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SOCIAL SECURITY

Societal Changes Add Challenges to Program Protections

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Education, Workforce, and Income Security

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Highlights

Highlights of GAO-05-706T, a testimony before the Subcommittee on Social Security, Committee on Ways and Means, House of Representatives

Why GAO Did This Study

Before Social Security was enacted in 1935, at least half of those 65 and older in the United States were financially dependent upon others, including family members and public assistance. Today, the elderly's dependency on public assistance has dropped to a fraction of its depression-era levels, and poverty rates among this group are now lower than for the population as a whole. However, Social Security's long-term financing problems will require changes to restore fiscal stability to the program. The challenge for policymakers will be to make the necessary changes while retaining protections that are so important to millions of Americans.

The Chairman of the Subcommittee on Social Security of the House Committee on Ways and Means asked GAO to discuss the importance of Social Security for vulnerable populations. This testimony will address the key provisions in the Social Security program that support vulnerable populations, the ways in which those populations and American society in general have changed over time, and the implications of those changes for the Social Security program.

www.gao.gov/cgi-bin/getrpt?GAO-05-706T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Barbara D. Bovbjerg at (202) 512-7215 or bovbjergb@gao.gov.

SOCIAL SECURITY

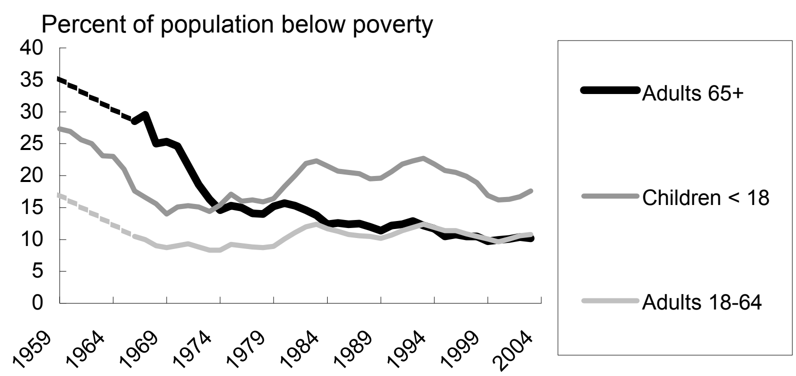
Societal Changes Add Challenges to Program Protections

What GAO Found

The Social Security program today continues to provide protection from poverty in old age just as it was designed to do 70 years ago. Social Security protects workers through a benefit formula that advantages low-wage workers, benefits for the disabled, spousal and survivor benefits, and a monthly annuity and yearly cost of living adjustment. At the same time, much in American society has changed greatly since the inception of the Social Security program. People are living longer, women's labor force participation has increased significantly and household composition has changed dramatically. In addition, labor force growth has slowed significantly, and the nature of work has changed in ways that affect workers' ability to save for retirement. These changes suggest that the Social Security system as it is currently designed may not be as effective as it could be in addressing the needs of our society. Some of the areas where changes in design could bring the program more in alignment with the current structures of work and families include encouraging older workers to remain in the labor force, addressing questions about the equity of spousal benefits, and redesigning the Disability Insurance program.

Given its long-term solvency problems, however, there are difficult decisions to be made about Social Security, largely because the program is so important to so many. In addition, the more immediate financial problems of the Medicare program also require attention. Policymakers will need to address the escalating costs of both Social Security and Medicare while recognizing that these programs are crucial to retirement wellbeing. Most importantly, the solvency and sustainability of Social Security should be addressed within the context of the program's role of protecting vulnerable populations, while at the same time considering how carrying out that role may need to change to better address changing societal needs.

Poverty Rates for Elderly Have Declined Faster than for Other Groups



Source: U.S. Bureau of the Census.

Note: Data for years indicated by dashed lines were not available but are available for 1959.

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss how the Social Security program protects vulnerable populations and how the program may need to evolve to meet their changing needs. Before Social Security was enacted in 1935, at least half of those 65 and older in the United States were financially dependent upon others, including family members and public assistance.[1] Today, the elderly's dependency on public assistance has dropped to a fraction of its Depression-era levels, and poverty rates among this group are now lower than for the population as a whole. At the same time, Social Security has become the single largest source of retirement income for Americans, supporting over 90 percent of those 65 and older. Moreover, it is the only source of income for approximately 22 percent of the elderly population. However, Social Security's long-term financing problems will require changes to restore fiscal stability to the program. The challenge for policymakers will be to make the necessary changes while retaining protections that are so important to millions of Americans.

Today, I would like to talk about the key provisions in the Social Security program that support vulnerable populations, the ways in which those populations and American society in general have changed over time, and the implications of those changes for the Social Security program. GAO has conducted several studies related to Social Security reform and its impact on vulnerable populations;[2] my statement is largely based on that work.

In summary, the Social Security program today continues to provide protection from poverty in old age just as it was designed to do 70 years ago. Social Security protects workers through a benefit formula that advantages low-wage workers, benefits for the disabled, spousal and survivor benefits, and a monthly annuity and yearly cost of living adjustment. At the same time, much in American society has changed

[1] S. Rep. No. 74-628 at 4 (1935).

[2] See *Social Security and Minorities: Earnings, Disability Incidence, and Mortality Are Key Factors That Influence Taxes Paid and Benefits Received*, GAO-03-387 (Washington, DC: April 23, 2003); *Social Security: Program's Role in Helping Ensure Income Adequacy*, GAO-02-62 (Washington, DC: Nov. 30, 2001); *Social Security Reform: Potential Effects on SSA's Disability Programs and Beneficiaries*, GAO-01-35 (Washington, DC: Jan. 24, 2001); *Social Security Reform: Implications of Raising the Retirement Age*, GAO/HEHS-99-112 (Washington, DC: Aug. 27, 1999); *Social Security Reform: Implications for Women's Retirement Income*, GAO/HEHS-98-42, (Washington, DC: Dec. 31, 1997).

greatly since the inception of the Social Security program. People are living longer, women's labor force participation has increased significantly and household composition has changed dramatically. In addition, labor force growth has slowed significantly, and the nature of work has changed in many ways, some of which affect workers' ability to save for retirement. These changes suggest that the Social Security system as it is currently designed may not be as effective as it could be in addressing the needs of our society. Some of the areas where changes in design could bring the program more in alignment with the current structures of work and families include encouraging older workers to remain in the labor force, addressing questions about the equity of spousal benefits, and redesigning the Disability Insurance program. At the same time, as policymakers consider changes that will restore financial solvency and modernize the program, it will be important for them to keep in mind Social Security's role in protecting vulnerable populations.

Background

Title II of the Social Security Act, as amended, establishes the Old-Age, Survivors, and Disability Insurance program, which is generally known as Social Security. The program provides cash benefits to retired and disabled workers and their dependents and survivors. The Congress designed Social Security benefits, at least implicitly, with a focus on replacing lost wages.[3] Because the program is financed on a modified pay-as-you-go basis, payroll tax contributions of those currently working are transferred to current beneficiaries. Current beneficiaries include insured workers who are eligible for retirement or who cannot work due to disability, these workers' dependents, and certain survivors of deceased insured workers. Workers become eligible when they have enough years of earnings covered under Social Security (i.e., earnings from which Social Security taxes are deducted); they and their employers pay payroll taxes on those covered earnings to finance benefits. In 2004, more than 156 million people had earnings covered by Social Security.

Social Security was originally an old-age retirement program. However, the Social Security Amendments of 1939 added two new categories of benefits: dependent benefits paid to the spouse and minor children of a retired worker, and survivor benefits paid to the family after the death of a covered worker. The Amendments transformed Social Security from a

[3] The original formula, as well as subsequent modifications, computed benefits as a percentage of wages covered under the program in a way that favors low-wage earners.

retirement program for workers into a family-based economic security program. The amount of Old-Age and Survivors Insurance (OASI) benefits paid in 2004 totaled $415 billion for about 40 million recipients.

Similarly, the Social Security Disability Insurance (DI) program was established in 1956 to provide monthly payments to eligible workers with disabilities who are under the normal retirement age, and to their dependents.[4] To be eligible for DI benefits as an adult, a person must have a certain number of recent quarters of covered earnings[5] and must be unable to perform any substantial gainful activity by reason of a medically determinable physical or mental impairment. The impairment must be expected to result in death or last or be expected to last for a continuous period of at least 12 months.[6] As with retired worker benefits, disability benefits are funded by payroll taxes paid by covered employees and their employers. In calendar year 2004, about 8 million individuals received approximately $78 billion in DI benefits.[7]

Outside Social Security, but integrated with the program, other legislation has also addressed income adequacy in various ways. In 1965, Medicare and Medicaid were created to alleviate the historically increasing strain that health care placed on incomes. In 1972, Title XVI's Supplemental Security Income (SSI) replaced Title I's Old-Age Assistance. This means-tested program provides cash to meet basic needs for food, clothing, and shelter. It is the nation's largest cash assistance program for the poor, and although it is administered by the Social Security Administration, it is funded by general tax revenues and not the Social Security trust fund.[8]

[4] In 1956, the Social Security Act was amended to provide benefits to disabled workers aged 50-64 and disabled adult children. Over the next 4 years, Congress broadened the scope of the program, permitting disabled workers under age 50 and their dependents to qualify for benefits, and eventually disabled workers at any age could qualify.

[5] The eligibility requirements for DI are different from the requirements for OASI.

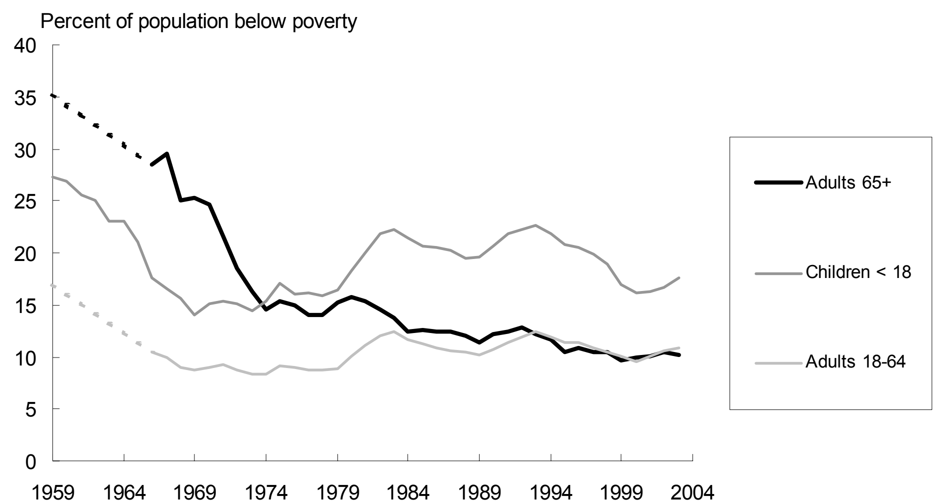
[6] Work activity is generally considered substantial and gainful if the person's earnings exceed a particular level established by statute and regulations.

[7] These numbers do not include adult disabled children who are dependents of deceased or retired workers, disabled widows and widowers, or disabled parents, who receive their disability benefits from the OASI program. About $6 billion were paid out of the OASI trust fund to these beneficiaries.

[8] States have the option of supplementing their residents' SSI payments. This state-supplemented SSI payment may be administered by the state, or states may choose to have the additional payments administered by the federal government.

Over the years Social Security has contributed to reducing poverty among the elderly. (See fig. 1) Since 1959, poverty rates for the elderly have dropped by more than two-thirds, from 35 percent to about 10 percent in 2003. While poverty rates for the elderly in 1959 were higher than for children or for working-age adults (aged 18 to 64), in 2003 they were lower than for either group. Factors other than Social Security, for example, employer-provided pensions, have also contributed to lower poverty for the elderly. Still, for about half of today's elderly, their incomes excluding Social Security benefits are below the poverty threshold, the level of income needed to maintain a minimal standard of living. Nearly two-thirds of the elderly get at least half of their income from Social Security.

Figure 1: Poverty Rates for Elderly Have Declined Faster than for Other Groups



Source: U.S. Bureau of the Census

Notes: Data for years indicated by dashed lines were not available but are available for 1959.

Currently Social Security faces a long-term structural financing shortfall, largely because people are living longer and having fewer children. Social Security's benefit costs will soon start to grow rapidly. According to the 2005 intermediate—or best-estimate—assumptions of the Social Security trustees, Social Security's annual benefit payments will exceed annual revenues beginning in 2017, and it will be necessary to draw on trust fund reserves to pay full benefits. And, in 2041 the trust funds will be depleted. At that time, annual income will only be sufficient to pay about 74 percent of promised benefits. As a result, some combination of benefit and/or revenue changes will be needed to restore the long-term solvency and sustainability of the program.

Key Provisions of the Social Security Program Protect the Most Vulnerable Populations

From its inception, Social Security was intended to help reduce the extent of dependency on public assistance programs. Over time, that objective has come to be stated more broadly as helping ensure adequate incomes. Several key provisions of the program have helped to protect the most vulnerable individuals: the progressive benefit formula that advantages low-wage workers, disability insurance benefits, survivor and dependent benefits, and the fact that the benefit comes in the form of an annuity, with an annual cost-of-living adjustment (COLA).

Progressive Benefit Formula

Social Security's benefit formula is designed to be progressive; that is, it provides disproportionately larger benefits, as a percentage of earnings, to low-wage earners than to high-wage earners.[9] By replacing a larger percentage of low-wage workers' pre-retirement income in this way, the Social Security benefit helps ensure adequate retirement incomes for these workers. The progressive nature of the Social Security system remains even after taking account of the fact that contributions to the system come in the form of a regressive payroll tax.

Disability Insurance and Supplemental Security Income Benefits

From its origin in 1956, the purpose of the DI program has been to provide compensation for the reduced earnings of individuals who, having worked long enough and recently enough to become insured, have lost their ability to work.[10] Payroll deductions paid into a trust fund by employers and workers fund DI benefits. Thus, DI, while it has important protections for vulnerable populations, is designed to provide insurance for all insured workers. The purpose of the SSI program, on the other hand, is to provide cash assistance to those who are age 65 and older, blind, or disabled and who have limited income and resources. It is a means-tested program that serves those not insured by Social Security or those whose Social Security benefits fall below SSI's means-test threshold.

[9] *Social Security: Distribution of Benefits and Taxes Relative to Earnings Level*, GAO-04-747 (Washington, D.C.: Jun. 15, 2004).

[10] The DI program was established under title II of the Social Security Act.

Spousal and Survivors' Benefits

Workers' earnings may generate Social Security benefits for their spouses and dependents as well as themselves. For example, spouses of retired or disabled workers may receive benefits based on a percentage of the workers' benefits. Additionally, after the worker has died, their eligible dependents receive survivor benefits.[11] Because workers do not make any additional contributions to receive these auxiliary benefits, workers with families receive a higher implicit rate of return than workers without families. Benefits are paid to family members of workers under certain circumstances. Spouses and divorced spouses of eligible workers may also be eligible at age 62 but can be eligible at younger ages if they are disabled, widowed, or caring for eligible children. An eligible worker's children under 18 are eligible for survivors' benefits, and adult children are eligible if they became disabled before age 22. Dependent parents and grandchildren of eligible workers are also eligible for survivors' benefits under certain circumstances.

Annuitization and Cost of Living Adjustment

Social Security benefits are paid out in the form of an annuity. Annuities are monthly payments for a specific period time, for example, the lifetime of a retired worker.[12] Benefits are also increased each year to keep pace with increases in the cost-of-living (inflation). The COLA is based on the Consumer Price Index. This automatic adjustment was not always a feature of the program. It was introduced in the 1970s, as part of a broader set of reforms, in order to ensure that benefits did not erode over time.

Changes in the Workforce and the Nature of Work

Much in American society has changed greatly since the inception of the Social Security program. People are living longer, women's labor force participation has increased significantly and household composition has changed dramatically. In addition labor force growth has slowed significantly, and the nature of work and workers' benefits has changed in many ways, some of which affect workers' ability to save for retirement.

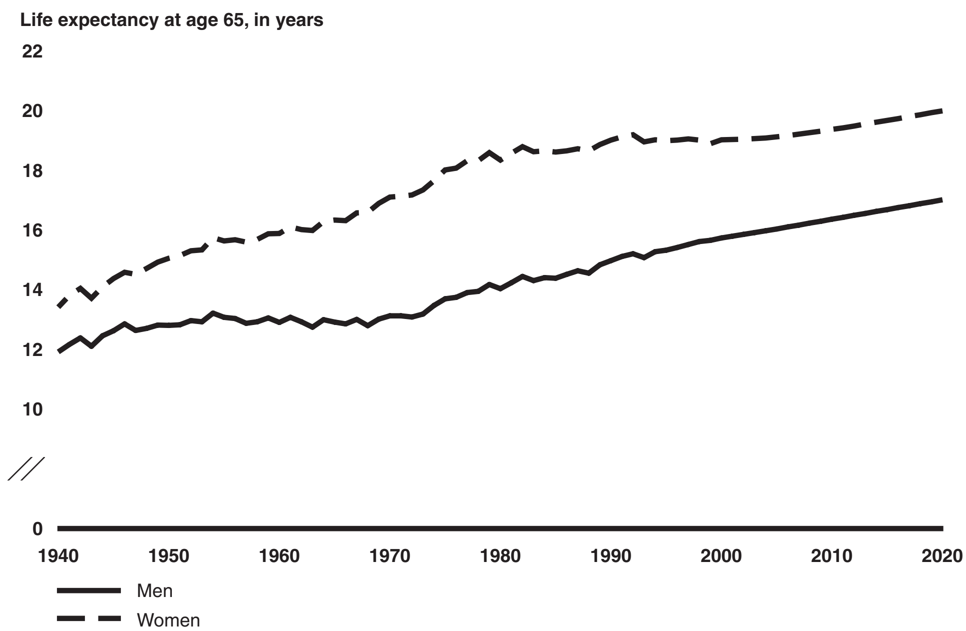
[11] Some workers qualify for Social Security benefits from both their own work and their spouses'. Such workers are called dually entitled spouses. Such workers do not receive both the benefits earned as a worker and the full spousal benefit; rather the worker receives the higher amount of the two.

[12] Social Security benefits are not paid for the lifetime of all beneficiaries depending on various eligibility requirements, for example, for surviving parents of young children.

Life expectancy

Life expectancy has increased continually since the 1930s, and further increases are expected. The average life expectancy for men who reach age 65 has increased from 12 years in the 1940s to 16 years in 2005, and is projected to increase to 17 years by 2020. Women have experienced a similar rise—from 14 years in the 1940s to over 19 years in 2005. Life expectancy for women who reach age 65 is projected to be 20 years by 2020. (See fig. 2)

Figure 2: Life Expectancy at Age 65 Has Increased



Source: Felicitie C. Bell and Michael L. Miller, "Life Tables for the United States Social Security Area 1900-2100," Actuarial Study No. 116, http://www.ssa.gov/OACT/NOTES/as116/as116TOC.html.

Note: Life expectancy numbers are based on period tables.

The aged population is growing dramatically, as a result of increased life expectancy and the aging of the baby boom generation. For example, individuals aged 65 and over are currently 12 percent of the population. In 30 years, they will be more than 20 percent of the population.

Changing Composition of Households and Increased Labor Force Participation of Women

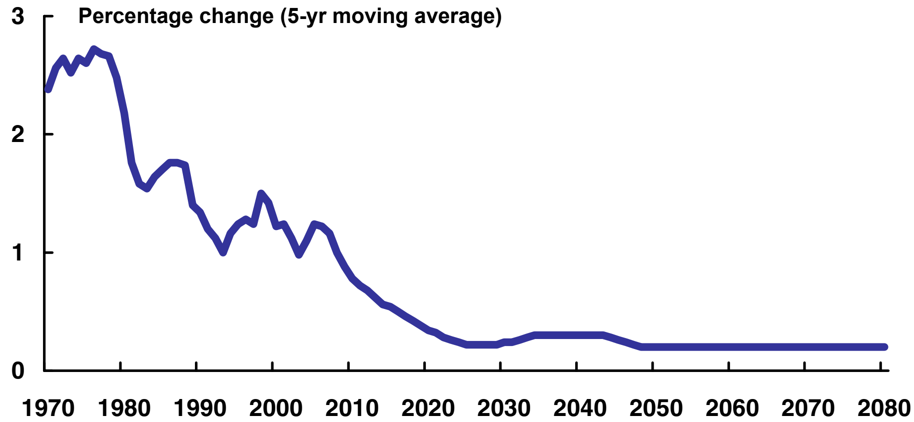
Social Security was designed around a working father, a stay-at-home mother, and children. Society has moved away from this model. There are many more single parent and two-earner households than in the past. Women's labor force participation rates are now at 59 percent —a substantial increase from their participation rates when the program was introduced.[13] At the same time, women have different work patterns from men. Women are more likely to work part-time and work intermittently as they may take time out of the labor force to raise children or care for elderly parents.

Slow Labor Force Growth

Increasing life expectancy, coupled with lower fertility rates, means that labor force growth will begin to slow by 2010. By 2025 it is expected to be less than a fifth of what it is today. (See fig. 3) Relatively fewer U.S. workers will be available to produce the goods and services that all will consume. Without a major increase in productivity or immigration, low labor force growth will lead to slower growth in the economy and to slower growth of federal revenues. This in turn will only increase the overall pressure on the federal budget.

[13] In 1961, women's labor force participation rate was 38 percent, compared to 83 percent for men.

Figure 3: Labor Force Growth Is Expected to Slow Significantly



Source: GAO analysis of data from the Office of the Chief Actuary, SSA.

Note: Percentage change is calculated as a centered 5-yr moving average of projections based on the intermediate assumptions of the 2005 Trustees Reports.

This slowing labor force growth, as well as the increases in life expectancy, has important implications for the solvency of the Social Security system. Fewer workers will be contributing to Social Security for each aged, disabled, dependent, or surviving beneficiary.

Change in the Nature of Work

In recent decades the national economy has moved away from manufacturing-based jobs to service- and knowledge-based employment. Another change in the nature of work is employers' increasing use of temporary and contingent workers. Contingent workers are less likely than the rest of the workforce to receive health insurance and pension benefits through their employers. Many of these workers either are not offered benefits by their employers or do not qualify for benefits because they do not work enough hours or have not worked for their employers long enough. Furthermore, when their employers offer health insurance and pension plans, many contingent workers do not participate because of the cost of the plans. The mobility of these workers also has an impact on their ability to save for retirement, since they may not stay with one employer long enough to qualify for a pension.

Re-structuring of Employer-Sponsored Pension Plans

Currently, only about 50 percent of workers have an employer-sponsored pension plan to supplement their Social Security benefit. For those workers who do have pensions, however, the structure of those plans has changed over time. More and more employers are switching from defined benefit (DB) to defined contribution (DC) plans. In doing so they are shifting an increasing share of the responsibility for providing for one's retirement from the employer to the employee. DC plans have lower participation rates than DB plans because many DC plans require the employee to opt for coverage, whereas most DB plans enroll participants automatically. Additionally, increasing costs of other benefits, such as health care, are making employers less willing or able to increase other forms of compensation packages, including pensions. As a result, employer-sponsored pensions may provide workers a smaller share of retirement income than they have in the past.

Changing Needs of Society Has Implications for Social Security

Regardless of all these changes, and in some cases, because of them, many workers still rely heavily on Social Security for their retirement. At the same time, changes in household structure, labor force participation, and life expectancy all suggest that the system as it is currently designed is not as effective as it could be in addressing the needs of our society. There are several areas where changes in design could bring the program more in alignment with the current structures of work and family.

Working Longer

As a consequence of increases in life expectancy, individuals are generally spending more years in retirement. The average male worker spent 18 years in retirement in 2003, up from less than 12 years in 1950. Encouraging older workers to remain in the labor force could increase revenues to Social Security and significantly improve individuals' standard of living in retirement. Although some workers may face significant health problems, there is evidence that the health of older persons generally is improving. Research has shown that the majority of workers aged 62 to 67 do not appear to have health limitations that would prevent them from extending their careers, although some could face severe challenges in attempting to remain in the workforce.[14] In general, however, today's older population may have an increased capacity to work compared with that of

[14] GAO/HEHS-99-112.

previous generations.[15] Congress has already provided an incentive for older workers to continue working by repealing the earnings test for individuals at or above the full retirement age. This change allows older workers to continue working without any reduction in their Social Security benefits. It will be important to have institutions in place that can further facilitate the continued employment of older workers.

Spousal Benefits

As women's participation in the labor force has increased, more of them may be entitled to Social Security benefits based on their own earnings records rather than their spouses'. As a result, there will probably be relatively more two-earner couples and relatively fewer one-earner couples in the system. Under the current program, non-working spouses can receive a spousal benefit even though they had no covered earnings of their own. Spouses can be entitled to a benefit based on their own earnings record that is equal to or less than the benefit they are entitled to on their spouses' earnings records. The household benefit in such cases is no greater than if such spouses had never worked at all. Similarly, when a woman becomes widowed, her total household income can potentially be cut much more deeply if she was receiving a retirement benefit based on her own earnings while her spouse was alive, compared to a widow whose benefit was based only on her spouse's earnings. Thus two-earner couples may question whether they are receiving an adequate return on their contributions. In considering alternatives to the one-earner model on which the program was created, however, a two-earner model is not necessarily the answer. In a country as heterogeneous as America, probably no one model is optimal. The increase in women in the workforce and two-earner couples raises questions about the equity for working women of the current design of the spousal benefit.

Federal Disability Programs

The DI program is based on the concept of assisting individuals whose impairments have adversely affected their work capabilities. The program provides compensation for reduced earnings due to a disability and attempts to facilitate the efforts of individuals with disabilities to return to work. However, GAO's work on federal disability programs,[16] including DI, has found that these programs are neither well aligned with 21st Century

[15] It should be noted, however, that life expectancy is related to income, and low-income workers tend to have lower life expectancies and poorer health outcomes.

[16] *High-Risk Series: An Update*, GAO-05-207 (Washington, DC: Jan. 2005).

realities nor are they positioned to provide meaningful and timely support for Americans with disabilities. Our work suggests that these programs remain grounded in outmoded concepts of disability, and are not updated to reflect scientific, medical, technological and labor market improvements. Moreover, the enactment of various DI work incentives that are intended to encourage beneficiaries to work—and, potentially, to leave the disability rolls— has had little discernible impact on beneficiaries' success in returning to the workforce. Policymakers will need to consider how these realities fit into the evolving role of the DI program, particularly as the baby boom generation reaches their disability-prone years.[17]

Concluding Observations

Before the advent of Social Security, being old often meant being poor. Today, older Americans' dependency on public assistance is dramatically lower than Depression-era levels, and poverty rates among the elderly are now lower than for the population as a whole. At the same time, Social Security has become the single largest source of income for the elderly, providing retirement income to more than 90 percent of persons aged 65 and older.

Given its long-term solvency problems, however, there are difficult decisions to be made about Social Security, largely because the program is so important to so many people. The challenges posed by the growth in Social Security spending become even more significant in combination with the more rapid growth expected in Medicare and Medicaid spending and the need for reform of the private pension system. Medicare, in particular, presents a much greater, and more complex fiscal challenge than does Social Security. Policymakers will need to address the escalating costs of both Social Security and Medicare while recognizing that these programs are crucial to retirement wellbeing, especially for vulnerable populations.

There are tough decisions to be made, and action is needed sooner rather than later. Most importantly, however, the solvency and sustainability of Social Security should be addressed within the context of the program's role of protecting vulnerable populations, while at the same time considering how carrying out that role may need to change to better address changing societal needs. We at GAO look forward to continuing to

[17] The average age of disabled workers is approximately 50.

work with this Committee and the Congress in addressing this and other important issues facing our nation.

Mr. Chairman and Members of the Subcommittee, this concludes my prepared statement. I'd be happy to answer any questions you may have.

GAO Contacts and Staff Acknowledgments

For further information regarding this testimony, please contact Alicia Puente Cackley, Assistant Director, on (202) 512-7215. Gretta L. Goodwin also made key contributions to this testimony.

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