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MODERNIZING SOCIAL SECURITY: HELPING THE OLDEST OLD

By Alicia H. Munnell and Andrew D. Eschtruth*

Introduction

People become more financially vulnerable the longer they live and the odds of living to advanced ages are growing as average life expectancy rises. In response, policy experts have proposed improving benefits for the "oldest old" (defined here as those ages 85 and over). The two main options are: 1) base the annual cost-of-living adjustment (COLA) on a price index that more accurately reflects the spending patterns of older Americans; or 2) introduce a targeted benefit adjustment at age 85.

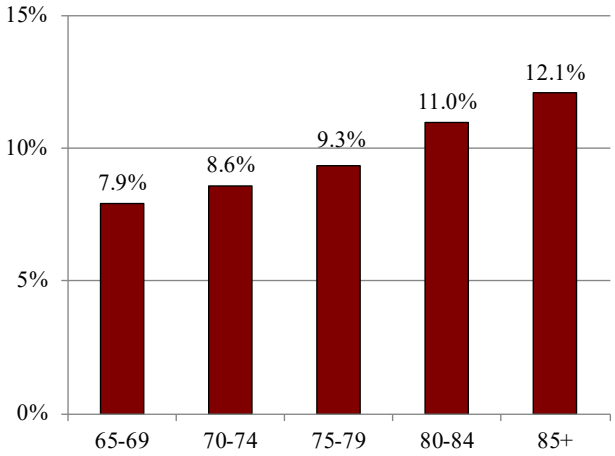
This *brief* on helping the oldest old is the fourth in a series on modernizing Social Security to account for changing social, economic, and demographic circumstances. The discussion proceeds as follows. The first section describes poverty patterns by age. The second section examines the two options for reducing poverty risk at advanced ages: using a Consumer Price Index for the elderly and adjusting benefits at 85. The third section assesses the reforms based on three criteria: targeting efficiency, administrative feasibility, and cost offsets. The final section concludes that raising benefits at 85 is the more cost-effective way to target the problem of poverty risk among the oldest old and that its modest cost could be offset by a very small reduction in the COLA.

Poverty and Age

Poverty rates for older Americans increase consistently with age, from 7.9 percent for new retirees to 12.1 percent for those 85 and older (see Figure 1 on the next page). The numbers may not sound so serious until one considers the poverty thresholds. In 2017, for ages 65 and older, the thresholds were $11,756 for a single-person household and $14,816 for a two-person household. These levels seem low even to some poverty experts, who believe that the traditional poverty measure understates actual privation for older Americans.[1] Regardless of the poverty measure,

* Alicia H. Munnell is director of the Center for Retirement Research at Boston College (CRR) and the Peter F. Drucker Professor of Management Sciences at Boston College's Carroll School of Management. Andrew D. Eschtruth is associate director for external relations at the CRR. The authors thank the AARP Public Policy Institute for helpful comments and Anqi Chen for excellent research assistance. The CRR gratefully acknowledges AARP for its support of this series of *briefs*.

Figure 1. Percentage of Older Individuals in Poverty, by Age Group, 2017

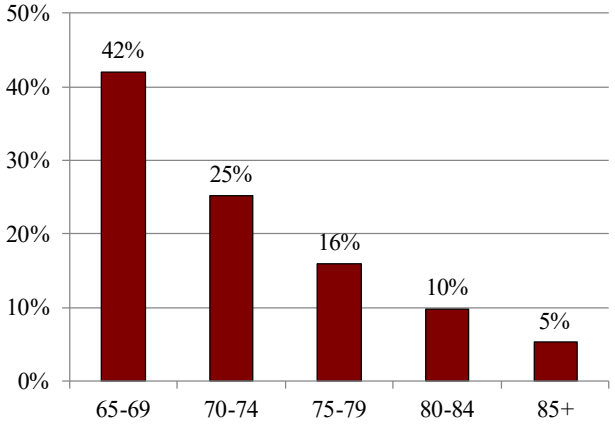


Source: Authors' calculations from U.S. Census Bureau, *Current Population Survey* (2018).

though, rising poverty risk with age is becoming a more serious problem due to increasing life expectancy. For example, average life expectancy for a 65-year-old in 2018 is 84.2 for a man and 86.6 for a woman, which represents a 5-year increase for men and a 3-year increase for women over the past 40 years.[2]

Poverty rates rise with age for a number of reasons. First, younger retirees often supplement their income with work, while those in their 80s or older rarely do (see Figure 2).

Figure 2. Percentage of Older Households with Earnings, by Age Group, 2017



Source: Authors' calculations from 2018 CPS.

Second, the financial well-being of intact couples declines over time, because private pensions rarely keep up with the cost of living. As a result, if inflation were 2.6 percent – the intermediate projection of the Social Security Trustees – the purchasing power of the pension would fall by 40 percent after 20 years.

Third, many women become widowed as they age, which affects their financial well-being in two ways. First, when the husband dies, the household's Social Security benefit declines by one third to one half – a drop that exceeds the reduction in household expenses, leaving the widow worse off.[3] Second, the household's private pension benefit is either cut in half – the default option – or disappears completely if the couple does not opt for the joint-and-survivor annuity.

Improving Benefits for the Oldest Old

To reduce poverty risk among the oldest old, policy experts have proposed two types of options within the Social Security program. One option is to use a Consumer Price Index (CPI) that more accurately reflects the spending patterns of the elderly. The other option is to adjust benefits at age 85 to target those most in need of additional support.

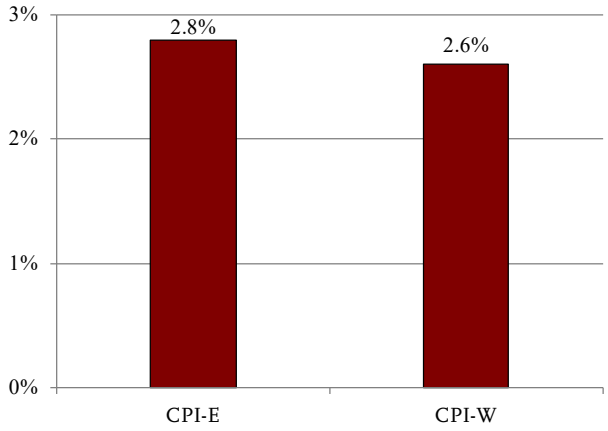
Adopt a Price Index for the Elderly

Social Security benefits are subject each year to a COLA, which is based on the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W).[4] The goal of providing a COLA is to offset increases in the prices of goods and services that Social Security beneficiaries buy so that they can maintain the same standard of living throughout their retirement. If the index used to construct the COLA understates inflation, then the purchasing power of benefits would erode over time and poverty would increase.

For a long time, critics have contended that the CPI-W understates inflation for the elderly because it does not reflect their spending patterns. In 1987, Congress directed the Bureau of Labor Statistics to calculate a separate price index for people ages 62 and older. This index, called the CPI-E, is used only for informational purposes, but it has been extended back to December 1982 for historical comparisons.[5]

From the third quarter of 1983 to the third quarter of 2017, the average annual increase for the CPI-E was 2.8 percent, compared to 2.6 percent for the CPI-W (see Figure 3). This more rapid inflation for the elderly has been attributed primarily to the fact that they spend more of their money on medical care – that is, medical care has a larger "weight" in the CPI-E – and the cost of medical care has been rising rapidly. Indeed in 2017, the elderly spent about 70 percent more on medical care – relative to their total expenditures – than the working population.[6]

Figure 3. Average Annual Change in Inflation Measured by the CPI-E and the CPI-W, 1983-2017



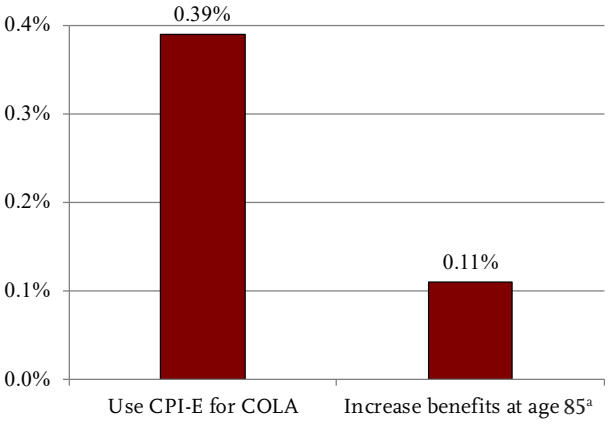
Sources: U.S. Bureau of Labor Statistics (1983-2017a,b).

Going forward, the Social Security actuaries project that using the CPI-E, rather than the CPI-W, would on average increase the COLA by 0.2 percentage point each year.[7] As a result of the compounding effect of these increases over time, benefits for an 85-year-old would be about 5 percent higher than currently scheduled.

It should be noted that the CPI-E, which was designed as an experimental index, is far from ideal. It is not constructed from scratch but rather is derived from an index for the broader population, so it has a number of limitations.[8] First, expenditure patterns are based on relatively few households, so the weights are subject to much greater sampling error than those in the broad index. Second, prices may not be representative of the location and types of stores frequented by the older population. Third, the items sampled may not be the same as those bought by the elderly. Fourth, the availability of senior-citizen discounts is likely understated. Finally, as with other government inflation indices, the CPI-E does not fully reflect the extent to which people substitute one item for another in the face of a price increase.[9]

Switching to the experimental index is also relatively expensive; it would cost 0.39 percent of taxable payroll over Social Security's traditional 75-year cost horizon (see Figure 4), which would require a substantial offsetting reduction in other benefits to make the change cost neutral. Using a more rapidly rising index for all retirees means that benefits would be higher for retirees of all ages, not just those 85 and over. And this approach provides higher benefits for those who die before reaching 85. While having a more accurate measure of inflation would be desirable in its own right, it would not be the ideal way to address the problem of rising poverty risk at advanced old ages. Therefore, a more targeted approach (not tied to the COLA) would hold off on any benefit changes until age 85.

Figure 4. Cost of Options to Improve Benefits for the Oldest Old as a Percentage of Taxable Payroll, Over 75 Years



[a] The discussion below covers two different ways to increase benefits at age 85; each has the same cost.
Source: U.S. Social Security Administration (2018b).

Adjust Benefits at 85

Policy experts have suggested several similar ways to provide targeted benefit adjustments to those in their 80s.[10] This discussion addresses two of them.[11] The first way would increase benefits by 5 percent for all beneficiaries ages 85 and over in 2019 and for those reaching age 85 after 2019. It would cost 0.11 percent of taxable payroll over the 75-year horizon (as shown in Figure 4), which could be offset by other benefit changes as discussed in the next section.

The second way would increase benefits by the same dollar amount for all beneficiaries ages 85 and over. The increase would equal 5 percent of the average retired-worker benefit in the prior year. For example, the increase in 2019 would be 5 percent of the average 2018 monthly benefit of $1,415, or $71 per month (about $850 per year).[12] Like the first option for improving benefits at ages 85 and over, it would cost 0.11 percent of taxable payroll, but it would have a progressive impact on beneficiaries. That is, the increase would constitute a much larger percentage of the benefit of lower earners than higher earners.

Targeting, Administration, and Offsets

The best way to target a benefit adjustment to those at advanced ages is raising benefits at age 85, rather than the more general increase provided by the CPI-E alternative. In addition, opting for the flat-dollar-amount increase at 85 – rather than the percentage increase – particularly helps the lower-income beneficiaries, who are most at risk of poverty.

From an administrative standpoint, the age-85 adjustment is not complicated; the Social Security Administration (SSA) would need to flag individuals turning 85 and update their benefit calculations and payouts accordingly. The alternative of changing the inflation index would also not add complexity for SSA. However, given the shortcomings of the current CPI-E measure, using it to index benefits might not be advisable. Instead, policymakers could direct the Bureau of Labor Statistics to construct a new version from scratch.

The final question is how to pay for the relatively modest cost of an age-85 adjustment. One option would be to reduce the annual COLA for all beneficiaries by a very small amount. The Social Security actuaries estimate that reducing the COLA by 0.5 percentage point would reduce the deficit by 0.94 percentage point of taxable payrolls. Based on that estimate, reducing the COLA by just 0.06 percentage point each year would generate enough savings to cover the 0.11 percent of taxable payroll associated with the age-85 adjustment.

Conclusion

As individuals reach advanced old age, they become increasingly vulnerable to falling into poverty due to declining resources, no labor earnings, the cumulative effects of inflation, and a growing likelihood of widowhood. This problem is becoming more serious as rising life expectancies make it more common for people to live into their mid-80s and beyond.

Policy experts have proposed addressing this problem by increasing Social Security benefits. One option is to switch to an inflation index that is designed to capture the rising cost of living faced by older Americans, particularly the growth of health care costs. However, this approach raises benefits for seniors of all ages, rather than focusing on the oldest old. A better alternative is to bump up the benefits of those who reach age 85. This approach, which could be offset by a very small reduction in the COLA for retirees of all ages, better targets the poverty risk faced by the oldest retirees.

Endnotes

1 The Census Bureau's supplemental poverty measure shows higher poverty rates for older Americans than the traditional measure. See Bridges and Gesumaria (2016) for a detailed discussion.

2 The figures are for cohort life expectancy; see U.S. Social Security Administration (2018a).

3 For more on the poverty risk faced by widows, see Munnell and Eschtruth (2018) – another *brief* in this series – and Karamcheva and Munnell (2007).

4 When the automatic Social Security COLA was created in 1972, the Bureau of Labor Statistics had only one CPI; it was for urban wage earners and clerical workers, which covers about 32 percent of the population. After the introduction of other versions, this original CPI was designated the CPI-W and is still used today to adjust Social Security benefits. As new uses were developed for the CPI, the need for a broader and more representative index became apparent. In 1978, the BLS expanded the sample to all urban residents and created the CPI-U, which covers about 87 percent of the population, including most retirees. The CPI-U is used to index the brackets and other parameters in the personal income tax.

5 The CPI-E is not designed to precisely track the inflation experience of Social Security beneficiaries, because some individuals ages 62 and older are not receiving benefits and some beneficiaries are under age 62.

6 The 2017 expenditure weights for health care were 12.1 percent for the CPI-E and 7.2 percent for the CPI-W (Bureau of Labor Statistics 2017a,b). For a more detailed historical comparison of the CPI-E and CPI-W, see Munnell and Chen (2015).

7 This option has appeared in a number of Congressional proposals over the past several years. See, for example, Sanders and DeFazio (2017).

8 Stewart (2008).

9 Making an adjustment for the substitution effect alone could potentially lower the CPI-E. However, the effect of better addressing substitution patterns is unclear, with some evidence indicating that the low-income elderly are less able to substitute. See Munnell and Hisey (2011) for details.

10 See U.S. Social Security Administration (2018b), provisions B6.1 through B6.7. Advocates of these various proposals include two separate bipartisan commissions, legislators from both parties, and researchers such as Turner (2013) and Dilley (2009).

11 Both of these options were discussed in Reno and Lavery (2009).

12 The 2018 benefit figure is for the month of July; see Social Security Administration (2018c).

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Contact Information

Center for Retirement Research
Boston College
Hovey House
140 Commonwealth Avenue
Chestnut Hill, MA 02467-3808
Phone: (617) 552-1762
Fax: (617) 552-0191
E-mail: crr@bc.edu
Website: http://crr.bc.edu

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