WILL SOCIAL SECURITY KEEP FEWER OF TOMORROW’S ELDERLY OUT OF POVERTY?

By Steven A. Sass*

Introduction

Social Security has been remarkably successful in reducing old-age poverty. The elderly had traditionally been a distinctly poor population. As recently as 1959, more than one out of three older Americans had incomes below the federal poverty threshold – twice the rate for working-age adults and more than 10 percentage points above the rate for children. Social Security is largely credited with reducing the incidence of poverty among the elderly today below the rate for both children and working-age adults.

This achievement will be challenged by Social Security’s long-term financing shortfall. In its initial attempt to close the shortfall, Congress in 1983 raised the program’s Full Retirement Age (FRA) from 65 to 67, cutting benefits by 13 percent when fully in place, for workers turning 62 in 2022. The Social Security Trust Fund is nonetheless projected to be depleted in 2034. Absent additional revenues, benefits would then be cut an additional 21 percent.¹

This brief reviews studies by the Social Security Administration’s Retirement Research Consortium that address the challenge of keeping the elderly out of poverty. Since poverty is hard to define, the first section presents the government’s “official” and recently developed “supplemental” definitions. The second section discusses the reduction in old-age poverty since the enactment of Social Security, as indicated by the official statistics. The third section compares official and supplemental estimates of elderly poverty today, and the ability of each measure to identify individuals experiencing financial distress. The fourth section shows that the magnitude of the challenge of keeping the elderly out of poverty tomorrow depends on how poverty is defined. The final section concludes that, if the supplemental measure is better, Social Security and the safety net could need significant structural adjustments to avoid a spike in poverty should benefits be cut.

Poverty Is Hard to Define

The ability of Social Security to keep the elderly out of poverty depends on the definition of poverty. The official definition – pre-tax cash income below the “federal poverty threshold” – was set in the 1960s as the government geared up to fight the “War on Poverty.” Thresholds were based on the cost of a “basic” diet, and the observation that low-income families spent about a third of their pre-tax income on food. The government set thresholds for different types of families, then indexed these thresholds to the Con-

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Social Security and the Reduction of Old-age Poverty

Poverty, using the official definition, has declined dramatically since Social Security was enacted. In 1939, a year before Social Security retirement benefits were first mailed out, an estimated 78 percent of the elderly had incomes below the federal poverty threshold. Poverty then fell to 35 percent of the elderly by 1959. Congress then created Medicare, significantly increased Social Security benefits, and formally indexed the initial retirement benefits of future cohorts to the growth of average wages. The benefit increase and link to wage growth were largely responsible for reducing the share of the elderly with incomes below the official price-indexed poverty threshold to 15 percent by the mid-1970s and to 10 percent by the mid-1990s (see Figure 1).

Experts generally agree that the official definition has serious limitations. In particular, it adopts an “absolute” notion of poverty, a definition of deprivation best suited for subsistence economies or for measuring progress over relatively short stretches of time. Unlike “relative” notions of poverty, the official definition fails to capture changes over the past 50 years in the general understanding of a basic standard of living, and changes in the expenditures on food, housing, medical care, and other items needed to secure that standard of living. The official definition’s use of a “pre-tax cash income” yardstick also ignores the important contribution of government initiatives that have reduced the need for such income, including the earned income tax credit and means-tested benefits such as food stamps and housing subsidies. Especially important for assessing poverty at older ages, the official measure also ignores the contribution of wealth – primarily the benefit that older homeowners receive for living in their home rent-free – that also reduce the need for cash income. In addition, the official measure uses a poverty threshold for elderly couples that may be too low relative to the amount for a single elderly person.

In response to these concerns, the National Academy of Sciences — after 20 years of research and debate — recommended, and key government agencies created, a new “Supplemental Poverty Measure” (SPM). The SPM defines poverty as the inability to secure a basic standard of living that changes over time. The SPM thresholds, recalculated every five years, are 1.2 times the value of food, clothing, shelter, and utilities consumed by families at the 33rd percentile in the expenditure distribution. In addition, the SPM uses a threshold for couples that is 41 percent higher than the threshold for singles. The SPM also accounts for: 1) items that reduce the need for cash income, such as in-kind government transfers, the earned income tax credit, and owning a home free and clear; 2) items that increase the need for cash income, such as work expenses, child support, mortgage payments, and out-of-pocket medical expenses; and 3) geographic differences in the cost of living. The Census Bureau has reported poverty rates using the SPM, alongside the official measure, since 2011.

A study by Richard W. Johnson and Gordon B. T. Mermin shows how Social Security acts as a safety net, pulling workers unable to secure an adequate income from employment out of poverty. The study tracks the incidence of poverty in a cohort of workers ages 52-54 in 1991 using the official poverty measure and data from the Health and Retirement Study (HRS), a biennial survey of a nationally representative panel of older households.
The study finds that poverty rose sharply as the cohort approached age 62 – the earliest age of eligibility for Social Security benefits – as health and employment shocks pushed an increasing share of low-wage workers out of the labor force (see Figure 2). Those most affected were: 1) minority and less-educated workers, who have few sources of income other than work; and 2) single workers, who do not have spousal earnings to keep them out of poverty should they fall out of employment. Once the cohort became eligible for Social Security, the incidence of poverty declined.

Social Security provided most workers in the cohort an income above the official poverty threshold. Even low-wage workers who earned just half the average wage over the course of their careers got a benefit above poverty if they delayed claiming until the FRA. Such workers got barely 80 percent of the poverty threshold if they claimed at 62. But most workers retire as couples, and couples consisting of two such workers who claimed at 62 got an income comfortably above the threshold for couples (see Table 1). Survivors, however, will not, and widows account for a third of the elderly poor.

### Table 1. Social Security Benefits as a Percentage of the Federal Poverty Threshold, Workers Age 62 in 2000

<table>
<thead>
<tr>
<th>Benefits of</th>
<th>Single worker</th>
<th>2-earner couple</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average earner, claim at FRA</td>
<td>158%</td>
<td>251%</td>
</tr>
<tr>
<td>Low-wage earner, claim at FRA</td>
<td>102</td>
<td>161</td>
</tr>
<tr>
<td>Low-wage earner, claim at 62</td>
<td>81</td>
<td>128</td>
</tr>
</tbody>
</table>

Notes: The average earner is assumed to earn 100 percent and the low earner 50 percent of the national average wage over 35 years. Both spouses in two-earner couples are assumed to have the same earnings and claiming age.

Sources: Author’s calculations using data in U.S. Social Security Administration (2003); and U.S. Census Bureau (2015).

### How Poor Are the Elderly?

The Census Bureau now reports both official and SPM poverty rates. As shown in Figure 3, the Census data show that poverty under the SPM is much higher among the elderly, somewhat higher for working-age adults, and significantly lower for children. The SPM also exhibits much less difference in poverty rates among age groups; and – if historical data were avail-

![Figure 2. Official Poverty Rate by Age for HRS Cohort Ages 52-54 in 1991](image)

Source: Johnson and Mermin (2009).

![Figure 3. Official and Supplemental Poverty Rates by Age, 2013](image)

Source: Short (2014).
able – it would likely show less progress in reducing old-age poverty than the official figures because the SPM includes out-of-pocket medical spending, which is much higher today than in the past.

Both poverty measures in Figure 3 use data from the Current Population Survey (CPS), which underreported income that is especially important for the elderly – dividends, interest, rents, and funds drawn from retirement accounts. The Census SPM estimates also use expected, rather than actual, medical out-of-pocket expenditures. A study by Barbara Butrica, Daniel Murphy, and Sheila Zedlewski addresses these concerns using the HRS, which has better data on income, assets, and medical expenditures.12

The study finds the more complete reporting of income reduces poverty under the official definition from 9.9 percent to 6.5 percent of the elderly. However, after making key SPM adjustments – accounting for taxes, in-kind transfers, capital gains and losses, and using actual medical expenditures – 12.3 percent of the elderly were classified as poor, with medical expenditures responsible for the entire increase above the official definition.13

The study also found the SPM-type measure better at identifying individuals facing financial distress. For example, among those who found paying bills either “very” or “extremely” difficult, half are identified as poor using the official measure while more than 71 percent are identified as poor using the SPM-type measure (see Figure 4).14 A likely reason for this disparity is the inclusion of medical expenditures in the SPM; households burdened by high medical costs are more likely to find their other expenditures severely squeezed than otherwise similar households with lower medical costs.

The Safety Net and Prospective Benefit Cuts

Social Security’s long-term financing shortfall could result in benefit cuts that challenge the program’s ability to keep the elderly out of poverty. To reduce the shortfall, Congress in 1983 cut benefits by raising the FRA from 65 to 66 for workers turning 62 between 2000 and 2005; and from 66 to 67 for workers turning 62 between 2017 and 2022. Each one-year increase cuts benefits claimed at any age by about 7 percent. If the program fails to get additional revenues, benefits will be cut an additional 21 percent when the Trust Fund is depleted, now projected in 2034.

Workers in the Johnson and Mermin cohort turned 62, on average, in 2000 when the FRA was 65 and 2 months. Since then, the FRA has risen to 66, which cuts benefits claimed at 62 by 5.5 percent. Low-wage workers who claimed at 62 in 2010 nevertheless got a benefit equal to 84 percent of the official poverty threshold – more than the 81 percent such workers received a decade earlier. The explanation is that real average wage growth – the growth of average wages above inflation – more than offset the effect of the rise in the FRA.15 Wage growth allowed Social Security to retain its ability to reduce poverty – when poverty is defined as income below the official price-indexed thresholds.

The official statistics could also show Social Security’s funding shortfall to be just a transient challenge to the program’s effectiveness in reducing poverty. If wages rise as projected by the Social Security actuaries, the purchasing power of benefits claimed in 2034 (the projected Trust Fund depletion date) would be nearly one-third higher than benefits claimed in 2010. An across-the-board cut could clearly push the incomes of older beneficiaries below the official poverty threshold. But benefits claimed in 2034 would still be 5 percent higher than benefits claimed in 2010, and benefits claimed thereafter would be increasingly higher. A study by Melissa Favreault, using the Urban Institute’s DYNASIM model and assuming an across-the-board cut when the Trust Fund is depleted, thus projects the official elderly poverty rate falling to 5.5 percent by 2060, and to 4.9 percent by 2070.17

Figure 4. Percentage of Elderly Individuals Who Say Paying Bills Is “Very” or “Extremely” Difficult Classified as Poor, by Poverty Measure

Source: Butrica, Murphy, and Zedlewski (2007).
The challenge is dramatically greater if the SPM is the better measure. A study by Barbara Butrica, Karen Smith, and Howard Iams, using the Social Security Administration’s Modeling Income in the Near Term microsimulation model, projects a sharp 7.5-percentage-point rise in elderly poverty as assessed by the SPM between 2010 and 2040 – assuming no reduction in benefits when the Trust Fund is depleted. Reducing poverty is far more difficult when poverty thresholds are pegged to the expenditures of low-income households, which the study assumes will rise in line with wages. Wage growth thus will not raise the value of Social Security benefits relative to the SPM’s poverty benchmarks.

What primarily drives up the study’s projected SPM poverty rate is the aging of the elderly population. The study projects the share of individuals age 75 and older will rise from 29 percent of the elderly in 2010 to 48 percent in 2040. As retirees age, a greater share are widows and their price-indexed Social Security benefits provide a declining share of the SPM’s wage-indexed thresholds. More significantly, out-of-pocket medical expenses rise sharply as retirees age, a trend that is not captured in the official poverty measure.

The study’s projections nevertheless show the SPM elderly poverty rate would be dramatically lower if retirees draw down their wealth to pay for medical and other necessities. If the elderly use their financial assets and home equity to cover such expenses, less than 10 percent would lack a basic standard of living in 2040 – assuming no reduction in Social Security benefits, aside from the scheduled rise in the FRA, to close the program’s financing shortfall.

Conclusion

Social Security has been remarkably successful in reducing old-age poverty. Using the official definition, poverty fell from nearly 80 percent of the elderly in 1939 to about 10 percent today. Out-of-pocket medical expenses raise the incidence of poverty as measured by the SPM above the official rate. The SPM nevertheless also suggests a far smaller share of the elderly is poor today than in the past, and the elderly are no longer a distinctly poor population.

Social Security’s funding shortfall could require adjustments to the safety net to avoid a spike in poverty. If the official definition is the better measure of poverty, the spike could be transient and best addressed with initiatives that dissipate over time. But if the SPM is the better measure, the Social Security safety net could need significant structural adjustments. Initiatives that also target out-of-pocket medical expenses and facilitate the use of retiree assets to cover medical and other necessities, however, would be even more effective in keeping tomorrow’s elderly out of poverty than just raising “basic” Social Security benefits.
Endnotes

1 U.S. Social Security Administration (2015).


3 Most prosperous OECD countries use poverty thresholds that adjust to changes in basic living standards, with thresholds generally defined as 50 percent of median disposable income and in-kind government transfers (Forster and Levy 2013).

4 Michael and Citro (1995), Short (2011 and 2014). The SPM also has separate thresholds for renters and homeowners with a mortgage, with thresholds for renters somewhat lower.

5 Smolensky, Danziger, and Gottschalk (1988). An estimated 78 percent of the elderly in 1939 had pretax incomes whose purchasing power was less than the “absolute” federal thresholds set in the far more prosperous 1960s.

6 Benefits are based on a worker’s highest 35 years of earnings, with wages prior to age 60 indexed to age 60 by the growth of national average wages (Myers 1985).

7 Engelhardt and Gruber (2004).

8 Johnson and Mermin (2009).

9 Full-time employment at the federal minimum wage would have kept a single worker out of poverty; a bit more than one such job, or a wage a bit higher than the federal minimum, would have done the same for a couple.

10 The benefit estimates in Table 1 assume 35 years of employment covered by Social Security, which is the earnings record that Social Security uses to calculate benefits. Benefits would be less for workers with less than 35 years of covered employment or who earned less than half the average wage over the course of their career. Workers who earn half the average wage today earn about $24,000 a year. Workers who receive Social Security Disability Insurance benefits are entitled to their FRA benefit. Benefits once claimed are indexed to prices. So benefits initially above poverty would remain above the official price-indexed poverty threshold.

11 Survivors are entitled to the larger of the two spouses’ benefits or 82.5 percent of their spouse’s FRA benefit, which in this case would give the survivor an income equal to 84 percent of the poverty threshold for a single individual.

12 Butrica, Murphy, and Zedlewski (2010).

13 The Butrica, Murphy, and Zedlewski SPM-type estimates do not include adjustments for differences in homeownership or the regional cost-of-living. Using “actual” as opposed to “expected” medical out-of-pocket expenditures resulted in an additional 2 percent of the elderly being classified as poor. Johnson and Smeeding (2000), Levy (2009), Short (2011), and Bridges and Gesumaria (2013) also identify medical expenditures as the key factor driving up SPM-type poverty rates and hardship.

14 Many individuals classified as poor under the SPM due to high medical expenses have assets they could use to cover those expenses. Even if they experience financial distress, classifying such individuals as poor is debatable. For different treatments of both medical expenditures (including in-kind Medicare and Medicaid benefits) and household assets, and very different estimates of elderly poverty using price-indexed thresholds, see Meyer and Sullivan (2012 and 2013); Hurd and Rohwedder (2006); and Korenman and Remler (2013).

15 U.S. Social Security Administration (2015), U.S. Census Bureau (2015), and author’s calculations.


17 Favreault (2009). The projections are Favreault’s baseline projections. The purchasing power of Social Security benefits would be lower, and official elderly poverty rates higher, if wages fail to rise as projected – and average wages have only grown a sluggish 0.2 percent above inflation since 2000 (U.S. Social Security Administration 2015, U.S. Social Security Administration 2012, and author’s calculations). But so long as wages rise above inflation, benefits would rise relative to the official absolute poverty thresholds.

18 This effect could be overstated. Retirement planning typically aims at maintaining living standards, not seeing that living standards rise in line with the living standards of working-age adults. If SPM poverty thresholds rise above price-indexed retirement incomes, retirees might not experience any increase in financial distress.
References


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The mission of the Center for Retirement Research at Boston College is to produce first-class research and educational tools and forge a strong link between the academic community and decision-makers in the public and private sectors around an issue of critical importance to the nation’s future. To achieve this mission, the Center sponsors a wide variety of research projects, transmits new findings to a broad audience, trains new scholars, and broadens access to valuable data sources. Since its inception in 1998, the Center has established a reputation as an authoritative source of information on all major aspects of the retirement income debate.

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