THE POTENTIAL IMPACT OF SOCIAL SECURITY REFORM ON WOMEN

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Chairman Grassley, Senator Breaux, members of the Committee, I am delighted to have the opportunity to appear before you today to discuss the important topic of how Social Security reform could affect women. My view is that women do very well under the current Social Security system. Therefore, replacing 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. At the same time, single older women continue to experience high poverty rates, so some targeted change within the current system should be made to help this group. Let me briefly summarize my views.

I. In the context of a retirement program, women differ from men in two important ways:

- They have lower lifetime earnings than men.
- Women who work are more likely to work part-time.
- Full-time women workers earn less than full-time men workers.
- Women take more time out of the labor force than men do.
- They live longer.

II. Although gender neutral, the present Social Security system compensates for these differences.

- The progressive benefit formula provides proportionately higher benefits for low earners than for high earners.
- For women who spend their careers taking care of their families, Social Security provides spouse's benefits. Divorced homemakers (married least 10 years) can also get these benefits.
- For older women whose husbands die, Social Security provides survivors' benefits equal to 100 percent of their husbands' benefits.
- If children are getting survivors' benefits, younger widows who stay home to care for them also receive benefits.
- Social Security pays monthly benefits for life, which is particularly valuable to women who on average live longer than men.
- Social Security adjusts benefits annually for changes in the cost of living. Inflation protection matters more for women than for men because women live longer after retirement.

III. Moving toward a system of individual accounts would endanger these protections.

- A woman's overall retirement benefit would depend, at least in part, on her contributions into her personal account and the earnings on those contributions. Low earnings and less time in the labor force would produce low contributions and low retirement benefits.
- Many of the family benefits currently provided by Social Security would likely be cut back.
- With individual accounts the money is not automatically converted to a lifetime annuity; retirees could use it up before they die and leave nothing for their widows.
- This risk 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 a virtually non-existent in the United States.

- Proposals that purport to introduce individual accounts and guarantee all benefits under the current system should be viewed skeptically. These proposals are inherently unstable and would undermine Social Security's defined benefit structure.

IV. Women have little to gain from individual accounts.

- Shifting payroll taxes to individual accounts will not increase the rate of return on Social Security contributions, defined broadly.
- Returns on individual accounts may appear higher initially, but not after adjusting for the cost of paying benefits to current Social Security retirees.

V. Despite the protections of Social Security non-married older women have poverty rates around 20 percent.

- Part of the problem stems from non-Social Security factors.
- Private pension benefits erode due to inflation, and are either cut in half or terminated when the husband dies.
- Interest income declines as assets are drawn down.
- Part of the problem is due to the cutback in Social Security benefits when husband dies.
- Raising survivor benefits would alleviate some of the problem.

In summary, Social Security's current defined benefit system with a progressive benefit formula, dependents' benefits, annuitization, and inflation protection serve women well. They and other lower paid people should be cautious about moving away from the existing system.

1. **Women Earn Less and Live Longer**

Poverty among women over 65 is already twice as severe as among men over 65, without Social Security the discrepancy would be even greater. The reason is that in the context of a retirement program women differ from men in two important ways: they are likely to have earned less than men and the are likely to live longer.

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), women continue to have lower lifetime earnings than men for three reasons. First, women who work are more likely to work part-time. At the end of 1998, roughly 26 percent of women worked part-time, compared with 11 percent of men. Women account for 68 percent of all part-time workers. Second, women working full-time earned less than men working full-time. The median earnings of full-time year-round women workers in 1997 was $24, 973, compared to $33,674 for men. That is, among full-time workers, women earn 74 percent of men's earnings. Third, women take more years out of the labor force, since they interrupt their careers to care for young children or elderly parents. Of workers retiring in 1996, at the median a woman had worked 27 years over her lifetime compared to 39 years for a man.

Women also live longer than men do. A 65-year-old woman today can expect to live to 85, compared to 81 for a man. This gap has increased since 1940 and is expected to persist in the future. Because women live longer, they rely on Social Security for more years. They also become increasingly dependent on Social Security as they age. Among unmarried women, those aged 65 to 74 get 43 percent of their income from Social Security, whereas those 75 and over get 55 percent of their income from Social Security.

II. **Women Do Very Well Under Social Security**

The current Social Security program recognizes the special characteristics of women and compensates through its benefit structure for the fact that they earn less and live longer. It is useful to tick off the ways in which Social Security's benefit rules are particularly helpful for women. First, the progressive benefit formula provides proportionately higher benefits for low earners than for high earners, and women are more likely to be low earners.

Second, for women who spend their careers taking care of their families, Social Security provides retirement benefits equal to 50 percent of their husbands' benefits. Divorced homemakers (married least 10 years) can also get these benefits.

Third, for older women whose husbands die, Social Security provides widows' benefits equal to 100 percent of their husbands' benefits. This is important because women tend to outlive their husbands.

Fourth, if children are getting survivors' benefits, younger widows who stay home to care for them also receive benefits.

Even with increasing numbers of women in the labor force, these family benefits remain very important. In 1996 the majority (63 percent) of women 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 a progressive benefit structure and family benefits, Social Security has two other features that help women. First, because Social Security pays monthly benefits for life, it is particularly valuable to women who on average live longer than men. Second, because benefits are adjusted annually for changes in the cost of living, their buying power is protected against inflation. This protection matters more for women than for men because women live longer after retirement.

Economists have somewhat obscured how well women fare under Social Security by focusing on the so-called "second-earner" problem. From the beginning, Social Security has treated men and women earners the same; each receives a benefit based on his or her own earnings. In addition, if a spouse has low or no earnings, Social Security provides a spouse's benefit equal to 50 percent of the primary earner's. This benefit reflects the fact that in 1939, when the benefit was introduced, most married women stayed home to care for children.

As more women entered the labor force over time, the existence of this benefit has created the so-called "second-earner" problem. Working wives pay payroll taxes from the first dollar of earnings, but increase their benefit only after the benefit based on their own earnings exceeds half of the primary worker's benefit. That is, since women are entitled to 50 percent of their husband's benefit even if they do not contribute to Social Security, critics charge that the system discriminates against women because they get nothing back for much of their payroll taxes. Some also worry that payroll tax payments without corresponding benefits will discourage women from working.

The clearest way to see that the spouse's benefit does not discriminate against the second earner is to consider the easiest way to solve the alleged inequity -- simply eliminate the spouse's benefit completely. Such a move would solve the problem, but it would also certainly make women worse off. Social Security does not discriminate against second earners, who usually tend to be women; it discriminates in favor of couples by paying a spouse Is benefit even if the wife's earnings are small or non-existent, and thereby helps women.

In short, the current Social Security program offers a range of protections - progressive benefit formula, family benefits, lifetime benefits, and inflation adjustments. These are of great importance to women and are not duplicated by many of the proposals to privatize the system.

III. **Moving Toward Individual Accounts Endangers Women's Protections**

All the protections of the current program would be put at risk if reform moved toward individual accounts. 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 low earnings and less time in the labor force, these contributions and earnings would, on average, produce low retirement benefits. Thus, individual accounts would perpetuate the earnings differences between men and women into retirement.

Second, many of the family benefits currently provided by Social Security would likely be cut back.

Third, with individual accounts the money is not automatically converted to a lifetime annuity or protected against inflation. If people get their money back in a lump sum, they could use it up before they die and leave nothing for their widow. This risk is compounded by the absence of inflation protection.

Some proponents of individual accounts argue that these concerns can be addressed. It is possible, they say, to introduce individual accounts and guarantee everyone the full benefits they would receive under the current system - the so-called Feldstein plan. The best of both worlds; women would do fine. This is a false promise, because Feldsteintype plans are inherently unstable. Consider two scenarios.

Although various versions of the Feldstein plan are floating around, they all have more or less the same structure. Workers would deposit 2 percent of their earnings up to the taxable maximum in an individual account. They would be reimbursed dollar-for-dollar for these deposits through a refundable income tax credit, financed in the short-run by the budget surpluses. The individual accounts would be invested in regulated stock and bond funds. When workers reach retirement age and begin to draw their pensions from their personal savings account, their Social Security benefits would be reduced by $3 for every $4 withdrawn. Overall workers would receive 60 percent of their benefits from Social Security and 40 percent from their personal accounts. The reductions in Social Security would eventually close the long-term financing gap.

- Start/Stop Scenario. One scenario is to start the Feldstein plan during this period of budget surpluses, but discontinue it once the surpluses disappear. The Feldstein plan appears painless in the short-term because contributions to personal savings accounts would in essence be financed by the surpluses. Once the surpluses disappear as the baby boom retires, continuing to provide tax credits for contributions to personal accounts would require more taxes, cutbacks in other programs, or increased borrowing. (Feldstein claims that the plan would be self-financing by 2030, but the Congressional Budget Office rejected this claim and the Social Security actuaries found that the Feldstein plan would have a negative effect on the federal budget in each of the next 75 years.) If the plan is abandoned once the surpluses disappear:

- Social Security's financing gap will have grown because no steps will have been taken to -solve the problem.

- The pressure to cut benefits will be great because people will have accumulated funds in their personal accounts. The personal accounts will be temporary, but the benefit cuts will be permanent.

- Long-run scenario. If the Feldstein plan continues, it would involve an enormous increase in government-mandated retirement pensions that would favor middle and high earners, who are disproportionately men, and it would eventually undermine support for a defined benefit guarantee like Social Security.

- The premise of the Feldstein plan does not make sense. It raises, not lowers, the level of mandated government pensions. Given the great concern about financing projected retirement and health cost for an aging population, mandating increased benefits for this group puts an unreasonable burden on the rest of society. Moreover, the bulk of the increased mandatory spending on retirement income would go to higher earners, who tend to be men, not women.

- The Feldstein plan would eventually undermine support for a defined benefit guarantee like Social Security. High and moderate earners would pay substantial payroll taxes to Social Security over their lifetimes, but would lose a large percentage of their Social Security benefits under the offset provision. When these earners compared their returns from Social Security with their returns from their personal savings account, they would conclude that Social Security was an unacceptably bad deal.

In short, the Feldstein plan is likely to lead to the unraveling of the current Social Security system. If a proposal sounds too good to be true, it probably is. There is no way to get around the fact that women have a lot to lose by moving to a system of individual accounts.

IV. **Women Have Little to Gain from Individual Accounts**

Women not only have a lot to lose from substituting individual accounts for traditional Social Security benefits, but also have little to gain. Shifting payroll taxes to individual accounts will not increase the rate of return on Social Security contributions, defined broadly. Yes, the returns on individual accounts may appear higher, but that's not the whole story. It is necessary to subtract from those higher returns the cost of paying benefits to current retirees under the existing Social Security system.

When Social Security first started, the President and the Congress decided to pay benefits to the first generation of retirees whose lives had been disrupted by the Great Depression. Because the taxes of today's retirees went to support these early beneficiaries, someone must pay benefits for today's elderly. If current payroll taxes are diverted to individual accounts, then the government will have to raise other money or borrow to pay off this obligation. Subtracting the cost of higher taxes or borrowing reduces the return on individual accounts to the level of the Social Security fund.

There is no disagreement on this point among professional economists: simply diverting payroll taxes to individual accounts will not raise the rate of return on Social Security contributions. Therefore, women have a lot to lose and little to gain.

V. Some Reforms Would Improve the Current System

Retaining the current defined benefit structure will serve women the best in the long run. That does not mean, however, that the current benefit structure cannot be improved. Specifically, some change is needed to help elderly widows and divorcees.

Although poverty rates among the elderly have fallen dramatically, poverty among widowed, divorced, and never married women remains high. While poverty among married women averaged 4.6 percent in

1997, poverty rates for unmarried women hovered around 20 percent (divorcees 22.2 percent, widows 18.0 percent, never married women 20.0 percent). For elderly black and Hispanic women the poverty rate was closer to 30 percent.

Some of the reason for the higher poverty among widows than among married women rests outside the Social Security system. In some cases, private pension benefits end when the husband dies; in most cases the benefit is cut in half In addition, since, unlike Social Security, most private pensions are not indexed for inflation, their purchasing power erodes over time. Furthermore, the amount of interest income tends to decline during retirement as people spend down their assets. But Social Security also contributes to the problem by providing an inadequate benefit for widows. Under current law, when the husband dies the widow gets a benefit equal to the higher of her own or her spouse's benefit. If the husband and wife were receiving equal benefits, the widow would end up with 50 percent of the couple's benefit. If the wife had not worked and was entitled only to the spouses benefit of 50 percent, then the widow would receive the husband's benefit, which would equal 67 percent of the couples benefit.

Liberalizing the survivor benefit would improve the economic well being of widows and elderly divorcees significantly. Most proposals suggest raising the survivor benefit to three-quarters of the combined couple's benefit. Such a change is of increasing importance given the projected increases in life expectancy.

VI. **Conclusion**

Let me conclude. Women have a large stake in the current Social Security debate. They can be hurt if Social Security payroll taxes are diverted to individual accounts. At the same time, a shift to individual accounts will not increase the returns on their Social Security contributions. Women should be very reluctant to give up current Social Security protections for an untried system that relies on individual accounts for even part of their basic retirement income. Reforming the treatment of widows, however, could help alleviate the serious problems that still exist among this segment of the population.