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A Silver Lining to the Economic Crisis: The Case for Improving Social Security and Medicare

Today's economic meltdown has been compared to the Great Depression of the 1930s, here is one substantial difference. In the 1930s, hidden in the shadows of the unemployment and home foreclosure statistics were elderly parents living with their adult children.

At that time, people worked as long as they could hold jobs, but this was an insecure state of affairs, even before the Depression. Those unable to work routinely moved in with their children. A primary anxiety of the vast majority of workers in those days was simply growing old. Squier (1922) quotes a 1912 description of old age:

After the age of sixty has been reached, the transition from non-dependence to dependence is an easy stage- property gone, friends passed away or removed, relatives become few, ambition collapsed, only a few short years left to live, with death a final and welcome end to it all- such conclusions inevitably sweep the wage-earners from the class of hopeful independent citizens into that of the helpless poor. p. 21

Social Security has changed all of that. Since its enactment, poverty rates among those age 65 and older have declined dramatically. Although no national figures existed at the time right before the Depression, available state figures show that poverty rates among older adults were around 50 percent. In 1959, the poverty rate for those 65 and older was 35.2 percent; today, it is roughly one in ten, about the same as the poverty rate among the working-age population. This improved economic security not only affords Americans the freedom to retire with dignity and independence at the end of a long career, it provides the economy with stability. Think where we would be today without Social Security, if vast numbers of older people were impoverished, rather than having secure incomes to stimulate the economy with their purchases.

The Need to Increase Social Security

The economic meltdown that we have just experienced has underscored the importance and soundness of Social Security. While the nation has lost trillions of dollars of private pension wealth and home equity, Social Security has retained its value, because its benefits are guaranteed.

The program was created to provide a foundation of economic support to help workers maintain their standards of living and prevent them from falling into poverty once they ceased work. The program was intended as a base of protection upon which employer-provided retirement income and other sources of supplementation could build. Even before the recent meltdown, however, private pensions and private savings never provided adequate supplementation for most retirees.

In the past few decades, these sources have become less adequate and less secure, not more. Traditional employer-sponsored pensions, so-called defined-benefit plans, which covered about percent of the workforce in 1977, covered only about 20 percent in 2003. The downward trajectory shows no signs of abating. As regulation of traditional private pensions has increased, along with changes in accounting rules governing how pension liabilities are to be reported, traditional, defined-benefit plans increasingly have been terminated or frozen. While the number of defined-contribution 401(k) plans has grown over recent years, they have many shortcomings. These arrangements often lack employer contributions, shift the risks of investment and longevity to the individual, are subject to the vagaries of individual investment experience, as well as high administrative costs, and are vulnerable to being cashed out before retirement. Perhaps of greatest concern, accumulations in those plans are extremely low. In 2004- prior to the economic collapse- the median account balance for household heads ages 55 to 64 participating in a 401(k) plan was \$60,000, a starkly inadequate sum of money for individuals who may spend 15 or more years in retirement.

Even prior to the economic collapse, two-thirds of the elderly received half or more of their income from Social Security. The nonpartisan Center on Budget and Policy Priorities projected in 2005- again, well before the economic collapse- that without Social Security, almost half of people age 65 and older would have incomes below the poverty line.

Crucial and effective as Social Security is in providing a foundation of economic security to workers and their families, Social Security benefits are low by virtually any measure. Despite the reduction in the overall poverty rate of older people, the improvements have not been uniform across all economic groups. For example, according to the Congressional Research Service, older people who are unmarried, who are African American or Hispanic, who are age 80 or older, or who are female all have disproportionately high rates of poverty. When an older person falls into two or more of these categories, the cumulative impact increases the chances of an impoverished old age; more than four out of ten African American women age 65 or older and living alone, for example, are impoverished (Purcell, 2008).

Moreover, the official poverty line vastly understates the needs of the elderly because it fails to take into account healthcare expenditures and housing costs, which are an increasing part of all American budgets. Today's official U.S. poverty thresholds were established in 1963-64 by taking a minimal food budget and multiplying it by three for households with three or more people (and slightly lower multipliers for individuals and couples). One particularly troubling aspect of the poverty threshold is its assumption that people age 65 and older need less to eat than younger people. As a result of this supposedly reduced nutritional requirement, the poverty threshold for people age 65 and over is around \$1,000 lower than for others.

A more refined measure than the federal poverty line, the Elder Economic Security Standard (EESS), is currently being developed by two nonprofit groups, Wider Opportunities for Women and the University of Massachusetts Gerontology Institute. Unlike the poverty line, the EESS takes into account healthcare costs, as well as whether a household rents, owns a home without a mortgage, or owns a home with a mortgage. Average Social Security benefits are well below this new standard. For an elder homeowner without a mortgage and in good health, an average Social Security benefit covers only 81 percent of minimal expenses; for a renter, in good health, the percentage falls to 63. These figures are really unsurprising when one realizes that the average Social Security benefit is less than the wages of someone working full-time at the minimum wage.

The measure of adequacy compared to some minimal standard tells only part of the story. Experts generally measure the adequacy of retirement income in terms of preretirement income. The concept is that in order to be adequate, retirement income should replace wages earned at retirement. In this way, retirees are able to maintain their preretirement standards of living. If a person has a replacement rate that is too low, she may not necessarily fall into poverty but may be forced to sell her home, move from her neighborhood, and cut all expenses dramatically- not a great benchmark when understood as insurance in exchange for a lifetime of work.

Most experts believe replacement rates have to be around 70 percent for average workers to maintain their standards of living in retirement. Higher percentages are needed for low-income workers, somewhat lower for the highest paid if the preretirement standard of living is to be maintained.

Social Security's current replacement rates are too low to allow the maintenance of preretirement standards of living. In 2007, Social Security replaced only about 27.4 percent of the wages of workers who consistently earned the maximum amount of covered wages, 40 percent of a medium-income earner, and 54 percent of a lifetime of low wages. These replacement rates are extremely low by international standards, as revealed in Figure 1, which shows replacement rates

of social security programs in member countries of the Organisation for Economic Co-operation and Development (OECD).

Moreover, these already minimal replacement rates will decline sharply in the future. The Social Security Amendments of 1983 included a gradual increase in the age at which retirees receive full benefits. Because of Social Security's structure, this increase in the retirement age amounts to a 14 percent reduction in benefits for people born in 1960 or after. Moreover, the effective replacement rate will be even lower in the future because Medicare premiums, which are automatically deducted from Social Security benefits for most beneficiaries, are, as a result of the rapid increase in healthcare costs, increasing faster than inflation generally. As a consequence, an average earner retiring at 65 in 2030 will have net Social Security income that replaces only about 29 percent of prior earnings.

Taken together, the inadequacy of both Social Security benefit levels, the insufficiency of private pensions, and the shortage of savings and other asset wealth means that most Americans will have insufficient income in retirement to maintain their standards of living. A March 2009 study (Munnell et al., 2009) found that 65 percent of American households are at risk of insufficient income at retirement, when one takes into account potential costs of healthcare and long-term care.

The Affordability of Increased Social Security Benefits

Given the strength of Social Security and the shortcomings of private pensions, made abundantly clear by the recent economic crisis, the logical response to the inadequacy of retirement income is to expand Social Security. But is it affordable? The news is full of talk of an entitlement crisis, of which Social Security is a major culprit.

Lumping Social Security together with Medicare and Medicaid as part of a so-called entitlement crisis obscures, rather than clarifies, the facts. The growth in the nation's healthcare costs, private as well as public, for decades has far outpaced income growth in the United States, a disparity that shows no signs of abating. In 1960, the nation's total spending on healthcare, public and private, for example, equaled 4 percent of GDP. By 1980, this percentage had almost doubled, to 8.4 percent. By 2005, the percentage had almost doubled again, to 14.9 percent of GDP. The Budget office (CBO) has determined that if the historical rate of growth were to continue into the future, we would spend more than 30 percent of our GDP on healthcare in another twenty-five years, approximately 56 percent in fifty years, and an amazing 99 percent in seventy-five years (CBO, 2007).

Public spending on Medicare and Medicaid simply mirrors these trends (CBO, 2007). In 1980, Medicare and Medicaid accounted for 2.3 percent of GDP.

By 2005, the cost of the two programs had more than doubled to 5.3 percent. In 2030, if the historical trend continues, the cost of these two programs will almost double again to 8 percent. In 2050, the programs will cost 14 percent of GDP. From 1960 on, federal receipts have ranged between 17 percent and 21 percent of GDP. Medicare and Medicaid by themselves are projected to cost more than 17 percent of GDP in 2059, only fifty years from now, if present trends continue. Obviously, this rate of growth cannot be maintained. No nation can allocate its entire gross domestic product, including its entire national budget, to healthcare.

In stark contrast, Social Security, which today costs 4.8 percent of GDP, is projected to peak at around 6.2 percent of GDP in twenty-five years, and then settle back to 5.8 percent sixteen years later and remain at that level thereafter. This increase in cost is not only manageable but unsurprising and fully warranted. At a time when the percentage of the population composed of people age 65 and older will grow from 12 percent to 20 percent, it is perfectly appropriate that they consume a somewhat larger percentage of the nation's goods and services.

Recent history assures that the nation can absorb the increase in spending on Social Security. The increase as a percentage of GDP is smaller than the growth in spending for public education when members of the baby boom generation were children. Spending on public education rose by 2.8 percentage points between 1950 and 1975, from 2.5 percent to 5.3 percent of GDP. In that case, states and localities had little, if any, advance warning. In contrast, the fact that this same generation is now becoming eligible for Social Security benefits has been part of the official Social Security projections since these people were born.

Improving Social Security's Benefit Levels

Each year, Social Security issues a trustees' report projecting future income and expenditures over the subsequent seventy-five years. According to the 2009 Trustees Report, Social Security will have sufficient income to pay benefits in full until 2037, but will have insufficient income to pay full benefits thereafter (Board of Trustees, 2009). This projected deficit should and can be eliminated without benefit cuts and without further increasing the age at which full benefits can be claimed. (Elsewhere [Altman, 2005], I have put forth such a plan, which restores Social Security to long-range actuarial balance without benefit cuts, without increasing the retirement age, and with only modest tax increases on the top 6 percent of the workforce.)

In addition to eliminating the projected shortfall without benefit reductions, benefits should be increased. A number of proposals exist to do just that. One approach is simply to increase benefits across-the-board. Less expensive improvements would institute targeted increases aimed at alleviating those

pockets of poverty that remain among older people. One such group is the so-called old-old, those over age 85. Poverty rates rise with age. Greater longevity increases the risk of either outliving assets other than Social Security or having the value of those other assets dwindle as a result of the compound effects of annual inflation over time. To reduce poverty among this group, some have proposed increasing Social Security benefits, a so-called birthday bump, at age 85.

Poverty at advanced ages is particularly serious for women, partly because of their longevity and partly because they often start out with lower retirement incomes compared to men. One reason women have lower retirement incomes is because they have taken time out to care for children. Some have proposed addressing this concern by giving Social Security credit for childcare. Others have proposed providing larger benefits for widows, another group for whom poverty rates are higher. Some have proposed providing a floor under steady, longtime workers to ensure that someone who works hard for thirty or more years is not forced to retire in poverty. Obviously, there are many variations on a theme, many ways to increase benefit levels. The important point is the recognition that Social Security is important to the economic security of all Americans, that its benefits are low, and that, as a nation, we can afford to increase them.

Expanding Medicare's Coverage

Even with an increase in benefit levels, true economic security is impossible if people are one illness away from bankruptcy. Medicare is crucial in this regard. However, mirroring the rapid rise in healthcare costs, Medicare's costs have been increasing too rapidly to be sustained. To ensure that this vital program can continue to protect older people adequately, healthcare costs must be brought under control. The fact that Medicare's administrative costs are substantially lower than those of private insurance argues for the expansion of Medicare. Providing Medicare prior to age 65, perhaps at age 62 or even younger, should result in lower costs overall. Further, the two-year waiting period that disabled Americans must endure before becoming eligible for Medicare should be repealed.

The silver lining in the economic meltdown is that it has reminded Americans of the importance of Social Security and Medicare. Underlying Social Security and Medicare is the recognition that we are all connected and all "in it" together. Through these programs, we help each other and, because any of us could be unlucky and become disabled or die prematurely or could be fortunate and live to old age, we also are helping ourselves and our dependents. It will be a silver lining indeed if the result of the economic downturn is a renewed commitment to the most vulnerable among us and a restrengthened effort to

make Social Security and Medicare more generous for Americans who rely on these programs.

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