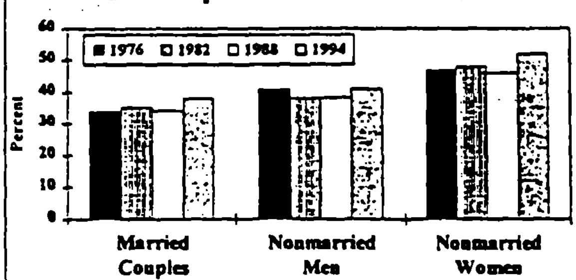
Table 4
Women's Pension Coverage Rates, Full-time Private Wage and Salary Workers: 1972-1993 (in percent)

Year	Coverage
1972	38
1979	40
1983	42
1988	44
1993	48

Source: U.S. Department of Labor et al. 1994 Table B16.

Fewer than one in five (18 percent) elderly women were receiving income from private pensions or annuities in 1994. A much higher proportion (two-thirds) reported owning assets, but median asset income in 1994 was barely over $1,300 for all aged recipients; among nonmarried women, the median was less than $900 (ibid.: Table V.D.1).

Figure 1
Social Security As a Share of Aggregate Income by Marital Status: 1976-1994



Source: Grad and Foster 1979; Grad 1984, 1990, and 1996.

Subject to numerous uncertainties under the best of circumstances, Social Security projections are especially problematic in light of recently proposed reform measures. As noted above, in the future, women will have greater access to sources of retirement income in addition to Social Security, as their behavior continues to undergo changes. For example, as Ross (1997) notes, women nearing retirement age--55 to 64 years old--had a labor force participation rate of 41 percent 30 years ago, when they were 25 to 34. Women who are between the ages of 25 and 34 today, in contrast, have a participation rate of 75 percent. For this as well as other reasons, seven in ten baby boomer females in 2030 are expected to have pensions and assets in addition to Social Security, according to simulations by Lewin-VHI (AARP 1994: Table 10). Only about one in 25 female boomers is likely to have income from only one of these sources.[2]

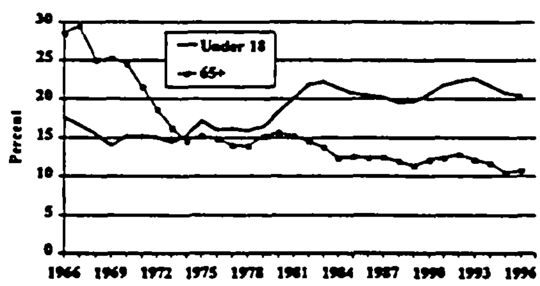
Despite these developments, reliance on Social Security may not lessen as dramatically as women's changing roles might suggest, at least not for several decades. Pension coverage rates have stagnated since the 1970s, and although more future retirees will receive pensions, the amounts could be small. This is because the average benefits to shorter tenured workers "who would not have received pensions previously" may be low (U.S. General Accounting Office 1997: 7).

In addition, efforts to foster personal savings "appear to have had only marginal success" (U.S. General Accounting Office 1997: 7). The temptation to utilize lump-sum pension distributions upon job change may be overwhelming for many workers (see, e.g., Korczyk 1996a and 1996b), leaving future retirees with less retirement income than pension coverage rates might imply. When offered the chance, workers are apparently far more likely to opt for lump-sum payouts, even at retirement (Salisbury 1997), when a lifetime annuity might be more appropriate. At least one set of simulations warns that Social Security's contribution to aggregate income could change only modestly, especially for nonmarried women through 2030 (Zedlewski, et al. 1989), a conclusion echoed by Lewin-VHI for widowed females (AARP 1994).[3]

Vulnerability in Old Age

Social Security has been a major contributor to the marked decline in poverty among elderly persons in recent decades. In 1966, nearly 29 percent of persons aged 65 and older had incomes below the official poverty level, but by 1996, that figure had fallen to just 10.8 percent, partly the result of substantial Social Security benefit increases in the 1970s and automatic cost-of-living increases as of 1975. The overall poverty rate for the older population is now below that for the population under the age of 18 (Lamison-White 1997; see Figure 2).

Figure 2
Poverty Rates of Persons Under Age 18 and 65+: 1966-1996



Source: Lamison-White 1997.

The loss of Social Security benefits would not put every older person in the poorhouse, but millions would find themselves strapped

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[2] In 1994, only 5 percent of aged married couples and 1 percent of nonmarried women received three or more retirement benefits (Grad 1996: Table I.6).

[3] Zedlewski et al., for example, estimate that Social Security will account for 68 percent of the aggregate income of nonmarried women in 2030, while Lewin-VHI projects that it will account for almost 49 percent of the income of widows.

or financially at risk without them. Unpublished calculations by AARP's Public Policy Institute indicate that the 1995 poverty rate for persons 65 and older would have risen from 10.5 percent to 47.8 percent if their Social Security benefits had been eliminated. Without Social Security, the poverty rate of older women--who predominate among the aged poor--would have been 52.9 percent in 1995, rather than 13.6 percent.

Aggregate poverty rates obscure significant differences by subgroups that make it clear that, as Choudhury and Leonesio (1997: 1) put it, "the gains that have accrued to the aged in aggregate have not been equally shared by men and women." So, for example, older women have a higher poverty rate than older men; nonmarried women are far worse off than married women; minority women have much higher rates of poverty than white women (see Table 5); very old women (85-plus) are at greater risk of being poor than women in their 60s.

Women's Eligibility for Social Security[4]

Women can receive Social Security benefits in old age in one of essentially three ways[5]--based on their own work histories and earnings records, based on the work histories and earnings records of their husbands, or based on a combination of the two. Women with the requisite Social Security coverage (a minimum of 40 quarters for workers reaching retirement age today) are entitled to a full retired worker benefit at the age of 65. Actuarially reduced benefits are available to qualified workers as early as age 62.

If, upon reaching retirement age, a woman is married or had been married for at least ten years before becoming divorced, she may be entitled to spousal benefits that at their maximum are equal to half of her husband's or ex-husband's retired worker benefit.[6]

Women receiving spousal benefits may have worked during their marriages, but not enough to qualify for benefits of their own that exceed their spousal benefits. Women lacking 40 quarters of coverage are entitled only to spousal benefits.[7]

Table 5
Poverty Rates of Selected Groups: 1996
(in percent)

Persons 65 and older	10.8
Persons under age 18	20.5
Women 65 and older	13.6
Men 65 and older	6.8
White women 65 and older	12.1
Black women 65 and older	29.8
Hispanic women 65 and older	27.7
Married women 65 and older	5.2
Nonmarried women 65 and older*	19.5

*Includes separated women.
Source: Lamison-White 1997, Table 1; unpublished AARP-Public Policy Institute tabulations of March 1997 Current Population Survey.

More likely today, married women will have worked enough to qualify for retired

[4] For ease of reading and because it is concerned primarily with women, this issue brief will generally refer only to women even when the observations apply to men as well. Social Security, it should be stressed, is gender neutral.

[5] Under certain circumstances, workers may also qualify for benefits at younger ages, e.g., if they become disabled. A very few Social Security beneficiaries are receiving special age-72 benefits or benefits as parents; however, these beneficiaries are not treated in this issue brief.

[6] Early (pre-65) collection of benefits results in an actuarial reduction. The full 50-percent spousal benefit is received only when both spouses are 65 or older at the time of receipt.

[7] Spousal benefits are sometimes referred to as dependents' benefits, a term that has come to have a pejorative connotation as the concept of marriage as an economic partnership has achieved greater currency.

worker benefits of their own but, upon reaching retirement age, find that their own benefits amount to less than half of their spouses'. Technically, these women—who are "dually entitled"—receive their own retired worker benefits plus an auxiliary benefit that tops their worker benefits up to what they are otherwise entitled to as spouses. In other words, they do, in fact, collect benefits based on their earnings, but this technicality is lost on many married women, who are only too aware that when it comes to old age and survivors' benefits, they are no better off than if they had never worked for pay.[8] In practical terms, dually entitled beneficiaries get the higher of two benefit amounts; they cannot collect both full benefits.

When spousal benefits were introduced in 1939, relatively few married women worked outside the home, although even then it was assumed that "most wives, in the long run, [would] build up wage credits on their own employment" (Chater cited in U.S. General Accounting Office 1996: 64), as indeed they have. Today, the majority of adult women under the age of 65 are employed outside the home, regardless of marital status or the presence of children. Even the mothers of young children are likely to be employed. As of 1996, nearly 58 percent of married women with a child under the age of three were in the labor force, over 2.5 times the figure 30 years earlier (Ferber 1993 and U.S. Depart-ment of Labor 1998).

The figures in Table 6 highlight how women's changing roles have been reflected in their Social Security benefits, as a growing proportion now collects worker benefits. Over 62 percent of women qualified for worker benefits in 1995, up from 43 percent in 1960. That women are increasingly working long enough to qualify for retired worker benefits of their own is a big plus in the event of divorce.

Table 6
Women Social Security Beneficiaries Aged 62 or Older, by Type of Entitlement: 1960-1995 (in percent)

Entitlement	1960	1980	1995
Worker	43.3	56.9	62.1
Worker only	38.7	41.0	36.2
Dually entitled	4.6	15.9	25.9
Wife/widow only	56.7	43.1	37.9

Source: Social Security Administration 1996: Table 5A.14.

Women today, it is clear, are far less likely to be "dependent" on a spouse, at least as far as Social Security is concerned. This is evident in the decline in wife/widow-only recipients from almost 57 percent in 1960 to just under 38 percent in 1995.

Despite women's growing labor force attachment, "there are still," as Ferber (1993: 43) states, "millions of women who have been full-time homemakers most of their lives, although their number has been declining rapidly. There are many more women who have been full-time or part-time homemakers intermittently" (Ferber 1993: 43). Thus, women's gains have come mainly in the form of dual entitlement (see Table 6). If these women's own worker benefits had been higher than half of their husband's, they would be classified as "worker only,"[9] a figure that was actually lower in 1995 than it was in 1960, perhaps as a result of more low-wage women entering the labor force and accumulating sufficient quarters of coverage to qualify for worker benefits. Instead, these

[8] If they lack the requisite work history, however, married women are not eligible for disability benefits based on their husbands' work records, so employment does provide them a benefit that marriage alone does not.

[9] This designation may be confusing because the beneficiaries in question would have qualified for spousal benefits if they were not entitled to retired worker benefits that are greater than the spousal benefits.

dually entitled women do better with what is, in essence, the spousal benefit.

At widowhood--and most women outlive their husbands--survivors either collect their spouses' full benefits or continue to receive their own retired worker benefits, whichever are greater. They cease to get the 50-percent spousal benefit. The same holds true for divorced women. If their ex-husbands die, they, too, may be eligible for higher survivors' benefits.

Receipt of benefits based on husbands' work records and earnings may continue into the foreseeable future, in spite of women's growing labor force attachment. Sandell and Iams (1996) estimate that women's changing work patterns and earnings will result in higher income for couples, but little improvement for most widows. A growing proportion of wives, they maintain, will qualify for Social Security benefits of their own that exceed *half* of their husbands' benefits but are less than 100 percent of those benefits. If they outlive their husbands, these women will find themselves "better off" with survivors' benefits than they would be with their own retired worker ones.

The projections of Sandell and Iams suggest that fewer than 20 percent of baby boom widows in the early part of the next century will collect higher benefits based on their own earnings, in contrast to about 8 percent today. As a result, "a sizable proportion, not too different than today's, of next century's elderly widows will be at risk of economic distress" (Sandell and Iams 1996: 12).

Reinforcing this observation are projections from the Commonwealth Fund Commission on the Elderly People Living Alone (1987: OR-2), which indicate that by 2020, poverty among the aged will be largely confined to persons living alone, virtually all of whom will be women. Moreover, the gap between these women and other elderly persons is expected to widen. Hence, developments that threaten to undermine the income support the aged *now* receive should be examined carefully for their potential impact on this vulnerable group.

Social Security Provisions of Particular Importance to Women

Social Security is gender neutral, which means that men and women with identical work histories and earnings can expect identical benefits. The gender neutrality of Social Security extends to its actuarial calculations. In the private market, sellers of annuities can take into consideration the fact that a set sum or accumulation of savings must, on average, last longer in the case of women. Thus, the same accumulation may purchase lower monthly benefits for women than for men, though payments over a lifetime may be the same. This cannot happen under Social Security.

Nonetheless, because women's and men's lives are anything but gender neutral, the Social Security benefits they receive typically vary substantially in both type and amount. Not surprisingly, women's benefits typically are lower than men's.

At the end of 1995, female retired workers were receiving monthly benefits that averaged $621, in contrast to $810 for men (Social Security Administration 1996: Table 5.A1). This gap reflects less time in the labor force on the part of women, as well as their greater probability of working part time and their continued concentration in lower-wage occupations.

The gender neutrality aspect of Social Security aside, a number of Social Security's provisions are especially beneficial to women, although men in comparable circumstances would benefit from these provisions as well. For example, 99 percent of the spousal benefit recipients are women, as are 98 percent of the dually entitled (Social Security

Administration 1996: Tables 5.A1 and 5.G2). The U.S. General Accounting Office (GAO) notes that "because women receive spousal and survivor benefits more often than men and, hence, are subject to the dual entitlement limitation more often, these concerns are often viewed as women's issues" (U.S. General Accounting Office 1996: 48).

The Benefit Formula

Women also gain from the way Social Security benefits are calculated because the benefit calculation formula replaces a higher proportion of the wages of low-wage workers than of higher-wage workers. For single earners with low, average, and high earnings, for example, Social Security replaces, respectively, about 53 percent, 40 percent, and 26 percent of their wages (Steuerle and Bakija 1994: 96).

The progressive benefit formula redistributes income from higher-wage earners to lower-wage earners who, it has been recognized since the system's inception, would have more difficulty achieving income adequacy in old age than their higher-earning counterparts. Since women are disproportionately found among the lower earners, this "weighted benefit formula" is especially important to them.[10] Private pension benefits lack the redistributive element of a weighted benefit formula, which is a fundamental feature of social insurance in the United States.[11]

The fact that divorced women can collect benefits on their ex-husbands' work records and that multiple ex-spouses who meet the duration-of-marriage test can collect benefits as divorcees or widows, underscores the role that Social Security plays in protecting against income loss and providing a floor of security. In sum, as Ferber (1993: 43) notes, Social Security "favors lower income workers and makes provisions for spouses who are not employed," two aspects of the system that favor women as a result.

Defined Benefit vs. Defined Contribution Protection

Social Security is a defined benefit retirement income plan that uses a formula set by law to calculate benefits based on earnings up to an annual maximum limit and years of coverage (35 years of highest earnings). Workers can, albeit generally with some help from the Social Security Administration, estimate what their benefits will be under reasonable assumptions about wage increases and years of employment. That is not, however, the case with defined contribution private pension plans, such as 401(k)s, which are claiming an increasing share of the private pension market. With defined contribution plans, market risk is a real risk: retirement annuities or lump-sum distributions from those plans depend on the amount invested and the earnings on the investments. Poor investment choices, as well as both the unwillingness and inability to save, can also undermine retirement-income accumulations.

Moreover, retirees need never fear outliving their Social Security benefits. Because Social Security cannot be taken as a lump sum or as graduated payments or phased withdrawals, beneficiaries can never "use up" their Social Security. Furthermore, because old-age and survivor benefits cannot be cashed out at early ages, qualifying retirees can never get their hands on the money prematurely. Assuming workers have sufficient quarters of coverage, something will always be there for retirement. In contrast, cashouts pose a significant problem for savers

[10] Of course, the weighted benefit formula is no substitute for improving the wages and benefits of women. High earners still receive higher absolute benefits than low earners, even if those benefits replace a lower proportion of pre-retirement earnings.

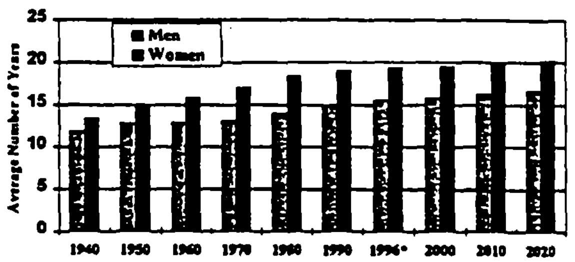
[11] Women may lose some of that progressivity if their Social Security and private pension benefits are integrated.

in defined contribution plans, especially at the time of a job change. Women are more likely than men to cash out their defined-contribution accumulations before retirement age (Korczyk 1996a).

Longevity

Longevity should also be kept in mind by women as well as men as they plan for their income needs in old age. Life expectancy at age 65 has risen for both men and women since the early years of Social Security (Figure 3), though the female/male longevity gap is wider than it was six decades ago. As of 1996, at age 65 the average woman could expect to live more than 19 years; future female retirees will have to plan for an even longer retirement. Very old Social Security beneficiaries today, the vast majority of whom are women, are among the poorest of Americans. They may also face catastrophic health and long-term care expenditure at the same time that they risk exhausting their non-Social Security resources. Just how much more secure the very old of the future will be remains to be seen.

Figure 3
Life Expectancy at Age 65: 1940-2020
(intermediate assumptions)



*Preliminary.
Source: Board of Trustees, Federal Old-Age and Survivors Insurance Disability Trust Funds 1997

Longer life expectancy for women, coupled with the fact that wives are generally younger than their husbands, means that women are more likely than men to become widowed and, as a result, have a far greater probability of living alone. Some women reach old age never having married, but the percentage currently is low (about 4 percent). Many more are widowed, and by age 75, only about one fourth of women are married, in contrast to about 70 percent of men of the same age. Women are thus more likely to suffer the loss of income and social support resulting from the death of a spouse.

One of the great advantages of the Social Security system is that benefits are indexed. This guarantees that retirement benefits maintain their purchasing power over time. Almost no private pensions are automatically indexed, although a few grant ad hoc increases. A very long life expectancy accompanied by even modest inflation can seriously erode private retirement benefits. Private annuitants must purchase indexed annuities if they want any inflation protection in their defined contribution plans, but they pay for that protection in the form of lower benefits.

Social Security and Women's Unmet Needs

Despite the benefits that accrue to women under Social Security, the program today is not without critics. Its gender neutrality, for example, by definition fails to make allowances for the fact that caregiving responsibilities are one reason that women's work histories continue to be shorter than men's. Social Security benefit calculations assume a 40-year work history, with the five lowest years of earnings omitted from the calculation. For women, some or all of these five years may be years of zero earnings. Earnings over the remaining 35 years are averaged, but if Social Security applicants have more than five years of no earnings—as many women still do—anything in excess of five is included as zeros in the estimation of average wages and calculation of benefits.

To be sure, more women are reaching retirement age with a full work history, but most still fall short of the full averaging period. GAO observes that the median number of years with covered earnings was 36 for men reaching age 62 in 1993; it was only 25 for women; less than 20 percent of women had 35 years, in contrast to almost 60 percent of men (Ross 1997).

"Provid[ing Social Security] participants with retirement benefits adequate to secure a basic subsistence standard of living" is the goal that drove the architects of the Social Security system (Steuerle and Bakija 1994: 15-16) and that has driven many of the system's subsequent reforms. Though attention to equity issues, or the fairness of benefits compared to contributions, was apparent at the outset, benefit adequacy was the greater concern at the outset as the architects of the program sought first to deal with the problem of poverty (ibid.: 14).

Concern about the well-being of dependent family members, particularly women and children, manifested itself in the early days of Social Security. The addition of benefits for wives and children that were not tied to their own work records, according to Derthick (1979: 260-261), "consciously introduced an avoidable bias into the program for the sake of welfare objectives."

That bias--an inequity accepted for the sake of adequacy--was the advantage accruing to a married couple with a single earner over a two-earner couple with the same earnings. The latter couple might pay the same Social Security taxes as the former, but the couple would collect less from Social Security. Each qualifying worker in a two-earner couple would get a retired worker's benefit, while the single-earner couple could claim a worker's benefit and a spousal benefit.

This inequity has proven nettlesome to many dual-earner couples as their numbers have increased. It also translates into an adequacy issue, especially upon widowhood. The benefit to which the surviving spouse, again generally a woman, is entitled will be substantially lower for the survivor of a dual-earning couple than the survivor of the single earner with comparable earnings. Household expenses may fall at this time, but, as Rappaport (1997: 35) observes, "the difference in cost of living is far smaller than the difference in income." Survivors of dual-earner couples may experience considerable hardship as a result of the decline in household income at this time.

As more married women began to find themselves part of dual-earner couples, issues of equity or fairness began to strike a chord,[12] and by the late 1970s, women's advocates were increasingly seeking to bring some of these issues to the fore. Income adequacy, especially for nonmarried women and the very old, continued to be a concern. Although women's status in retirement was clearly improving, many women's advocates agreed with former Congresswoman Mary Rose Oakar, Chair of the House Task Force on Social Security and Women, when she argued that correcting the inequities toward women in the Social Security system was "one of our top domestic issues" (U.S. House of Representatives 1980: 2).

Improving Women's Status in Old Age

There have been numerous proposals since the 1970s and early 1980s to make Social Security more equitable and/or more adequate for women (see, e.g., U.S. House of Representatives 1980 and 1985; Beedon 1991; Burkhauser and Smeeding 1994; Center for Women Policy Studies 1988; Save Our Security 1996; Steuerle and Bakija 1994). Reform proposals have varied, from the radical solution of earnings-sharing for married couples--whereby the earnings of both partners would be halved and credited to

[12] GAO (1996) recently summed up the key inequities that have the greatest impact on women: two-earner couples receive lower benefits than one-earner couples with the same earnings; the survivors of these couples get less as well. In addition, dually entitled beneficiaries get no more in Social Security benefits than they would receive if they had never worked.

the earnings records of each spouse—to more modest proposals, such as increasing the number of dropout years in the calculation of average earnings under Social Security.

However, most proposals, as Ferber points out, "have come to naught," which she does not find surprising, since there is so much disagreement "about what the effects of Social Security are, and what the outcomes should be" (Ferber 1993: 43). Moreover, many of the proposals have been costly, involved benefit cuts to some beneficiaries--never politically popular--, and/or would be phased in over such a long period of time that years or decades would have to pass before full implementation. Hence few women who need help immediately would benefit from the change.

Though momentum for reform that would benefit women under Social Security seemed to be building in the late 1970s, demographic, economic, and other pressures were conspiring against significant improvements. Costly changes, in particular, were beginning to look doomed. By 1983, the Social Security system was in short-term actuarial imbalance, and the situation was urgent. Restoring solvency to the system at that time allowed for very few benefit enhancements, though the modest improve-ments that were included in the 1983 amendments to the Social Security Act were largely seen as "women's" benefits.[13]

Social Security for the 21st Century

Despite the fact that the Old-Age, Survivors, and Disability Insurance (OASDI) Trust Funds will build up sizable reserves for the next dozen years, the long term picture is not auspicious for costly benefit improvements, whether or not they involve enhanced adequacy or equity.

While Social Security revenues currently exceed payments, the system is not in actuarial balance over the long-term; the estimated deficit over the 75-year horizon used in Social Security projections amounts to 2.23 percent of taxable payroll for the Old-Age and Survivors Insurance (OASI) and Disability Insurance (DI) Trust Funds (Board of Trustees 1997).[14] The 1997 report of the Social Security Trustees notes that, all else being equal, the trust fund reserves which are currently growing will be drawn down beginning in about 2012 and will be exhausted by 2029.[15] Thus, Social Security will be able to pay full benefits on time for more than three decades. To ensure that benefits will be paid in a timely fashion after that date, some changes will be necessary. The only possibilities are revenue increases and/or benefit decreases, the magnitude of which will depend on the specific proposals and when the changes are introduced.

Coupled with the solvency issue is growing concern about declining confidence in the ability of Social Security to pay benefits (see, e.g., Reno and Friedland 1997). According to a 1997 opinion survey by Public Agenda, about one-third of the public thinks "they won't get any Social Security benefits at

[13] Under these amendments, a divorced spouse who was at least age 62 would be able to collect Social Security benefits based on the earnings of her ex-spouse as long as the ex-spouse was eligible to receive benefits; he need not have begun collecting them. Benefits were also liberalized for certain spouses.

[14] This is the average difference between income (e.g., payroll contributions) and outgo (benefits and administrative costs) as a percent of taxable payroll over 75 years. To bring the trust funds into balance, revenues would have to be augmented or costs reduced by an average of 2.23 percent in each of the next 75 years.

[15] The sensitivity of deficit projections to the assumptions on which they are based can be seen in the fact that, under the Social Security Actuaries' low cost assumptions, the OASDI trust funds will never be exhausted (at least over the 75-year period), while under high-cost assumptions, exhaustion will occur in 2018, rather than 2029.

all," up from one-fourth since 1994 (Farkas and Johnson 1997: 23), even though at its lowest point, income to Social Security should be sufficient to pay three-fourths of projected benefits. The Social Security trustees refer to "an alarming erosion of public confidence in the Social Security system over the past few years, particularly among younger generations," insisting that early action is needed to ensure long-range solvency to restore that confidence (Social Security and Medicare Boards of Trustees 1997: 13).

As of fall 1997, Social Security reform was not yet on the Congressional Agenda, although President Clinton was promising "to do something soon" about Social Security (Harris 1997: A1), contending that the administration "'would fulfill [its] responsibilities to curb the costs of Social Security." In his 1998 State of the Union address, he called for a national dialogue on Social Security to be facilitated by a series of bipartisan regional forums designed to increase public understanding of Social Security and various reform proposals.

Few politicians relish the prospects of reforming Social Security, long referred to as the third rail of politics. But while reform may be inevitable, opinions vary widely as to the degree of change that is necessary to restore long-range solvency. January 1997 saw the release of the report of the 1994-96 Advisory Council on Social Security, which had been appointed by the Secretary of Health and Human Services under Section 706 of the Social Security Act to "advise the public, the Administration, and Congress on how best to prepare" Social Security and Medicare for the future (Advisory Council on Social Security, Vol. I 1997: 6).

The Council's long-anticipated report was preceded by considerable media attention and discussion by policymakers and Social Security experts and aficionados for at least two reasons. This was the first Council that was unable to achieve consensus on major recommendations. Its 13 members could not agree on how best to prepare Social Security for the future. But most likely accounting for the flurry of media interest in the topic of Social Security were recommendations for what would amount to restructuring of the Social Security system. Proposals to privatize Social Security by allowing workers to establish individual investment accounts and decide where to invest all or part of their Social Security contributions were being seriously considered.

It is worth emphasizing that most members of the Advisory Council did agree on a number of fundamental principles. For example, members eschewed conventional means-testing and approved continuing to finance the programs through contributions from employers and employees, rather than from general revenues. Members also indicated that full cost-of-living adjustments should be maintained. However, opinions differed greatly as to the most appropriate course of action to restore solvency. The result was three very distinct approaches to the solvency issue.

These plans are by no means the only ones that will figure in upcoming debates about Social Security. Social Security reform proposals have been offered by a number of organizations, some politicians, researchers, and policy analysts, including the Committee for Economic Development, the National Taxpayers' Union Foundation, Senators Kerrey and Simpson, the Concord Coalition, and the CATO Institute. More can be expected once Social Security moves to the top of the Congressional agenda. Space limitations preclude a consideration in this paper of all the plans. Instead, this issue brief highlights components of the three Advisory Council plans as they may affect women.

Because of the publicity surrounding, and a fair degree of public interest in, these plans, because many of the other plans include similar features, and because these plans could serve as a point of departure for debate on reform in general, it seems reasonable to restrict discussion to the Advisory Council's recommendations at this time.

Social Security Reform and the 1994-1996 Social Security Advisory Council

Although the three reform plans of Social Security Advisory Council have some elements in common, they approach restoration of solvency in very different ways. The differences can largely be summed up with respect to the degree to which efforts would be made to maintain the system's social insurance principles, especially redistribution of income, or instead move toward a more privatized system, thereby shifting more of the burden of retirement support to future retirees themselves. A very brief summary of the three plans follows. (Greater detail can be found in Advisory Council on Social Security, Vol. I 1997.)

Maintain Benefits

Of the three Advisory Council reports, what is referred to as the Maintain Benefits (MB) plan would, as its name suggests, maintain the structure of the Social Security system much as it is today. Social Security would continue as a defined benefit plan, with benefits based on a set formula established by law. Income redistribution--so fundamental to this social insurance program and so important in ensuring income adequacy for low-wage workers--would be retained.

Solvency would be achieved by a number of rather modest changes. The plan would, for example, extend Social Security coverage to new state and local workers, tax Social Security benefits like private pension benefits, lengthen the benefit computation period from 35 to 38 years *or*, alternatively, slightly increase the payroll contribution rate, and eventually shift to OASDI that portion of Social Security revenues generated from taxing Social Security that now goes to the Hospital Insurance (HI) Fund. If these changes proved insufficient to bring the system into actuarial balance, the plan would increase employer and employee payroll taxes in 2045.

The most innovative feature of the Maintain Benefits plan involves the possible investment after further study of a portion (up to perhaps 40 percent) of the Social Security trust fund reserves in private equities in a search for higher returns. Although some observers see such investment as a form of privatization, workers themselves would have no say over how funds were invested; an investment policy board nominated by the President and confirmed by the Senate would oversee investments. Earnings would accrue to the trust funds, not to workers' individual accounts. Despite the fact that the Maintain Benefits plan would make the fewest changes to Social Security, equity investment would nonetheless represent a significant departure from present policy.

Individual Accounts

The second plan proposes establishing mandatory individual accounts (IAs) similar to a 401(k) defined contribution plan. Workers, but not employers, would contribute an additional 1.6 percent of earnings to their individual accounts. They would be provided with limited investment choices, the accumulations of which would have to be converted to indexed annuities at retirement.

The IA plan would also extend Social Security coverage to new state and local workers, extend the benefit computation period to 38 years, lower the earnings replacement rate for middle- and high-wage earners, accelerate the scheduled increase in Social Security's full retirement age and subsequently index it to increases in longevity, and tax Social Security benefits like private pensions. The result of these changes, according to GAO, would be lower benefits from the "basic" Social Security program for all workers (Advisory Council on Social Security 1997; Ross 1997: 7), although benefits from the individual accounts are intended to help offset the losses.

Finally, the 50-percent spousal benefit would be gradually reduced to 33 percent, and the survivor benefit increased. Under this plan, a survivor would collect the highest of his or her own basic benefit, the deceased spouse's benefits, or 75 percent of the couple's combined benefits.

Personal Securitv Accounts

The most radical of the three Advisory Council plans would turn Social Security into a two-tier system. Tier I would become a flat-rate benefit based on years of covered employment that, after 35 years of earnings, would amount to about two-thirds of the poverty level for a person living alone (which was $410 a month in 1996).[16] Tier II would consist of retirement income from workers' personal security accounts (PSAs) financed by allocating 5 percentage points of workers' payroll taxes to the new accounts.

Workers could invest their 5 percent in a wide-range of financial instruments. At retirement, workers would not be required to annuitize their investments. The Tier I benefit for spouses would be the highest of their own benefit, half their retired spouse's benefit, or half of the flat benefit, when fully phased in. Survivors would be eligible for 75 percent of the benefit payable to the couple; they could also inherit any balance in the PSA of the deceased worker.

In addition, the PSA plan would accelerate and index the increase in retirement age and then periodically examine the need for additional changes, raise the age of early eligibility, and cover new state and local workers.

Social Security Reform's Impact on Women

Certainly, *everyone* has a stake in Social Security, and everyone will be affected by whatever reforms are ultimately implemented. However, as this issue brief and a sizable literature demonstrate, Social Security is without question a women's issue. Any proposal that would change the system, therefore, ought to be carefully scrutinized in terms of its impact on women. Rappaport (1997: 39) calls for making the changes needed to "ensure that we will have a strong Social Security system going forward," including a system that "will better handle a variety of family patterns."

All three plans could lead to long-term Social Security solvency, although their impact on various groups in the population will vary. Just how secure women would be under the various plans, though, remains a matter for further research. Since the Maintain Benefits plan would result in the fewest changes to the system, how women would fare in the future is essentially how they are faring today, although many might be worse off as a result of the lengthening of the benefit calculation period (discussed below).

Under the Individual Accounts (IA) plan, the National Academy of Social Insurance (NASI) calculates that the average earner would see a drop of 17 percent in his or her basic benefit from Social Security (Ross 1997: 8). Reductions would be higher for high-wage workers than low-wage workers.

The amount invested in individual accounts (an additional 1.6 percent of wages) would be expected to make up the difference between the basic benefit and what would be paid to workers under current law. It may do this, but it seems unlikely that income

[16] Ultimately, workers with only 10 years of covered employment would be eligible for a benefit amounting to 50 percent of the full flat amount; this percentage would increase by two for each additional year worked up to 35.

adequacy in retirement would be greatly improved over what it is today.

The more dramatic changes would take place under the Personal Security Accounts (PSA) plan, whose provisions, especially the reconfiguration into a two-tier plan, stand to have a significant impact on women. As has been noted elsewhere in this paper, women with high-wage jobs have less to be concerned about when it comes to the Advisory Council's proposed changes (Williamson 1997b: 98), including those in the PSA plan. Affluent women, like everyone else, face market risk under privatization, but would come out ahead under many circumstances.

Privatization, even the partial privatization of the PSA and IA plans, poses big risks, especially for persons with limited resources. Low-income women, for example, have less to invest in the first place and would be less able than more affluent women to weather market downturns. They might also find it harder to obtain good market advice, given their limited income.

It also appears that women are more conservative investors than men (Hinz, McCarthy, and Turner 1997). That being the case, Ross (1997) notes, two investors with identical earnings could end up with very different retirement benefits. Women, in such instances, could expect the lower accumulations.

Women would also see lower benefits for the same accumulations because separate life tables could be used when IA or PSA accumulations were annuitized.[17] Since women live longer, their monthly annuity benefits would be lower than those of men with the same accumulations. Payments over a lifetime might be identical, but that is small consolation when monthly bills must be paid.

Moreover, although privatization proponents generally contend that most workers *could* do better in the private market than under Social Security, IA and PSA investors would face market risk. How the market has performed historically may not apply to specific groups of workers, and may not be in evidence at the time a particular cohort retires.

Over the long run, investments in the stock market have returned approximately 10 percent per year in nominal terms; between 1926 and 1994, the average return for the S&P 500 was 10.2 percent, or 6.9 percent after adjusting for inflation (Levine and Levine 1996: 222). However, some bear markets are deep and prolonged. On September 3, 1929, the Dow Jones reached a level it did not see again until November 23, 1954 (Pierce 1996). More recently, between January of 1973 and September of 1974, the market declined by 43 percent (or by 52 percent after factoring in inflation) (Ibbotson and Brinson 1993: 162). The phenomenal bull market of the past 15 years is not typical of the last 50 years, nor is it likely to be typical of the next 50 years, particularly if growth rates turn out to be lower than the nation experienced during the past 50 years (Williamson 1997a: 565).

There is also the question of who would actually own the accumulations in married workers' accounts. In the case of PSAs, the owner is clearly the worker, despite the fact that husbands and wives may make joint decisions about who works and when, and how money should be invested. Under the PSA plan, the owner would be under no obligation at the time of disbursement to purchase an annuity but could opt instead for a lump-sum payment. Unless Congress decided otherwise, that decision would be left to the owner of the PSA; spouses would not have a say in receiving any share of the money. This provision in the PSA plan could

[17] As noted elsewhere in this paper, the PSA plan does not require annuitization. Adverse selection under such circumstances could make annuities very expensive in the private market.

have a disproportionate and negative impact on women.

Divorced women are given short shrift in both IA and PSA plans. They would apparently have to depend on the divorce settlement for any share of the accumulation in a spouse's account. Williamson (1997b: 103) explains that under the IA plan a divorced woman would otherwise have no claim on her former husband's individual account so long as he was alive. At his death she would become eligible for only half of his benefit from his mandatory individual account. The divorced spouse of a worker with a PSA could not even count on that, as annuitization would not be required.

Women with sufficient work histories would always qualify for PSA's Tier I benefits, but that benefit would guarantee substantially less relative to the poverty level than the average woman's retired worker benefit today. Many women would be able to make up the difference with their PSA Tier II benefits, but others might not fare so well. This might tend to be the case if workers were tempted and allowed to gain access to their accumulations before retirement.

The question of preretirement access to IAs or PSAs is a critical concern, and Congress may be reluctant to limit people's access to their own money in time of need. Women tend to be less likely to retain lump-sum pension distributions for retirement (Korczyk 1996a). Might they also be more likely to tap into these new retirement savings, if permitted?

Advisory Council member Thomas Jones speculates that the pressure to use retirement savings prematurely might "dwarf the political risk attributed to the current pay-as-you-go system" (Jones 1996: 5). He also worries that "political support for the first pillar [the basic benefit] might weaken once it is explicitly separated from the individual account pillar." Women would have a great deal to lose if this were to happen.

Although the PSA plan represents the most radical of the proposed changes discussed in this paper, a number of the other proposals would likely have a disproportionate impact on certain groups, such as women and those with low incomes. Raising the full retirement age might disproportionately affect low-wage workers in demanding jobs that do not lend themselves to a longer worklife. Skills obsolescence is also a problem for many low-wage workers, who may also be at greater risk than high-wage workers of experiencing health problems that affect ability to work. Not all such workers would be women, but women are heavily represented in the low-wage jobs whose numbers are projected to increase the most over the next decade (Silvestri 1997). More affluent workers, on the other hand, may have the resources to continue to retire early, as well as the education and skills that encourage employers to retain them longer.

Women will also find it more difficult than men to meet the longer benefit computation period. According to Social Security actuaries, only 15 percent of women retiring in 1999 vs. 57 percent of men, would be able to meet a 38-year averaging period (Fierst 1997: 137).

Benefit Improvements

Given the need for revenue increases or benefit cuts just to keep the present system afloat, the prospects for benefit expansion would appear to be dim. And, to be sure, like everyone, women will benefit from a fiscally solvent Social Security system.

Yet many people continue to worry about income adequacy in old age, especially among nonmarried women, and have proposed reforms to address that inadequacy. The majority of Advisory Council members (as well as others [e.g., Burkhauser and Smeeding

1994; Sandell and Iams 1997]) support reducing spousal benefits and increasing benefits for survivors. While there are various ways to do this, one way, as mentioned above, is to reduce the spousal benefit from 50 to 33 percent and increase the survivors' benefit to 75 percent of combined benefits. Such a proposal is actually a nod in the direction of greater equity, as higher benefits would go to survivors of dual-, not single-, earner couples.

Many survivors would be no better off under the change, however, and the change would do nothing for never-married or divorced women, who are among the poorest aged today. In fact, divorced women could be far worse off, as they would qualify for only one-third of their ex-husbands' benefits, rather than half. While the number of women who collect benefits as divorced spouses is low, they are a particularly needy group. Finally, intact couples would have to get by on less while both partners were alive if one partner were entitled to the spousal benefit. This might prove difficult for low-income couples. Choudhury and Leonesio (1997) caution that this proposed change might not have the desired impact due to the fact that a lifetime of poverty, rather than loss of a spouse, appears to be the primary determinant of poverty in old age for the majority of women.

Conclusions

The market risk of even a partially privatized Social Security system is very real and deserves a great deal more attention than it has received to date. Policymakers, retirement-income experts, and women's advocates, among others, need to think long and hard before asking moderate- and particularly low-wage workers, a category that includes many women, to take those risks (Williamson 1997a). The market does not just go up. Declines can be swift, deep, and prolonged.

The Social Security Trustees argue that many of the proposals for reform would involve "a profound shift in philosophy and would have significant ramifications [that] deserve careful examination and consideration by policymakers and the American public before any changes are made" (Social Security and Medicare Boards of Trustees 1997: 13.) The recently confirmed administrator of the now-independent Social Security Administration, Kenneth S. Apfel, hopes to enhance understanding of Social Security and foster dialogue on the tough choices not only on Capitol Hill, "but also in family living rooms all across America" (Social Security Administration 1997).

The level of ignorance about Social Security basics, to say nothing of its financing and reform (see, e.g., Farkas and Johnson 1997), suggests that the public debate and discussion about the "tough choices" must be preceded by a public information/education campaign that tries to provide the public with the tools it needs to make informed decisions. Women, in particular, must be a focus of the campaigns.

However, before Social Security is fundamentally overhauled, more and far better data are required on the combined effect and distributional impact of any changes. There can be little doubt that women's well-being would be profoundly affected by some of the reforms being considered. Just who would be most affected and by how much needs further examination. Even the experts don't have the answers. Reform might not make women better off than they are today, but it should not worsen their often precarious situation in old age.

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DO NOT CIRCULATE

December 3, 1998

SOCIAL SECURITY ISSUES FACING THE ADMINISTRATION

The most important domestic policy debate of the next two years is the debate over Social Security. The decisions made will have profound effects on American life for decades to come.

Democrats are rightly proud of Social Security and their role in creating, expanding, and defending it. While many government endeavors yield mixed results and fall short of expectations, Social Security has been a spectacular success.

- The latest Census data show that without Social Security, 48 percent of elderly Americans would have been below the poverty line in 1997; Social Security alone lowered their poverty rate from 48 percent to 12 percent.
- Nine of every 10 elderly people lifted from poverty by government programs are lifted out by Social Security. Nearly two-thirds of Americans of all ages lifted from poverty by government programs are lifted out by Social Security. In other words, Social Security reduces poverty among the general population nearly twice as much as all other government programs combined.

Social Security is the elderly's main income source. Two-thirds of the elderly rely on it for more than half of their income. Elderly African Americans rely on Social Security for 76 percent of their income. Elderly Hispanics receive 87 percent of their income from it.

Social Security also is critical for disabled workers and their families and for the families of workers who die before retirement. Nearly one of every three Social Security beneficiaries receives disability or survivors benefits. This includes large number of children of workers who have become disabled or died before reaching retirement.

Social Security now faces a long-term financing problem. Although it can pay full benefits until 2032, it can pay only 70 percent to 75 percent of benefits (rather than 100 percent) after that.

There is little question among experts that this long-term imbalance can be closed without radical program changes. The imbalance can be closed without severe benefit cuts or large tax increases and without converting part of Social Security to individual accounts. Experts such as Robert Reischauer and Henry Aaron of Brookings, as well as former Social Security commissioner Robert Ball, have designed plans to restore long-term balance without deep benefit cuts or tax increases and without converting part of Social Security to private accounts. Rep. Earl Pomeroy plans to introduce legislation based on the Ball plan in January, possibly with House Democratic leadership backing. Given the enormous success of Social Security, those who wish to make more radical changes in it bear a large burden in demonstrating why such changes ought to be made.

The Question of Individual Accounts

The most critical question is whether to replace part of Social Security with individual accounts. (Some proposals, including the Ball plan and the forthcoming Pomeroy bill, offer voluntary individual accounts *on top of* the Social Security structure but do not replace part of Social Security with individual accounts.) Proposals that replace part of Social Security with individual accounts have several troubling consequences.

Effects of these Proposals on Social Security Benefits

The Social Security trustees estimate that Social Security's funding shortfall equals 2.19 percent of taxable payroll over the next 75 years. Proposals such as the Reischauer/Aaron plan and the Ball plan would shrink this shortfall by slightly more than half by investing a portion of Social Security trust fund reserves in financial markets so these reserves can earn a higher rate of return. Such a step leaves a need for modest benefit and revenue adjustments equaling about *one percent* of taxable payroll over the next 75 years.

Compare this to the depth of the reductions in Social Security benefits required under one of the most painstakingly designed partial privatization proposals — a bill developed by a private panel known as the National Commission on Retirement Policy (NCRP) and introduced by Senators Gregg and Breaux and Reps. Kolbe and Stenholm, all of whom served on the panel. The proposal shifts two percentage points of the Social Security payroll tax from the Social Security trust funds to individual accounts. By removing these payroll tax revenues from the trust funds, the plan deepens the shortfall in the trust funds from 2.19 percent of payroll to about *four percent* of payroll. As a result, the plan necessitates steep reductions in Social Security benefits to close this financing gap (reductions several times deeper than those required under the type of plan that Reischauer and Aaron, and Ball, have fashioned).

According to estimates by the Social Security actuaries, an average wage-earner who retires in 2025 would face a 33 percent Social Security benefit reduction under the NCRP plan, compared to the Social Security benefits the retiree would receive under current law. An average wage-earner retiring in 2070 would face a 48 percent Social Security benefit cut. The NCRP plan includes a wide array of benefit cuts.

- It would raise the "normal retirement age" — now 65 and scheduled to rise to 67 by 2022 — to 70 by 2029 and 72½ by 2075. The *early* Social Security retirement age — the age at which individuals can retire and begin drawing reduced Social Security benefits — would rise from 62 today to 65 by 2029 and 67½ by 2075.

- The plan would cut Social Security disability benefits nearly 20 percent for an average wage-earner who becomes disabled and for survivors of average wage-earners who die before retirement. These reductions are particularly serious since people who die or become disabled at a relatively young age will not have had time to accumulate much in their individual accounts.

- The plan would reduce Social Security spousal benefits one-third. It also would set the annual cost-of-living adjustment below the CPI.

To be sure, beneficiaries would receive income from their individual accounts to supplement their Social Security benefits. For some beneficiaries, this might offset the Social Security benefit reductions. But that would not be the case for other beneficiaries.

How much a beneficiary would receive from his or her individual account would be uncertain. While Social Security provides a "defined" — or guaranteed — benefit, individual accounts are "defined contribution" plans in which the income the accounts generate is *not* guaranteed and is subject to market risk. How much income an individual would receive from an account would depend on how the markets performed and how lucky or wise the individual was in his or her investments, as well as on what portion of the account was consumed by administrative and management fees.

Of note here is work by Gary Burtless of Brookings. He examined what would have happened to average male wage-earners of different ages who established individual accounts, contributed the same percentage of their earnings to these accounts, and made identical investments in indexed funds. He found that an individual reaching retirement age and converting his or her account to an annuity in 1975 — a year when the market was down — would have received a monthly annuity for the rest of his or her life *less than two-fifths as large* as the monthly annuity check an individual who reached retirement age and retired six years earlier, in 1969, would have received. Similarly, a retired worker who feared the market would keep falling and converted a retirement account invested in equities to an annuity or a savings account on August 31, 1998 would have lost 21 percent of his or her retirement income from the account, compared to the income the worker would have received if he or she had converted the account to an annuity just six weeks earlier. Steps can be taken to lessen the effects of market swings such as these on income from individual accounts, but the fact remains that under individual accounts, those who retire and convert their accounts to annuities during bear markets will have significantly less to live on than those fortunate enough to do so during bull markets.

A related concern is the potential for millions of Americans who are not sophisticated in investing to make unwise investment choices. SEC chair Arthur Levitt recently wrote that "more than half of all Americans do not know the difference between a stock and a bond; only 12 percent know the difference between a load and no-load mutual fund; only 16 percent say they have a clear understanding of what an Individual Retirement Account is...." Levitt raised strong concerns about converting part of Social Security to individual accounts when public knowledge of investment basics is so limited.

Effects on Women

Individual accounts also raise other questions. For example, under Social Security, a divorced woman can receive Social Security spousal benefits if she was married at least 10 years, is 62 or over, and has not remarried. After her ex-spouse dies, she and her minor children by the ex-spouse can receive survivor benefits. The amounts she receives do *not* reduce the benefits the ex-spouse himself, and his current spouse if he has remarried, can receive. By contrast, an individual account would not grow larger to cover more beneficiaries in the event of divorce, death, or disability; *there would be no more money to go around.* Any amounts taken from an individual account — for instance for a divorced spouse — would reduce the amount remaining in the account for other beneficiaries. This poses risks for divorced women.

Individual accounts also pose risks for women who spend a number of years out of the labor force raising children or performing unpaid work in a school, church, hospital, or other setting. Social Security pays a spousal benefit to lower-earning spouses who would not otherwise receive a significant benefit based on their own earnings records. But an individual account does not enlarge to pay spousal benefits; it is limited to what the contributions to the account from a worker's earnings will support.

Widows could face substantial risks as well. Suppose workers are not required to convert their individual accounts to annuities when they retire; some workers could spend most or all of the funds in their accounts by the time they die, with little remaining in the accounts for spouses who outlive them. To address this problem, workers could be *required* to purchase annuities. But such a requirement could be hard to sustain politically over time. Can workers who retire during a bear market really be required to annuitize? How about workers who are terminally ill when they retire?

By contrast, Social Security benefits never run out before a widow dies. In addition, Social Security benefits are fully indexed for inflation no matter how long one lives; this is a feature that few private annuities now offer. If Social Security is partially replaced by private annuities that do not provide automatic inflation protection, the consequences could be severe for widows who live to a very old age and have little or no income other than Social Security. Even if inflation were just 2.5 percent per year, the value of an unidexed annuity would fall 43 *percent* between the time a worker retired at age 62 and the time he or she reached age 85.

Finally, individual accounts pose dangers for low-wage workers. The benefits that Social Security provides to a low-wage worker equal a much higher percentage of such a worker's pre-retirement earnings than the benefits that Social Security pays to a high-wage worker equal of that worker's earnings. Individual accounts generally provide no such redistribution to low-wage workers, or, for that matter, to widows, divorced women, low-earning spouses, disabled workers, or children who are the dependents of disabled or deceased workers.

Administrative Complexities and Costs

Another problem with individual accounts is that they could be difficult to administer, especially for small businesses. A new report from the respected Employee Benefit Research Institute (EBRI) cautions that establishing and administering individual accounts for 148 million American workers "could be the largest undertaking in the history of the U.S. financial market, and no system to date has the capacity to administer such a system." EBRI also warned that individual accounts cannot be administered like 401(k) plans, with contributions made each pay period through payroll deductions, without adding significant employer burdens, especially on the small-business sector.

Moreover, substantial sums in the individual accounts would be consumed by administrative costs and hence would not be available to provide retirement income. Annual fees on stock mutual funds now average 1.2 percent; a one percent annual charge on an individual account (the amount the Social Security Advisory Council estimated it would cost to administer privately managed accounts) would consume approximately 20 percent of the funds in the account over a 40-year work career. While there are ways to reduce administrative costs significantly by having a federal entity administer the accounts and limiting investment choices, the costs will remain substantial, reducing the retirement income the accounts generate. In addition, when a retiree converts the amount in his or her retirement account to an annuity, the company selling the annuity typically takes about another 15 percent to 20 percent of the account to cover its costs, risks, and profits. In combination, administrative costs and annuitization costs would consume a significant portion of the funds in these accounts. Finally, there is a potential for significant fraud and sales practice abuse at the expense of account-holders, as has occurred in Great Britain. This is a matter about which SEC chairman Levitt has recently spoken forcefully.

Another Approach to Individual Accounts: the Feldstein Plan

The biggest political obstacle facing proposals that seek to divert a portion of payroll tax revenue to individual accounts, such as the NCRP plan, is the deep cuts in Social Security benefits these plans entail. Martin Feldstein has developed an alternative approach that seeks to replace part of Social Security with private accounts without engendering these political problems.

The Feldstein approach, which is attracting growing interest, is extremely clever. It also, however, is in conflict with basic principles for which this Administration has stood since its first hours — principles of long-term fiscal responsibility, protecting children and future generations, and avoiding policies that further widen gaps between rich and poor.

Under the Feldstein plan, individual accounts would be established and initially financed by the budget surplus. When workers retired, their Social Security benefits would be reduced $3 for each $4 in retirement income they received from their individual accounts. As a result, all beneficiaries appear to come out ahead. In addition, the reduction in the amount of Social Security benefits that would be paid out would close Social Security's long-term imbalance, according to Feldstein's projections, and do so without any cuts in the Social Security benefit structure or any tax increases.

When something appears too good to be true, it usually is. This adage holds for the Feldstein plan.

- Although proponents of the plan present it as a "free lunch" that would restore Social Security solvency with no pain, analyses of the plan — including analyses by the Congressional Budget Office and the Office of the Chief Actuary at the Social Security Administration — show otherwise. Despite the fact that Social Security benefits under current law are projected to exceed payroll tax revenues, the Feldstein plan would *increase* government-funded retirement benefits to higher levels without providing any offsetting increase in government revenues to cover the added costs. The plan would consume the lion's share of the budget surpluses while they last, including surpluses projected in the non-Social Security budget, thereby squeezing new resources for other needs such as education, environmental protection, expanding health care coverage, or shoring up Medicare. When budget surpluses wane, securing the needed financing for the individual accounts would entail cutting back other parts of the federal government substantially, imposing hefty tax increases, or borrowing large sums and swelling the already-large budget deficits that CBO forecasts will return when the baby-boom generation retires in large numbers.

  In this respect, the Feldstein plan is reminiscent of the feature of the first Reagan budget that David Stockman called a "magic asterisk." It leaves a big financing hole that future Congresses would have to address at some later date if a sea of red ink is to be avoided.

- Not only would the Feldstein plan necessitate substantial cutbacks in other parts of the budget or large tax increases if it is to be paid for, but the increase in retirement benefits the plan provides would be inequitably distributed. *Retirement income would rise much more, both in dollar terms and percentage terms, for those elderly already most well-off than for those with modest* *incomes.* Cutting other government benefits or raising taxes to finance increases in retirement benefits disproportionately for the affluent elderly is a formula for exacerbating disparities in income in the United States, which already are at their widest point since the end of World War II.

- Of particular concern, the Social Security component of the Feldstein plan is likely to prove politically unsustainable over the long term. As noted, the plan reduces Social Security benefits $3 for each $4 in income from an individual account; as a result, many middle- and upper-income retirees eventually would receive most or all of their retirement income from their private accounts and little or none from Social Security benefits. Yet they still would be required to pay substantial payroll taxes to the Social Security trust fund. This almost certainly would erode the broad-based support that Social Security enjoys. A Social Security system that collects significant payroll taxes from everyone, but provides the bulk of its benefits to retirees who earned below-average wages during their working years and their spouses and survivors is not likely to endure. The private accounts will appear a much better deal than Social Security. The Feldstein plan thus contains the seeds of its own transformation to a fuller privatization of Social Security.

Investing a Portion of Social Security Reserves in Equities

The principal argument in favor of individual accounts is that such an approach would secure a higher rate of return. The higher rate of return can be secured, however, without exposing individuals to the risks that individual accounts pose and without risking the ultimate unraveling of the social insurance functions that Social Security provides. This can be done by diversifying the investment of Social Security reserves and investing a portion of the reserves in index funds in the equities markets, as former CBO director (and now Brookings senior fellow) Bob Reischauer has proposed with his Brookings colleague Henry Aaron.

As Reischauer and Aaron explain, investing a portion of the reserves in equities markets actually would secure a higher rate of return than individual accounts. Assume that individual accounts, on average, secure the average rate of return in the market. If a portion of Social Security reserves are invested in broad index funds, they, too, should earn the average rate of return. The return on the individual accounts, however, would be reduced by the sizeable administrative costs of managing 148 million such accounts. By comparison, the administrative costs involved in managing trust fund investments in the equities market would be very small. Because the administrative costs would be much lower, investing a portion of trust fund reserves in equities markets would yield a higher *net* rate of return than individual accounts, while protecting beneficiaries from the risks they would have to bear individually under a system of individual accounts.

Is Social Security Politically Sustainable Over Time if Combined with Private Accounts?

Plans that replace part of Social Security with individual accounts risk destabilizing Social Security over time. Under these plans, retired workers generally would receive substantially lower Social Security benefits that under current law; a portion of their Social Security benefit would be replaced with income from an individual account. Yet the workers would still pay substantial payroll taxes into the Social Security trust fund; under most of these plans, the payroll tax deposited in the Social Security trust fund would be two or three percentage points lower than under current law (i.e., the combined employee and employer contribution to the trust fund would equal 9.4 percent or 10.4 percent of earnings, as compared to 12.4 percent under current law).

The average worker's payroll taxes would need to remain high because a large share of these taxes would be used both to pay Social Security benefits to workers who had already retired or worked a substantial number of years before the individual accounts were established and to provide a more adequate level of income to retirees who had earned low wages, widows, divorced women, low-earning spouses, the disabled, and the children of disabled and deceased workers. As a result, the amount a typical middle-income worker received in Social Security benefits, compared to the amount he or she paid in, would appear low. Alongside such a Social Security system would stand individual accounts from which *no* funds would be taken to pay benefits to those who had already retired or worked for many years when the accounts were set up and *no* funds would be used to finance benefits for the vulnerable groups just mentioned. As a result, many workers with above-average earnings could receive nearly as much — or more — from individual accounts into which they had paid only a few percentage points of their earnings than from Social Security into which they had paid a much larger percentage of their earnings. This would lessen the broad-based support Social Security has long enjoyed and generate strong pressure to shift more payroll contributions from Social Security to individual accounts. Over time, such pressures would likely prove irresistible.

A hybrid system that is part Social Security and part individual accounts consequently may not be politically sustainable over the long run. Nor can this problem be solved simply by having the Social Security Administration administer the individual accounts and provide beneficiaries a single monthly check combining income from Social Security with income from a retiree's individual account. Workers would receive periodic statements on their Social Security contributions and benefits as well as on their individual accounts, and many would compare the statements and conclude Social Security was a bad deal. Conservative Members of Congress, commentators, and think tanks would endlessly broadcast the message that individual accounts had proved to be a much-better deal and should replace a larger portion — or all — of Social Security, which they would portray as providing abysmally low rates of return to middle-class workers. A hybrid system thus risks leading over time to the unraveling of the social compact that Social Security provides.

Under this approach, Social Security would retain the majority of its reserves in Treasury securities. It thus would be able to ride out market downturns without having to sell off substantial holdings when stock prices are low. Under individual accounts, by contrast, individuals who retire during a bear market or are unlucky in their investments could be faced with reduced incomes for the rest of their lives.

Private pension funds and state employee pension funds virtually all diversify their investments and take advantage of the higher long-term rates of return that equities markets provide. Social Security should not be prohibited from following a similar course.

The principal arguments advanced against this approach are that there could be political interference with trust fund investment decisions and that the government would own too much of corporations. These concerns can be addressed, as Reischauer and Aaron have shown. Management of Social Security reserves could be placed in the hands of a Social Security Reserve Board modeled on the Federal Reserve Board; the Fed has successfully maintained its political independence for eight decades. Fed governors serve staggered 14-year terms and cannot be removed for political reasons; the same would be true here. In addition, the Social Security Reserve Board — like the Fed — would be financially independent of Congress and the White House, getting its revenue from small charges on the earnings of its investments. As noted, the investments would be limited to broad, passively managed index funds, and the legislation establishing the SSRB could deny it voting rights on shares the SSRB holds. Finally, a low percentage limit could be set on the proportion of the shares of any corporate entity the SSRB could hold. These safeguards would both protect the SSRB from political interference by Congress and the White House and ensure that the SSRB did not influence decisions of individual corporations.

There is, of course, the question of the political appeal of this approach — how would the public respond to it? The public would have to be persuaded. But if the President, other Administration officials, and Democratic Congressional leaders explained that this approach would substantially reduce the magnitude of the Social Security benefit reductions otherwise needed, would protect individuals from undue risk, would be managed by a distinguished entity governed by financial leaders and enjoying the independence and authority of the Fed, and would simply diversify Social Security assets in the same way that virtually all other private and public pension funds do to gain better value for American workers, the Administration should be able to rally public support for this approach as part of a larger package to save Social Security.

Political Considerations

Proposals to replace part of Social Security with individual accounts pose some political dangers for the White House. Until rather recently, groups representing core Democratic constituencies have focused largely on issues other than Social Security, but that is changing rapidly. The AFL-CIO increasingly is turning its attention to Social Security; it strongly opposes any replacement of Social Security with individual accounts. The principal civil rights, minority, elderly, and women's groups also are increasingly focusing on Social Security. A strong statement sharply criticizing proposals to replace any part of Social Security with individual accounts is scheduled for release on December 3; its growing list of signatories includes: John Sweeney and an array of union presidents; the heads of the NAACP (Kweisi Mfume and Julian Bond), the Urban League (Hugh Price), and the National Council of La Raza (Raul Yzaguirre); Jesse Jackson; Marian Wright Edelman; Rev. Joan Brown Campbell, the head of the National Council of Churches; Catholic Charities' deputy director Sharon Daly; the heads of major women's, disability, and other elderly organizations; and numerous others.

A growing array of such groups is gearing up to make Social Security one of their highest priority issues in 1999. They differ on some Social Security matters. What unites them is opposition to shifting a portion of Social Security to individual accounts. This opposition is sufficiently strong that the key groups involved are willing to accept some benefit reductions as part of a package that restores long-term balance without replacing part of Social Security with individual accounts.

How Might the Administration Proceed?

The Administration will face tough negotiations with Republican leaders on Social Security. Wherever the Administration starts, the Republicans will insist on pulling it to the right. A final agreement is virtually certain to be somewhere to the right of where the White House starts. The White House should not start out where it hopes to end up.

A useful place to *end up* could be to restore long-term solvency to Social Security through a combination of modest benefit adjustments, bringing uncovered state and local employees into the Social Security system, gradually raising by a modest amount (and over a number of years) the upper limit on the amount of wages subject to the payroll tax (but not raising the payroll tax rate), investing a portion of trust fund reserves in financial markets with appropriate safeguards, and possibly establishing individual accounts *on top of* Social Security (possibly through some surplus financing of individual accounts on a flat-dollar basis for all workers or through the establishment of such accounts on a voluntary basis with favorable tax treatment of the amounts invested in the accounts; such an approach would *not* transfer revenue from the trust funds to individual accounts or reduce Social Security benefits when income is received from individual accounts). If the Administration wanted to end up in such a place, it would need to start out without individual accounts on top and move to that position in the negotiations.

In such negotiations, it is important that the Administration negotiate from strength. To this end, the White House needs in early 1999 not only to advance its position on Social Security persuasively but also to explain to the public the dangers posed by certain other approaches, including some approaches Republican leaders may favor. The public will place much more trust in the President to look out for its interests on Social Security than in Trent Lott, Bob Livingston, Bill Archer, or Bill Roth. If the President speaks to the nation not only about the advantages of his proposals but also about the risks of certain other types of approaches — in other words, about both what he is for and what he is against and why — he will do well with public opinion and place the White House in a strong position to negotiate an agreement that is substantively and politically sound.

This opportunity could be missed, however, and the White House could find itself negotiating more from weakness than strength. Some recent White House contacts with some Republican Congressional leaders on Social Security reportedly have led some Republicans and their allies to conclude the President is so eager for a deal on Social Security that they may be able to cut a deal substantially on their terms.

Furthermore, conservative proponents of partial privatization have been taking their case to the public for months. They have been feeding fears that Social Security is in more dire shape than is the case, that the program is on the verge of collapse, and that retirement security can be provided only by beginning to replace Social Security with private accounts. The President and the White House will need to take their case to the public and explain in a respectful way the jeopardy in which some approaches could place millions of hard-working Americans. If the President makes that case this winter, he will be in a strong position to negotiate from strength and reach a good deal by summer or early fall. If the President does *not* expose the weaknesses in these other approaches, however, he will be negotiating with a weaker hand, which will make it harder to reach an agreement that does not ultimately place millions of Americans at risk and rip the Democratic Party down the middle.

This suggestion may elicit a rejoinder that such an effort by the President would anger Republicans and make it harder to secure an agreement. A deal is not needed, however, in March or April. A deal in the summer or fall should be fine. Taking this issue to the public this winter to help frame the debate on the White House's terms — and then largely curtailing public criticism of other approaches as negotiations begin — should pay dividends in terms of the negotiations' ultimate outcome. Furthermore, because such an approach would expose political vulnerabilities in some Republican positions (and subtly remind Republicans of the dangers they face in resisting the President on issues like Social Security or Medicare), it should make Republicans more eager to close a deal in 1999 so they are not politically exposed on this issue in 2000.

The Tax-cut Issue and a Social Security Deal

The point is sometimes made in some Administration circles that a Social Security deal is needed quickly because without a deal by summer, the "save Social Security first" argument may not continue to hold and a very large tax cut may not be able to be stopped. Fear of a tax cut, however, should not lead the Administration to consummate a Social Security deal before a sound agreement can be secured. Furthermore, if a Social Security deal ultimately cannot be consummated in 1999, Republicans are *not* likely to seek to pass a large, multi-hundred-billion dollar tax cut.

- Republicans will have to worry that if they push a big tax cut before Social Security is resolved, they will be seen as taking large sums from the Social Security reserve. This was somewhat of an issue in the 1998 election; if Republicans push a big tax cut without a Social Security settlement, it is likely to be more of an issue in 2000 because the public will have a heightened awareness of Social Security issues — and of Social Security's long-term financing gap — following extensive media coverage of Social Security issues in 1999. If Social Security negotiations have stalled and Democrats on Capitol Hill are arguing that Republican plans would place retirees, the disabled, women, and survivors at too-great risk, Republicans are unlikely to risk bolstering these Democratic arguments by enabling Democrats to point to an attempted large-scale Republican raid on the trust fund.

- In addition, Republicans who support converting part of Social Security to private accounts are starting to understand, as Phil Gramm has recognized for some time, that they will need most of the surplus to help cover the very large transition costs that partial privatization proposals entail — and that big tax cuts consequently would undermine their partial privatization proposals by consuming too much of the surplus.

There are signs that conservative Republicans are beginning to grasp these realities. This is reflected in the announcement on November 18 by the Members of Congress who make up the Conservative Action Team, the hard-line drivers this year for big tax cuts in the House, that they are abandoning their call for a large tax cut in 1999 financed by the surplus and will instead seek a smaller tax cut financed with spending-cut offsets. The CATS announced that their new position is that the Social Security reserve should be used solely for Social Security purposes.

To be sure, in the absence of a Social Security deal by summer or fall, a more modest tax cut — perhaps of the size of the $80 billion tax cut over five years the House passed in September — could begin to move. That would be unfortunate. But such a tax cut is small potatoes compared to the massive policy changes that a Social Security deal, and especially the partial replacement of Social Security with individual accounts, would entail. It would not be wise to reach prematurely a questionable Social Security deal that could create significant policy problems for the next 75 or 100 years — and alter the nation's most important social program in undesirable ways — to avoid a tax cut whose adverse effects are of much lesser consequence.

CENTER ON BUDGET AND POLICY PRIORITIES

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HOW WOULD VARIOUS SOCIAL SECURITY REFORM PLANS AFFECT SOCIAL SECURITY BENEFITS?

An Analysis of the Congressional Research Service Report

by Kilolo Kijakazi and Robert Greenstein

Summary

In June of this year, Rep. Charles Rangel, ranking member of the House Ways and Means Committee, released a Congressional Research Service analysis he had requested on the extent to which three Social Security reform proposals would reduce defined Social Security benefits. The three plans include:

- the bill introduced by Senators Daniel Patrick Moynihan and Robert Kerrey (S. 1792);

- a proposal by the National Commission on Retirement Policy, a panel of Members of Congress and private citizens organized by the Center for Strategic and International Studies (legislation recently introduced in the Senate by Senators Judd Gregg, John Breaux and a few other senators — S. 2313 — and in the House by Reps. Jim Kolbe, Charles Stenholm, and others — H.R. 4256 — is based on the NCRP proposal); and

- a May 1998 proposal by Robert Ball, commissioner of the Social Security Administration under Presidents Kennedy, Johnson, and Nixon and a member of the 1994-1996 Social Security Advisory Council.

The CRS analysis was not designed to be a comprehensive analysis of all components of these three plans, but rather an assessment of an important issue — the degree to which the "defined," or guaranteed, benefits that beneficiaries would be assured of receiving through the Social Security system would change under the three plans. Accordingly, the study does not examine the retirement income that could be generated by individual accounts, which the three plans all contain in differing forms. [1]

The CRS analysis finds that the Social Security benefits guaranteed under the three plans vary greatly.

[1] The analysis also does not examine changes in payroll taxes or the effects of a few features of the plans, such as proposals in some plans to eliminate the Social Security earnings test.

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- Over the next 75 years, average Social Security benefits would be 23 percent lower under the NCRP plan than under the current benefit structure, 16 percent lower under the Moynihan-Kerrey plan than under the current benefit structure, and six percent lower under the Ball plan.[2]

- In other words, the CRS analysis finds that the reduction in guaranteed Social Security benefits would be approximately four times larger under the NCRP plan than under the Ball plan and nearly three times greater under the Moynihan-Kerrey plan than under the Ball plan.

As noted, these figures are 75-year averages. The depth of the reductions in Social Security benefits, as well as the differences among the three plans in the size of the defined benefit reductions, would grow significantly as the years pass. The CRS study reports the results of analyses the Social Security actuaries have conducted of the three plans:

- In 2025, the Social Security benefits received by average wage-earners who retire at age 65 would be 33 percent lower under the NCRP plan than under the current Social Security benefit structure. They would be 11 percent lower under the Moynihan-Kerrey plan than under the current benefit structure and about one percent lower under the Ball plan.

- By 2070, the Social Security benefit reductions would be considerably deeper. The Social Security benefits of average wage-earners retiring that year at age 67 would be 48 percent lower under the NCRP plan than under the current benefit structure, meaning that the guaranteed benefit would be cut about in half. Under the Moynihan-Kerrey plan, the average benefit for an individual retiring in 2070 at age 65 would be

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[2] These estimates reflect the effects of provisions in the Ball and Moynihan/Kerrey plans to increase the taxation of Social Security benefits, since such measures are a benefit reduction from the beneficiary's perspective. The figures subsequently cited for the percentage benefit reductions for individuals retiring in 2025 and 2070, however, do *not* include the taxation-of-benefit provisions; the memorandum prepared by the Social Security actuaries that CRS used in conducting its analysis did not include the effects of those provisions when examining benefit reductions for individuals retiring in given years. This is the principal reason that while the Ball plan would reduce total Social Security benefits an estimated six percent over the next 75 years, the benefit reduction for an individual retiring in 2025 is estimated at one percent. (Ball subsequently presented a proposal to the House Ways and Means Committee in testimony on June 3, 1998 that dropped the taxation-of-benefits provision included in the Ball proposal analyzed here.)

Table 1

Estimates by the Social Security Actuaries of Benefit Reductions for Average-Wage Earners Under the Three Plans[1]

Year of Retirement	Moynihan-Kerrey	NCRP	Ball
2025	11%	33%	1-2%
2070	22%	48%	1-2%

Source: SSA actuaries estimates, as reported by CRS

[1] These estimates reflect benefit reductions in the year of retirement for beneficiaries retiring at age 65, except that the estimates for the NCRP plan in 2070 reflect benefit reductions for individuals retiring at age 67. The SSA actuaries did not prepare estimates of the effects of the NCRP plan in 2070 for individuals retiring at age 65. These estimates do not include the effects of certain features of these plans, including changes in the taxation of Social Security benefits and in the length of the earnings averaging period that is used to compute Social Security benefits. These estimates also do not reflect the effects on retirees as they grow older of provisions reducing cost-of-living adjustments.

reduced by 22 percent, or more than one-fifth.[3] The benefit reduction percentage would remain very small under the Ball plan. (See Table 1.)

(Note: Under the NCRP plan, reductions in Social Security benefits would be smaller for low-wage earners than to average-wage earners due to establishment of a new Social Security minimum benefit. According to the CRS study, the reduction in Social Security benefits for a low-wage earner retiring in 2025 at age 65 would be 13 percent under the NCRP plan. The reduction for a low-wage earner retiring at 67 in 2070 would be 31 percent. In conducting this analysis, CRS defined a low-wage earner as one who earned 45 percent of the average wage throughout his work career; currently, 45 percent of the average wage is $12,552.[4])

The CRS study also explains that under the three plans, there would be additional reductions in guaranteed benefits as beneficiaries grow older after retirement, due to changes the plans make in procedures either for computing annual Social Security cost-of-living adjustments or for measuring changes in the Consumer Price Index on which the cost-of-living adjustments depend. The additional reductions

[3] The memoranda prepared by the Social Security actuaries that CRS used in conducting its analysis do not provide data on the percentage reduction in benefits for workers retiring at age 67 under the Moynihan-Kerrey plan.

[4] Individuals with earnings lower than 45 percent of the average wage would face smaller Social Security benefit reductions in the NCRP plan if they worked a sufficient number of years. The minimum benefit for a very low-wage worker under the NCRP plan could exceed the benefit the worker would receive under current law.

are largest in the Moynihan-Kerrey plan, which sets annual cost-of-living adjustments below the Consumer Price Index. The additional reduction is much smaller in the other two plans and smallest in the Ball plan, which would result in the measured CPI being slightly lower but would maintain the cost-of-living adjustment at the CPI level.[5] CRS projects that as a result of these provisions, benefits would decline between age 65 and age 80 by an additional 13 percent under the Moynihan-Kerrey plan, an additional seven percent under the NCRP plan, and an additional four percent under the Ball plan. For those living into their early 90's, the additional benefit reductions would be nearly twice this size.

It should be noted that the figures shown in Table 1 reflect reductions in Social Security *retirement* benefits. Under the legislation embodying the NCRP and Moynihan-Kerrey proposals, there also would be substantial reductions in Social Security disability and survivors benefits, because the changes in the Social Security benefit formula and cost-of-living provisions would apply to disability and survivors benefits as well as to retirement benefits.[6]

Finally, the study finds that all three plans would fully restore long-term, or 75-year, actuarial balance to the Social Security system. The actuaries of the Social Security system project that the system faces a deficit over the next 75 years equal to 2.19 percent of taxable payroll. The NCRP plan results in a saving of 2.23 percent of taxable payroll over this period. The Moynihan-Kerrey plan saves 2.25 percent of taxable payroll. The Ball plan saves 2.33 percent.

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[5] Under the Moynihan-Kerrey plan, the annual cost-of-living adjustment would be set one percentage point below inflation as measured by the CPI. The Ball plan would keep the cost-of-living adjustment at the CPI, but directs the Bureau of Labor Statistics to update the market basket on which the CPI is based no less frequently than every five years instead of every 10. CRS estimates that would be equivalent to reducing the cost-of-living adjustment by three-tenths of one percentage point per year. The legislation on which the NCRP plan is based calls for development of a new Social Security CPI that would be lower than the regular CPI to the extent that the Bureau of Labor Statistics estimates the regular CPI contains "substitution bias." If BLS concluded that the measures it announced in April 1998 to reduce substitution bias in the CPI have addressed this matter and no such further bias remains or can be estimated, the Social Security CPI that the NCRP plan establishes would be set .33 percentage points below the regular CPI each year. This level of detail on how the cost-of-living adjustments would work under the NCRP plan was not available when the Social Security actuaries prepared the estimates on which the CRS analysis is based; as a result, the CRS analysis may somewhat overstate the degree to which this aspect of the NCRP plan would result in additional benefit reductions as retirees grow older.

[6] Some sponsors of the legislation embodying the NCRP plan have stated that it does not change disability benefits. Such statements are not correct and appear to reflect some misunderstanding on the part of these sponsors of the effect of their legislation on disability benefits. The NCRP plan changes the benefit formula for computing a beneficiary's primary insurance amount (or PIA), on which Social Security benefits are based for retirement benefits, disability benefits, and survivors benefits alike. A forthcoming Center on Budget and Policy Priorities analysis will explain this matter in more detail.

Why Does the Depth of the Benefit Reductions Differ So Much?

These findings raise an important question. What accounts for the CRS finding that the Ball plan would reduce defined Social Security benefits much less than the other two plans while doing as well in closing the 75-year imbalance? There are two principal reasons for this finding.

First, the other two plans reduce the revenue going into the Social Security trust fund and place greater reliance on individual accounts; they essentially divert payroll contributions from the trust fund to individual accounts. The Ball plan, by contrast, does not reduce the revenue going into the trust fund. It adds voluntary individual accounts on top of Social Security but does not divert money from the trust fund for them.

Under current law, the revenue the trust fund is projected to receive over the next 75 years is insufficient to pay the full benefits to which beneficiaries would be entitled during this period. This is what is meant by the statement that Social Security eventually becomes insolvent. Diverting payroll tax revenue from the Social Security trust fund makes the financing shortfall larger and consequently necessitates deeper benefit reductions (or larger payroll tax increases) to put the trust fund back into long-term balance. As the Congressional Research Service explained in an earlier report: "Obviously, if it is projected that the taxes that finance the [Social Security] system are insufficient to pay future promised benefits, earmarking some of them for the buildup of private accounts would make this problem worse. It would mean that to restore the system to solvency future tax increases would have to be larger or benefits cut deeper."[7]

Not surprisingly, CRS found that the NCRP plan, which diverts the most revenue from the Social Security trust fund, contains the deepest Social Security benefit reductions. Among the large benefit reductions in this plan is an across-the-board benefit cut resulting from an increase in the age at which individuals may retire and receive full benefits; the age at which individuals can retire and receive full Social Security benefits would be raised to 70 by 2029 and to approximately 72½ by 2075, a larger increase than any other major plan has proposed.[8] The plan also includes a reduction of one-third in Social Security spousal benefits. (These benefit reductions are described in more detail later in this paper.)

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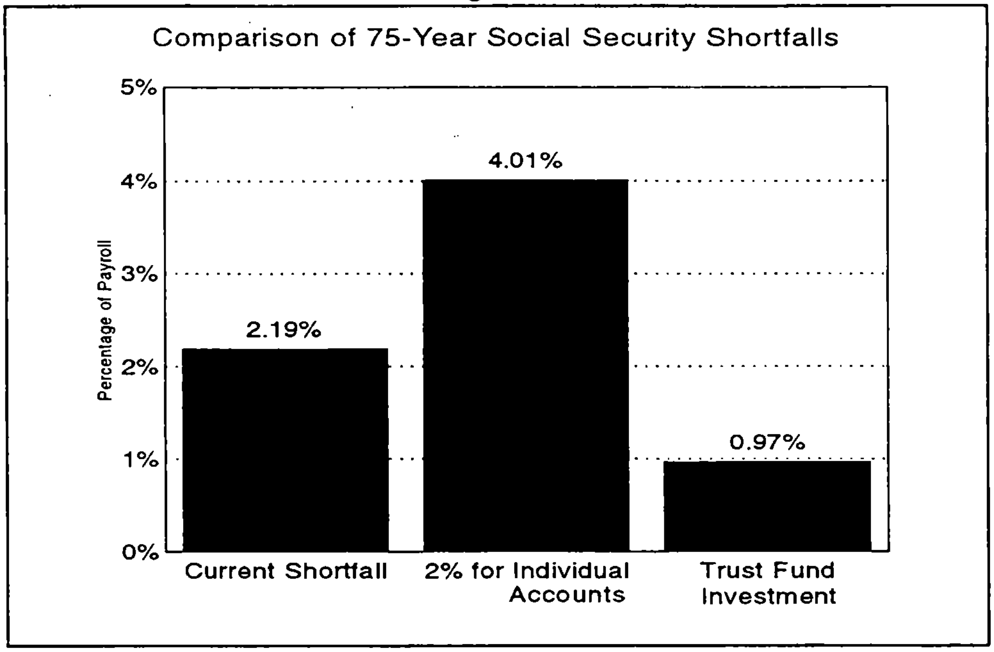
[7] "Ideas for Privatizing Social Security," Congressional Research Service, April 6, 1998.

[8] The age at which individuals may retire and receive full Social Security benefits is commonly referred to as the "normal retirement age." That term, however, is a misnomer; the majority of Social Security beneficiaries retire and begin drawing benefits before this age. What is commonly called the "normal retirement age" is simply the age at which full, rather than reduced, Social Security benefits are paid.

Figure 1



The second reason the Social Security benefit reductions are much more modest under the Ball plan than under the other plans is that the Ball plan invests a portion of the Social Security trust fund reserves in equities. This enables the trust fund to capture the stock market's higher rates of return. The actuaries estimate that the earnings the trust fund would receive from this investment would reduce the 75-year imbalance in the Social Security system by slightly more than half. That, in turn, reduces the benefit reductions or tax increases needed under the Ball plan to restore long-term balance.

Figure 1 illustrates that redirecting two percent of the payroll tax to individual accounts, as the NCRP plan would do, would enlarge the 75-year shortfall from 2.19 percent of taxable payroll to 4.01 percent, in the absence of other changes. The Figure also shows that investing up to 50 percent of the trust fund in equities, as the Ball plan would do, would reduce the 75-year deficit from 2.19 percent of taxable payroll to 0.97 percent, in the absence of other changes.

For these reasons, Rudolph Penner, a former CBO director now at the Urban Institute who supports the NCRP plan, recently observed that "plans that have the trust fund buying equities generally cut [Social Security] benefits less than plans establishing individual accounts."[9]

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[9] Testimony of Rudolph G. Penner before the Senate Budget Committee, July 23, 1998.

The CRS Analysis and Individual Accounts

Proponents of the NCRP plan and the Moynihan/Kerrey bill have criticized the CRS analysis. They fault it for not including the retirement income that would result from the individual accounts the plans contain. They also argue that it is not appropriate to compare benefits under these plans to benefits under the current Social Security system since the current system will not be solvent over the long term. They contend the proposed plans should be compared to a Social Security system revised in a manner that puts it in long-term actuarial balance.

Proposals to divert part of the payroll tax revenue from the Social Security trust fund to individual accounts entail moving partially from a "defined benefit" plan that specifies the payment of particular benefit amounts based on a retiree's earnings history (i.e., from Social Security) to a "defined contribution" plan in which the benefits available to retirees vary greatly. Under a defined contribution plan, benefits depend not only on a beneficiary's earnings history but also on individual investment decisions, the performance of the stock and bond markets (including the state of the markets in the year an individual retires), the real interest rate assumptions used when retirees convert their accounts to annuities, the extent to which funds in individual accounts are consumed by fees that firms charge for managing the accounts (and, where applicable, for converting accounts to annuities at retirement), and other factors.

In weighing options for reforming Social Security, policymakers need to understand the degree to which the defined benefits — that is, the benefits Social Security provides — would be reduced under various approaches, since it is only the defined benefits that retirees are assured of receiving at specified levels. This is the information the CRS study provides.

More comprehensive analyses that factor in the anticipated returns from individual accounts also are needed and should be undertaken. Such analyses are more difficult to conduct, however, than the type of analysis CRS has conducted on the extent to which these three plans would reduce Social Security benefits. Analyses attempting to factor in returns from individual accounts consequently will need to be undertaken with great care. In particular, such studies will need to consider several factors that may have a large impact on the retirement income that individual accounts generate:

> Variation in returns from individual accounts: Since individual accounts do not provide defined benefits, the levels of income they generate will differ considerably among beneficiaries and over time. The retirement income from such accounts is likely to offset the reductions in Social Security benefits for some retirees but not others. Retirees who are lucky or wise in their investments should be able to offset the full loss in their guaranteed benefits. Retirees who are unlucky or unwise in their investments — including those who retire and convert their account to a lifetime annuity in a year the market is down — would

likely face large reductions in the income they have to live on in their declining years.

A recent GAO report took note of these issues. "There is a much greater potential for significant deterioration of an individual's retirement 'nest egg' under a system of individual accounts," the GAO wrote. "Not only would individuals bear the risk that market returns would fall overall but also that their own investments would perform poorly even if the market, as a whole, did well"[10]

Of particular concern are the returns received by those who lack investment experience. Today, fewer than half of all U.S. households have any investments in the stock market; this lack of experience is likely to make it harder for many to earn solid returns. Moreover, even experienced investors pursuing sound investment strategies can have investments that turn sour and earn below-market returns. The fact that a substantial majority of mutual funds earn rates of return that are below the performance of the S&P 500, a broad measure of the major stocks in the market, is evidence of this fact. These concerns are greatest for plans that allow individuals a wide array of choices in how to invest the funds in their accounts, such as plans that establish accounts similar to IRAs or 401(k) accounts.

Another group likely to face substantial reductions in retirement income under individual accounts are those who must retire early for health reasons but are not sufficiently infirm to meet the stringent Social Security disability criteria, as well as those who have been employed in physically strenuous occupations that are not suitable for someone past their early or mid-60s. Individuals who must retire early would tend to have smaller individual accounts because they would have fewer years of contributing to these accounts. At the same time, they also are likely to have lower Social Security benefits because most of the reform plans that divert revenue from the Social Security trust fund to individual accounts — such as the NCRP plan — raise the normal Social Security retirement age substantially. These plans take this step to shrink Social Security benefit costs enough to help compensate for the large Social Security revenue losses that the diversion of payroll tax revenue to individual accounts entails.

Analyses of the retirement income generated by individual accounts should reflect the range of outcomes these accounts are likely to produce. Simply estimating the average anticipated rate of return for such accounts would obscure the fact that substantial numbers of people would likely receive significantly less income than that from their individual accounts, while others would receive more. Stated another way, such an approach would be

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[10] General Accounting Office, *Social Security: Different Approaches for Addressing Program Solutions*, July 1998, p. 6.

problematic because it would fail to reflect the increased risk to beneficiaries that individual accounts carry.

Administrative and Other Costs: Analyses of the retirement income that individual accounts would provide also need to factor in the costs associated with such accounts. Since such costs are paid out of the funds in the accounts, they affect the amount of money available in the accounts to pay retirement benefits.

Private accounts necessarily incur administrative and management fees. Some private account systems also incur costs when account-holders retire and convert the funds in their accounts to lifetime annuities. The individual retirement accounts — or IRAs — and the 401(k) accounts that many Americans possess incur all of these costs. Estimates from two eminent economists, Peter Diamond of M.I.T and Henry Aaron of the Brookings Institution, indicate that between 7.5 percent and 30 percent or more of the amounts saved or earned under the individual account systems that would be established under various Social Security privatization proposals would be consumed by administrative, management, and (where applicable) annuitization costs and fees.

Plans that invest Social Security trust fund revenues in equities, rather than diverting trust fund revenue to individual accounts, avoid almost all of these costs. The General Accounting Office recently reported: "Most of the cost of managing an index fund is incurred maintaining thousands of individual accounts. In contrast, the government, as a single investor, would incur negligible costs as a percentage of its assets. Therefore, investing collectively through the government would result in significant administrative savings compared to investing through individual accounts."[11]

This is one of the reasons some Social Security experts, such as Brookings Institution senior fellows Henry Aaron and Robert Reischauer, the former CBO director, favor investing a portion of trust fund reserves in equities as an alternative to individual accounts. Aaron and Reischauer observe that because investing trust fund reserves in equities would avoid such costs, it would generate a higher average net rate of return than individual accounts while exposing beneficiaries to much less individual investment risk.

The Social Security "Baseline"

The other criticism lodged against the CRS analysis by proponents of the NCRP plan and the Moynihan/Kerrey bill is that comparing benefits under reform plans to

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[11] General Accounting Office, "Social Security Financing: Implications of Stock Investing for the Trust Fund, the Federal Budget, and Economy," statement of Barbara D. Bovbjerg before the Senate Special Committee on Aging, April 22, 1998.

benefits under the current Social Security benefit structure is inappropriate since the current Social Security system will not be solvent over the long term. They contend that the appropriate standard against which reform proposals should be measured is an altered model of Social Security that includes measures bringing the system into long-term balance.

This criticism of the CRS study is unconvincing. Use of a baseline, or a point of reference where no change has taken place, is common in research. The benefit levels the current benefit structure pays provide an appropriate baseline measure against which to compare the Social Security benefits that various reform plans would provide. To use these benefit levels as a baseline in no way suggests that changes are not needed to restore long-term solvency to the system; it simply provides a readily understandable measure of comparison.

Nor does use of this baseline alter comparisons to each other of the plans CRS examined. The comparative standing of these plans would remain unchanged if CRS had used a different standard. For example, if CRS had used the Moynihan-Kerrey bill as its standard, the NCRP plan would be shown to reduce Social Security benefits relative to the standard while the Ball plan would be shown to raise them.

More important, there is no widely accepted way of altering Social Security to achieve long-term balance that can serve as a baseline. In particular, to compare alternative plans to a policy of restoring balance solely by cutting Social Security benefits may be misleading; that is an option no one is suggesting. Not a single member of the 1994-1996 Social Security Advisory Council recommended such an approach. No proponent of Social Security reform has proposed it.

Furthermore, use of a standard which assumes that balance will be restored solely by cutting benefits could lead to some misunderstanding among the public. Some plans that reduce retirement income below the levels the current benefit structure provides could be shown to *increase* benefits relative to such a standard; some of the public could mistakenly think this means that such plans would raise benefits relative to the standard-of-living that the current benefit structure provides. If many Americans mistakenly believed such a plan would raise retirement income above the levels the current system provides, they could conclude that no sacrifice would be involved and no increase needed in saving by individuals.

A number of these issues are discussed in more detail below.

Why Do Plans that Reduce or Divert Payroll Tax Revenue Result in Large Reductions in Social Security Benefits?

The principal reason the NCRP and Moynihan-Kerrey plans reduce Social Security benefits much more deeply than the Ball plan does is that they reduce the revenue going into the Social Security trust fund. This deepens the trust fund's financing shortfall and necessitates deeper benefit reductions to eliminate the shortfall. The NCRP plan reduces the revenue going into the trust fund on a permanent basis, while the Moynihan-Kerrey plan reduces trust fund revenue for the next 30 years (and, on average, over the 75-year period used in Social Security projections).

The NCRP plan mandates the permanent diversion of two percentage points of the payroll tax from the Social Security trust fund to individual accounts. The Moynihan-Kerrey bill reduces the payroll tax by two percentage points through 2024 (and by less than two percentage points from 2025 through 2029).[12] The Moynihan-Kerrey plan provides for voluntary individual accounts funded with its one percentage point reduction in the *employee* share of the payroll tax, along with a mandatory employer matching contribution for any employee establishing such an account, financed by the one percentage point reduction in the *employer's* share of the payroll tax.

Reducing the revenue going into the Social Security trust fund necessitates deeper reductions in Social Security benefits to restore long-term balance. For example, an analysis by the Social Security actuaries shows that the NCRP plan's diversion of two percentage points of payroll tax revenue to individual accounts increases the deficit in the Social Security trust fund by an amount equal to 1.82 percent of taxable payroll over the next 75 years. The Social Security actuaries project that the current shortfall equals 2.19 percent of taxable payroll over the next 75 years. By deepening the shortfall by 1.82 percent of taxable payroll, the NCRP plan's diversion of two percent of the payroll tax enlarges the size of the Social Security deficit approximately 80 percent. That, in turn, necessitates Social Security benefit reductions about 80 percent larger than otherwise would be needed to restore Social Security to long-term balance.[13]

The NCRP plan achieves these deeper benefit reductions in a number of ways, including the following.

- The NCRP plan raises the age at which individuals can retire and receive full, rather than reduced, Social Security benefits to a higher age level than any of the other major plans that have been offered. For example,

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[12] The Moynihan-Kerrey plan begins to raise the payroll tax in 2025 and restores the tax rate to its current level by 2030. The plan also would begin to raise the payroll tax rate slightly *above* the current level in 2045 and continue raising it until 2060. At that time, the combined employee and employer shares of the payroll tax would be one percentage point above the current level.

[13] The NCRP plan offsets a modest portion of the revenue loss by shifting from the Medicare trust fund to the Social Security trust fund the share of the revenue from partial taxation of Social Security benefits that currently is deposited in the Medicare Hospital Insurance Trust. Shifting this revenue would deepen the long-term fiscal imbalance in the Medicare trust fund, however, which is more serious than the long-term imbalance in the Social Security trust funds. When all of its changes in trust fund revenue are considered, the NCRP plan deepens the trust fund shortfall by 1.39 percentage points of payroll, or 50 percent.

the plan advanced by the 1994-1996 Social Security Advisory Council that went the farthest in raising the age at which workers can retire and draw full benefits would raise this age from 65 today (and eventually 67 under current law) to 70 by 2083. By contrast, the NCRP plan would increase this age to 70 by 2029 and to approximately 72½ by 2075. The NCRP plan also would raise the *early* retirement age, the age at which retired individuals can retire and begin to draw reduced Social Security benefits, from 62 to 65 by 2029 and to approximately 67½ by 2075.

Raising the age at which individuals can retire and receive full benefits essentially constitutes an across-the-board reduction in Social Security benefits because it reduces benefits not only for those who retire earlier but also for those who remain at work until this age, a point that is not widely understood.[14] Each one-year increase in the age at which full benefits are paid results in a reduction of approximately seven percent in the Social Security benefits that an average worker receives over his or her retirement years.[15]

In addition, increasing from 62 to 65 the age at which individuals can retire and begin to draw *reduced* Social Security benefits would be particularly burdensome for those who are unable to work until 65 either because they are in poor health during their early 60s (but are not sufficiently infirm to meet the stringent Social Security disability criteria) or because they have been employed in physically strenuous occupations in which they cannot remain employed until 65.

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[14] Under current law, with the age at which full benefits are paid set at 65 and scheduled to rise to 67 by 2022, workers who retire at 62 (or 63 or 64) receive lower monthly benefits for the rest of their lives in recognition of the fact that their benefits will be spread over more years. Conversely, those who do not retire until age 70 receive *higher* monthly benefits for the rest of their lives because they will draw benefits for fewer years. Under proposals to raise to 70 the age at which full benefits are paid, however, those who retire at 70 would receive the standard benefit that now goes to those retiring at 65; they would no longer receive an enhanced benefit for workers who do not retire and begin drawing benefits after the age at which full benefits are paid. Raising the age at which full benefits are paid thus essentially constitutes an across-the-board cut; if the age is raised to 70, those retiring at 70 lose benefits along with those who retire in their 60s.

[15] "Increasing the Eligibility Age for Social Security Pensions," Testimony of Gary Burtless, senior fellow, The Brookings Institution, before the Senate Special Committee on Aging, July 15, 1998. When the age at which individuals can retire and draw full benefits is raised to 70 under the NCRP plan, individuals would be able to retire at 65 and begin drawing reduced Social Security benefits, just as individuals today can retire and begin receiving reduced benefits at 62. Those electing the early retirement option would receive reduced Social Security benefits for the rest of their lives. Under the NCRP plan, individuals could retire and begin to make withdrawals from their individual accounts before age 65 if there were enough funds in the accounts to provide monthly payments at least equal to the poverty line.

- The NCRP plan also makes major changes in the Social Security benefit computation formula. Under the current, progressive formula, Social Security benefits equal 90 percent of the first $477 of a worker's average monthly wage over his or her work-years, 32 percent of the next $2,875 of a worker's average monthly wage over his or her work years, and 15 percent of the remainder of a former worker's average monthly wage.[16] The NCRP plan would, over time, lower these 32 percent and 15 percent "replacement rates" to 21.36 percent and 10.01 percent, respectively, which would constitute a large benefit reduction. A significantly smaller percentage of the wages and salaries many workers earned would be replaced by Social Security benefits when they retired. This formula change alone reduces benefits for a worker whose average wages are $40,000 in 1998, and whose wages rise in subsequent years at the same rate as average wages in the economy, by 22 percent.

- In addition, the NCRP plan proposes to reduce the benefit Social Security provides to spouses of primary wage-earners; the spousal benefit would be lowered from 50 percent of the primary wage-earner's benefit, as under current law, to 33 percent of that benefit. Many spouses thus would experience a benefit reduction of up to one-third, on top of the NCRP plan's other benefit reductions. (Some members of the 1994-1996 Social Security Advisory Council also proposed to reduce the spousal benefit, but they used the savings from this proposal to help finance an *increase* in the benefits that Social Security pays to widows and widowers so as to provide more adequately for widows, who face poverty at very high rates.[17] In 1996, some 39 percent of elderly widows — about two in every five — had incomes below 150 percent of the poverty line.[18] Reducing spousal benefits without raising widows' benefits would reduce benefits principally among women.)

Since the Ball plan does not divert trust fund revenue to fund individual accounts, it does not need Social Security benefit reductions of this magnitude. As noted above, the Ball plan further shrinks the size of the benefit reductions or tax

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[16] In computing these average monthly wage figures, the Social Security Administration indexes wages earned in years before a worker's retirement by changes in average wages in the U.S. economy in the intervening years.

[17] Under the recommendation these Advisory Council members made, the widow or widower of a deceased worker would receive 75 percent of what the couple's *combined* benefit would have been, rather than receiving only the worker's benefit (or only the widow or widower's own benefit, if larger), as under current law. *Report of the 1994-1996 Advisory Council on Social Security, Volume I: Findings and Recommendations*, January 1997

[18] Bureau of the Census, Current Population Survey, 1996, March 1997.

increases needed to restore Social Security to long-term balance by investing a portion of Social Security reserves in the equities markets and thereby capturing the higher rates of return these markets provide. This is essentially the same strategy that state and private pension funds use.

Estimating the Effects of Various Plans When Income From Individual Accounts is Added

The CRS analysis does not purport to be a comprehensive analysis of all components of the three plans it examines, but rather an assessment of the changes made in the defined, or guaranteed, benefits that retirees would be assured of receiving through Social Security. Analyses also are needed that include projected returns from individual accounts. Undertaking such analyses is not easy or straightforward.

To factor in benefits from individual accounts one must make assumptions regarding investment behavior, stock market performance, the expectations that firms selling annuities have concerning what inflation and interest rates will be in coming years, and other factors. Since future earnings are unlikely to mirror past earnings exactly, all such projections are subject to a wide range of error. More important, projected rates of return from individual accounts generally are averages; the actual benefits that individuals would derive from such accounts would vary substantially from the estimated average figures, with some beneficiaries garnering higher rates of return and others receiving lower rates of return.

Many low-income earners may receive relatively low rates of returns from their investments. Low-income families tend to have little experience with retirement accounts or with investing in stocks, bonds, and mutual funds. They would be more likely than experienced investors to make poor investment choices. Experience with 401(k) accounts suggests they also would be likely to invest quite conservatively, probably out of fear of losing the limited resources they have. In a June 17, 1998 House Ways and Means Committee hearing on individual accounts, several witnesses testified that much of the public lacks sufficient knowledge about investing to manage such accounts well.[19]

When estimating the retirement income that individual accounts would generate, there is no easy way to factor in the potential for a substantial segment of the public — and in particular, those with below-average earnings — to invest unwisely or too conservatively. One possible approach is to show ranges for the levels of retirement income and rates of return that individual accounts would generate. Estimates that simply show projected average rates of return on individual accounts, rather than

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[19] Testimony of Teresa Tritch, senior editor of *Money* magazine, and Ric Edelman, head of Edelman Financial Services, before the U.S. House of Representatives Subcommittee on Social Security of the Committee on Ways and Means, June 18, 1998.

The Year of Retirement Can Greatly Affect a Beneficiary's Level of Retirement Income Under A System of Individual Accounts

There also are a number of other ways in which investment risk would affect the retirement income an individual would receive under a system of individual accounts. For example, Gary Burtless, a senior fellow at the Brookings Institution, has shown that under such a system, the amount of the monthly annuity for an individual who converts his or her individual account to an annuity at retirement could vary greatly not only as a result of the investment choices a worker has made but also as a result of the state of the stock market in the year the individual retired.

If an individual retires and converts his or her account to an annuity in a year in which the stock market is very high, the individual is likely to receive a more ample annuity check. But if the individual has the misfortune to retire and annuitize when the market is down, the individual can be faced with a meager income for the rest of his or her life. Burtless' research shows that if workers retiring in the 1960s and 1970s had deposited funds in individual accounts throughout their careers, with the money invested in stock index funds, an average male worker who retired and converted an individual account to an annuity in 1976 would have received a monthly benefit for the rest of his life that was *only a little more than half as large* as the monthly benefit an average male worker who retired and annuitized seven years earlier, in 1969, would have received.

ranges, tend to oversimplify this matter. Another possible approach is to attempt to estimate the percentage of individuals likely to secure rates of return lower (or higher) than the average rate of return. Such variations are particularly important in light of the fundamental purpose of social insurance, which is to *assure* the retired, the disabled, and survivors a certain basic income.

Even more difficult is the task of estimating how the stock market will perform in coming decades. Given the dizzying increases in the market in recent years, using market performance for a period that includes these years to predict future performance may generate estimates of rates of return for individual accounts that prove to be too high. The ratio of stock prices to corporate earnings has climbed will above its traditional range, which raises questions about how much further the equities markets will rise. No one knows the answer to this question. In recent congressional testimony, Rudolph Penner, who backs the NCRP plan, acknowledged that for this reason, "considerable uncertainty surrounds the assumption regarding what can be earned" through investment in equities.[20] (It may be recalled that only three decades ago, in the 1970s, the market preformed poorly and lost a large share of its value.)

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[20] Testimony of Rudolph G. Penner, senior fellow, the Urban Institute, before the Senate Budget Committee, July 23, 1998.

Administrative Costs

One set of factors that can more readily be taken into account in estimating the retirement income that individual accounts may generate involves the costs associated with these accounts, including administrative and management fees, costs under some plans of converting funds in these accounts to annuities that pay a monthly benefit until death, and costs under some plans of the transition from Social Security to private accounts. All private account plans entail some or all of these costs. Since the costs are generally paid from the accounts, they reduce the retirement income the accounts generate. Estimates that do not reflect such costs are not valid.

The administrative costs that must be paid from the funds in individual accounts are the expenses that investment firms incur in handling the accounts, conducting marketing efforts to attract investors, communicating with their investors, record-keeping, and corporate overhead. The fees these firms charge to account-holders also include a profit margin; no one can expect private firms to handle such accounts for free or at a loss. The administrative costs for IRAs currently range from $35 to $45 per account per year.[21] For private defined contribution pension plans, administrative costs vary by the number of participants in the plan and have been estimated to range from approximately $50 per year per participant for a plan with 10,000 or more participants to nearly $290 for a plan with 15 or fewer participants.[22] Flat-rate costs of this nature are most disadvantageous to low-wage workers, since these charges consume a larger percentage of the investments in small accounts than of the investments in larger accounts. In addition to these administrative costs are investment management fees that firms charge for investing the funds in these accounts and shifting the funds as account-holders direct.

Two eminent economists, Peter Diamond of MIT and Henry Aaron of the Brookings Institution, have studied administrative and management fees associated with IRAs and 401(k) plans.[23] They estimate that by retirement, costs for individual accounts established on an IRA or a 401(k) model would consume, on average, about 20 percent of the funds otherwise deposited in or earned by the accounts. As Diamond

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[21] Remarks by Philip Lussier, State Street Global Advisors, before the National Commission on Retirement Policy, Social Security Working Group, February 25, 1998.

[22] Edwin C. Hustead, "Trends in Retirement Income Plan Administrative Expenses," *Pension Research Council Working Paper*, 96-13, Philadelphia: University of Pennsylvania, 1996.

[23] Statement by Peter Diamond, AARP-Concord Coalition Debate on Social Security, Albuquerque, July 27, 1998; Peter Diamond, "The Future of Social Security for this Generation and the Next: Proposals Regarding Personal Accounts," testimony before the Subcommittee on Social Security of the House Committee on Ways and Means, June 18, 1998; testimony of Henry J. Aaron before the Senate Committee on the Budget, July 23, 1998.

Financial Securities Analyst Explains That Administrative Costs Can Substantially Reduce Returns From Accounts

In testimony July 24 before the Subcommittee on Finance and Hazardous Materials of the House Commerce Committee, Joel M. Dickson, Senior Investment Analyst with the Vanguard Group, explained the large role that administrative costs can play in lowering rates of return that individual accounts can provide, especially for the smaller-than-average accounts of workers with below-average earnings. Dickson stated:

"Much of the recent debate on individual accounts has centered around how Social Security participants can earn higher rates of return — like those experienced in the private financial markets. Unfortunately, there is often a large gap between the assumed market return on an investment and the actual return realized by investors. The reason? Cost... What may seem to be a relatively small cost difference over a short period of time can become an enormous difference over a long investment horizon....

"Consider a $1,000 investment in two equity funds; one earns a market return of 10%; the second earns only 8%, which represents the market's return reduced by an all-too-realistic total cost of 2% (arising from charged expenses and portfolio transaction costs). After the first year, the difference in account values between the two options is only $20. Of course, a participant investing over the course of their working lifetime must consider much longer time horizons. Over 40 years, the first fund soars to $45,000. The second fund, earning 2% less per year, grows to $22,000 — less than half what the market earned....

"The key pricing variable for private accounts is the average account size. To the extent that costs of servicing the accounts could not be covered by asset-based management fees, other charges — like account maintenance fees — are likely. One of the criticisms often made about privately-managed, individual accounts is that lower-income workers may not be as financially savvy, resulting in lower average returns. I think a bigger issue is that lower-income and part-time workers will have small account balances, potentially subjecting them to higher fees because asset-based revenue cannot begin to cover the costs of maintaining these accounts. Thus, they are likely to earn lower returns than higher-income workers that make the same investment choices for reasons unrelated to financial market sophistication."

explains, a one percent annual average charge on funds in such an account consumes, over a 40-year work career, 20 percent of the funds in the account.[24] Based on the most recent financial data on mutual funds, a one percent annual charge is a conservative

[24] Diamond explains that with a one-percent annual charge on holdings in accounts, a dollar deposited in an individual account in the first year of a 40-year work career will be subject to the one percent fee 40 times, while a dollar deposited in the final year before retirement will be subject to the fee once. On average, dollars in the account will be subject to the one percent annual charge 20 times, so approximately 20 percent of the amounts deposited or earned by the account will be consumed by these charges. Diamond also notes that in Chile, costs consume approximately 20 percent of the amounts in individual accounts, with the percentage being *higher* in Great Britain and Argentina.

estimate. Lipper Analytical Services reports that in 1997, the average charge on no-load stock funds equaled 1.21 percent of amounts invested in the funds, while the average charge on front-load stock funds equaled 1.25 percent.[25] Moreover, the 1994-1996 Advisory Council on Social Security estimated an annual charge of one percent on assets in privately managed individual accounts.[26]

The amounts consumed would generally be larger than 20 percent for smaller-than-average accounts and smaller than 20 percent for large accounts. This means the retirement income that individual accounts modeled on IRAs or 401(k) plans would generate would be about 20 percent smaller on average than the income would be without these fees and costs. It also means that estimates of the retirement income that IRA-type or 401(k)-type accounts would generate will overstate this income by approximately 20 percent on average if the estimates do not reflect these fees and costs.

Costs of Converting Accounts to Annuities

A sizable additional cost also would be incurred under plans that feature private accounts modeled on IRAs or 401(k) plans — the cost of converting the funds in a worker's account to a lifetime annuity when the worker retires. These costs cover a company's marketing expenses, commissions to agents, investment costs, overhead, and profits.

The leading study on this issue indicates that the fees charged for converting an account to an annuity at retirement consume, on average, approximately five to ten percent of the retirement savings of an individual purchasing a $100,000 annuity.[27] In other words, the insurance company would take five to 10 percent of the amount in the retiree's account to cover its costs and profits, with the amount of the monthly annuity check being based on the remaining 90 percent to 95 percent of the funds in the account. (These annuitization costs can vary by as much as 15 percent across insurance firms. A retiree would need to be fairly astute in selecting the best company from

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[25] See Robert McGough, "Robust Fund Industry Isn't Lowering Fees," *Wall Street Journal*, May 14, 1998.

[26] The Advisory Council assumed an annual change of one percent on accounts established under the Personal Security Accounts proposal, a proposal that diverted *five* percentage points of the payroll tax to individual accounts. Since many of the administrative costs involved in managing private accounts are fixed costs that do not vary with the size of the account, this suggests that the average charge could be larger than one percent per year on the smaller individual accounts that would be established under plans using IRA-type or 401(k)-type accounts that divert two or three percentage points of the payroll tax into these accounts rather than five percent.

[27] Olivia S. Mitchell, James M Porterba, and Mark J. Washawsky, *New Evidence on the Money's Worth of Individual Annuities,*"Cambridge, National Bureau of Economic Research, April 1997. Also see Aaron, *op. cit.*

which to purchase an annuity. Many people do not have sufficient investment expertise to make the wisest choices in purchasing annuities.)

In addition, prices for annuities are generally raised to cover the company's risk of incurring added costs due to "adverse selection." Adverse selection refers to the probability that people with longer-than-average life expectancies will be more likely to purchase lifetime annuities than people with shorter-than-average life expectancies. Insurance companies cover themselves for the costs of paying lifetime annuities to people who may live to very old ages. The resulting increase in the price of annuities has been estimated to reduce the value of retirement savings being converted to an annuity by an additional 10 percent.

Totaling all of these costs and charges, Henry Aaron concludes that the administrative and management costs *plus* the costs of converting funds in these accounts to annuities would consume *between 30 percent and 50 percent* of the amounts saved in IRA-type or 401(k)-type individual accounts. These are very large amounts and indicate why analyses of plans that include individual accounts need to reflect estimates of these costs in their computations. (Estimates of rates of return from individual accounts issued by privatization proponents such as the Heritage Foundation tend to ignore such costs and are not valid as a result.)

Costs Under the Thrift Savings Plan Model

Diamond also has examined likely administrative costs for individual accounts modeled on the Thrift Savings Plan. The individual accounts the NCRP plan would create are based on this model. The costs for this type of account would be considerably lower but would still be significant. Diamond estimates that the costs of administering this type of account would consume approximately 7.5 percent of the funds in an average worker's account (as distinguished from the 20 percent cost Diamond and Aaron estimate for plans with IRA or 401(k) type accounts), reducing the retirement benefits these accounts would pay by that percentage.[28] Under the NCRP

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[28] Administrative costs for TSP equaled approximately $20 per participant in 1997, which equaled about 3.75 percent of what would be the average worker's deposit into a private account under the NCRP plan. As Aaron, Diamond, and former Thrift Savings Plan head Francis Cavanaugh have testified, using this model for the accounts of 140 million to 150 million workers employed by millions of employers would entail significantly higher costs in percentage terms than the cost of operating the Thrift Savings Plan for employees of a single employer, the U.S. Government. The TSP's economies-of-scale would not be available due to the existence of millions of separate employers. In addition, many costs associated with operating the Thrift Savings Plan are borne by the federal agencies in their role as employer rather than by TSP itself (e.g., responding to employees' questions); such costs would almost certainly not be imposed upon private employers under an individual accounts plan based on the TSP model. These costs would have to be borne by the entity operating the accounts system and defrayed through charges on the accounts. In addition, federal agencies transmit the relevant data to TSP electronically, while many private employers submit data on paper; that would further increase the costs for the entity administering the accounts (as well as the risk of errors in maintaining accounts

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Investment of Trust Fund Reserves in Equities Likely to Yield Higher Rates of Return by Reducing Costs

Both the Ball plan and a separate plan designed by former Congressional Budget Office director (and now Brookings senior fellow) Robert Reischauer and Brookings senior fellow Henry Aaron would invest a portion of Social Security trust fund assets in broadly indexed funds. Such approaches would tend to generate higher rates of return than plans that divert a portion of payroll tax revenue to individual accounts, because investing a portion of the trust funds in the equities markets does not entail the administrative costs, management fees, and (in some cases) annuitization costs involved in systems with nearly 150 million individual accounts.

If individual accounts and trust fund reserves invested in index equity funds were both to earn the average market rate of return — but the retirement benefits the individual accounts paid had to reflect the administrative costs, management fees, and, where applicable, annuitization costs these accounts must pay — the investment of trust fund reserves in the market would necessarily generate a higher net rate of return. Investing a portion of trust fund reserves in the market also pools the risk of investing in the market so no single individual has to face the threat of large investment losses.

For these reasons, Reischauer, Aaron[25] and a number of other economists have concluded that this approach is likely to yield higher rates of return at lower risk to beneficiaries than a system of individual accounts.

[28] Henry J. Aaron and Robert D. Reischauer, "Tune It Up, Don't Trade It In,"*The Washington Post*, Outlook section, April 19, 1998. In addition, Francis Cavanaugh, former head of the Thrift Savings Plan, recently testified that "The only feasible way for the Social Security system to benefit from the higher returns offered by the stock market is to invest a portion of the trust fund in stocks, which is what virtually all large public and private pension and retirement funds have already done." Statement of Francis X. Cavanaugh before the Subcommittee on Social Security of the House Ways and Means Committee, June 18, 1998.

plan, the percentage by which accounts would be reduced to cover administrative costs would be the same for all accounts without regard to their size.

Annuitization costs under a plan such as the NCRP proposal are less clear. The NCRP plan requires a minority of retirees to annuitize. Others *could* annuitize but would not have to do so; those who did would have several options regarding how to annuitize. Some individuals who annuitized would likely incur large annuitization costs. Some others likely would not convert their accounts to annuities. Those who did not annuitize would not be able to withdraw all their funds at once; there would be limits on the amounts they could withdraw. The annual amount an individual would be allowed to withdraw would be based on his or her life expectancy. As the individual grows older, the maximum withdrawal allowed would decrease to stretch

[28] (...continued)
records).

the savings left in the account over the years expected to remain in the individual's life. If an individual with a modest account lived to a very old age, the withdrawals could eventually become very small. This stands in contrast to Social Security benefits, which do not decline in amount as an individual grows older but rather increase to keep pace with inflation.

(There also is some question as to the feasibility of using the Thrift Savings Plan model for a system of 140 million or 150 million individual accounts held by workers of millions of employers. Francis X. Cavanaugh, the former head of the Thrift Savings Plan and a former Reagan Administration Treasury official, recently testified that managing such a system would require 10,000 highly trained federal employees and stated that in his view, "... it would be impossible to establish cost-effective TSP-type PSAs [personal savings accounts] for the Social Security system."[29])

Conclusion

The CRS study provides a useful analysis of the effects of the three plans on the defined benefits that Social Security provides. The data in the study demonstrate that plans that reduce or divert Social Security payroll tax revenue from the trust fund to individual accounts entail deeper reductions in Social Security benefits than plans that do not reduce trust fund revenue. The data also illustrate the fact that plans that invest a portion of Social Security trust fund assets in equities can restore Social Security to long-term balance with smaller Social Security benefit reductions than other plans because such an approach boosts trust fund revenues.

Subsequent studies should attempt to incorporate the effects of the individual accounts that various plans establish on the income that retired workers would receive. Such analyses will need to take into account the average amounts the individual accounts are projected to earn, the risk that account-holders would face and the wide variation in retirement income that consequently could result, and the costs and fees that would affect the benefit payments these accounts can make.

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[29] "Statement of Francis X. Cavanaugh before the Subcommittee on Social Security of the House Ways and Means Committee, June 18, 1998.

CENTER ON BUDGET AND POLICY PRIORITIES

Revised October 8, 1998

AFRICAN AMERICANS, HISPANIC AMERICANS, AND SOCIAL SECURITY: THE SHORTCOMINGS OF THE HERITAGE FOUNDATION REPORTS

Executive Summary

by Kilolo Kijakazi

The Heritage Foundation has released two reports on Social Security's rate of return for minorities. One report addresses African Americans; the second speaks to Hispanic Americans. Heritage argues that the African-American community will secure poor and even potentially negative rates of return from Social Security because African Americans have lower life expectancies. Heritage asserts that Social Security also is a bad deal for Hispanic Americans because they are a disproportionally young population and will bear a significant share of the cost of financing Social Security in the future. According to these reports, these communities would fare better under a retirement program of individual accounts invested in the private market.

The Heritage reports contain critical flaws, however, in their assumptions about both Social Security and individual accounts. The erroneous assumptions result in large errors in Heritage's analysis of rates of return for the population in general and for minorities in particular. As this paper explains, Heritage's rate-of-return calculations substantially understate the rate of return from Social Security and heavily overstate the rate of return from the individual accounts that Heritage favors. As a result, the Heritage calculations are inaccurate.

> *The Social Security actuaries concluded that Heritage "grossly underestimates the expected rates of return from Social Security benefits" for workers in general and African Americans in particular.*

A major part of this paper is drawn from an assessment of the Heritage paper on African Americans that the Social Security Administration's highly respected Office of the Chief Actuary conducted. The Office of the Chief Actuary identified major errors in Heritage's work, including the fact that Heritage exaggerated the taxes that African Americans pay into Social Security while substantially understating the Social Security benefits that African Americans receive. The actuaries concluded that Heritage "grossly underestimates the expected rates of return from Social Security benefits" for the overall population and especially for African Americans. The actuaries also examined Heritage's subsequent work on Hispanic Americans and found it seriously flawed as well.

Dr. Kilolo Kijakazi is a senior policy analyst in the Income Security Division at the Center on Budget and Policy Priorities, where she specializes in Social Security. Dr. Kijakazi previously worked as a policy analyst at the National Urban League and the Food and Nutrition Service of the U. S. Department of Agriculture. She is the author of *African-American Economic Development and Small Business Ownership*, a book published by Garland Publishing, Inc. in 1997.

Excerpts from the Analysis of Heritage's Work On African Americans by the Social Security Administration's Office of the Chief Actuary

"... the [Heritage] conclusions are highly misleading due to two major errors in methodology, plus a number of incorrect or inappropriate assumptions. Due to these errors, rates of return for the general population in this study are at substantial variance with those produced for the 1994-6 Advisory Council on Social Security."

"More importantly, the methods utilized by the authors bias expected rates of return downward to a far greater degree for African Americans than for the general population. This study thus erroneously indicates differences in rates of return by race that are greatly exaggerated. In fact, results from more careful research reflecting actual work histories for workers by race indicate that the non-white population actually enjoys the same or better expected rates of return from Social Security than for the white population."

Source: Steve Goss, Deputy Chief Actuary, Social Security Administration, "Problems with 'Social Security's Rate of Return,' A Report of the Heritage Center for Data Analysis," January 27, 1998, p. 1.

Assumptions that Understate Social Security's Rate of Return

- **The Social Security Administration's Office of the Chief Actuary found that Heritage both overstated the payroll taxes that workers pay for Social Security and understated the Social Security retirement benefits that workers receive, with these errors being particularly large for African Americans.** The Office of the Chief Actuary found that in estimating the number of years an individual would work and make payroll tax contributions, Heritage failed to take into account the fact that some workers die before retirement and consequently contribute payroll tax for a smaller number of years than those who work into their 60s. Since a larger portion of African-American workers than of white workers die before 65, failing to take this factor into account led Heritage to make particularly large errors in its rate-of-return calculations for African Americans. For example, the actuaries found that the number of years a 20-year-old African-American man is expected to make payroll tax payments into the Social Security system is six years fewer than the Heritage methodology would predict. This flaw in its methodology led Heritage to overstate significantly the Social Security taxes that African Americans pay.

The actuaries found that Heritage made still larger errors in computing the number of years for which African-American workers receive Social Security retirement benefits. The actuaries found that a 20-year old African- American man would be expected to receive such benefits for nearly *four times as many years* as would be assumed under the Heritage methodology. The actuaries' analysis shows that for 20-year-old African-American men, the number of years of drawing Social Security retirement benefits will equal 20.7 percent of their work years. The Heritage methodology erroneously assumes the number of benefit years would equal *just 4.9 percent* of these individuals' work years.

The actuaries also found the Heritage methodology resulted in a large

Social Security and Hispanic Americans

Social Security provides a particularly large portion of the income of older Hispanic Americans. While nine percent of all couples age 65 and older rely on Social Security for all of their income, 23 percent of Hispanic couples do. Similarly, while 24 percent all of aged single individuals receive *all* of their income from Social Security, 40 percent of aged Hispanic single individuals do.

Social Security also is of particular value to Hispanic Americans for another reason. Hispanic retirees live longer, on average, than other Americans — the average American who reaches 65 (including both men and women) will live an additional 17½ years, while the average Hispanic reaching 65 lives an additional 20.5 years. Those with a longer life span receive more monthly benefit checks from Social Security. Furthermore, Social Security's annual cost-of-living adjustment — a feature most private annuities do not have — is of greater value for those who live longer.

Hispanics thus benefit doubly from Social Security; they benefit both from Social Security's provision of benefits that keep pace with inflation and cannot run out no matter how long one lives, and also from Social Security's progressive benefit formula, which ensures that individuals who earned lower wages and/or had fewer years in the workforce receive larger monthly benefit amounts, in proportion to the wages they earned and the taxes they paid, than other workers do. Since Hispanic retirees on average have lower wages and fewer covered years of employment and also live longer than other workers, they receive benefit levels that return the taxes they paid in fewer years than average retirees do, while also receiving benefits for more years than the average retiree.

Hispanics consequently are one of the groups for which Social Security is most beneficial. A recent Social Security Administration fact sheet notes that Hispanic American beneficiaries "on average receive a higher rate of return on taxes paid."[2] A recent analysis by the Deputy Chief Actuary of the Social Security Administration explains that "a somewhat higher rate of return for Hispanic Americans is to be expected, based on the higher life expectancy for Hispanic Americans, and the fact that Hispanic Americans have lower than average earnings."[3] Indeed, tables in Heritage's own report show Social Security provides higher rates of return to Hispanics than to the general population, although Heritage fails to acknowledge this in the text of the report.[4]

In addition, a conclusion drawn by the General Accounting Office that "because Social Security provides a lifetime annuity that is indexed for inflation, it becomes an increasingly important source as retirees grow older and exhaust other income sources" is particularly true for Hispanics.[5] By contrast, under individual accounts, Hispanics could, because of their greater life expectancy, face a greater-than-average risk both of having their accounts run out before they die and of losing a substantial amount of the purchasing power of the funds in their accounts to inflation as the years pass.

understatement of Social Security's rate of return "for younger workers who are far from retirement age in 1997," a finding of particular significance for Hispanic Americans, who are a younger-than-average population.

- **Heritage inappropriately assumed that if Social Security is not privatized, it will be restored to long-term actuarial balance entirely by raising payroll taxes and that this tax increase will begin in 2015, a decade earlier than the Social Security actuaries project would be necessary.** No proponent of restoring long-term balance to Social Security without privatization has recommended correcting the imbalance purely through payroll tax increases. Virtually all

Nearly half of all African Americans who receive Social Security benefits of any kind — 47 percent — receive disability or survivors benefits. By contrast, 28 percent of white Social Security beneficiaries do.

reform plans that do not include privatization components would increase Social Security revenue through such measures as expanding Social Security coverage to the 30 percent of state and local government employees not currently covered and/or investing a portion of the Social Security reserves in the equities market. In calculating Social Security's rate of return, however, Heritage assumed that the only method used to close the imbalance would be payroll tax increases. Heritage selected what is probably the single approach to closing the Social Security imbalance that would affect rates of return for minorities (and especially Hispanic Americans) most adversely.

Moreover, even if calculations of rates-of-return for Social Security are based on the implausible assumption that the imbalance will be closed entirely through payroll tax increases, Heritage's approach is deficient; Heritage assumed that payroll taxes would be raised years before that would be necessary. The Social Security actuaries project it would not be necessary to raise taxes until 2025 to maintain a pay-as-you-go system without any changes in eligibility or benefits, and even then not by as much as Heritage assumed. In its assessment of this aspect of the Heritage paper, the Office of the Chief Actuary wrote: "In order to provide a pay-as-you-go financed Social Security program, tax rates would not need to be raised until around 2025, and by less than the [Heritage] authors assumed. The early, too-large increase in tax rates results in rates of return that are estimated to be too low for Social Security."

- **Heritage failed to calculate the rate of return for the full Social Security system. It ignored Social Security disability and survivors benefits in making its calculations.** African Americans benefit disproportionately from the Social Security disability insurance and survivors' insurance programs. A considerably larger proportion of African Americans than of whites receive these benefits. While African Americans make up 11 percent of the civilian labor force, they account for 18 percent of the workers receiving Social Security disability benefits. Social Security Administration analyses have found that African Americans receive substantially more benefits from Social Security Disability Insurance in relation to the taxes they have paid than whites do. Moreover, nearly half of all African Americans who receive Social Security benefits of any kind — 47 percent — receive either disability or survivors benefits. By contrast, 28 percent of white Social Security beneficiaries receive disability or survivors benefits.

In calculating Social Security's rate of return, Heritage eliminated these two components of the system Social Security, the components most favorable to the African-American community. That makes Social Security appear less valuable to African Americans than it is.

Assumptions that Overstate Returns from Individual Accounts

While understating rates of return for Social Security, Heritage overstates rates of return for individual accounts.

Excerpts from the Social Security Actuaries' Analysis of Heritage's Work on Hispanic Americans

"...In a subsequent statement by Heritage...it was suggested that Hispanic Americans could expect far lower rates of return from Social Security than would be possible from individual accounts. The statement compared the (erroneously) computed expected rates of return from Social Security to the expected return from an individual account invested either all in bonds or partly in stocks. But the comparison ignores both the cost of transition to an individual-account program, and the administrative expenses associated with individual accounts. Transition costs associated with the continuation of benefit payments for current OASDI beneficiaries and today's older workers would be substantial. Adding in these costs, which are excluded from the Heritage analysis, would greatly reduce the overall rate of return...under the Heritage proposal.

"Finally, the authors fail to note...that, by their own calculations, see page 7 of January 15 report, *Hispanic Americans would be expected to receive a substantially higher rate of return from Social Security than would the general population*, on average."

Source: "Comments on Heritage Rates of Return for Hispanic Americans," Memorandum from Stephen C. Goss, Deputy Chief Actuary, to Harry C. Ballantyne, Chief Actuary, April 2, 1998.

- **Heritage failed to factor in transition costs — the costs that workers would have to pay under a privatized system to continue financing the Social Security benefits of current retirees and near-retirees.** If retirement benefits are privatized, the payroll taxes that are currently used to finance Social Security retirement benefits will instead be deposited in individual accounts. That will create a financing gap — funds will be needed to fulfill the government's obligation to pay Social Security benefits to current retirees and those nearing retirement. As a result, workers would have to pay a new tax to continue financing the Social Security benefits of current and soon-to-be retirees.

  As senior researcher Paul Yakoboski of the Employee Benefit Research Institute recently testified, "Because the current Social Security system is largely pay-as-you-go, most of what workers pay into the system funds today's benefits....[O]n top of paying current benefits, workers moving to a privatized system would have to pay "twice" — for the benefits going to today's beneficiaries and again to their own [personal] accounts."[7] For this reason, the General Accounting Office has noted that if Social Security retirement benefits were privatized, "the [payroll] contributions needed to fund both current and future retirement liabilities would clearly be higher than those currently collected."[8] Heritage fails to factor these added tax payments into its calculations. That leads it to overstate the rate of return that individual accounts would provide.

  This error is of particular importance in analyzing rates of return for Hispanics. A study conducted by the Employee Benefit Research Institute, a highly regarded research institution, incorporated transition costs into its calculations. It found that for workers who are 21 today and receive low wages, the rate of return would be *lower* under the individual accounts options it examined than under all options it examined to restore long-term balance to Social Security without individual accounts. The EBRI data are a further indication that Heritage's claim that Hispanics would fare better under an individual accounts system because they are disproportionately young is inaccurate.

- **The Heritage estimates fail to take into account administrative costs, the fees that investment companies charge on individual accounts, and the costs of converting accounts to annuities, an omission that results in a substantial overstatement of the rates of return for individual accounts.** Heritage compared the rate of return for Social Security to the rate of return for private accounts like IRAs. Use of IRAs results in significant administrative costs and management fees, which are paid out of the proceeds in the IRA accounts and consequently reduce the amounts available in those accounts to pay retirement benefits. Moreover, additional costs are incurred when the funds in these accounts are converted to lifetime annuities upon retirement.

  Heritage ignores these costs. Its estimates of the rate of return that individual accounts would generate rest on the invalid assumption that no such costs would be incurred.

  Based on data on IRA and 401(k) accounts, two eminent Social Security experts — Henry Aaron of the Brookings Institution and Peter Diamond of M.I.T. — have estimated that the administrative costs for retirement accounts like IRAs or 401(k)s would consume 20 percent of the amounts that otherwise would be available in these accounts to pay retirement benefits.[9] They note that a one percent annual charge on funds in such accounts eats up, over a 40-year work career, 20 percent of the funds in the accounts.[10] The 1994-1996 Advisory Council on Social Security estimated an annual charge of one percent on the assets in privately managed individual accounts.

  Furthermore, recent financial data indicate that a one percent annual charge is a conservative estimate. In 1997, the average annual charge on stock mutual funds was 1.2 percent of the amounts invested in those funds. In addition, Diamond has noted that administrative and management costs consume approximately 20 percent of the amounts in individual accounts in Chile's privatized retirement system and more than 20 percent of the funds in privatized retirement accounts in Great Britain and Argentina.

  Some of these costs are fixed-dollar expenses that do not vary with the size of an account. As a result, such costs would generally consume a larger percentage of the amounts in smaller-than-average accounts (and a smaller percentage of the amounts in large accounts). This suggests these costs would, on average, consume more than 20 percent of the funds in the accounts of lower-wage workers. That is of particular significance to minorities since, as a group, they receive lower-than-average wages and would consequently have smaller-than-average accounts.

  To these costs must be added the costs of converting an individual account to an annuity upon retirement. The leading research on this matter indicates that an additional 15 percent to 20 percent of the value of an individual account is consumed by the costs that private firms charge for converting accounts to annuities.[11] The General Accounting Office recently noted that "While individual annuities are available, they can be costly especially relative to annuities provided through Social Security."

  (Heritage may envision that account-holders would not have to convert the funds in their accounts to annuities when they retire. Lack of annuitization, however, would create large risks that substantial numbers of retirees would eventually exhaust their accounts and be thrust into poverty in very old age. Lack of a lifetime annuity would be a particularly severe problem for elderly widows and for Hispanic Americans, since they have longer-than-average life expectancies.)

Taking all of these costs into account — both administrative and management fees and the costs of converting accounts to annuities — Aaron estimates that at least 30 percent and as much as 50 percent of the amounts amassed in individual accounts similar to IRAs or 401(k)s would be consumed by these costs rather than being available to provide retirement income. The Heritage reports essentially assume that none of the amounts in these accounts would go for such costs.

- Heritage ignores the variation in rates of return that would occur with individual accounts and the likelihood that low-income workers and minorities would receive below-average rates of return. Retirees who are particularly lucky or wise in their investments could receive retirement income from individual accounts that more than offsets their loss of Social Security benefits. But retirees who are less lucky or wise, including those who retire and convert their account to a lifetime annuity in a year the stock market is down, would likely face large reductions in the income they have to live on in their declining years.

A recent GAO report takes note of these issues. "There is a much greater risk for significant deterioration of an individual's 'nest egg' under a system of individual accounts," the GAO wrote. "Not only would individuals bear the risk that market returns would fall overall but also that their own investments would perform poorly even if the market, as a whole, did well.[12]

An additional 15 percent to 20 percent of the value of an individual account could be consumed by the costs that private firms charge for converting accounts to annuities.

This is a concern for workers in general — surveys have found Americans are not very knowledgeable about financial markets — and a particular concern for lower-wage workers, who generally would not be able to afford as good investment advice as individuals at higher income levels. Moreover, lower-income groups have less investment experience and would be more likely to invest in an overly conservative manner because they could not afford to expose the funds in their accounts to much risk. African Americans and Hispanic Americans make up disproportionate shares of the low-income population. As a result, they would be likely to receive a somewhat lower-than-average return on amounts invested even while, as explained above, they would likely pay an above-average percentage of their holdings in fees. Heritage overlooks these factors.

To persuade the public that Social Security should be replaced with individual accounts, Heritage has targeted the African-American and Hispanic-American communities and portrayed them as winners under such a conversion. Yet Heritage's rate-of-return calculations do not withstand scrutiny. These calculations significantly understate the rate of return to Social Security and significantly overstate the return to an individual accounts program.

African Americans and Hispanic Americans make up disproportionate shares of the low-income population. As a result, they would be likely to receive a somewhat lower-than-average return on amounts invested while paying an above-average percentage of their holdings in administrative and management fees.

When these problems are corrected, African-American and Hispanic-American communities no longer are the big winners Heritage portrays them as being under privatization of Social Security retirement benefits. They would be more likely to come out behind than ahead. The largest winners under Heritage's proposal for IRA-type individual accounts would more likely be financial investment companies, which could reap administrative and management fees running into the tens of billions of dollars on the accounts of nearly 150 million workers.

Notes:

2. Social Security Administration, "Social Security and Hispanic-Americans: Some Basic Facts, July 1998."

3. "Comments on Heritage Rates of Return for Hispanic Americans," Memorandum from Stephen C. Goss, Deputy Chief Actuary, to Harry C. Ballantyne, Chief Actuary, Social Security Administration, April 2, 1998.

4. William W. Beach and Gareth G. Davis, "Social Security's Rate of Return," Heritage Foundation, January 1998, Table 1, p. 7.

6. General Accounting Office, *Social Security: Different Approaches for Addressing Program Solvency,* July 1998, p. 78.

7. Statement of Paul Yakoboski before the Senate Finance Committee, July 22, 1998.

8. General Accounting Office, "Social Security: Restoring Long-Term Solvency Will Require Difficult Choices," Testimony of Jane L. Ross before the Senate Special Committee on Aging, February 10, 1998, p. 11.

9. Statement by Peter Diamond, AARP-Concord Coalition Debate on Social Security, Albuquerque, July 27, 1998; Peter Diamond, "The Future of Social Security for this Generation and the Next: Proposals Regarding Personal Accounts," Testimony before the Subcommittee on Social Security of the House Committee on Ways and Means, June 18, 1998; Testimony of Henry J. Aaron before the Senate Committee on the Budget, July 23, 1998.

10. As Diamond has explained, with a one-percent annual charge on holdings in accounts, a dollar deposited in an individual account in the first year of a 40-year work career will be subject to the one percent fee 40 times, while a dollar deposited in the final year before retirement will be subject to the fee once. On average, dollars in the account will be subject to the one percent annual charge 20 times, so approximately 20 percent of the amounts deposited or earned by the account will be consumed by these charges.

11. Olivia S. Mitchell, James M. Porterba, and Mark J. Warshawsky, *New Evidence on the Money's Worth of Individual Annuities*, Cambridge, MA: National Bureau of Economic Research, April 1997.

12. General Accounting Office, *Social Security: Different approaches for Addressing Program Solutions,* July 1998, p. 6.

CENTER ON BUDGET AND POLICY PRIORITIES

Statement of Robert Reischauer at the White House Forum on Social Security

Albuquerque, New Mexico
July 27 1998[1]

Many workers, particularly younger ones, are worried that they may not get a very good return on the payroll taxes that they and their employers are sending in to the Social Security system. They wonder whether some other type of pension system might give them a better payback than Social Security promises.

The answer to their question, of course, is "yes." A reformed and strengthened version of the current system can give workers better returns than those of the current system or those of any of the alternative structures that have been proposed.

To see why this is the case we need to look at the three reasons why returns on Social Security payroll taxes are relatively low for today's workers. One of these reasons, no rational person should want to change; another we can do nothing about; and the third we can and should act to correct. If we take this corrective step, Social Security will be able to pay higher average benefits than any of the various privatization plans could pay for similar levels of contributions.

The first reason why today's workers will get a rather low return on the Social Security taxes they pay is that a portion of their contributions — about $1 out of every $4 — goes not for retirement purposes but rather to provide disability and survivors insurance. Just like the fire insurance we all have on our homes and the collision insurance we purchase for our cars and trucks, none of us should want to have a high return on this portion of our contributions because that would mean that we had suffered either a disability that kept us from working or the death of a breadwinner.

The second reason why future retirees can expect low returns arises because most payroll tax dollars we send in for retirement purposes — some $13 out of every $15 — are used immediately to pay benefits to current retirees, our parents and grandparents. This practice dates back to 1939

we need to look at the three reasons why returns on Social Security payroll taxes are relatively low for today's workers. One of these reasons, no rational person should want to change; another we can do nothing about; and the third we can and should act to correct. If we take this corrective step, Social Security will be able to pay higher average benefits than any of the various privatization plans could pay for similar levels of contributions.

[1] Robert D. Reischauer is a senior fellow at the Brookings Institution. He is the former director of the Congressional Budget Office and is co-author of a forthcoming Century Fund-Brookings guide to the debate on Social Security reform. He also is a member of the Board of Directors of the Center on Budget and Policy Priorities.

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when Congress decided to pay relatively generous benefits to those who had contributed payroll taxes for only a portion of their working lives. Not until 1982 did workers who were 20 when the payroll tax was first imposed and, therefore, paid the tax during their entire careers, turn 65.

The decision to provide adequate retirement benefits to those who had not contributed to Social Security over their full careers was a fair and sensible one. Many of these workers had fought in World War I and had had their careers blighted by the Great Depression. Congress's decision greatly reduced the appalling incidence of poverty among the elderly. It allowed many to live independently and with dignity which benefitted all of society. But it also meant that workers' contributions were not building up as reserves that could support them when they retired. The result is the so-called unfunded liability — that is, the current promises Social Security has made to pay benefits in the future that are unmatched by reserves. Whether we retain the exiting system or privatize it, this unfunded liability will have to be met unless we renege on the benefits promised to today's elderly and near elderly. Dealing with the unfunded liability inescapably will reduce the returns workers can expect on their contributions.

The third reason for relatively low returns is the restriction that Social Security reserves be invested in safe, but low-yielding, government bonds. This restriction mattered little until recently because Social Security had only meager reserves to invest. After 1983, the system's reserves began to grow and by 1991 they exceeded the amount experts believe is necessary to maintain as a contingency fund to protect a pay-as-you-go system from the consequences of a deep recession.

Currently, the reserves total $725 billion — enough to finance two years of benefit payments — and by 2020 they will exceed $3.7 trillion dollars. If reforms are adopted, the reserves could easily swell to several times this level. So we are talking about a considerable amount of money — and what kind of returns these reserves earn can have a huge impact on the Social Security program.

Under current law, the reserves must be invested in government bonds that are expected to earn about 2.8 percent more than the rate of inflation. Investments in a prudently diversified portfolio of common stocks, corporate bonds, and government guaranteed securities could double that yield.

So why don't we invest these growing Social Security reserves in assets that would generate a better rate of return than government bonds pay? If we did that about half of the long-run financing problem facing Social Security would be resolved, thereby reducing the size of the benefit cuts or the payroll tax increases that would be needed to restore the system to full fiscal soundness.

To answer this question we should go back to 1935 and look at the two reasons why Congress decided to require Social Security to invest its reserves solely in government bonds. One was the economic conditions of the time. In the middle of the Great Depression, few people wanted to sock away their retirement nest eggs in the highly unstable stock and corporate bond markets.

The second and more important concern of Congress was that politicians — like themselves — might be tempted to use reserve investment policy to interfere with markets or meddle in activities of private businesses.

The concerns that Congress had in 1935 were certainly legitimate ones. But conditions have changed. Stock and bond markets are far larger, less volatile, and more efficient now than they were in the 1930s. The concept of investing passively in a broad index of bonds or stocks, which was unheard of then, is widely recommended for long-term investing today.

Furthermore, we can establish new institutions that can shield Social Security reserve investment decisions from political interference. This responsibility should be put in the hands of an independent entity patterned after the Federal Reserve Board. Its members would be chosen for their integrity and expertise for staggered terms of 10 or more years. The Board would be charged with selecting private sector fund managers through an open and competitive process. These fund managers would be required to invest the Social Security funds entrusted to them passively in stocks and bonds that reflected the broadest market indexes. As is the case now with the shares of stock owned by mutual funds, the managers would be required to vote Social Security's shares solely to protect the economic interests of their owners — that is, future retirees.

Switching from holding solely government bonds to holding government bonds, stocks, and corporate bonds is one, but not the only, step necessary to reform and strengthen Social Security. It is not a panacea or a silver bullet. Neither this step nor investing through private individual accounts would increase national saving as we must do; only benefit reductions or tax increases can do that. Furthermore, investing the reserves in stocks and bonds could push federal government borrowing rates a bit because private investors would have to be induced to buy the government bonds that Social Security would no longer hold.

Nevertheless, investing a portion of the growing Social Security reserves in private sector securities would give participants in the program a more equitable share of the benefit that increased Social Security reserves provide for the overall economy. Such a change would improve the return today's workers will get on their Social Security contributions without exposing them to the market risks and high administrative costs that would come if such investments were made through individual retirement accounts.

CENTER ON BUDGET AND POLICY PRIORITIES

To: Melanne Verveer

From: Bob and Ellen

Subject: Social Security reform and the impact on women

Date: October 2, 1998

Ellen was recently asked by someone at the White House if we had reviewed some of the materials available on the impact of Social Security reform proposals on women, and if we could pull together a few of the most useful pieces. We thought these materials might be helpful to you as well. Perhaps after the election we might have a chance to chat with you about Social Security and related issues for next year.

We've included the following:

- An excellent three-page piece on how Social Security privatization would affect women by Alicia Munnell, a leading Social Security expert.

- A fact sheet on Social Security and women prepared by the Democratic staff of the House Ways and Means Committee. (Both the Democratic staff director of the full Ways and Means Committee and the Democratic staff director of the Social Security Subcommittee of Ways and Means are women.) The fact sheet is based in part on a fact sheet from the Institute form Women's Policy Research.

- A column on Social Security and women by syndicated columnist Jane Bryant Quinn, and two articles by Social Security expert Edith Fierst, who was a member of the 1994-96 Social Security Advisory Council and is a leading expert on Social Security and women.

- Finally, in the event that you would like more comprehensive background, we are enclosing a 17-page issue brief entitled "Social Security Reform: How Might Women Fare?," prepared by the Public Policy Institute at AARP. This is the single best comprehensive background piece now available on these issues and is largely written as a straight policy analysis, not as an advocacy document.

While these pieces cover a number of issues, one feature of these pieces stands out — *consistent warnings that privatization plans that would shift a portion of payroll tax* *revenues from the Social Security trust funds to individual accounts would hold particular dangers for women, especially divorced women and widows.* The Social Security benefit structure contains a number of unique features highly beneficial to women that individual accounts are unlikely to contain. For example:

- Social Security redistributes benefits toward workers who had below-average earnings over their lives. This is beneficial to women both because they have lower average wages than men and because they spend more years out of the full-time labor force. Private accounts contain no such redistribution.

- Social Security provides benefits that last as long as you live and that are fully adjusted for inflation. This is of greatest value to those with the longest life expectancies. Since women have longer life expectancies than men, these features of Social Security are particularly valuable to them.

  By contrast, funds in individual accounts can run out before an aged person dies if the person lives to a very old age, unless the funds in the account have been used to purchase a private annuity. But private annuities are expensive. Moreover, for a private account of a given size, firms provide *lower* monthly annuity payments to women than to men because women are likely to live longer. This is not true of Social Security.

  In addition, when private firms sell joint annuities to a husband and wife, these annuities provide a *lower* monthly payment than a single annuity does, because joint annuities must pay benefits for a longer number of years (i.e., until both spouses die).

  Finally, most private annuities do not adjust monthly benefits for inflation, so the purchasing power of the monthly payments declines with each passing year. All of these problems primarily affect women.

- Women both earn less than men and tend to invest more conservatively. As a result, they would end up, on average, with significantly smaller private accounts.

- Proposals to shift a portion of the payroll tax to private accounts necessarily entail deeper cuts in Social Security benefits; under such proposals, Social Security benefits must be reduced enough to eliminate the current Social Security shortfall and then reduced further to make up for the loss of the payroll tax revenues being shifted from Social Security to private accounts. For example, proposals to shift two percentage points of the payroll tax to private accounts *double* the financial shortfall in Social Security and greatly enlarge the benefit reductions needed to close the shortfall. Most current proposals of this nature include substantial reductions in spouse benefits, survivors' benefits (which mainly go to widows), and disability benefits as part of their effort to reduce Social Security benefits enough to put Social Security in balance while shifting funds to private accounts at the same time.

- By their nature, private accounts cannot provide the protection to spouses, divorcees, and widows that Social Security does. The funds that a private account can provide to a retiree, his current spouse, and possibly to a former spouse are strictly limited to the money in that account. If money from the account goes to an ex-spouse, less is left for the retiree and his current spouse. It is a zero-sum game.

  This is not true of Social Security. Based on a single retiree's earnings record, Social Security benefits can be paid to the retiree, his current spouse, and all divorced spouses who were married to him at least 10 years and are not currently married. The level of benefits paid to the retiree, his current spouse, and one or more divorced spouses are set by law — these benefit levels do *not* affect each other. Payment of a benefit to one beneficiary does not lower the payments to other beneficiaries.

  It is very likely that replacing a portion of Social Security benefits with private accounts will result in significant reductions in income for elderly women who are divorced. Such women would probably be able to gain access to funds in their ex-spouse's individual account only by going to divorce court. Moreover, the court would be limited in what it could provide a divorced woman from her ex-husband's account by the need to leave adequate funds in the account for the husband and his current spouse.

Washington Post
Washington, DC
Februray 8, 1998

JANE BRYANT QUINN

Women, Be Wary of Social Security Change

In his State of the Union address, President Clinton said he would use any budget surplus first to save the Social Security system.

But women, in particular, need to take a hard look at any "reforms" Congress proposes.

On average, women gain relatively more than men from Social Security today. That's because it favors lower earners and dependents, most of whom are women and children. Some of the reforms would erase this advantage.

Workers like to calculate how much more their money might earn if invested in stocks rather than paid in Social Security taxes. But they often forget that their taxes buy other benefits, too.

For example, when workers die, their spouses and young children are eligible for monthly benefits—so Social Security provides life insurance.

Retirees who had low or spotty earnings during their working years (usually women), and don't get much personally out of Social Security, can collect a higher benefit through their spouse's account. So there's retirement-income insurance, too.

The program includes divorce insurance. The divorced can collect on an ex-spouse's account if the marriage lasted at least 10 years. So a divorced, single woman isn't abandoned financially in old age.

These payments to a former spouse don't take one penny away from the worker or current spouse. Everyone has a safety net.

It even includes inflation insurance. Your check rises annually with the inflation rate.

These would be costly insurance plans if workers had to buy them from private insurers. Without them, dependents and ex-dependents would be at risk.

Many of the reform proposals would cast off or slash the social insurance plans and use part or all of the Social Security tax for some form of mandatory 401(k).

Money would be diverted from your paycheck into a personal account. You could decide where to invest it. Your standard of living in retirement would depend on how large this nest egg grew.

How would life differ for women under these privatization proposals? Each plan is a little different. But the government's General Accounting Office has provided some broad answers in a study requested by Rep. Barbara B. Kennelly (D-Conn.). Said the GAO:

- Benefit payments: Women on average earn less than men, so less money would go into their investment accounts. Social Security helps low earners by raising their benefits a bit. That wouldn't happen in private accounts. Those accounts might yield more for your money than Social Security does, but the gap between men's and women's retirement income would grow.
- Investment returns: Women tend to be more conservative investors than men. If stocks did poorly for a long period of time, their conservatism would pay. But if stocks did well, their cautious investing would leave them even further behind men's retirement incomes.
- Longevity: Women with the same earnings and investments as men could wind up with lower monthly incomes because they tend to live longer. They would have to draw less from their accounts to be sure the money lasted a lifetime.

In the Social Security program, people who had equal incomes get equal monthly benefits for life.

You also could get equal payments from a private plan. The government might decree that, if you bought a lifetime annuity, you would be charged a unisex rate obtained by averaging male and female life spans.

But men wouldn't like that. Their incomes would be lower than if they paid the "male" rate.

- Divorce: None of the plans provide monthly payments to an ex-spouse. My crystal ball sees more impoverished divorcees.

Some reformers would split the investment account at divorce. That helps the unemployed spouse at the worker's expense but has no guarantee that spouse will get the same income that Social Security now pays.

- Spouse protection: When a worker dies today, a spouse can get 100 percent of the worker's monthly Social Security benefit for life.

With private savings, the retired worker can take money as needed, in a lump sum or as a lifetime annuity. So spouses get no income guarantees.

A private investment account might give a spouse more than Social Security pays. It also might give less. That depends on life's tragedies, how the money is invested and how the stock market behaves.

We all need private savings. But dependents, in particular, also need a Social Security guarantee.

ALICE COULD STILL LIVE HERE — WITH SOCIAL SECURITY

By Edith U. Fierst

Recently I watched an old movie, "Alice Doesn't Live Here Any More," a very popular film when it came out in 1974. Readers may remember it as the story of a 35-year old woman whose husband was killed in an accident, leaving her without income. She sold her home and its contents and with her son, Tommy (then perhaps 11 years old), began to travel drearily around the country seeking work. What she found were low-paying and, in some cases, seedy jobs. Eventually she was saved by a new man, played by Kris Kristofferson.

When the movie first came out, it was seen as raising important feminist issues. Was it true that a young woman, unexpectedly widowed, couldn't make it without a man to support her, as the movie suggested? What should women do to avoid a catastrophe like hers?

What I don't remember is any discussion about the Social Security that would have supported Alice if only she had applied. Why didn't she? Obviously it would have spoiled the plot, but its benefits would have made life much better for her and her son, at least until Kris Kristofferson came along. Tommy would have been eligible for monthly payments until he reached 18, or if he was still in school, until he was 20. If he was disabled, he would have been entitled to benefits for life. In addition, Alice would have been eligible to receive benefits for herself as a widowed parent until Tommy reached age 16 or, if he was disabled, until he recovered from his disability.

If Alice's husband had been an average earner, Alice and Tommy were respectively 35 and 11, and this was taking place in 1998, their combined monthly Social Security benefits would be $1,454. (If Alice earned more than $9,120 this year, her benefit would be reduced by half of her earnings above that amount. If she earned more than about $15,000, her benefit would be eliminated, but her son would still get $727 a month.)

When Tommy reached his 16th birthday in 2003, Alice would have to become self-supporting until she reached age 60. But she would then be eligible for a widow's benefit of $1,908 a month.

If Alice were disabled herself, she would be eligible for widow's benefits at age 50 rather than 60. Moreover, Alice could increase her benefits in old age by waiting until normal retirement age — now 65 — before starting to collect her widow's benefit (or by earning enough to qualify for a benefit larger than her widow's benefit).

These Social Security benefits would have enabled Alice to stay in her home rather than sell it and to keep Tommy in his familiar school and neighborhood instead of, as in the movie, leaving him alone in lonely motel rooms while she hunted for jobs and worked. When she was ready to enter the workforce, Social Security would have supported her and Tommy while she trained or looked for work.

Some people argue today that women like Alice would be better off if instead of Social Security, her husband had established a privatized account. A look at the figures shows how unlikely it is that a privatized system would be better for her. Social Security's actuaries estimate that to obtain equivalent income to what Social Security would provide for her and Tommy, she would need to receive a lump sum of about $150,000. If her husband had been three years older than she and had gone to college before entering the workforce, he would have worked for 17 years before his death. If he had average earnings and saved five percent of them in a privatized account, it is highly unlikely his individual account would have accumulated anything close to $150,000. In addition, after his death, the much touted magic of compound interest wouldn't help much because interest is payable only on money that is not spent, and Alice and her son would have begun using the money for their support during the period right after she became a widow.

Recently on a CBS news program, a woman in Galveston, Texas, in a public employment job not covered by Social Security, described the nest egg she had been able to acquire in a privatized account established as an alternative to Social Security. She thought she was better off than under Social Security. But her next egg totaled $85,000, only a little more than *half* the present value of the benefits to which Alice would be entitled. If she became a widow with children — clearly a possibility at the age she appeared to be — or if she became disabled, her nest egg could not offer her anything close to what Social Security would have provided.

To be sure, there are circumstances in which privatization might be better for some individuals, such as those who never marry, have children, or become disabled. They could acquire a significant savings account, provided their investments are well-chosen, and the market does not go down when they are ready to retire. But who can be sure ahead of time he or she will have such a life? Who would risk their security on the guess that they will? Perhaps the same kind of person who does not buy fire insurance because it seems unlikely the house will burn down.

As Americans looking to the future, do we want to abandon or curtail Social Security for privatized accounts in the hope some of us will strike it rich? I'd like to see everyone become rich. But I'm not prepared to sacrifice the guaranteed protection for widows, surviving children, disabled people and people who live until a very old age, among others — as well as people who don't know how to invest wisely — so some of us can grow wealthier. Why not let those who can afford it save more on their own, but keep the vital safety net Social Security provides? None of us knows for sure when we will need it badly.

Edith U. Fierst was a member of the 1994-1996 Advisory Council on Social Security.

WOMEN AND A PRIVATIZED RETIREMENT

By Edith U. Fierst

When I was in my teens, a scandal in our small suburban town shocked the community. A husband of 20 years, father of four children, one of whom was my friend, a man deemed a pillar of society, walked out on his wife to marry another woman. Today a departure like his has become more commonplace, but when I was in high school, it didn't happen. Everyone, including the teenagers talked about it. But one subject we never considered was what the wife would live on as she approached old age in the years to come. She was short and fat, well into her fifties, unlikely to marry again, and a consummate housewife, unequipped to earn a living. Would the husband pay her adequate alimony? Suppose he died and the alimony expired, what would she then do?

Today many people, especially young women planning their lives, ask that question. One important answer is Social Security. Sometimes it is the only answer. Under current law, Social Security pays:

- *A spouse benefit* to a married woman or one divorced after 10 or more years of marriage. This benefit equals the difference between the Social Security benefit she earned herself and an amount equal to *half* of her husband's benefit if it is larger. The spouse benefit is payable while the husband lives.
- *A survivor benefit* to a widow or widower, including one who was divorced after 10 years of marriage. This benefit is the difference between the benefit she earned herself and the *full* amount of the worker's benefit, if it is larger.

Both spouse and survivor benefits are paid from the Social Security trust fund to those eligible. These benefits are guaranteed by law. Such benefits now provide a basic minimum income for millions of elderly women, enabling them to live with self-respect independent of their children. These benefits also provide invaluable peace of mind to younger women who know they can count on these benefits. To the extent Social Security were to be privatized, the financial independence and peace of mind that spouse and survivor benefits now provide to these women could greatly diminish.

Under privatization, payroll taxes would be directed into private individual accounts instead of into the trust fund. Control of the private accounts would vest in the worker who paid the tax. Any payment to the wife would come from payments that would otherwise go the worker, giving him an incentive to resist or limit sharing with her.

This would change the psychology of the financial relationship of the couple. Today no one objects to Social Security payments to a spouse, even if estranged or divorced, since the benefits are paid by the trust fund and *there is no reduction of benefits* *to the retiree himself.* Any woman who has been married 10 years or more is entitled to a spouse or survivor benefit based on marriage. Indeed, the earnings record of a much-married man could be the basis for benefits to several former spouses to whom he was married for 10 or more years, as well as to a current wife to whom he need not have been married that long. (Note: A woman may not collect benefits based on more than one marriage. Her spouse and survivor benefits are based on the earnings of the husband with the highest earnings, except that spouse benefits must be based on the earnings of her current husband if she married him before reaching age 60.)

To the extent benefits were privatized, payments to a spouse could depend on the willingness of the worker to share the funds in his personal account, as well as on the success of his investments. Since any benefits a current or former spouse received would come from his account, a retired worker would have an incentive to resist or limit such sharing. To be sure, under some partial privatization proposals, account owners would be required to purchase survivor annuities for their spouses unless the spouses waive their right to such benefits. Except for such limited requirements, however, privatized benefits would generally be under the unrestricted control of the retired worker, who would have complete freedom over how to spend them.

Payments to a spouse from the privatized portion of Social Security would compete with other uses the owner of the account might find necessary or appropriate. For example, the owner of a privatized account with good intentions might be forced to spend his savings on nursing home care for himself or his spouse. Similarly, the account-holder might buy a small business which later failed, leaving both husband and wife without adequate retirement funds. Or, as in the case of the family I knew in high school, the man might leave for another woman after many years in which his wife thought their marriage was happy, taking his money with him.

What could she do to assure he would help support her in old age, especially if she outlives him? One possibility is to seek assistance from the divorce courts, on the likely assumption that they would divide privatized funds as they now do other marital assets. To assure success, she might conclude she had to act before her husband retired. While divorce courts can award alimony whether the worker is working or retired, there may not be enough funds left after he retires and begins to spend some of the savings in his privatized account for him to be able purchase an adequate survivor annuity for his spouse. For this reason, privatization could even provide an incentive for some women to consider seeking a divorce. I can imagine a woman faced with a terrible dilemma — whether to risk eventual poverty or to act early to gain access to her husband's account before it is spent. Afterwards, it might be too late; there might be too little left for the court to divide.

Even divorce courts would not give women a benefit based on the lifetime earnings of their husbands. Divorce courts generally have jurisdiction to give the wife a share only of what was earned *during* marriage. By contrast, under current law, a wife's Social Security benefits are based on her husband's lifetime earnings, including those earned *before or after* their marriage.

Proponents of privatization sometimes argue that with women working more outside the home, the need for spouse and survivor benefits is diminishing and may soon vanish. The facts are otherwise. The Social Security actuaries estimate that among married women retiring in 2015, approximately 40 percent will continue to qualify for at least a partial spouse benefit.

Moreover, since few women earn as much or more over a lifetime as their husbands do, more than 80 percent of widows will continue to qualify for survivor benefits. As noted above, the benefits equal the husband's entire Social Security benefit. These widows will have earned less at their jobs, perhaps because their attention was divided during the years they were raising children, or because they chose to stay home for extended periods to bring up children, care for elderly parents, or serve in their community. All of these are life-style choices that would be at some risk under privatization.

Another major issue is how to be sure benefits will last a lifetime. The only way is for monthly benefits to be paid for life, as Social Security benefits are. By contrast, most privatization plans allow the retiree access to much or all of his savings at retirement. This means that many people may encounter difficulty spreading their retirement incomes over their and their spouse's lifetimes, whatever their intentions. At age 65, men have an average life expectancy of 15.3 years (to over age 80) and women an average of 19.1 years (to over age 84).

Those who want to protect themselves and their spouses against outliving their benefits could purchase private annuities, but private annuities are expensive. Experience has shown that those who buy them tend to live longer than the average for the population as a whole. Insurance companies and other private purveyors of lifetime annuities charge high prices to compensate for the likelihood of longer lives by their customers and to enable them to earn a profit.

Moreover, unless federal regulations preclude differential charges for annuities by sex, companies will charge women more for annuities or give them lower monthly annuity benefits, since on average women live to older ages than men.

Without annuities, what will keep elderly widows from destitution? Perhaps SSI, welfare for the elderly, which currently supplements the income of the elderly poor. But SSI raises the income of elderly individuals only to $494 a month for those with assets of less than $2,000 (excluding certain items such as a home, a car and prepaid funeral expenses). This is well below the poverty line.

Social Security not only pays a benefit every month for life but also provides an annual cost-of-living supplement to keep up with inflation. Because of the COLA,

A Way to Improve Life for Elderly Widows

One change that has been proposed could make life more secure for elderly widows, who are the poorest component of the elderly population. More than 20 percent of them, including divorced widows, are below the poverty line. This proposal also would give women who have earned their own benefits a greater return for their taxes.

Under the proposal, survivor benefits would be increased from half to three-quarters of the husband and wife's combined benefits. For example, if husband and wife each had earned a benefit of $1,000 a month, under current law the survivor benefit would be $1,000 a month; under this proposal, it would rise to $1,500. If only one partner had worked, the benefit would remain at $1,000.

The beneficiaries of this change would be couples in which both had worked, especially if their earnings had been nearly the same. Researchers at the Social Security Administration estimate that the incomes of about one of every six poor widows who came on the rolls in 1990 would be raised above the poverty level by such a change.

The cost of this modification could be paid for mostly by reducing the spouse benefit from one-half to one-third of the husband's benefit. Of the 40 percent of married women who are expected to qualify for spouse benefits in 2015, many earn more than a third of their husbands' benefits and would keep their worker benefits. Those who did not would still get at least one-third of their husband's benefits. Over time, as women earn higher benefits themselves, such a reduction would affect fewer of them.

Further, most couples in which the wife has earned benefits less than one-third of her husband's are relatively affluent. This is what enabled them to work so little outside the home. The poverty rate among married couples, whether they are of working or retirement age, is less than six percent, while that for widows is more than three times as high.

Social Security never loses its purchasing power. Nothing similar is available in the private market.

The present discussion of privatization has arisen because Social Security is expected to have a shortfall in the 75 years ahead. This shortfall can be solved with modifications in Social Security, such as raising the retirement age modestly, bringing state and local employees under mandatory coverage, and taxing benefits in the same manner as other pension payments are taxed. Such changes are what we should be debating, not proposals that would significantly reduce the security of elderly women.

ISSUE BRIEF

SOCIAL SECURITY REFORM: HOW MIGHT WOMEN FARE?

Highlights

Trends in female labor force participation rates, female earnings as a percent of male earnings, and women's pension coverage all point to improvements in the economic status of women that have taken place in recent decades. In the years ahead, more women will be receiving Social Security and pension benefits based on their own work histories and, in the aggregate, are likely to have higher real incomes in retirement than women who are retired today.

Despite these positive trends, many millions of women will receive low or no private pension benefits and will remain heavily dependent upon Social Security for retirement-income support. Thus, how Social Security treats women, and how women might fare under various proposals to restore long-term solvency to the Social Security system are matters of critical concern to women.

This issue brief examines the potential impact on women of a number of proposed Social Security reforms. Some of the changes would maintain the system's social insurance principles, while others call for a privatized system that would allow workers to invest all or part of their Social Security contributions in the private market.

Privatization, even partial privatization, poses big risks, especially for persons with limited resources. How the market has performed historically, for example, cannot be counted on to apply to specific groups of workers or to the time that a particular cohort retires. The market does not just go up, and declines can be swift, deep, and prolonged. Low-income women would have less to invest and would be less able than higher-income women to weather market downturns.

Women appear to be more conservative investors than men. Under a privatized system, two investors with identical earnings but different investment philosophies could end up with very different retirement benefits. Women, in such instances, could expect the lower accumulations.

Because Social Security is gender neutral, men and women with identical work histories and earnings can expect identical benefits. In the private market, however, sellers of annuities can take into consideration women's longer life expectancy. Thus, the same accumulation may purchase lower monthly benefits for women than for men.

Social Security provides benefits to the spouses and survivors of workers eligible for Social Security. Not all privatization proposals would require account owners to annuitize their accumulations. This could leave married women and survivors with no assurance of any income from their husbands' retirement investments.

Divorced women are entitled to Social Security benefits based on the earnings of their former husbands, if they had been married for at least ten years. Under some proposed changes to Social Security, such women would apparently have to depend on the vagaries of the divorce court for any share of the accumulations in their husbands' privatized accounts.

Other more modest changes to Social Security have also been proposed, and some of them could adversely affect women. For example, because women's average work histories remain much shorter than men's, they would find it hard to meet an increase in the number of years included in the benefit computation formula or a higher normal retirement age.

Introduction

Women's rising labor force participation rates, increasing earnings, and expanded pension coverage (Tables 1 to 4) point to a brighter old age for millions of women, who at one time could count on little in the way of retirement income beyond a Social Security benefit based on the earnings of their husbands. Growing numbers of women in the future will receive Social Security and private pension benefits as a result of their own work histories, and many will be able to supplement those benefits with income from savings and investments.

Table 1
Labor Force Participation Rates of Women, Selected Ages: 1950-1996 (in percent)

Year	16+	24-34	35-44	45-54	55-64
1950	33.9	34.0	39.1	37.9	27.0
1955	35.7	34.9	41.6	43.8	32.5
1960	37.7	36.0	43.4	49.9	37.2
1965	39.3	38.5	46.1	50.9	41.1
1970	43.3	45.0	51.1	54.4	43.0
1975	46.3	54.9	55.8	54.6	40.9
1980	51.5	65.5	65.5	59.9	41.3
1985	54.5	70.9	71.8	64.4	42.0
1990	57.5	73.6	76.5	71.2	45.3
1995	58.9	74.9	77.2	74.4	49.2
1996	59.3	75.2	77.5	75.4	49.6

Source: U.S. Department of Labor 1985, 1986, 1991, 1996, and 1997.

Despite these developments, the retirement income security of millions of women in the near- and longer-term future is by no means guaranteed.[1] Women with lengthy work careers and jobs with high wages and pension coverage may look forward to a financially secure old age, but even they could find themselves at risk of outliving their assets and watching the value of their private pensions dwindle from even moderate inflation or a stay in a nursing home. Moreover, although women's employment prospects have brightened considerably over the past several decades, their labor force attachment and work experiences have yet to measure up to men's, and it is on work patterns more typical of men that much of the country's retirement-income system is based.

Women are still more likely than men to be out of the labor force at any age, to experience discontinuous work histories, and to be employed part time--all of which have implications for their ability to accrue pension credits and save for retirement.

Table 2
Median Earnings of Full-time Working Women: 1970-1996* (in 1996 dollars)

Year	Number with Earnings (in 000s)	Annual Earnings
1970	25,926	$15,576
1980	34,727	$17,570
1990	42,940	$20,284
1996	46,944	$21,185

*Civilian workers only prior to 1989.
Source: U.S. Census Bureau 1998.

Government efforts to encourage people to assume more responsibility for their own well-being in old age notwithstanding, Social Security will continue to provide much of the

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[1] The same can be said of men, of course. However, as discussed in this paper, older women are, and most likely will remain, more vulnerable financially than men. For this reason, and because the number of vulnerable older women far exceeds the number of vulnerable men, this paper focuses on women.

retirement income on which millions of women depend. Hence, how Social Security treats women, and how women might fare under various proposals designed to restore long-term solvency to the Social Security system, are matters of critical concern to women. This issue brief examines the importance of Social Security to women now and into the 21st century, especially with respect to their continued economic vulnerability. It also addresses issues of benefit adequacy and equity for women and assesses how some of the more prominent proposed changes to the Social Security system might affect them.

Table 3
Female Earnings as Percent of Male Earnings: 1970-1996 (median earnings of full-time workers)

Year	Annual	Weekly
1970	59.4	62.3
1980	60.2	64.4
1990	71.6	71.8
1995	71.4	75.4
1996	73.8	75.0

*Year-round workers.
Source: Institute for Women's Policy Research (IWPR) 1997; U.S. Department of Commerce 1998; U.S. Department of Labor 1988.

Income Security in Old Age

Not only do over 90 percent of women aged 65 or older collect Social Security benefits, but Social Security accounts for over half the income of nonmarried women in this age group and 38 percent of the income of married couples. In fact, Social Security actually contributed more to household income for couples and nonmarried women in 1994 than it did in 1976 (Grad and Foster 1979: Table 28; Grad 1996: Tables I.8 and VII.2). Social Security plays almost as important a role in the financial well-being of nonmarried older men. (See Figure 1.)

Social Security was designed to help protect people against income loss resulting from events--retirement and disability, in particular--over which they have little or no control. While never intended to serve as the sole source of retirement income, it is just that for approximately 2.7 million nonmarried elderly women and nearly three-fourths of a million aged married couples (Grad 1996: Table VI.B.2).

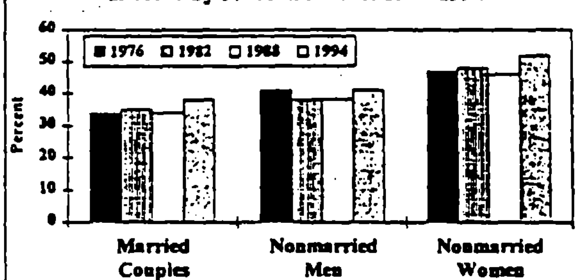
Table 4
Women's Pension Coverage Rates, Full-time Private Wage and Salary Workers: 1972-1993 (in percent)

Year	Coverage
1972	38
1979	40
1983	42
1988	44
1993	48

Source: U.S. Department of Labor et al. 1994 Table B16.

Fewer than one in five (18 percent) elderly women were receiving income from private pensions or annuities in 1994. A much higher proportion (two-thirds) reported owning assets, but median asset income in 1994 was barely over $1,300 for all aged recipients; among nonmarried women, the median was less than $900 (ibid.: Table V.D.1).

Figure 1
Social Security As a Share of Aggregate Income by Marital Status: 1976-1994



Source: Grad and Foster 1979; Grad 1984, 1990, and 1996.

Subject to numerous uncertainties under the best of circumstances, Social Security projections are especially problematic in light of recently proposed reform measures. As noted above, in the future, women will have greater access to sources of retirement income in addition to Social Security, as their behavior continues to undergo changes. For example, as Ross (1997) notes, women nearing retirement age--55 to 64 years old--had a labor force participation rate of 41 percent 30 years ago, when they were 25 to 34. Women who are between the ages of 25 and 34 today, in contrast, have a participation rate of 75 percent. For this as well as other reasons, seven in ten baby boomer females in 2030 are expected to have pensions and assets in addition to Social Security, according to simulations by Lewin-VHI (AARP 1994: Table 10). Only about one in 25 female boomers is likely to have income from only one of these sources.[2]

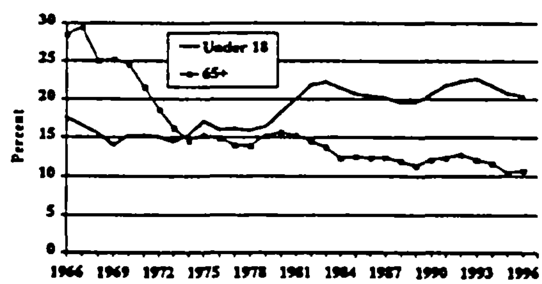
Despite these developments, reliance on Social Security may not lessen as dramatically as women's changing roles might suggest, at least not for several decades. Pension coverage rates have stagnated since the 1970s, and although more future retirees will receive pensions, the amounts could be small. This is because the average benefits to shorter tenured workers "who would not have received pensions previously" may be low (U.S. General Accounting Office 1997: 7).

In addition, efforts to foster personal savings "appear to have had only marginal success" (U.S. General Accounting Office 1997: 7). The temptation to utilize lump-sum pension distributions upon job change may be overwhelming for many workers (see, e.g., Korczyk 1996a and 1996b), leaving future retirees with less retirement income than pension coverage rates might imply. When offered the chance, workers are apparently far more likely to opt for lump-sum payouts, even at retirement (Salisbury 1997), when a lifetime annuity might be more appropriate. At least one set of simulations warns that Social Security's contribution to aggregate income could change only modestly, especially for nonmarried women through 2030 (Zedlewski, et al. 1989), a conclusion echoed by Lewin-VHI for widowed females (AARP 1994).[3]

Vulnerability in Old Age

Social Security has been a major contributor to the marked decline in poverty among elderly persons in recent decades. In 1966, nearly 29 percent of persons aged 65 and older had incomes below the official poverty level, but by 1996, that figure had fallen to just 10.8 percent, partly the result of substantial Social Security benefit increases in the 1970s and automatic cost-of-living increases as of 1975. The overall poverty rate for the older population is now below that for the population under the age of 18 (Lamison-White 1997; see Figure 2).

Figure 2
Poverty Rates of Persons Under Age 18 and 65+: 1966-1996



Source: Lamison-White 1997.

The loss of Social Security benefits would not put every older person in the poorhouse, but millions would find themselves strapped

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[2] In 1994, only 5 percent of aged married couples and 1 percent of nonmarried women received three or more retirement benefits (Grad 1996: Table I.6).

[3] Zedlewski et al., for example, estimate that Social Security will account for 68 percent of the aggregate income of nonmarried women in 2030, while Lewin-VHI projects that it will account for almost 49 percent of the income of widows.

or financially at risk without them. Unpublished calculations by AARP's Public Policy Institute indicate that the 1995 poverty rate for persons 65 and older would have risen from 10.5 percent to 47.8 percent if their Social Security benefits had been eliminated. Without Social Security, the poverty rate of older women--who predominate among the aged poor--would have been 52.9 percent in 1995, rather than 13.6 percent.

Aggregate poverty rates obscure significant differences by subgroups that make it clear that, as Choudhury and Leonesio (1997: 1) put it, "the gains that have accrued to the aged in aggregate have not been equally shared by men and women." So, for example, older women have a higher poverty rate than older men; nonmarried women are far worse off than married women; minority women have much higher rates of poverty than white women (see Table 5); very old women (85-plus) are at greater risk of being poor than women in their 60s.

Women's Eligibility for Social Security[4]

Women can receive Social Security benefits in old age in one of essentially three ways[5]--based on their own work histories and earnings records, based on the work histories and earnings records of their husbands, or based on a combination of the two. Women with the requisite Social Security coverage (a minimum of 40 quarters for workers reaching retirement age today) are entitled to a full retired worker benefit at the age of 65. Actuarially reduced benefits are available to qualified workers as early as age 62.

If, upon reaching retirement age, a woman is married or had been married for at least ten years before becoming divorced, she may be entitled to spousal benefits that at their maximum are equal to half of her husband's or ex-husband's retired worker benefit.[6]

Women receiving spousal benefits may have worked during their marriages, but not enough to qualify for benefits of their own that exceed their spousal benefits. Women lacking 40 quarters of coverage are entitled only to spousal benefits.[7]

Table 5
Poverty Rates of Selected Groups: 1996
(in percent)

Persons 65 and older	10.8
Persons under age 18	20.5
Women 65 and older	13.6
Men 65 and older	6.8
White women 65 and older	12.1
Black women 65 and older	29.8
Hispanic women 65 and older	27.7
Married women 65 and older	5.2
Nonmarried women 65 and older*	19.5

*Includes separated women.
Source: Lamison-White 1997, Table 1; unpublished AARP-Public Policy Institute tabulations of March 1997 Current Population Survey.

More likely today, married women will have worked enough to qualify for retired

[4] For ease of reading and because it is concerned primarily with women, this issue brief will generally refer only to women even when the observations apply to men as well. Social Security, it should be stressed, is gender neutral.

[5] Under certain circumstances, workers may also qualify for benefits at younger ages, e.g., if they become disabled. A very few Social Security beneficiaries are receiving special age-72 benefits or benefits as parents; however, these beneficiaries are not treated in this issue brief.

[6] Early (pre-65) collection of benefits results in an actuarial reduction. The full 50-percent spousal benefit is received only when both spouses are 65 or older at the time of receipt.

[7] Spousal benefits are sometimes referred to as dependents' benefits, a term that has come to have a pejorative connotation as the concept of marriage as an economic partnership has achieved greater currency.

worker benefits of their own but, upon reaching retirement age, find that their own benefits amount to less than half of their spouses'. Technically, these women—who are "dually entitled"—receive their own retired worker benefits plus an auxiliary benefit that tops their worker benefits up to what they are otherwise entitled to as spouses. In other words, they do, in fact, collect benefits based on their earnings, but this technicality is lost on many married women, who are only too aware that when it comes to old age and survivors' benefits, they are no better off than if they had never worked for pay.[8] In practical terms, dually entitled beneficiaries get the higher of two benefit amounts; they cannot collect both full benefits.

When spousal benefits were introduced in 1939, relatively few married women worked outside the home, although even then it was assumed that "most wives, in the long run, [would] build up wage credits on their own employment" (Chater cited in U.S. General Accounting Office 1996: 64), as indeed they have. Today, the majority of adult women under the age of 65 are employed outside the home, regardless of marital status or the presence of children. Even the mothers of young children are likely to be employed. As of 1996, nearly 58 percent of married women with a child under the age of three were in the labor force, over 2.5 times the figure 30 years earlier (Ferber 1993 and U.S. Depart-ment of Labor 1998).

The figures in Table 6 highlight how women's changing roles have been reflected in their Social Security benefits, as a growing proportion now collects worker benefits. Over 62 percent of women qualified for worker benefits in 1995, up from 43 percent in 1960. That women are increasingly working long enough to qualify for retired worker benefits of their own is a big plus in the event of divorce.

Table 6
Women Social Security Beneficiaries Aged 62 or Older, by Type of Entitlement: 1960-1995 (in percent)

Entitlement	1960	1980	1995
Worker	43.3	56.9	62.1
Worker only	38.7	41.0	36.2
Dually entitled	4.6	15.9	25.9
Wife/widow only	56.7	43.1	37.9

Source: Social Security Administration 1996: Table 5A.14.

Women today, it is clear, are far less likely to be "dependent" on a spouse, at least as far as Social Security is concerned. This is evident in the decline in wife/widow-only recipients from almost 57 percent in 1960 to just under 38 percent in 1995.

Despite women's growing labor force attachment, "there are still," as Ferber (1993: 43) states, "millions of women who have been full-time homemakers most of their lives, although their number has been declining rapidly. There are many more women who have been full-time or part-time homemakers intermittently" (Ferber 1993: 43). Thus, women's gains have come mainly in the form of dual entitlement (see Table 6). If these women's own worker benefits had been higher than half of their husband's, they would be classified as "worker only,"[9] a figure that was actually lower in 1995 than it was in 1960, perhaps as a result of more low-wage women entering the labor force and accumulating sufficient quarters of coverage to qualify for worker benefits. Instead, these

[8] If they lack the requisite work history, however, married women are not eligible for disability benefits based on their husbands' work records, so employment does provide them a benefit that marriage alone does not.

[9] This designation may be confusing because the beneficiaries in question would have qualified for spousal benefits if they were not entitled to retired worker benefits that are greater than the spousal benefits.

dually entitled women do better with what is, in essence, the spousal benefit.

At widowhood--and most women outlive their husbands--survivors either collect their spouses' full benefits or continue to receive their own retired worker benefits, whichever are greater. They cease to get the 50-percent spousal benefit. The same holds true for divorced women. If their ex-husbands die, they, too, may be eligible for higher survivors' benefits.

Receipt of benefits based on husbands' work records and earnings may continue into the foreseeable future, in spite of women's growing labor force attachment. Sandell and Iams (1996) estimate that women's changing work patterns and earnings will result in higher income for couples, but little improvement for most widows. A growing proportion of wives, they maintain, will qualify for Social Security benefits of their own that exceed *half* of their husbands' benefits but are less than 100 percent of those benefits. If they outlive their husbands, these women will find themselves "better off" with survivors' benefits than they would be with their own retired worker ones.

The projections of Sandell and Iams suggest that fewer than 20 percent of baby boom widows in the early part of the next century will collect higher benefits based on their own earnings, in contrast to about 8 percent today. As a result, "a sizable proportion, not too different than today's, of next century's elderly widows will be at risk of economic distress" (Sandell and Iams 1996: 12).

Reinforcing this observation are projections from the Commonwealth Fund Commission on the Elderly People Living Alone (1987: OR-2), which indicate that by 2020, poverty among the aged will be largely confined to persons living alone, virtually all of whom will be women. Moreover, the gap between these women and other elderly persons is expected to widen. Hence, developments that threaten to undermine the income support the aged *now* receive should be examined carefully for their potential impact on this vulnerable group.

Social Security Provisions of Particular Importance to Women

Social Security is gender neutral, which means that men and women with identical work histories and earnings can expect identical benefits. The gender neutrality of Social Security extends to its actuarial calculations. In the private market, sellers of annuities can take into consideration the fact that a set sum or accumulation of savings must, on average, last longer in the case of women. Thus, the same accumulation may purchase lower monthly benefits for women than for men, though payments over a lifetime may be the same. This cannot happen under Social Security.

Nonetheless, because women's and men's lives are anything but gender neutral, the Social Security benefits they receive typically vary substantially in both type and amount. Not surprisingly, women's benefits typically are lower than men's.

At the end of 1995, female retired workers were receiving monthly benefits that averaged $621, in contrast to $810 for men (Social Security Administration 1996: Table 5.A1). This gap reflects less time in the labor force on the part of women, as well as their greater probability of working part time and their continued concentration in lower-wage occupations.

The gender neutrality aspect of Social Security aside, a number of Social Security's provisions are especially beneficial to women, although men in comparable circumstances would benefit from these provisions as well. For example, 99 percent of the spousal benefit recipients are women, as are 98 percent of the dually entitled (Social Security

Administration 1996: Tables 5.A1 and 5.G2). The U.S. General Accounting Office (GAO) notes that "because women receive spousal and survivor benefits more often than men and, hence, are subject to the dual entitlement limitation more often, these concerns are often viewed as women's issues" (U.S. General Accounting Office 1996: 48).

The Benefit Formula

Women also gain from the way Social Security benefits are calculated because the benefit calculation formula replaces a higher proportion of the wages of low-wage workers than of higher-wage workers. For single earners with low, average, and high earnings, for example, Social Security replaces, respectively, about 53 percent, 40 percent, and 26 percent of their wages (Steuerle and Bakija 1994: 96).

The progressive benefit formula redistributes income from higher-wage earners to lower-wage earners who, it has been recognized since the system's inception, would have more difficulty achieving income adequacy in old age than their higher-earning counterparts. Since women are disproportionately found among the lower earners, this "weighted benefit formula" is especially important to them.[10] Private pension benefits lack the redistributive element of a weighted benefit formula, which is a fundamental feature of social insurance in the United States.[11]

The fact that divorced women can collect benefits on their ex-husbands' work records and that multiple ex-spouses who meet the duration-of-marriage test can collect benefits as divorcees or widows, underscores the role that Social Security plays in protecting against income loss and providing a floor of security. In sum, as Ferber (1993: 43) notes, Social Security "favors lower income workers and makes provisions for spouses who are not employed," two aspects of the system that favor women as a result.

Defined Benefit vs. Defined Contribution Protection

Social Security is a defined benefit retirement income plan that uses a formula set by law to calculate benefits based on earnings up to an annual maximum limit and years of coverage (35 years of highest earnings). Workers can, albeit generally with some help from the Social Security Administration, estimate what their benefits will be under reasonable assumptions about wage increases and years of employment. That is not, however, the case with defined contribution private pension plans, such as 401(k)s, which are claiming an increasing share of the private pension market. With defined contribution plans, market risk is a real risk: retirement annuities or lump-sum distributions from those plans depend on the amount invested and the earnings on the investments. Poor investment choices, as well as both the unwillingness and inability to save, can also undermine retirement-income accumulations.

Moreover, retirees need never fear outliving their Social Security benefits. Because Social Security cannot be taken as a lump sum or as graduated payments or phased withdrawals, beneficiaries can never "use up" their Social Security. Furthermore, because old-age and survivor benefits cannot be cashed out at early ages, qualifying retirees can never get their hands on the money prematurely. Assuming workers have sufficient quarters of coverage, something will always be there for retirement. In contrast, cashouts pose a significant problem for savers

[10] Of course, the weighted benefit formula is no substitute for improving the wages and benefits of women. High earners still receive higher absolute benefits than low earners, even if those benefits replace a lower proportion of pre-retirement earnings.

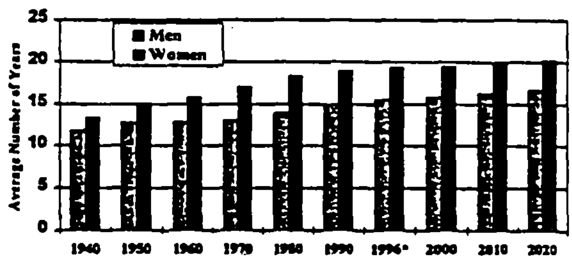
[11] Women may lose some of that progressivity if their Social Security and private pension benefits are integrated.

in defined contribution plans, especially at the time of a job change. Women are more likely than men to cash out their defined-contribution accumulations before retirement age (Korczyk 1996a).

Longevity

Longevity should also be kept in mind by women as well as men as they plan for their income needs in old age. Life expectancy at age 65 has risen for both men and women since the early years of Social Security (Figure 3), though the female/male longevity gap is wider than it was six decades ago. As of 1996, at age 65 the average woman could expect to live more than 19 years; future female retirees will have to plan for an even longer retirement. Very old Social Security beneficiaries today, the vast majority of whom are women, are among the poorest of Americans. They may also face catastrophic health and long-term care expenditure at the same time that they risk exhausting their non-Social Security resources. Just how much more secure the very old of the future will be remains to be seen.

Figure 3
Life Expectancy at Age 65: 1940-2020
(intermediate assumptions)



*Preliminary.
Source: Board of Trustees, Federal Old-Age and Survivors Insurance Disability Trust Funds 1997

Longer life expectancy for women, coupled with the fact that wives are generally younger than their husbands, means that women are more likely than men to become widowed and, as a result, have a far greater probability of living alone. Some women reach old age never having married, but the percentage currently is low (about 4 percent). Many more are widowed, and by age 75, only about one fourth of women are married, in contrast to about 70 percent of men of the same age. Women are thus more likely to suffer the loss of income and social support resulting from the death of a spouse.

One of the great advantages of the Social Security system is that benefits are indexed. This guarantees that retirement benefits maintain their purchasing power over time. Almost no private pensions are automatically indexed, although a few grant ad hoc increases. A very long life expectancy accompanied by even modest inflation can seriously erode private retirement benefits. Private annuitants must purchase indexed annuities if they want any inflation protection in their defined contribution plans, but they pay for that protection in the form of lower benefits.

Social Security and Women's Unmet Needs

Despite the benefits that accrue to women under Social Security, the program today is not without critics. Its gender neutrality, for example, by definition fails to make allowances for the fact that caregiving responsibilities are one reason that women's work histories continue to be shorter than men's. Social Security benefit calculations assume a 40-year work history, with the five lowest years of earnings omitted from the calculation. For women, some or all of these five years may be years of zero earnings. Earnings over the remaining 35 years are averaged, but if Social Security applicants have more than five years of no earnings--as many women still do--anything in excess of five is included as zeros in the estimation of average wages and calculation of benefits.

To be sure, more women are reaching retirement age with a full work history, but most still fall short of the full averaging period. GAO observes that the median number of years with covered earnings was 36 for men reaching age 62 in 1993; it was only 25 for women; less than 20 percent of women had 35 years, in contrast to almost 60 percent of men (Ross 1997).

"Provid[ing Social Security] participants with retirement benefits adequate to secure a basic subsistence standard of living" is the goal that drove the architects of the Social Security system (Steuerle and Bakija 1994: 15-16) and that has driven many of the system's subsequent reforms. Though attention to equity issues, or the fairness of benefits compared to contributions, was apparent at the outset, benefit adequacy was the greater concern at the outset as the architects of the program sought first to deal with the problem of poverty (ibid.: 14).

Concern about the well-being of dependent family members, particularly women and children, manifested itself in the early days of Social Security. The addition of benefits for wives and children that were not tied to their own work records, according to Derthick (1979: 260-261), "consciously introduced an avoidable bias into the program for the sake of welfare objectives."

That bias--an inequity accepted for the sake of adequacy--was the advantage accruing to a married couple with a single earner over a two-earner couple with the same earnings. The latter couple might pay the same Social Security taxes as the former, but the couple would collect less from Social Security. Each qualifying worker in a two-earner couple would get a retired worker's benefit, while the single-earner couple could claim a worker's benefit and a spousal benefit.

This inequity has proven nettlesome to many dual-earner couples as their numbers have increased. It also translates into an adequacy issue, especially upon widowhood. The benefit to which the surviving spouse, again generally a woman, is entitled will be substantially lower for the survivor of a dual-earning couple than the survivor of the single earner with comparable earnings. Household expenses may fall at this time, but, as Rappaport (1997: 35) observes, "the difference in cost of living is far smaller than the difference in income." Survivors of dual-earner couples may experience considerable hardship as a result of the decline in household income at this time.

As more married women began to find themselves part of dual-earner couples, issues of equity or fairness began to strike a chord,[12] and by the late 1970s, women's advocates were increasingly seeking to bring some of these issues to the fore. Income adequacy, especially for nonmarried women and the very old, continued to be a concern. Although women's status in retirement was clearly improving, many women's advocates agreed with former Congresswoman Mary Rose Oakar, Chair of the House Task Force on Social Security and Women, when she argued that correcting the inequities toward women in the Social Security system was "one of our top domestic issues" (U.S. House of Representatives 1980: 2).

Improving Women's Status in Old Age

There have been numerous proposals since the 1970s and early 1980s to make Social Security more equitable and/or more adequate for women (see, e.g., U.S. House of Representatives 1980 and 1985; Beedon 1991; Burkhauser and Smeeding 1994; Center for Women Policy Studies 1988; Save Our Security 1996; Steuerle and Bakija 1994). Reform proposals have varied, from the radical solution of earnings-sharing for married couples--whereby the earnings of both partners would be halved and credited to

[12] GAO (1996) recently summed up the key inequities that have the greatest impact on women: two-earner couples receive lower benefits than one-earner couples with the same earnings; the survivors of these couples get less as well. In addition, dually entitled beneficiaries get no more in Social Security benefits than they would receive if they had never worked.

the earnings records of each spouse—to more modest proposals, such as increasing the number of dropout years in the calculation of average earnings under Social Security.

However, most proposals, as Ferber points out, "have come to naught," which she does not find surprising, since there is so much disagreement "about what the effects of Social Security are, and what the outcomes should be" (Ferber 1993: 43). Moreover, many of the proposals have been costly, involved benefit cuts to some beneficiaries--never politically popular–, and/or would be phased in over such a long period of time that years or decades would have to pass before full implementation. Hence few women who need help immediately would benefit from the change.

Though momentum for reform that would benefit women under Social Security seemed to be building in the late 1970s, demographic, economic, and other pressures were conspiring against significant improvements. Costly changes, in particular, were beginning to look doomed. By 1983, the Social Security system was in short-term actuarial imbalance, and the situation was urgent. Restoring solvency to the system at that time allowed for very few benefit enhancements, though the modest improve-ments that were included in the 1983 amendments to the Social Security Act were largely seen as "women's" benefits.[13]

Social Security for the 21st Century

Despite the fact that the Old-Age, Survivors, and Disability Insurance (OASDI) Trust Funds will build up sizable reserves for the next dozen years, the long term picture is not auspicious for costly benefit improvements, whether or not they involve enhanced adequacy or equity.

While Social Security revenues currently exceed payments, the system is not in actuarial balance over the long-term; the estimated deficit over the 75-year horizon used in Social Security projections amounts to 2.23 percent of taxable payroll for the Old-Age and Survivors Insurance (OASI) and Disability Insurance (DI) Trust Funds (Board of Trustees 1997).[14] The 1997 report of the Social Security Trustees notes that, all else being equal, the trust fund reserves which are currently growing will be drawn down beginning in about 2012 and will be exhausted by 2029.[15] Thus, Social Security will be able to pay full benefits on time for more than three decades. To ensure that benefits will be paid in a timely fashion after that date, some changes will be necessary. The only possibilities are revenue increases and/or benefit decreases, the magnitude of which will depend on the specific proposals and when the changes are introduced.

Coupled with the solvency issue is growing concern about declining confidence in the ability of Social Security to pay benefits (see, e.g., Reno and Friedland 1997). According to a 1997 opinion survey by Public Agenda, about one-third of the public thinks "they won't get any Social Security benefits at

[13] Under these amendments, a divorced spouse who was at least age 62 would be able to collect Social Security benefits based on the earnings of her ex-spouse as long as the ex-spouse was eligible to receive benefits; he need not have begun collecting them. Benefits were also liberalized for certain spouses.

[14] This is the average difference between income (e.g., payroll contributions) and outgo (benefits and administrative costs) as a percent of taxable payroll over 75 years. To bring the trust funds into balance, revenues would have to be augmented or costs reduced by an average of 2.23 percent in each of the next 75 years.

[15] The sensitivity of deficit projections to the assumptions on which they are based can be seen in the fact that, under the Social Security Actuaries' low cost assumptions, the OASDI trust funds will never be exhausted (at least over the 75-year period), while under high-cost assumptions, exhaustion will occur in 2018, rather than 2029.

all," up from one-fourth since 1994 (Farkas and Johnson 1997: 23), even though at its lowest point, income to Social Security should be sufficient to pay three-fourths of projected benefits. The Social Security trustees refer to "an alarming erosion of public confidence in the Social Security system over the past few years, particularly among younger generations," insisting that early action is needed to ensure long-range solvency to restore that confidence (Social Security and Medicare Boards of Trustees 1997: 13).

As of fall 1997, Social Security reform was not yet on the Congressional Agenda, although President Clinton was promising "to do something soon" about Social Security (Harris 1997: A1), contending that the administration "'would fulfill [its] responsibilities to curb the costs of Social Security." In his 1998 State of the Union address, he called for a national dialogue on Social Security to be facilitated by a series of bipartisan regional forums designed to increase public understanding of Social Security and various reform proposals.

Few politicians relish the prospects of reforming Social Security, long referred to as the third rail of politics. But while reform may be inevitable, opinions vary widely as to the degree of change that is necessary to restore long-range solvency. January 1997 saw the release of the report of the 1994-96 Advisory Council on Social Security, which had been appointed by the Secretary of Health and Human Services under Section 706 of the Social Security Act to "advise the public, the Administration, and Congress on how best to prepare" Social Security and Medicare for the future (Advisory Council on Social Security, Vol. I 1997: 6).

The Council's long-anticipated report was preceded by considerable media attention and discussion by policymakers and Social Security experts and aficionados for at least two reasons. This was the first Council that was unable to achieve consensus on major recommendations. Its 13 members could not agree on how best to prepare Social Security for the future. But most likely accounting for the flurry of media interest in the topic of Social Security were recommendations for what would amount to restructuring of the Social Security system. Proposals to privatize Social Security by allowing workers to establish individual investment accounts and decide where to invest all or part of their Social Security contributions were being seriously considered.

It is worth emphasizing that most members of the Advisory Council did agree on a number of fundamental principles. For example, members eschewed conventional means-testing and approved continuing to finance the programs through contributions from employers and employees, rather than from general revenues. Members also indicated that full cost-of-living adjustments should be maintained. However, opinions differed greatly as to the most appropriate course of action to restore solvency. The result was three very distinct approaches to the solvency issue.

These plans are by no means the only ones that will figure in upcoming debates about Social Security. Social Security reform proposals have been offered by a number of organizations, some politicians, researchers, and policy analysts, including the Committee for Economic Development, the National Taxpayers' Union Foundation, Senators Kerrey and Simpson, the Concord Coalition, and the CATO Institute. More can be expected once Social Security moves to the top of the Congressional agenda. Space limitations preclude a consideration in this paper of all the plans. Instead, this issue brief highlights components of the three Advisory Council plans as they may affect women.

Because of the publicity surrounding, and a fair degree of public interest in, these plans, because many of the other plans include similar features, and because these plans could serve as a point of departure for debate on reform in general, it seems reasonable to restrict discussion to the Advisory Council's recommendations at this time.

Social Security Reform and the 1994-1996 Social Security Advisory Council

Although the three reform plans of Social Security Advisory Council have some elements in common, they approach restoration of solvency in very different ways. The differences can largely be summed up with respect to the degree to which efforts would be made to maintain the system's social insurance principles, especially redistribution of income, or instead move toward a more privatized system, thereby shifting more of the burden of retirement support to future retirees themselves. A very brief summary of the three plans follows. (Greater detail can be found in Advisory Council on Social Security, Vol. I 1997.)

Maintain Benefits

Of the three Advisory Council reports, what is referred to as the Maintain Benefits (MB) plan would, as its name suggests, maintain the structure of the Social Security system much as it is today. Social Security would continue as a defined benefit plan, with benefits based on a set formula established by law. Income redistribution--so fundamental to this social insurance program and so important in ensuring income adequacy for low-wage workers--would be retained.

Solvency would be achieved by a number of rather modest changes. The plan would, for example, extend Social Security coverage to new state and local workers, tax Social Security benefits like private pension benefits, lengthen the benefit computation period from 35 to 38 years *or*, alternatively, slightly increase the payroll contribution rate, and eventually shift to OASDI that portion of Social Security revenues generated from taxing Social Security that now goes to the Hospital Insurance (HI) Fund. If these changes proved insufficient to bring the system into actuarial balance, the plan would increase employer and employee payroll taxes in 2045.

The most innovative feature of the Maintain Benefits plan involves the possible investment after further study of a portion (up to perhaps 40 percent) of the Social Security trust fund reserves in private equities in a search for higher returns. Although some observers see such investment as a form of privatization, workers themselves would have no say over how funds were invested; an investment policy board nominated by the President and confirmed by the Senate would oversee investments. Earnings would accrue to the trust funds, not to workers' individual accounts. Despite the fact that the Maintain Benefits plan would make the fewest changes to Social Security, equity investment would nonetheless represent a significant departure from present policy.

Individual Accounts

The second plan proposes establishing mandatory individual accounts (IAs) similar to a 401(k) defined contribution plan. Workers, but not employers, would contribute an additional 1.6 percent of earnings to their individual accounts. They would be provided with limited investment choices, the accumulations of which would have to be converted to indexed annuities at retirement.

The IA plan would also extend Social Security coverage to new state and local workers, extend the benefit computation period to 38 years, lower the earnings replacement rate for middle- and high-wage earners, accelerate the scheduled increase in Social Security's full retirement age and subsequently index it to increases in longevity, and tax Social Security benefits like private pensions. The result of these changes, according to GAO, would be lower benefits from the "basic" Social Security program for all workers (Advisory Council on Social Security 1997; Ross 1997: 7), although benefits from the individual accounts are intended to help offset the losses.

Finally, the 50-percent spousal benefit would be gradually reduced to 33 percent, and the survivor benefit increased. Under this plan, a survivor would collect the highest of his or her own basic benefit, the deceased spouse's benefits, or 75 percent of the couple's combined benefits.

Personal Security Accounts

The most radical of the three Advisory Council plans would turn Social Security into a two-tier system. Tier I would become a flat-rate benefit based on years of covered employment that, after 35 years of earnings, would amount to about two-thirds of the poverty level for a person living alone (which was $410 a month in 1996).[16] Tier II would consist of retirement income from workers' personal security accounts (PSAs) financed by allocating 5 percentage points of workers' payroll taxes to the new accounts.

Workers could invest their 5 percent in a wide-range of financial instruments. At retirement, workers would not be required to annuitize their investments. The Tier I benefit for spouses would be the highest of their own benefit, half their retired spouse's benefit, or half of the flat benefit, when fully phased in. Survivors would be eligible for 75 percent of the benefit payable to the couple; they could also inherit any balance in the PSA of the deceased worker.

In addition, the PSA plan would accelerate and index the increase in retirement age and then periodically examine the need for additional changes, raise the age of early eligibility, and cover new state and local workers.

Social Security Reform's Impact on Women

Certainly, *everyone* has a stake in Social Security, and everyone will be affected by whatever reforms are ultimately implemented. However, as this issue brief and a sizable literature demonstrate, Social Security is without question a women's issue. Any proposal that would change the system, therefore, ought to be carefully scrutinized in terms of its impact on women. Rappaport (1997: 39) calls for making the changes needed to "ensure that we will have a strong Social Security system going forward," including a system that "will better handle a variety of family patterns."

All three plans could lead to long-term Social Security solvency, although their impact on various groups in the population will vary. Just how secure women would be under the various plans, though, remains a matter for further research. Since the Maintain Benefits plan would result in the fewest changes to the system, how women would fare in the future is essentially how they are faring today, although many might be worse off as a result of the lengthening of the benefit calculation period (discussed below).

Under the Individual Accounts (IA) plan, the National Academy of Social Insurance (NASI) calculates that the average earner would see a drop of 17 percent in his or her basic benefit from Social Security (Ross 1997: 8). Reductions would be higher for high-wage workers than low-wage workers.

The amount invested in individual accounts (an additional 1.6 percent of wages) would be expected to make up the difference between the basic benefit and what would be paid to workers under current law. It may do this, but it seems unlikely that income

[16] Ultimately, workers with only 10 years of covered employment would be eligible for a benefit amounting to 50 percent of the full flat amount; this percentage would increase by two for each additional year worked up to 35.

adequacy in retirement would be greatly improved over what it is today.

The more dramatic changes would take place under the Personal Security Accounts (PSA) plan, whose provisions, especially the reconfiguration into a two-tier plan, stand to have a significant impact on women. As has been noted elsewhere in this paper, women with high-wage jobs have less to be concerned about when it comes to the Advisory Council's proposed changes (Williamson 1997b: 98), including those in the PSA plan. Affluent women, like everyone else, face market risk under privatization, but would come out ahead under many circumstances.

Privatization, even the partial privatization of the PSA and IA plans, poses big risks, especially for persons with limited resources. Low-income women, for example, have less to invest in the first place and would be less able than more affluent women to weather market downturns. They might also find it harder to obtain good market advice, given their limited income.

It also appears that women are more conservative investors than men (Hinz, McCarthy, and Turner 1997). That being the case, Ross (1997) notes, two investors with identical earnings could end up with very different retirement benefits. Women, in such instances, could expect the lower accumulations.

Women would also see lower benefits for the same accumulations because separate life tables could be used when IA or PSA accumulations were annuitized.[17] Since women live longer, their monthly annuity benefits would be lower than those of men with the same accumulations. Payments over a lifetime might be identical, but that is small consolation when monthly bills must be paid.

Moreover, although privatization proponents generally contend that most workers *could* do better in the private market than under Social Security, IA and PSA investors would face market risk. How the market has performed historically may not apply to specific groups of workers, and may not be in evidence at the time a particular cohort retires.

Over the long run, investments in the stock market have returned approximately 10 percent per year in nominal terms; between 1926 and 1994, the average return for the S&P 500 was 10.2 percent, or 6.9 percent after adjusting for inflation (Levine and Levine 1996: 222). However, some bear markets are deep and prolonged. On September 3, 1929, the Dow Jones reached a level it did not see again until November 23, 1954 (Pierce 1996). More recently, between January of 1973 and September of 1974, the market declined by 43 percent (or by 52 percent after factoring in inflation) (Ibbotson and Brinson 1993: 162). The phenomenal bull market of the past 15 years is not typical of the last 50 years, nor is it likely to be typical of the next 50 years, particularly if growth rates turn out to be lower than the nation experienced during the past 50 years (Williamson 1997a: 565).

There is also the question of who would actually own the accumulations in married workers' accounts. In the case of PSAs, the owner is clearly the worker, despite the fact that husbands and wives may make joint decisions about who works and when, and how money should be invested. Under the PSA plan, the owner would be under no obligation at the time of disbursement to purchase an annuity but could opt instead for a lump-sum payment. Unless Congress decided otherwise, that decision would be left to the owner of the PSA; spouses would not have a say in receiving any share of the money. This provision in the PSA plan could

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[17] As noted elsewhere in this paper, the PSA plan does not require annuitization. Adverse selection under such circumstances could make annuities very expensive in the private market.

have a disproportionate and negative impact on women.

Divorced women are given short shrift in both IA and PSA plans. They would apparently have to depend on the divorce settlement for any share of the accumulation in a spouse's account. Williamson (1997b: 103) explains that under the IA plan a divorced woman would otherwise have no claim on her former husband's individual account so long as he was alive. At his death she would become eligible for only half of his benefit from his mandatory individual account. The divorced spouse of a worker with a PSA could not even count on that, as annuitization would not be required.

Women with sufficient work histories would always qualify for PSA's Tier I benefits, but that benefit would guarantee substantially less relative to the poverty level than the average woman's retired worker benefit today. Many women would be able to make up the difference with their PSA Tier II benefits, but others might not fare so well. This might tend to be the case if workers were tempted and allowed to gain access to their accumulations before retirement.

The question of preretirement access to IAs or PSAs is a critical concern, and Congress may be reluctant to limit people's access to their own money in time of need. Women tend to be less likely to retain lump-sum pension distributions for retirement (Korczyk 1996a). Might they also be more likely to tap into these new retirement savings, if permitted?

Advisory Council member Thomas Jones speculates that the pressure to use retirement savings prematurely might "dwarf the political risk attributed to the current pay-as-you-go system" (Jones 1996: 5). He also worries that "political support for the first pillar [the basic benefit] might weaken once it is explicitly separated from the individual account pillar." Women would have a great deal to lose if this were to happen.

Although the PSA plan represents the most radical of the proposed changes discussed in this paper, a number of the other proposals would likely have a disproportionate impact on certain groups, such as women and those with low incomes. Raising the full retirement age might disproportionately affect low-wage workers in demanding jobs that do not lend themselves to a longer worklife. Skills obsolescence is also a problem for many low-wage workers, who may also be at greater risk than high-wage workers of experiencing health problems that affect ability to work. Not all such workers would be women, but women are heavily represented in the low-wage jobs whose numbers are projected to increase the most over the next decade (Silvestri 1997). More affluent workers, on the other hand, may have the resources to continue to retire early, as well as the education and skills that encourage employers to retain them longer.

Women will also find it more difficult than men to meet the longer benefit computation period. According to Social Security actuaries, only 15 percent of women retiring in 1999 vs. 57 percent of men, would be able to meet a 38-year averaging period (Fierst 1997: 137).

Benefit Improvements

Given the need for revenue increases or benefit cuts just to keep the present system afloat, the prospects for benefit expansion would appear to be dim. And, to be sure, like everyone, women will benefit from a fiscally solvent Social Security system.

Yet many people continue to worry about income adequacy in old age, especially among nonmarried women, and have proposed reforms to address that inadequacy. The majority of Advisory Council members (as well as others [e.g., Burkhauser and Smeeding

1994; Sandell and Iams 1997]) support reducing spousal benefits and increasing benefits for survivors. While there are various ways to do this, one way, as mentioned above, is to reduce the spousal benefit from 50 to 33 percent and increase the survivors' benefit to 75 percent of combined benefits. Such a proposal is actually a nod in the direction of greater equity, as higher benefits would go to survivors of dual-, not single-, earner couples.

Many survivors would be no better off under the change, however, and the change would do nothing for never-married or divorced women, who are among the poorest aged today. In fact, divorced women could be far worse off, as they would qualify for only one-third of their ex-husbands' benefits, rather than half. While the number of women who collect benefits as divorced spouses is low, they are a particularly needy group. Finally, intact couples would have to get by on less while both partners were alive if one partner were entitled to the spousal benefit. This might prove difficult for low-income couples. Choudhury and Leonesio (1997) caution that this proposed change might not have the desired impact due to the fact that a lifetime of poverty, rather than loss of a spouse, appears to be the primary determinant of poverty in old age for the majority of women.

Conclusions

The market risk of even a partially privatized Social Security system is very real and deserves a great deal more attention than it has received to date. Policymakers, retirement-income experts, and women's advocates, among others, need to think long and hard before asking moderate- and particularly low-wage workers, a category that includes many women, to take those risks (Williamson 1997a). The market does not just go up. Declines can be swift, deep, and prolonged.

The Social Security Trustees argue that many of the proposals for reform would involve "a profound shift in philosophy and would have significant ramifications [that] deserve careful examination and consideration by policymakers and the American public before any changes are made" (Social Security and Medicare Boards of Trustees 1997: 13.) The recently confirmed administrator of the now-independent Social Security Administration, Kenneth S. Apfel, hopes to enhance understanding of Social Security and foster dialogue on the tough choices not only on Capitol Hill, "but also in family living rooms all across America" (Social Security Administration 1997).

The level of ignorance about Social Security basics, to say nothing of its financing and reform (see, e.g., Farkas and Johnson 1997), suggests that the public debate and discussion about the "tough choices" must be preceded by a public information/education campaign that tries to provide the public with the tools it needs to make informed decisions. Women, in particular, must be a focus of the campaigns.

However, before Social Security is fundamentally overhauled, more and far better data are required on the combined effect and distributional impact of any changes. There can be little doubt that women's well-being would be profoundly affected by some of the reforms being considered. Just who would be most affected and by how much needs further examination. Even the experts don't have the answers. Reform might not make women better off than they are today, but it should not worsen their often precarious situation in old age.

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CENTER ON BUDGET AND POLICY PRIORITIES

Statement of Robert Reischauer at the White House Forum on Social Security

Albuquerque, New Mexico
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Many workers, particularly younger ones, are worried that they may not get a very good return on the payroll taxes that they and their employers are sending in to the Social Security system. They wonder whether some other type of pension system might give them a better payback than Social Security promises.

The answer to their question, of course, is "yes." A reformed and strengthened version of the current system can give workers better returns than those of the current system or those of any of the alternative structures that have been proposed.

To see why this is the case we need to look at the three reasons why returns on Social Security payroll taxes are relatively low for today's workers. One of these reasons, no rational person should want to change; another we can do nothing about; and the third we can and should act to correct. If we take this corrective step, Social Security will be able to pay higher average benefits than any of the various privatization plans could pay for similar levels of contributions.

The first reason why today's workers will get a rather low return on the Social Security taxes they pay is that a portion of their contributions — about $1 out of every $4 — goes not for retirement purposes but rather to provide disability and survivors insurance. Just like the fire insurance we all have on our homes and the collision insurance we purchase for our cars and trucks, none of us should want to have a high return on this portion of our contributions because that would mean that we had suffered either a disability that kept us from working or the death of a breadwinner.

The second reason why future retirees can expect low returns arises because most payroll tax dollars we send in for retirement purposes — some $13 out of every $15 — are used immediately to pay benefits to current retirees, our parents and grandparents. This practice dates back to 1939

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when Congress decided to pay relatively generous benefits to those who had contributed payroll taxes for only a portion of their working lives. Not until 1982 did workers who were 20 when the payroll tax was first imposed and, therefore, paid the tax during their entire careers, turn 65.

The decision to provide adequate retirement benefits to those who had not contributed to Social Security over their full careers was a fair and sensible one. Many of these workers had fought in World War I and had had their careers blighted by the Great Depression. Congress's decision greatly reduced the appalling incidence of poverty among the elderly. It allowed many to live independently and with dignity which benefitted all of society. But it also meant that workers' contributions were not building up as reserves that could support them when they retired. The result is the so-called unfunded liability — that is, the current promises Social Security has made to pay benefits in the future that are unmatched by reserves. Whether we retain the exiting system or privatize it, this unfunded liability will have to be met unless we renege on the benefits promised to today's elderly and near elderly. Dealing with the unfunded liability inescapably will reduce the returns workers can expect on their contributions.

The third reason for relatively low returns is the restriction that Social Security reserves be invested in safe, but low-yielding, government bonds. This restriction mattered little until recently because Social Security had only meager reserves to invest. After 1983, the system's reserves began to grow and by 1991 they exceeded the amount experts believe is necessary to maintain as a contingency fund to protect a pay-as-you-go system from the consequences of a deep recession.

Currently, the reserves total $725 billion — enough to finance two years of benefit payments — and by 2020 they will exceed $3.7 trillion dollars. If reforms are adopted, the reserves could easily swell to several times this level. So we are talking about a considerable amount of money — and what kind of returns these reserves earn can have a huge impact on the Social Security program.

Under current law, the reserves must be invested in government bonds that are expected to earn about 2.8 percent more than the rate of inflation. Investments in a prudently diversified portfolio of common stocks, corporate bonds, and government guaranteed securities could double that yield.

So why don't we invest these growing Social Security reserves in assets that would generate a better rate of return than government bonds pay? If we did that about half of the long-run financing problem facing Social Security would be resolved, thereby reducing the size of the benefit cuts or the payroll tax increases that would be needed to restore the system to full fiscal soundness.

To answer this question we should go back to 1935 and look at the two reasons why Congress decided to require Social Security to invest its reserves solely in government bonds. One was the economic conditions of the time. In the middle of the Great Depression, few people wanted to sock away their retirement nest eggs in the highly unstable stock and corporate bond markets.

The second and more important concern of Congress was that politicians — like themselves — might be tempted to use reserve investment policy to interfere with markets or meddle in activities of private businesses.

The concerns that Congress had in 1935 were certainly legitimate ones. But conditions have changed. Stock and bond markets are far larger, less volatile, and more efficient now than they were in the 1930s. The concept of investing passively in a broad index of bonds or stocks, which was unheard of then, is widely recommended for long-term investing today.

Furthermore, we can establish new institutions that can shield Social Security reserve investment decisions from political interference. This responsibility should be put in the hands of an independent entity patterned after the Federal Reserve Board. Its members would be chosen for their integrity and expertise for staggered terms of 10 or more years. The Board would be charged with selecting private sector fund managers through an open and competitive process. These fund managers would be required to invest the Social Security funds entrusted to them passively in stocks and bonds that reflected the broadest market indexes. As is the case now with the shares of stock owned by mutual funds, the managers would be required to vote Social Security's shares solely to protect the economic interests of their owners — that is, future retirees.

Switching from holding solely government bonds to holding government bonds, stocks, and corporate bonds is one, but not the only, step necessary to reform and strengthen Social Security. It is not a panacea or a silver bullet. Neither this step nor investing through private individual accounts would increase national saving as we must do; only benefit reductions or tax increases can do that. Furthermore, investing the reserves in stocks and bonds could push federal government borrowing rates a bit because private investors would have to be induced to buy the government bonds that Social Security would no longer hold.

Nevertheless, investing a portion of the growing Social Security reserves in private sector securities would give participants in the program a more equitable share of the benefit that increased Social Security reserves provide for the overall economy. Such a change would improve the return today's workers will get on their Social Security contributions without exposing them to the market risks and high administrative costs that would come if such investments were made through individual retirement accounts.