



Highlights of GAO-04-872T, a testimony for the Special Committee on Aging, United States Senate

SOCIAL SECURITY

Reform Proposals Could Have a Variety of Effects on Distribution of Benefits and Payroll Taxes

Why GAO Did This Study

Under the current Social Security benefit formula, retired workers can receive benefits at age 65 that equal about 50 percent of pre-retirement earnings for an illustrative low-wage worker but only about 30 percent for an illustrative high-wage worker. Factors other than earnings also influence the distribution of benefits, including the program's provisions for disabled workers, spouses, children, and survivors. Changes in the program over time also affect the distribution of benefits across generations.

Social Security faces a long-term structural financing shortfall. Program changes to address that shortfall could alter the way Social Security's benefits and revenues are distributed across the population and affect the income security of millions of Americans.

The Chairman of the Senate Special Committee on Aging asked us to discuss how selected Social Security reform proposals might affect the distribution of benefits and taxes.

What GAO Found

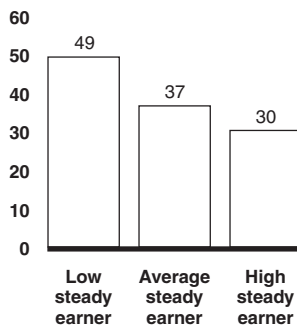
Two distinct perspectives on Social Security's goals suggest different approaches to measuring "progressivity," or the distribution of benefits and taxes with respect to various earnings levels. Both perspectives provide valuable insights. An adequacy perspective focuses on benefit levels and how well they maintain pre-retirement living standards. An equity perspective focuses on rates of return and other measures relating lifetime benefits to contributions. Both perspectives examine how their measures are distributed across earnings levels. However, equity measures take all benefits and taxes into account, which is difficult to calculate for reform proposals that rely on general revenue transfers because it is unclear who will bear the relative burden for those general revenues.

The Social Security program's distributional effects reflect both program features and demographic patterns among its recipients. In addition to the benefit formula, disability benefits favor lower earners because disabled workers are more likely to be lower lifetime earners. In contrast, certain household patterns reduce the system's tilt toward lower earners, for example, when lower earners have high-earner spouses. The advantage for lower earners is also diminished by the fact that they may not live as long as higher earners and therefore would get benefits for fewer years on average.

Proposals to alter the Social Security program would have different distributional effects, depending on their design. Model 2 of the President's Commission to Strengthen Social Security proposes new individual accounts, certain benefit reductions for all beneficiaries, and certain benefit enhancements for selected low earners and survivors. According to our simulations, the combined effect could result in lower earners receiving a greater relative share of all benefits than under the current system if all workers invest in the same portfolio.

Social Security Benefit Formula Provides Higher Replacement Rates for Lower Earners

Percentage replacement rate at age 65



Source: GAO analysis using SSA ANYPIA program.

Notes: Replacement rates are the annual retired worker benefits at age 65 for workers born in 1985 divided by the earnings in the previous year. For such workers, the full retirement age will be 67. Steady earners have earnings equal to various percentages of Social Security's Average Wage Index in every year of their careers.

www.gao.gov/cgi-bin/getrpt?GAO-04-872T.

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