



## SOCIAL SECURITY: A SAFETY NET FOR AMERICA'S FAMILIES?

### INTRODUCTION

Most people think of Social Security as a program for older people, but Social Security benefits families and children as well. About one-third (34%) of Social Security beneficiaries are under age 65. These include spouses and children of retirees, early retirees, and people with disabilities.<sup>1</sup> About 7%, or 3.2 million, Social Security beneficiaries are children under the age of 18<sup>1</sup>. Social Security is more than a retirement program; it also offers disability insurance and benefits to widows and children, providing a safety net to families in crisis.

A major policy debate today is whether to revise the Social Security program to meet the upcoming flow of Baby Boomers who soon will be retiring. Several proposals have been put forth regarding changes to meet future demands. It is important to consider the family implications of these proposals. In this policy brief, we summarize evidence from economic and social science research to examine the implications of change for families.

### HOW SOCIAL SECURITY AFFECTS FAMILIES TODAY

- Social Security provides benefits to 48 million Americans: 33 million retired workers and their dependents, 7 million survivors of deceased workers, and 8 million disabled workers and their dependents<sup>2</sup>.
- 3.2 million children under the age of 18 receive Social Security benefits. Children comprise 7% of current Social Security beneficiaries. The majority of these children are dependents of disabled or retired workers<sup>1</sup>.
- While over two thirds (69%) of Social Security beneficiaries receive benefits because of retirement, 16% (8 million Americans) receive Social Security because of a disability that prevents them from working, and another 14% (7 million) receive Social Security benefits as survivors of a deceased worker<sup>1</sup>.
- Social Security is the only source of retirement income for 29% of older unmarried women, most of whom are widows<sup>3</sup>.
- Without Social Security benefits, 47% of seniors would live below the poverty line<sup>4</sup>.
- Social Security provides the majority of retirement income for two thirds (66%) of seniors<sup>1</sup>.
- While 90% of seniors receive Social Security benefits, less than half (43%) receive pensions, making Social Security the most widespread and secure source of income in retirement<sup>1</sup>.

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Social Security is a social insurance program designed for workers of all ages and their families. During the Depression, unemployment reached a high of almost 33%. The safety nets that older Americans had arranged for themselves, such as retirement savings, investments, and home equity, evaporated. Congress created Social Security in 1935 because so many older people were living in poverty that traditional supports — communities, religious organizations, and private charities — could not meet their needs.

Starting in 1939, Congress expanded the program to provide benefits for deceased workers' young children and widows, as well as people with disabilities. Today Social Security benefits support older widows, young parents who lose a spouse, children who lose a parent, and families that lose income because of serious disability.

### How does Social Security work?

- "Social Security" is a shorthand term for the OASDI program: Old Age, Survivors, and Disability Insurance. OASDI consists of two parts that pay monthly benefits to workers and their families.
- Old Age and Survivors Insurance (OASI) provides benefits to retired workers and their families as well as to survivors of deceased workers. To qualify for these benefits workers must have paid Social Security tax for at least 40 quarters, or about 10 years.
- Disability Insurance (DI) provides benefits to disabled workers and their families. To qualify, workers must have contributed to Social Security for 5 years and must have been diagnosed with a permanent disability that prevents them from working.

The average Social Security benefit is about \$950<sup>1</sup> per month – only 20% higher than the official poverty level.

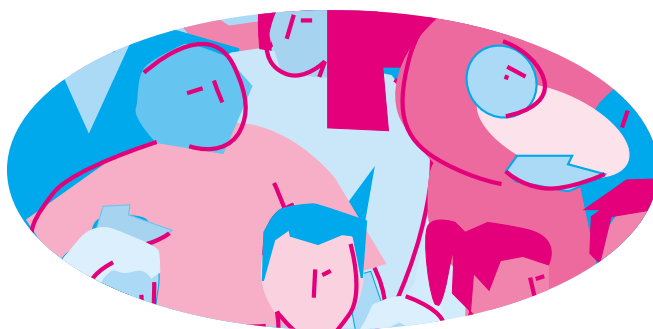
## Social Security Myths and Realities

### Myth #1: Social Security is facing a financing crisis.

#### Reality:

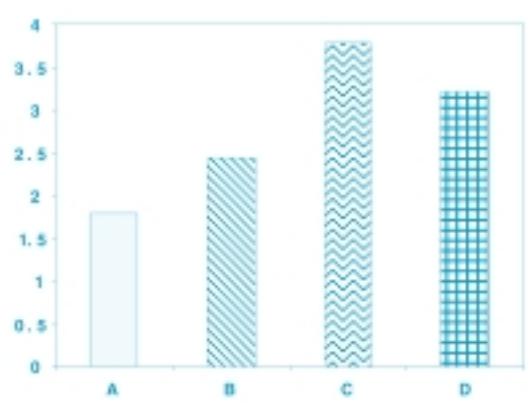
The Social Security Trust Fund currently has a balance of over 1.7 trillion dollars<sup>2</sup>. For two decades, the Fund has been taking in more money than it pays out in benefits; today, the program is in the best financial health of its 69-year history. As the number of retiring Baby Boomers grows, however, the Social Security Trust Fund will be required to draw on these reserves. By 2017 the annual cost of benefits will exceed payroll tax income, requiring expenditures from the trust fund<sup>2</sup>. According to 2005 projections from the Social Security Administration, reserve assets will be exhausted by 2041<sup>2</sup>. Payroll tax income will cover 74% of promised benefits<sup>2</sup>. These projections are based on conservative estimates of our economic growth — about 1.8% per year. The American economy has consistently outperformed these estimates, with a growth of about 3.2% per year since 1970. Consequently, the date of Social Security insolvency has been continually delayed. Less conservative projections from the nonpartisan Congressional Budget Office point to 2052 as the date when payouts will exceed the trust fund level<sup>3</sup>.

When the economy exceeds economic projections of 1.8% growth per year, the Social Security Trust Fund grows and the "shortfall date" recedes further and further.



Year of projection date	Projected shortfall date
1997	2029
1999	2034
2005	2041

Source: Social Security Administration <sup>2, 6, 7</sup>



- A. 1.8% -- Yearly economic growth assumed by Social Security trustees.
- B. 2.5% -- Economic growth per year needed to keep Social Security solvent until 2090 without reducing benefits
- C. 3.8% -- Current level of U.S. economic growth per year
- D. 3.2% -- Average level of U.S. economic growth over last 30 years.

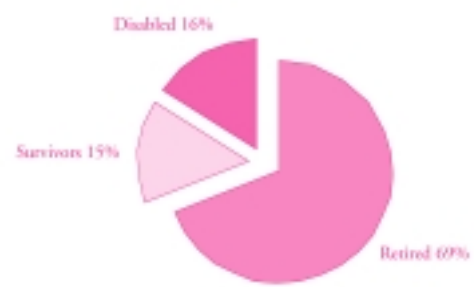
The prediction that Social Security will have depleted its reserves by 2041 is based on the assumption that the US economy will grow at a rate of 1.8% a year between now and 2041. To put this conservative projection in context, the US economy has grown by an average of 3.2 percent per year over the last 30 years; and it will need to grow only 2.5 percent per year between now and 2040 in order to keep Social Security solvent at least into the 22nd Century – without any reduction in benefits.

**Myth #2: Social Security is a program for seniors.**

**Reality:**

Congress designed Social Security to benefit working families and people of all ages. One-third (34%) of Social Security beneficiaries are

under age 65; these include spouses, children, early retirees, and people with disabilities<sup>1</sup>. Social Security today is both a retirement insurance program and a disability and life insurance program. It provides benefits to people with serious disabilities and to family members who have lost income because of disability or death. Additionally, in its capacity as a retirement insurance program, Social Security alleviates some of the physical, financial, and emotional stress that comes from caring for an older parent or in-law.



**Myth #3: Social Security offers generous benefits to the elderly at the expense of younger workers.**

**Reality:**

Social Security was designed by Congress to supplement personal retirement income, not to replace it at the expense of younger workers. The average Social Security benefit is only \$955 and is intended to provide about 40% of the average worker's income<sup>1</sup>.

**The Four Legged Stool**

On average, Social Security makes up about 40% of retiree incomes. Social Security is a safety net; it was never intended to replace other important sources of income, including personal savings. Retirement income is often characterized as a four-legged stool, made up of Social Security, pensions, savings, and earnings from work.



Sources of income for the U.S. population aged 65 and over, 2002



Source: *Older Americans 2004: Key Indicators of Well-Being*<sup>8</sup>

## Are changes needed to ensure Social Security for future generations?

Although Social Security is not in "crisis" today, it may need changes in order to achieve long-term health. As Baby Boomers born between 1946 and 1964 reach retirement, the number of Social Security beneficiaries will increase more rapidly than the number of workers. By 2030, there will be only 2.2 workers per retiree<sup>2</sup>. Currently, with about 3 workers for each retiree, Social Security has a growing surplus. Rapid changes on the horizon such as expanded longevity, globalization, education, and technology may also dramatically change the picture for Social Security in ways that are hard to predict.

In light of these issues, some have suggested that the best course for now is to do nothing. Social Security will be fiscally sound for more than 35 years, based on conservative estimates of growth. If economic growth continues at rates similar to the last 50 years, Social Security will be solvent even longer. However, the risk in this approach is that deficits may be allowed to grow until they require large tax increases or benefit cuts.

## Five options proposed to strengthen Social Security for future beneficiaries

### 1. Increase payroll tax earnings cap

Annual earnings are now taxed only up to \$90,000. Every dollar earned over and above this cap is exempt from Social Security taxes. One proposal is to raise this earnings cap to \$140,000. This tax increase would affect about 6% of workers and would cover about 43% of the currently projected shortfall<sup>9</sup>.

**Pro:** Only a few workers, and only the most well off, are forced to pay more taxes.

**Con:** Those who do pay are less likely to benefit directly.

### 2. Reduce or eliminate benefits for high income recipients

Retirees with incomes in the top 20% for their age group currently rely on Social Security for less than a fifth of their income<sup>8</sup>. This proposal would reduce or eliminate benefits to these high earners, providing benefits only to those who need them — in other words, "means testing" for eligibility.

**Pro:** Social Security benefits are allocated in a cost efficient way to those who need them most.

**Con:** Social Security could be considered a welfare program, rather than a social insurance program. One of the reasons there is widespread support for Social Security is because it provides nearly universal coverage. Under this proposal, some taxpayers would have to pay in without receiving full benefits, which might erode support for the program.

### 3. Raise the age of retirement eligibility

When Social Security was enacted in 1935, life expectancy was about 65 years. Today, the average American can expect to live over 77 years<sup>10</sup>. Congress passed legislation in 1983 that increased the eligibility age gradually from 65 to 67. Some proposals suggest raising it further over time, perhaps to age 70. Raising the retirement age would cover more than half of the projected shortfall<sup>11</sup>.

**Pro:** A small delay in the start of retirement would produce large savings.

**Con:** Many older persons retire because of poor health; they would be denied benefits. Some groups already disadvantaged by a greater risk of disability and shorter life expectancies (racial and ethnic minorities, blue collar workers) would receive lower rates of return before their death.

### 4. Change the index mechanism

Social Security benefits are currently indexed to wages at the time of retirement. Each year benefits rise through a Cost of Living Adjustment, and the size of the increase is based on the price growth, or inflation. This proposal would tie benefit increases more closely to the consumer price index, and because the wage index grows faster than the price index, benefits would be lessened.

**Pro:** Slowed benefit increases would produce a large savings and would better tie retirement

income to real changes in the cost of goods and services. **Con:** Slowed increases would lower benefits long-term for individuals, and decreased benefits would increase strain in low-to-middle-income households.

## 5. Create personal accounts with Social Security taxes

Personal accounts would permit workers to divert up to one-third of their Social Security tax payment into a private account that could be invested in stocks or bonds. Creating personal accounts would convert the Social Security system from a pay-as-you-go system, in which current workers finance current retirees, to a pre-funded system. At the same time, it would convert the system from a defined benefit system, in which retirees are guaranteed a minimum benefit, to a defined contribution system, similar to a 401(k), in which retirees draw from their own accumulated savings.

**Pro:** Individuals could have more control over investments to provide retirement income. They would have the opportunity to earn greater returns on their retirement investment and could potentially pass on a portion of these funds to their children.

**Con:** Creating private accounts would not address the solvency of Social Security and would place a tax burden on future generations required to pay up to \$2 trillion in transition costs. It would change Social Security from an insurance program protecting families to a retirement investment program, thereby limiting benefits for disabled workers, widows, and children.

### **What are the implications of these changes for families?**

Most of the debate so far has been focused on costs or benefits to individuals — the 157 million workers insured by Social Security and the 48 million current Social Security beneficiaries — but proposed changes have significant implications for families as well as individuals.

Reducing benefits would hurt families, especially among the middle class, minorities, and those with chronic health conditions.

Raising the retirement age or changing the index mechanisms (proposals 3 and 4 above) would reduce Social Security benefits for middle-class workers and strain family resources.

Delaying retirement eligibility would be particularly detrimental to low- and middle- income workers. Those who cannot afford to participate in early

retirement at age 62 could have to continue working up to age 70, which is especially difficult for workers in manual labor and those with chronic health conditions. Furthermore, because minority workers have average lower life expectancies and are more likely to have chronic health conditions, they would be especially disadvantaged.

Price indexing would reduce benefit growth; over time, this change results in as much as a 26% decrease in benefits relative to wage-indexed benefits<sup>12</sup>. This change would be particularly difficult for middle-class families because it would reduce retirement income, without reducing it enough to enable families to qualify for additional benefits. This proposal would likely increase the numbers of "near poor," those with incomes less than twice the federal poverty limit.

### **Creating personal accounts reduces Social Security's ability to protect families against poverty.**

Creating personal accounts (option 5) would change the nature of Social Security from an insurance program to an investment program, and investments carry certain risks. Although these accounts could enable individuals to increase their rate of return on Social Security investments, they could also result in a reduction in the rate of return, and therefore their retirement income. Historical analysis suggests that an average person working 40 years and investing his Social Security in the stock market could find that his benefits replaced anywhere from 104% of his income (in 1965) to just 19% of his income (in 1942)<sup>13</sup>.

The proposed personal account plans all contain some sort of floor, or minimum, to provide for those who lose retirement income because of poor investment performance. This floor varies widely by proposal, however. According to one proposal<sup>14</sup>, individuals who have contributed for 40 years would be entitled to a benefit equal to the poverty level. One of the major unaddressed questions raised by these proposals is: Who will pay to support older people who have not invested wisely, or who have been victims of stock market fluctuation? Will it be adult children? Faith-based organizations? Local government?

Social Security is a safety net for families in crisis. To move from the social insurance model to an individual investment model could harm the well-being of families, seniors, and the disabled of future generations. Social Security is crucial for family caregivers. By providing income to people with disabilities, Social Security enables caregivers to stay home and take care of disabled family members. Social Security is

also a vital resource for the growing number of grandparents caring for grandchildren, many of whom depend on Social Security for financial support<sup>15</sup>.

Because personal accounts divert earnings from the traditional Social Security Trust Fund, they accelerate the Social Security shortfall. The Trust Fund could be exhausted as early as 2031, necessitating tax increases for workers or benefit cuts for seniors<sup>16</sup>.

Any effort to convert from a pay-as-you-go program to a personal account program will incur substantial transition costs<sup>17</sup>. These transition costs will have to be paid by future generations and will add to the growing federal deficit.

Policymakers must consider the family implications of proposed changes in Social Security benefits. Since 1939, Congress has worked to expand Social Security to cover spouses, survivors, and disabled persons in all sectors of the work force. Working families depend on Social Security for insurance and support in times of crisis. In evaluating the program's future, it is important to make sure we can meet the needs of these families.

For more information, contact Dawn Alley: [alley@usc.edu](mailto:alley@usc.edu). For additional copies of this Policy Brief, contact Nancy Gonzalez at [nancy@ncfr.org](mailto:nancy@ncfr.org). The National Council on Family Relations gratefully acknowledges the authors of this Policy Brief: Dawn Alley, Kathleen Wilber, and Vern Bengtson of the Andrus Gerontology Center at the University of Southern California.

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