

Increasing the Economic Security of Older Women

Jason Brown and Karen Dynan



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Increasing the Economic Security of Older Women

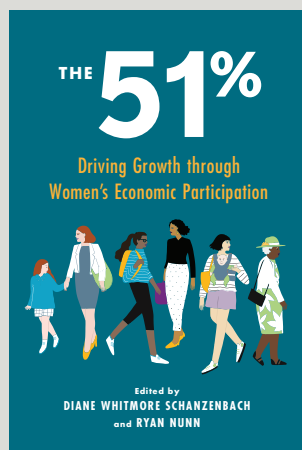
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A CHAPTER IN THE RECENTLY RELEASED HAMILTON PROJECT BOOK



The 51%: Driving Growth through Women's Economic Participation

The U.S. economy will not operate at its full potential unless government and employers remove impediments to full participation by women in the labor market. The failure to address structural problems in labor markets—including tax and employment policy—does more than hold back women's careers and aspirations for a better life. In fact, barriers to participation by women also act as brakes on the national economy, stifling the economy's ability to fully apply the talents of 51 percent of the population. By acting to remove barriers to women's participation, we can realize stronger economic growth that will be more broadly shared by the American people.

Abstract

Disability and widowhood are major drivers of economic insecurity for women later in life. To reduce the risk of economic insecurity among older women, we propose to allow Social Security beneficiaries to forgo some benefits when claiming to finance greater benefits in the event of widowhood, disability, or both. The proposed changes would be voluntary and self-financing.

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Introduction

Popular commentary often points to the lower lifetime earnings and longer expected life spans of women relative to men as a reason to be especially concerned about the economic risks women face as they age. Indeed, women aged 65 and older are twice as likely as their male counterparts to live in poverty. However, that economic vulnerability is tied to specific factors—being or becoming single and/or experiencing disability—rather than a product of aging generally. We therefore argue that policies designed to mitigate economic insecurity among older women should be linked to these factors. We offer two proposals for reforms to the Social Security program to mitigate economic insecurity among women in old age.

The first proposal is to allow married couples to choose a modified schedule of Social Security benefits that would reduce payments while both spouses are alive but limit the drop in benefits after one spouse dies. The second proposal is to use the Social Security system to provide a form of long-term care insurance (LTCI), allowing new Social Security recipients to elect lower payments when they are younger in exchange for supplementary income in the event of later-life disability. While the two proposals would not help all types of older women who face financial hardship, they have the potential to materially help at least the portion of the older female population that tends to face financial shocks due to the onset of disability or the death of a spouse.

The Challenge

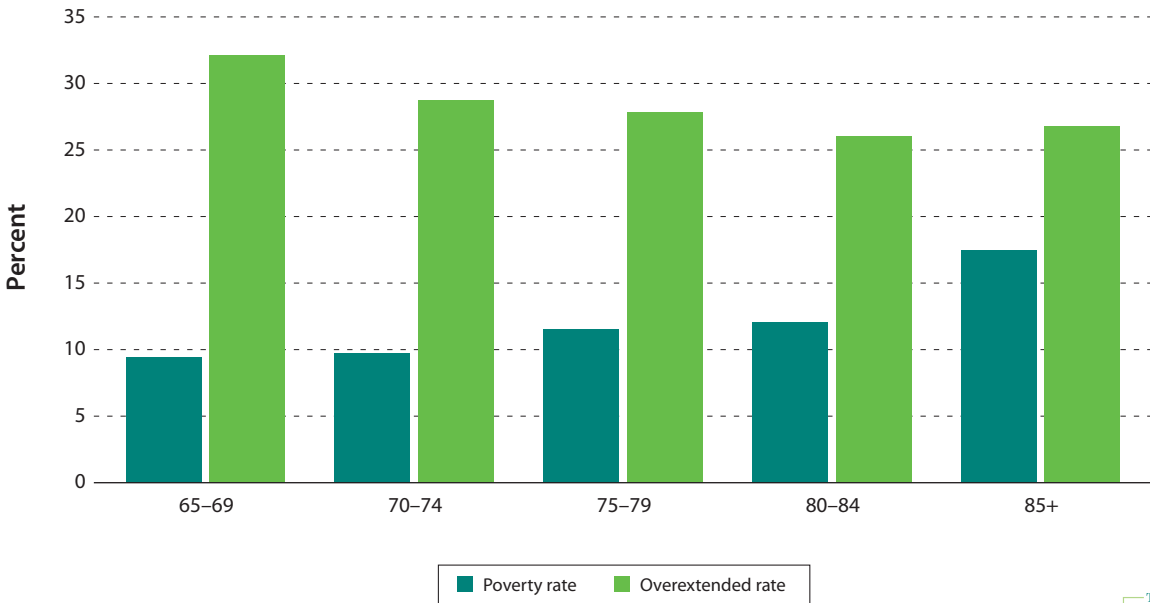
The most commonly used measure of economic vulnerability for the general population is the poverty rate—the share of people with income below a certain threshold, adjusted for family size. Older people, however, rely relatively more on accumulated wealth to support themselves than does the working-age population, which renders income-based measures like poverty incomplete. Moreover, households above the poverty threshold often experience economic insecurity. Levy (2015) finds that 11 percent of the elderly population above the poverty line experiences material hardship, such as struggling to pay for food, skipping meals, cutting back on medication, and experiencing difficulty paying bills.

A recent Treasury report (U.S. Department of the Treasury 2017) consequently explored economic insecurity among older women, focusing in part on a metric—complementary to the poverty rate—that incorporates wealth and uses a more

comprehensive definition of economic hardship. This metric, called the overextended rate, is the share of a given population whose annual household spending exceeds its means. Means, in this case, includes the sum of current noncapital income and an annuitized value of household financial and nonfinancial wealth, with the annuity amount determined by the life expectancies of household members. Thus, if a household is overextended, it will either have to reduce spending or increase wealth over its remaining life expectancy. Because most elderly households are unlikely to increase wealth, it usually will have to reduce spending—hence, the material hardship many elderly households experience.¹

Data from the Health and Retirement Study (National Institute on Aging n.d.) suggest that older women are considerably more likely than older men to experience economic insecurity, whether measured by the poverty rate or the overextended rate. With an average poverty rate of 12 percent from 2000

FIGURE 1.
Women’s Poverty and Overextended Rates by Age



Source: National Institute on Aging n.d.; authors’ calculations.

through 2012, women age 65 and older are twice as likely as their male counterparts to be in poverty.² More than a quarter of older women (29 percent) are overextended versus 21 percent of older men. Moreover, because women tend to live longer than men, the economically insecure population of older Americans is dominated by women: women make up 71 percent of the elderly in poverty, and 68 percent of the elderly who are overextended.

Overextended rates for older women are much higher than poverty rates regardless of age, but those rates evolve differently with age, as can be seen in figure 1. The poverty rate rises with age, starting below 10 percent for women in their late-60s and reaching 18 percent for women age 85 and above. The overextended rate for women in their late-60s is 32 percent, declining to 27 percent for women age 85 and above.³

Importantly, economic vulnerability appears to be tied to specific characteristics of older women—marital status and disability; understanding these links is essential to developing policies to address the insecurity. Of the older female population that is married and not disabled, only 3 percent is in poverty, whereas 17 percent of the unmarried (i.e., widowed, divorced, or single) or disabled female elderly population is

in poverty. Even among those age 80 and above, for whom poverty rates are much higher, only 4 percent of married, nondisabled women live in poverty. Similarly, 18 percent of married, nondisabled older women are overextended, while 35 percent of other older women are overextended.

Single women of all ages experience much higher rates of economic insecurity than married women. Much of this pattern likely reflects underlying differences between them and the married population that do not change appreciably over time. But when women are widowed, they experience a sharp drop in income, often compounded by a drop in wealth, which together necessitate a large reduction in consumption. This stress persists for the remainder of the widows' lives.

Becoming disabled can result in economic insecurity, in part because the high costs of formal long-term services and supports can rapidly deplete the remaining wealth that households rely on to finance the rest of their retirement. While the median non-housing financial wealth of women 65 and older is sufficient to cover an estimated 9.0 months of nursing home expenses or 15.9 months of home health-care expenses, the median non-housing financial wealth of disabled elderly women is enough to finance only 0.4 months in a nursing home or 0.7 months of home health care.⁴

A New Approach

As we have shown, economic security among older women is closely associated with being single and being disabled. For some women—notably non-widowed single women—economic insecurity is a chronic problem and predates old age. But others enjoy considerably more security prior to widowhood or disability. This latter fact suggests that some women could be made better off with insurance paid for during periods of relative security (i.e., when married and able-bodied) that pays out during possible subsequent periods of relative insecurity (i.e., when widowed or disabled). Of course, policy can always be changed to redistribute income away from less-vulnerable households to more-vulnerable households, but the decision to do so involves normative considerations. We thus focus on solutions that are largely neutral from a distributional point of view and that would be freely chosen by households when enrolling in Social Security.

Some private-market products can help to mitigate the risks of widowhood and disability. For instance, annuities include distribution options that offer survivor benefits at a cost of lower benefits while both spouses are alive. For a premium, private LTCI provides benefits when the policy holder becomes disabled, spreading the costs of financing long-term-care services and supports among the nondisabled population. While households should consider these options, the options have limitations. The decline of defined benefit pensions has made it more difficult to easily annuitize wealth upon retirement. In addition, the private LTCI market has struggled to catch on with consumers, particularly given its difficulties in pricing policies appropriately and in managing the risks associated with policies whose duration can extend 40 years or more for an individual (Ameriks et al. 2016). Subsidies and regulatory reforms might stimulate coverage on the private long-term care insurance market (Yin 2015), but in the absence of major reforms, sales of new policies have been trending downward even as the elderly population has been growing.

We believe that the Social Security program could be a mechanism for improving economic security for older Americans, particularly for certain groups of older women. One advantage to building off the existing Social Security program is that most of the people at risk of economic insecurity stemming from widowhood and disability are Social Security

recipients. Moreover, Social Security benefits represent a key source of support for many retired households, constituting 46 percent of effective household wealth for the median decile of households approaching retirement (Gustman, Steinmeier, and Tabatabai 2011).

We propose two new Social Security benefit options that are actuarially neutral for the program as a whole and for individual beneficiaries, on average. Under our proposals, households will expect to receive the same cumulative benefits over their remaining lives as they currently do, but in a stream that results in fewer benefits during periods of greater economic security and more benefits during periods of lesser economic security.

WIDOWHOOD

Our first proposal helps to address the economic insecurity that can result from widowhood. In particular, the proposal addresses the problem that married couples with fairly similar earnings histories can see a steep and potentially unmanageable drop in their Social Security benefits when one member of the couple dies.

When married Social Security beneficiaries are both alive, each spouse can claim benefits based on their own or their spouse's work history. In the latter case, benefits equal 50 percent of the spouse's benefit. Couples with very unequal earnings histories will generally find it financially advantageous for both spouses to claim benefits on the earnings history of the higher earner. If the higher earner dies first, the surviving spouse can then claim the full amount of their spouse's benefits, effectively making Social Security a joint life annuity with a two-thirds survivor benefit.⁵ But for couples with similar earnings history—for whom it makes sense to claim full benefits on both earnings histories while both are alive—Social Security is a joint life annuity with a smaller survivor benefit. In the most extreme case of identical earnings histories, these couples will see a drop in total benefits of 50 percent when one member dies. Given that two people can live together less expensively than two people separately, this decline in benefits is almost certain to exceed the drop in household spending needs.

To improve the economic security of widows, we propose that married individuals be allowed, at initial Social Security

benefits claiming, to irrevocably forgo their traditional benefit for a contingent annuity that would pay monthly benefits while both spouses are alive and continue to pay two-thirds of the benefits to a surviving spouse when the beneficiary dies. The surviving spouse, meanwhile, would also continue to receive their previous benefits. Benefits associated with the contingent annuity would be actuarially neutral relative to traditional benefits—in other words, the couple would accept fewer benefits while both spouses are alive in order to have more benefits when only one is alive. The calculation would need to take into account both spouses' ages and lifetime incomes at the time of claiming, because both of those factors would affect expected current law benefits.

DISABILITY

Our second proposal is based on similar principles and provides financial protection against the risk of late-life disability. At the time of enrolling in Social Security, individuals would be given a chance to sign up for a disability indemnity insurance policy, with premiums financed out of their Social Security benefits. The policy would pay a cash benefit in the event the individual satisfies a disability trigger, such as needing assistance with two or more activities of daily living or suffering moderate to severe cognitive impairment for at least 90 days. Individuals could decide for themselves what level of protection they wanted at the time of purchase, but benefits would continue as long as the beneficiary remained disabled. Individual underwriting would not be used to determine eligibility for the policy. However, a 10-year waiting period before claims could begin would prevent adverse selection: individuals at a high risk of imminent disability would not overwhelm the risk pool. Premiums would be actuarially fair, so that the government would not provide any additional subsidies to maintain the program. Participation would be voluntary, but the decision to join the program or not would be irrevocable. As under current law, Social Security benefits would not be exempt from income for Medicaid consideration.

In principle, individuals already have the option to use some of their Social Security benefits to purchase long-term care insurance. In practice, because of the problems associated with the LTCI market noted earlier and discussed in more detail in Frank (2011), many individuals who would benefit from LTCI do not have it.

An LTCI policy offered through Social Security could overcome some of the problems observed in the private market. For instance, Social Security is a trusted institution, and individuals might have more confidence that it would pay out promised benefits. Individuals also might be more willing to accept a 10-year waiting period, which permits the elimination of individual underwriting (and lowers costs), for the same reason. We also believe that timing the decision to purchase LTCI with the claiming of Social Security benefits would make it more straightforward to arrange for such insurance, because individuals are already doing retirement planning at this time and because it would be logistically easier (e.g., it could be done simply by filling out an additional section of the Social Security form).

Simulations of the cost of this policy for people with different health risks, using data from the Health and Retirement Study (National Institute on Aging n.d.), reveal that a 10-year waiting period is adequate for the formation of a viable risk pool.⁶ We also find that 75 percent of expected long-term care costs for the population age 65 and above are incurred at age 75 or above, meaning that this policy, even with a 10-year waiting period, can provide considerable protection against late-in-life long-term care needs. We further estimate that \$1 per month in premiums would cover \$12 per month in benefits. Thus, to receive \$3,000 per month in coverage—enough to finance \$100 per day of nursing home or home health care—beneficiaries would have to accept \$250 less in Social Security benefits each month.

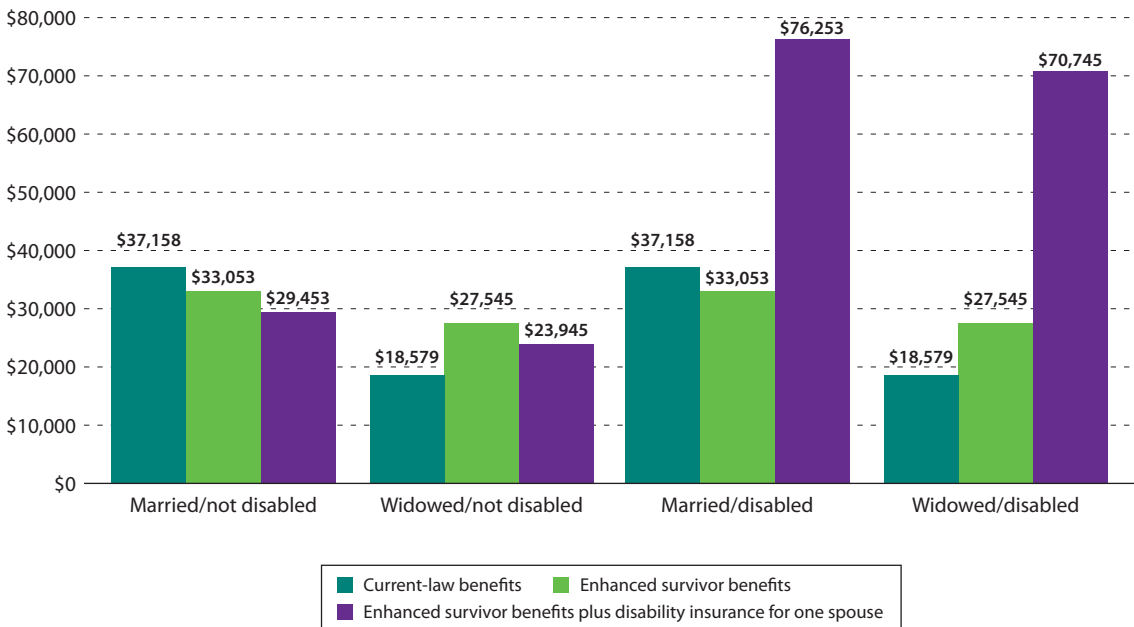
Impact

We now discuss how prototypical beneficiaries would fare under both the current and proposed benefits structures. We model the benefits of two types of married couples, with all dollar amounts adjusted for inflation to simplify comparisons over time. For both types, the spouses are exactly the same age, and both claim benefits at age 65. For one type of couple (shown in figure 2), both beneficiaries retire with scaled medium earnings (as defined in the 2016 Social Security report from the board of trustees [Social Security Administration 2016]) and would receive \$18,579 each under the current system. For the other type, one spouse is eligible for \$24,628 (due to having scaled high earnings), and the other spouse claims on the first spouse’s earnings history and thus is entitled to an annual benefit of \$12,314.

Under the current beneficiary structure, the couple with the identical earnings histories would receive a combined \$37,158 in annual Social Security benefits at claiming. If one died, benefits would fall by 50 percent to \$18,579, which is a substantial drop in income given that household expenses for the survivor are unlikely to fall commensurately. By contrast, the couple with one high earner and one low earner would receive \$36,942 in benefits at claiming. If one died, the survivor would receive \$24,628 in benefits (the high earner’s benefit), a drop of just one third.

In the event one spouse becomes disabled, Social Security provides no additional benefit for either type of couple. Given that the median cost of one month in a nursing home is \$6,844 and one month of home health care is \$3,861, formal care for one person could easily claim a household’s entire Social

FIGURE 2.
Social Security Benefits under Current and Proposed Structure for Equal Earners



Sources: National Institute on Aging n.d.; Social Security Administration 2016; authors’ calculations.

Note: Current law benefits for each beneficiary = \$18,579. Enhanced survivor benefits = two-thirds benefits of deceased spouse. Disabled benefits = \$3,600/month, financed by \$3,600/year reduction in Social Security benefits.

Security benefit, even for households in the middle of the income distribution (CareScout 2016).

Under our proposal—for individuals who opt in to the widowhood and/or disability provisions—benefits at claiming would be reduced by an amount that covers the expected costs of the enhancement to benefits, given Social Security’s survivor rates and interest rates, as well as modeled projections of disability. Under the new benefit structure, the equal-earning couple electing to claim enhanced widow benefits would receive \$33,053 in annual benefits after claiming, a reduction of \$4,104 compared with the current structure, as shown in figure 2. If one spouse were to die, the surviving spouse would receive \$27,545 in benefits, an increase of \$8,966 compared with the current survivor benefit formula. Thus, an 11 percent reduction in benefits while both spouses are alive can pay for an increase in benefits of 48 percent when only one spouse is alive. Because the average time spent in widowhood is shorter than the average time spent married, additional survivor benefits can be purchased for a relatively small reduction in base benefits in both absolute and percentage terms.

The couple with a high earner and a low earner would likewise have to sacrifice some benefits in the base year to finance

enhanced survivor benefits (not shown). But under the current benefits structure, survivor benefits are relatively more generous for the high earner/low earner couple than for the equal-earning couple, so the cost and benefit of the enhanced survivor benefits are smaller in this case. Specifically, the couple would need to sacrifice \$2,343 in base benefits for an increase of \$2,282 at the death of the high-earning spouse, and an increase of \$6,126 at the death of the low-earning spouse.

Under the proposal, each beneficiary could elect to purchase \$12 per month in disability benefits for a \$1 monthly reduction in Social Security benefits. In this example, we assume each couple selects \$43,200 per year in disability benefits for one spouse, at a cost of \$3,600 annually in reduced Social Security benefits. For the equal-earning couple that chose enhanced survivor benefits, this choice would further reduce base annual benefits by \$3,600, on top of the benefits already forgone, bringing the total reduction in benefits to \$7,705, or a drop of 21 percent. However, in the event the spouse purchasing disability coverage became disabled, benefits would increase by \$43,200. Whether the beneficiary were married or widowed, the combined benefits would be sufficient to cover average home health-care costs and the vast majority of nursing home costs for the prototypical beneficiaries we have modeled.

Questions and Concerns

1. Would this proposal leave some groups worse off?

The voluntary nature of these proposals leaves Social Security beneficiaries no worse off on a forward-looking basis; beneficiaries are free to stick with the current system if they prefer to do so. Nonetheless, the introduction of these choices would lead individuals and couples to make potentially difficult financial decisions. This situation is no different from the decisions couples already make when deciding to buy private-market LTCI or choosing how to distribute pensions, but it is unusual in the context of Social Security.

In addition, those who elect to enter the new system but do not experience long periods of widowhood or disability would receive fewer Social Security benefits. However, these beneficiaries tend to be economically secure—even at advanced elderly ages—so they might be able to cope with little difficulty.

2. Does this proposal help all older women who are economically insecure?

Enhanced survivor benefits do not protect those who never married or those who are divorced. These groups could be at particular risk given the lower average lifetime earnings of women relative to men. Furthermore, given their lower lifetime earnings (and, in turn, lower Social Security benefits), these women are less likely to be able to exchange some of their Social Security benefits for protection against expenses for long-term care. Other options will need to be developed to address economic insecurity among never-married and divorced women.

Because our proposals involve trading off current resources for future protection, they are not targeted at the poorest households who are already living hand-to-mouth. By design, the proposals do not redistribute resources across the population. The government already offers some assistance to the poorest households: for example, the Medicaid program pays nursing home costs for disabled older people who have sufficiently low financial resources. Strengthening such assistance is outside the scope of this proposal.

3. Do the proposals create risks for taxpayers?

Another concern is that the proposals would effectively expand the entitlement system and, in doing so, place more risk on the taxpayer. For example, despite the best efforts of actuaries to calculate adjustments to Social Security benefits that would cover the costs of a new disability benefit, there is potential for claims to be higher than expected. (Indeed, the possibility of such miscalculations is one reason why the private LTCI market has not thrived.) In the event of overly optimistic assumptions, the government would undoubtedly feel compelled to live up to its side of the bargain, with taxpayers footing the bill. With respect to the survivor benefit, actuaries could not simply calculate an adjustment to benefits that would make the program actuarially neutral for the average household because the option would be much more likely to be taken up by couples for whom the lower earner is expected to outlive the higher earner by a substantial amount. An assumption would need to be made about the degree to which this type of adverse selection would likely occur, and how to finance any shortfalls if the assumption proves too optimistic. Alternatively, the changes to the survivor benefit could be applied to all households, but doing so would give couples less choice and would likely be very unpopular with those who are myopic, have high time discount rates, or expect a short remaining lifetime.

Another potential fiscal risk posed by these proposals stems from the fact that they would—in the short run but not in the long run—strengthen the overall financial position of the Social Security program as well as federal finances more generally, given that both proposals would entail people electing smaller benefits now in exchange for higher expected benefits in the future. Thus, lawmakers would need to be mindful that the resulting short-run improvements in the financial position of either the Social Security program or the federal budget are illusory, and that these policies would not bring about any increase in national saving over the longer run.

4. Would it be preferable to require that disabled beneficiaries receive formal services?

The disability benefit is structured very simply, as a cash indemnity benefit tied only to specified criteria. While this

structure provides considerable flexibility for beneficiaries, it would almost certainly be more expensive than a service-based benefit in which a claimant would need both to satisfy the disability criteria and to receive formal services. Including a formal-service requirement could lower costs.

5. What role could the private sector play in the disability benefit?

The federal government should assess whether the private sector would do a better job of administering the disability benefit, either in servicing the benefit or bearing the risk, in which case the government might want to partner with the private sector on some dimensions of the policy.

6. Under this proposal, what would happen to widowhood benefits in the event of a divorce?

A couple's decision to opt in to the enhanced benefits associated with widowhood would not be affected by divorce. Importantly, the decision—made at the time of Social Security benefits claiming—would be irrevocable, meaning that neither of the divorced individuals could change the benefits due to the other individual. Likewise, remarriage would not affect the benefits received.

Conclusion

As women age, they become increasingly at risk of widowhood and disability, two important drivers of economic insecurity later in life. Many women would benefit from transferring wealth from periods of relative security to periods of relative insecurity. Because Social Security constitutes an important source of wealth for most elderly people, we believe that the program could

be altered to help reduce economic insecurity among older women. We show that relatively modest reductions in benefits while women are married and not disabled can finance more generous benefits during periods of widowhood and disability. This insurance could be voluntary and self-financing, thus leaving the long-run financing of Social Security unaffected.⁷

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Endnotes

1. Of course, for households with very low incomes, social insurance programs such as Medicaid will provide resources after financial wealth is exhausted. But the standards of living provided by these programs are generally associated with hardship.
2. The Census Bureau reports that the poverty rates for women and men 65 and older in 2015 were 10.3 percent and 7.0 percent, respectively, a slightly narrower difference than the gap based on the Health and Retirement Study data. See Proctor, Semega, and Kollar (2016).
3. U.S. Department of the Treasury (2017) finds that the fall in overextended rates with age is the result of this group's members adjusting their spending down at a faster rate than their wealth and income. This finding is not necessarily indicative of older women becoming better off with time since it is unclear whether women are cutting back spending out of choice or out of necessity.
4. Evidence in Hurst (2008) corroborates the link between health shocks and hardship among older households. The study finds that many households that experience substantial drops in real consumption at retirement have been forced into involuntary retirement because of health shocks.
5. Survivors over 60 who have not attained full retirement age are eligible for reduced benefits.
6. The methodology for estimating the costs of disability for different health risks is described in Brown and Warshawsky (2013).
7. The findings and conclusions expressed are solely those of the authors and do not necessarily represent the views of any institution with which they are affiliated.

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Highlights

To reduce the risk of economic insecurity among older women, Jason Brown and Karen Dynan propose to allow Social Security beneficiaries to exchange some initial benefits for enhanced benefits in the event of widowhood or disability or both. The proposed changes would be voluntary and self-financing.

The Proposals

Allow married couples to have a modified Social Security benefits schedule.

The authors propose that married individuals be allowed, at initial Social Security benefits claiming, to forgo their traditional benefit for a contingent annuity that would pay monthly benefits while both spouses are alive and continue to pay two thirds of the benefits to a surviving spouse when the beneficiary dies.

Offer long-term care insurance financed by Social Security benefits. The authors propose that Social Security beneficiaries be permitted to exchange some traditional benefits for a cash benefit paid in the event of disability.

Benefits

The proposals would enhance economic security for many older individuals, but particularly for those older women who face financial shocks in the wake of disability or the death of a spouse.



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