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SOCIAL SECURITY REFORM

Implications for Women

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Social Security Reform: Implications for Women

Mr. Chairman and Members of the Subcommittee:

Thank you for inviting me here today to speak about women and Social Security. Social Security has had a significant positive impact on the nation's elderly. Since 1959, poverty rates for the elderly have fallen from 35 percent to 10.5 percent, thanks largely to this insurance program. Nevertheless, some elderly women are at greater risk of living in poverty. In 1996, 55 percent of older women would have had incomes below the poverty line without Social Security.

My remarks today focus on (1) how women currently fare under Social Security, (2) how they might be affected by some of the proposed changes in benefits to restore solvency, and (3) how women might fare under a system restructured to include individual accounts. My testimony is based primarily upon a report already issued to the Subcommittee.[1]

In summary, women have benefited significantly from the Social Security program. Many women who work are advantaged by the progressive benefit formula that provides larger relative benefits to those with lower lifetime earnings. Women who did not work or had low lifetime earnings and who were married benefit from the program's spousal and survivor benefit provisions. However, women typically receive lower monthly benefits than men because benefits are based on earnings and the number of years worked. Any across-the-board benefit cuts to restore solvency might fall disproportionately on women as a group because they rely more heavily on Social Security income than men do. Other types of reform approaches can have positive or negative effects on women depending on how the reforms are designed.

Restructuring Social Security to include individual accounts also will likely have different effects on men and women. Because women earn less than men, contributions of a fixed percentage of earnings would put less into women's individual retirement accounts. Available evidence indicates that women also tend to invest more conservatively than men and thus would likely earn smaller returns on their accounts, although they would bear less risk. In addition, how such accounts are structured will be extremely important to women. For example, whether individuals will be required to purchase annuities with the proceeds of their accounts at retirement and how the annuities are priced could affect women quite differently from men. How benefits might be distributed to divorcees and how accounts

[1]Social Security Reform: Implications for Women's Retirement Income (GAO/HEHS-98-42, Dec. 31, 1997).

are transferred to survivors could critically affect the retirement income of some elderly women. Understanding the potential consequences of the various reform proposals can help ensure that Social Security continues to protect vulnerable populations, such as elderly unmarried women.

How Women Currently Fare Under Social Security

Social Security has provided significant income protection for the nation's women. While women, on average, have lower earnings than men, the program has several features that are advantageous to women. First, unlike lifetime annuities purchased from private insurance companies, Social Security does not reduce women's benefits to account for the fact that, as a group, they live longer than men. Second, Social Security uses a progressive formula to calculate individual benefits, which replaces a relatively larger proportion of lifetime earnings for people with low earnings than for people with high earnings. Because women typically earn less than men, women's monthly benefits replace a larger proportion of their earnings. The program also provides benefits to retirees' dependents—such as spouses, ex-spouses, and survivors—and roughly 99 percent of these benefits go to women.[2]

Nevertheless, women receive lower Social Security benefits than men. In December 1997, the average monthly retired worker benefit for women was $662.40 compared to $860.50 for men. This is because Social Security benefits are based primarily on a worker's lifetime covered earnings, which on average are much lower for women.[3] Although labor market differences between men and women have narrowed over time, the Bureau of Labor Statistics does not project that they will disappear entirely, even in the long term. Thus, women can expect to continue to receive lower average monthly benefits than men, although these differences are partially offset by the presence of spousal benefits.

Lower lifetime earnings can be traced to two principal causes. First, women's labor force participation rates (the percentage of the population aged 16 and older who are working or actively seeking employment) are lower than men's at every age. Women's labor force participation rates have increased substantially over the past 35 years, growing from just 38 percent in 1960 to 60 percent in 1997. At the same time, the rate for men fell from 83 percent to 75 percent. Both trends have leveled off since the early 1990s. The difference in labor force participation has implications for

[2]In addition, the program also provides benefits for the children of retired and deceased workers and for disabled workers and their dependents.

[3]Covered earnings are earnings subject to the Social Security payroll tax, up to $72,600 for 1999.

women's Social Security benefits relative to men's, since under the current rules Social Security calculates monthly benefits on the basis of lifetime taxable earnings averaged over a worker's 35 years of highest earnings. Because women generally spend more time out of the labor force than men (primarily for reasons associated with child rearing), they have fewer years of taxable earnings; thus, more years with zero earnings are included in calculating their benefits. Even if women and men had identical annual earnings when they both worked, women's shorter time spent in the labor force results in lower average lifetime earnings, which in turn leads to lower retirement benefits. In 1993, the average 62-year-old man had worked 36 years, whereas the average 62-year-old woman had worked only 25 years.[4] Almost 60 percent of these 62-year-old men had a full 35 years of covered earnings compared with less than 20 percent of women.

A second cause of lower lifetime earnings is women's lower wage rates. In part, this reflects the fact that women are more likely to work part-time, and part-time workers tend to earn lower wages than full-time workers. However, even if only year-round, full-time male and female workers are compared, the median earnings for women are still less than 75 percent of men's. The gap narrows when differences in education, years of work experience, age, and other relevant factors are taken into account.

How Women Might Be Affected by Various Reform Proposals Within the Existing Program Structure

The changes contained in various Social Security reform proposals would likely have a disproportionate effect on women. Many reform proposals include provisions that would reduce current benefit levels, for example, reductions in the cost-of-living adjustment and increases in the normal or early retirement ages. Reducing all benefits proportionately would hit hardest those who have little retirement income other than Social Security. Reducing Social Security benefits by, for example, 10 percent would result in a 10-percent reduction in total retirement income for those who have no other source of income but would cause only a 5-percent reduction for those who rely on Social Security for only half their retirement income. Women, especially elderly women, are more likely to rely heavily, if not entirely, on Social Security. Among Social Security beneficiaries aged 65 or older in 1996, about half the married couples, two-thirds of the unmarried men, and three-fourths of the unmarried women (who accounted for almost half of the three groups) relied on Social Security for at least half their retirement income. One-fourth of the unmarried women relied on Social Security for all their retirement income.

[4]These data include only earnings from 1951 to the year the worker reached age 61.

Other changes could exacerbate existing disadvantages for some women. For example, some proposals would extend the period for computing benefits from 35 years to 38 or 40 years. Because most women do not have even 35 years with covered earnings, increasing the computation period would increase the number of years with zero earnings used in calculating their benefits and, thus, lower their average benefit. The Social Security Administration (SSA) forecasts that fewer than 30 percent of women retiring in 2020 will have 38 years of covered earnings, compared with almost 60 percent of men. SSA estimates that extending the computation period to 38 years would reduce women's benefits by 3.9 percent, while extending the period to 40 years would reduce their benefits by 6.4 percent. The comparable impact on men from an extension to 38 or 40 years is 3.1 percent and 5.2 percent, respectively.[5]

Some reform proposals include a specific provision designed to improve the status of survivors, who are predominantly widows, but simultaneously reduce spousal benefits that generally accrue to women. Under the current system, a retired worker's spouse who is not entitled to benefits under her own work records will receive a benefit up to 50 percent of her husband's benefit and a widow will receive up to 100 percent of her deceased husband's benefit. One proposal would reduce the spousal benefit from 50 percent to 33 percent of the worker's benefit but would increase the survivor's benefit to either 75 percent of the couple's combined benefit or 100 percent of the worker's benefit, whichever is greater. One-earner couples would receive reduced lifetime benefits because the spousal benefit would be reduced while both the retiree and spouse were alive, but the survivor benefit would remain the same as under current law. Two-earner couples would lose some benefits while both were alive if one spouse was dually entitled,[6] but the survivor would receive higher benefits than under current law.

[5]These percentages are based on a sample of new awards in 1993.

[6]A person who is dually entitled receives a retired-worker benefit based on his or her own earnings but is entitled to a higher spousal or survivor benefit based on the earnings of a current or former spouse. The dually entitled beneficiary receives the benefit based on his or her own work record plus the difference between that benefit and the higher spousal or survivor benefit.

How Women Might Fare Under a System Restructured to Include Individual Accounts

Many reform proposals would fundamentally restructure Social Security by creating retirement accounts that would be owned and managed by individuals. While such accounts can increase benefits for retirees, women on average might not reap the same advantages such an investment could bring to men. As stated earlier, the difference is partly the result of women having shorter work histories and lower earning levels, which suggests they generally will contribute less to these accounts. The difference is also partly the result of differences in investment behavior.

Women Invest More Conservatively Than Men

Economists have found evidence suggesting that women generally are more risk averse than men in financial decisionmaking. Studies indicate that, compared with men, women might choose a relatively low-risk investment strategy that earns them lower rates of return for their retirement income accounts. Although proponents argue that individual accounts could raise retirement benefits for both sexes, an overly conservative investment strategy could leave women with lower final account balances than men, even if both make the same contributions. Thus, even though women could improve their financial situation under a retirement system that included individual accounts, the gap between the benefits received by men and women could increase.

In our December 1997 report, we attempted to calculate the difference in risk aversion between men and women by looking specifically at the differences in how unmarried men and women who were nearing retirement age invested their assets. We examined unmarried individuals because it was not possible to determine who made investment decisions in married households. We found that women aged 51 to 61 in 1992 had a lower percentage of their total assets in stocks, mutual funds, and investment trusts than men did. The returns on these assets are more volatile but potentially higher yielding than others, such as certificates of deposit, savings accounts, or government bonds.[7] On average, we found that the ratio of riskier assets to total assets held by men was 8 percentage points higher than the same ratio for women. Other researchers, looking at participants in the federal Thrift Savings Plan, have also found that women

[7]Total assets included non-housing equity from checking and savings accounts, money market funds, certificates of deposit, government bonds, Treasury bills, individual retirement accounts, KEOGHs, stocks, mutual funds, investment trusts, business equity, bonds, bond funds and other assets, and housing equity.

invest less in stocks than men.[8] Our analysis, using different data and focusing on individuals in their prime working and saving years, increases the robustness of this conclusion. By investing less in these riskier assets, women benefit less from the potentially greater rates of return that, in the long run, stocks could generate. At the same time, however, they are not as exposed to large losses from riskier assets. While it is true that in the past U.S. stocks have almost always posted higher returns than less risky assets, there is no guarantee that they will always do so.

Some pension specialists believe that information is a critical factor in helping individuals make the most of their retirement investments. Providing investors with information that covers general investment principles and financial planning advice might help both women and men to better manage their investments and close the gap in the average investment returns received by men and women. While employers are not legally required to provide this type of information, many have done so in the case of 401(k) accounts. It is not clear who would provide such information to workers under a restructured Social Security system that included mandatory individual accounts. The nature and extent of such information and education efforts, when combined with the design of related investment options, are likely to help maximize the effectiveness of, and minimize the risk associated with, individual accounts under the Social Security system.

Annuitization Choices Will Affect Retiree's Benefits

How individual account accumulations are paid out will also make a difference in retirement income for many women. Unless otherwise specified, workers could choose to receive their individual account balances at retirement as a lump-sum payment, as some pension plans now allow, to spend as they see fit. If retirees and their spouses do not accurately predict their remaining life spans and consume their account balances too quickly, they may end up with very small incomes late in life.

To preserve retirement income, retirees could be required to convert the capital accumulations in their individual accounts to a lifetime annuity. However, men and women could retire with similar amounts in their

[8]Richard P. Hinz, David D. McCarthy, and John A. Turner, "Are Women Conservative Investors? Gender Differences in Participant Directed Pension Investments," in Positioning Pensions for the Twenty-First Century, ed. by Michael S. Gordon, Olivia S. Mitchell, and Marc M. Twinney (Philadelphia, Penn.: University of Pennsylvania Press, 1997); Vickie L. Bajtelsmit, Alexandra Bernasek, and Nancy A. Jianakoplos, "Gender Differences in Pension Investment Allocation Decisions," Working Papers in Economics and Political Economy, Department of Economics, Colorado State University (Oct. 1996); and James M. Poterba and David A. Wise, "Individual Financial Decisions in Retirement Saving Plans and the Provision of Resources for Retirement," National Bureau of Economic Research Working Paper No. 5762 (Sept. 1996).

individual accounts and still end up with very different monthly benefits if they were to purchase annuities and if the annuities were based on gender-specific life tables.[9] Insurance companies that sell annuities usually take into account women's longer life expectancy and either provide a lower monthly benefit to women or charge women more for the same level of benefits given to men. In the case of employer-provided group annuities, gender-neutral life tables must be used in the calculation of monthly benefits, which ensures equal benefits for men and women with the same lifetime earnings.[10] Requirements to use gender-neutral life tables involve cross-subsidies between men and women.

Insurance companies also pay lower benefits for a joint and survivor annuity that covers both husband and wife than for a single life annuity that covers only the worker during his or her lifetime—again because the total time in which the benefits are expected to be paid is longer. Women are more likely to receive the survivor portion of this type of annuity, since they are more likely to outlive their husbands. Thus, while the total lifetime annuity benefits for men and women may be similar, the monthly benefit women receive, either as retirees or as survivors, will likely be lower and could result in a lower standard of living in retirement.[11]

Other groups of women will also need to be considered if individual accounts are introduced. Under current Social Security provisions, divorced spouses and survivors are entitled to receive benefits based on their former spouse's complete earnings record if they were married at least 10 years. Most of those receiving benefits under this provision are women. Many individual retirement account proposals do not acknowledge divorcees and survivors as having any specific claim on the individual accounts of their former spouses. Under these proposals, the current automatic provision of these benefits would be eliminated. The money in these accounts could become a part of the settlement at the time of a divorce, but the current benefit guarantee to these benefits might be lost.

Mandating the purchase of a joint and survivor annuity with the individual account balances at retirement will reduce the risk that some wives will have little to live on if they outlive their husbands. Requiring the use of

[9]An annuity can be single life, for the lifetime of the worker only, or joint and survivor, for the lifetime of the annuitant and his or her designated survivor.

[10]That is, same-aged men and women would receive identical annuity benefits for the same price.

[11]Some demographers believe that life expectancy will continue to increase in the future, affecting annuity values. However, it is unclear whether the gap between the life expectancy of men and women will also narrow in the future.

gender-neutral life tables would create cross-subsidies between men and women. However, doing so could protect retired women against a lower living standard that would result simply because they usually live longer than men. The needs of former spouses will also need to be considered in developing individual accounts.

Conclusions

While the Social Security system has benefited women significantly through the spousal benefit and the progressivity of the benefit formula, women generally receive lower Social Security benefits than men because they work fewer years and earn lower wages. These work and earnings characteristics will affect the relative changes in average benefits for men and women under some reform proposals. In particular, these characteristics will work against women should reforms based on years with covered earnings be enacted. Because of women's longer life expectancy, the creation of mandatory individual retirement accounts could also decrease women's benefits relative to men's if women continue to invest more conservatively than men. Women might also be disadvantaged if the accumulations in these accounts are paid as a lump sum rather than as a joint and survivor annuity based on gender-neutral life tables.

Whether reforms include relatively modest modifications to the current system or more major restructurings that could include mandatory individual retirement accounts, some elements of the reform proposals could adversely affect many elderly women. Because elderly women are at risk for living in poverty, understanding how various elements of the population will be affected by different changes will be necessary if we are to protect the most vulnerable members of our society.

This concludes my prepared statement. I would be happy to answer any questions you or other Members of the Subcommittee might have.

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