SOCIAL SECURITY HAS HAD GREAT SUCCESS IN reducing poverty, on average, among the elderly. Today, the elderly poverty rate is less than one-third the 35 percent rate seen in 1960. Social Security also protects people from inflation and other risks (as we think it should).

The success of any program, however, cannot be judged solely by how well that program succeeds on average. To assess Social Security’s marginal success, a good measure is how much each additional dollar spent improves the lot of the population it serves. Here, we describe three pieces of evidence suggesting that Social Security’s ability to meet one of its most fundamental tenets—alleviating old-age poverty—has hit several roadblocks.

Antipoverty Roadblocks

First, the significant increase in divorced and never-married individuals indicates that a larger share of society will not qualify for spousal and survivors benefits in the future. Since 1940, the Social Security program has paid out these supplemental benefits (originally to wives, but later to husbands as well) to ensure that persons with little or no earnings have adequate income in old age. Established as pure transfers, these benefits are not financed by added contributions or reduced worker benefits, unlike in private pension schemes. Rather, the program allocates spousal and survivors benefits according to the prime beneficiary’s earnings, so that spouses of higher earners gain more in benefits than spouses of lower earners. Moreover, single heads of household—mainly lower-income women raising children—do not gain at all from spousal and survivors benefits.

Recent research sponsored by the Social Security Administration (SSA) shows that poverty rates among the elderly could fall slightly as long as current marital and earnings patterns continue—from about 8.4 percent in the early 1990s to 6.5 percent by 2020. Over the same period, Social Security and Disability Insurance are scheduled to pay out an additional $451 billion in real benefits; that’s an average of $5,000 of additional spending per retiree, a 34 percent real increase and more than enough to wipe out the poverty gap several times over. Arguably, the unavailability of supplemental benefits to the most needy individuals limits the projected decline in the poverty rate, despite the very large infusion of funds. So little poverty reduction for so many additional dollars makes for a poor marginal return.

Second, the percentage of benefits paid to older retirees has fallen steadily relative to benefits paid to younger retirees. In 1968, men expecting to live another 10 years or less received 52 percent of all Social Security benefits paid to men. By 1997, this group received only 38 percent. Under current law, the percentage of benefits going to the oldest retirees is scheduled to decline further. A major reason for the shift is that people are retiring earlier and receiving Social Security for longer periods. Because retirees with longer expected life spans tend to work and have fewer chronic or acute health problems, the program’s current design will provide continually higher percentages of benefits to retirees who need them the least.

To further complicate matters, Social Security law schedules higher real levels of benefits for each year’s new retirees. The increase for each group approximately equals the average wage growth relative to the previous group’s. For instance, under current law, if future real wage growth averages 1 percentage point
per year, the average benefit for retirees age 67 in 2042 will be 21 percent higher than the average benefit for 87-year-old retirees in that same year.2

Finally, in the past, a majority of younger retirees used to work until older ages. In 1940, about 80 percent of men expecting to live 16 more years still worked, whereas today, only 35 percent of these men work. In some respects, Social Security has shifted from an old-age to a middle-age retirement program, replacing income that still-healthy individuals could earn themselves.

The Logic of Efficiency

Of course, we are not suggesting that all income substitutions could (or should) be eliminated, or that Social Security does not protect most retirees. Rather, we simply note what we see as a logical point: A system with the same average benefit level that concentrated a greater proportion of benefits among older persons would almost inevitably enhance total retirement income, because people would remain in the workforce longer and earn more. Correspondingly, concentrating the greatest proportion of benefits among workers with longer life expectancies buys more and more leisure, and less and less income protection, per additional dollar spent.

Social Security’s decreasing efficiency in meeting the primary needs of the truly old has important implications. One concerns reporting practices. SSA publishes reams of data on average program costs and benefits, but little on how the program’s additional moneys are spent. We believe the public deserves an accounting on that front as well.

For reform efforts, the decreasing antipoverty effectiveness of additional expenditures suggests:

- A reformulation of the spousal and survivors benefits could make distribution more equitable and remove the inherent disadvantage to single and divorced individuals, particularly single heads of household, who face a higher risk of poverty.

- Redirecting a higher share of benefits to the oldest retirees would help reduce poverty among the very old and increase the net income of the elderly by increasing earnings and annual benefits in later, more vulnerable years. A combination of retirement-age increases, actuarial adjustments favoring older age, and changes in postretirement indexing rules could help achieve this result.3

Policymakers should weigh these reforms regardless of whether the revamped system has a faster or slower benefit growth rate and whether or not it achieves saving through individual accounts or trust funds. Social Security funds, no matter what their size, should be allocated efficiently and in a way that best meets the program’s objectives.

1. These figures slightly understate poverty relative to U.S. Census data.

2. A scheduled increase in the normal retirement age from age 65 to 67, with an actuarial reduction for individuals who retire earlier and actuarial increases for those who retire later, will reduce the difference for a while if people still retire at the same age.

3. Note that some reform programs, such as the August 2001 proposal by Representatives Jim Kolbe (R-AZ) and Charles Stenholm (D-TX) and the Bipartisan Social Security Reform Act introduced by Senators John Breaux (D-LA) and Judd Gregg (R-NH) do address some of these issues. But much of the general debate simply bypasses the issue of whether the transfer system (whatever its size after reform) does its job well.

Eugene Steuerle is a senior fellow at the Urban Institute, where his research includes work on Social Security reform. Adam Carasso is a research associate at the Urban Institute.