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Social Policies that Support Financial Security

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Policies that Support Financial Security

- Background
- Social Security and Social Security Disability Insurance (SSDI)
- Supplemental Security Income program
- Programs to promote retirement savings
- Health insurance coverage

Social Security

- Provides benefits to retired workers and their dependents and survivors
- Workers and their employers make payroll tax contributions on earnings (up to a taxable maximum) and those with 40 quarters of contributions receive retired worker benefits.
- Benefits are calculated based on worker’s highest 35 years of wage-indexed earnings.
  - The income replacement rate (benefit as a share of average earnings) is higher for lower-wage workers, although the benefit amount is lower
- Retired worker benefits are first available at age 62 but may be claimed as late as age 70, with full retirement age rising from 65 to 67 for those born in 1960 or later.
- Protects workers from several risks:
  - Outliving retirement resources
  - Benchmarked to CPI to protect against inflation
  - Survivor’s benefits protect families in the event of a worker’s death

Social Security and Retirement

- Affects retirement decision through “wealth effects”
  - Social Security provides resources that make retirement possible
  - Birth cohort and lifetime earnings affect “rate of return” earned on Social Security contributions; expect earlier retirement for groups that received larger net transfers
  - Lack of access to benefits until age 62 can constrain retirement if liquidity constrained; expect to see some retirement at age 62
- Affects retirement decision through “accrual effects”
  - Expected total benefits received over the lifetime will vary with additional work in complex ways
  - Delaying retirement and benefit claiming means: receive benefits for a shorter time but later payments are higher (actuarial adjustment); pay more payroll taxes; have more years of earnings in the benefit calculation
  - Net effect on lifetime benefits can be positive or negative; expect people to work longer when work is “subsidized” by Social Security system and retire earlier when it is “taxed”
- Worker retirement behavior is responsive to both wealth and accrual effects

Social Security Disability Insurance (SSDI)

- Protects against the earnings loss associated with a long-term work-limiting disability
  - Must be "unable to engage in any substantial gainful activity because of a medically determinable physical or mental impairment(s) that is expected to result in death or last for at least 12 months"
- Determining medical eligibility often involves lengthy multistep application process
  - One-third of applications are initially approved; two-thirds of applications are approved after appeals
- Benefit calculation is (largely) the same as for Social Security
- SSDI and work
  - Most SSDI beneficiaries receive benefits until death or reaching the Social Security full retirement age, when they move to the rolls of that program; fewer than 10% return to the labor force
  - Some limited work capacity among those on margin of program eligibility
  - Application and enrollment rates increase counter-cyclically with the economy
- Enrollment rates have increased over time, but fallen since 2014
  - High school dropouts are 5-6 times more likely to enroll than those with a college degree
  - Enrollment rates are higher for Black adults than White adults

Inequality in Access to Work and Work-Related Benefits

- Recent cohorts of older adults have faced greater inequality in preretirement income as a result of declining job opportunities and work benefits for the least-educated
- Both low-skilled and mid-skilled workers may perform tasks that can be easily automated, which forces their early involuntary withdrawal from the labor force (e.g. Acemoglu, 1999; Katz and Murphy, 1992)
  - Displacement by automation of mid-skilled jobs has particularly affected Hispanic and Black workers (McKinsey Global Institute, 2019)

Percent Change in Median Wealth, 1983-2016

	Lower-Income	Middle-Income	High-Income
1983-2001	67%	42%	85%
2001-2016	-45%	-20%	33%

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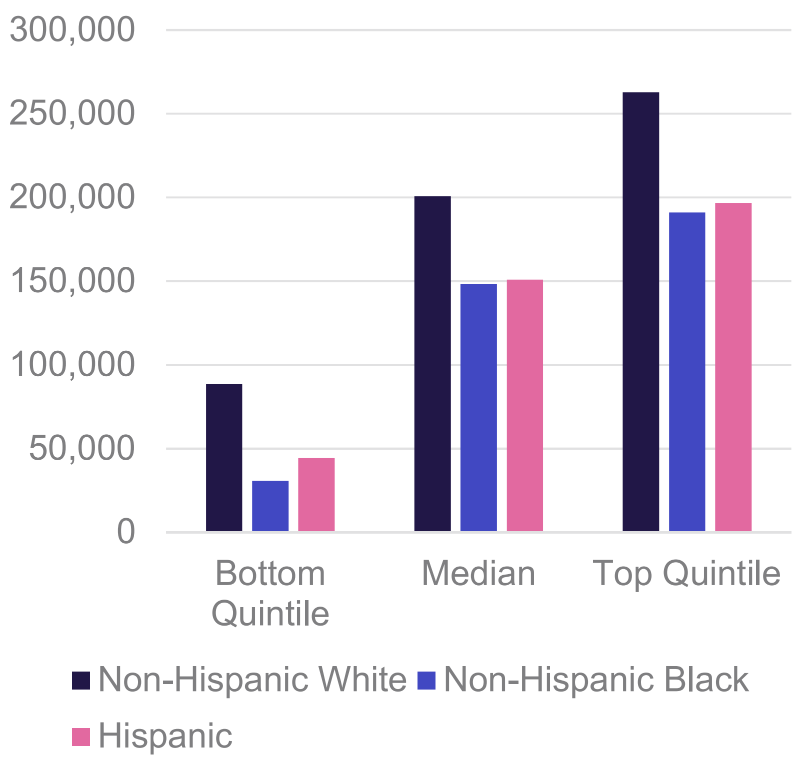
Social Security: Main Source of Retirement Income for Lower-Income Older Adults

- Social Security plays a central role in the retirement income of older Americans
- Among 65+:
  - 89% of Whites live in a family that receives Social Security income, 82% for Blacks, 75% for Hispanics, and 69% for Asians
- Social Security is distributed more equally across the income distribution than income prior to retirement
- Social Security represents about 50% of income for households ages 65+ though the share is higher in low-income households (Bee & Mitchell, 2017)
- Families in the highest quintile of income are at least 4 times as likely to have income from pensions and retirement savings than are families in the lowest quintile (Waid, 2016)

Social Security Wealth



- Although Social Security wealth is more redistributive than other forms of income and wealth, it is dependent on earnings
- There are large racial disparities in earnings, which cumulate over the life course, leading to large racial differences in Social Security wealth.

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Supplemental Security Income Program

- Seeks to provide a minimum income or safety net for basic needs through means-tested benefits for citizens living in the United States who are blind, disabled, or at least 65 years of age and have almost no assets (<$2000 for individuals, $3,000 for couples)
  - Means tests are not adjusted for inflation, which means fewer people have qualified for the program over time.
  - Only about 56% of those eligible for benefits apply
- Payments are low and are reduced dollar for dollar (after a small offset) for income, including SSDI or Social Security
- Recipients are eligible for other programs such as Medicaid, Medicare, and the Supplemental Nutrition Assistance Program
- SSI improved the health of older recipients within three years of program introduction, while higher SSI benefits are associated with lower disability rates
- More generous SSI benefits reduce employment and the work hours of likely SSI participants among low-income adults 62 to 64 years old

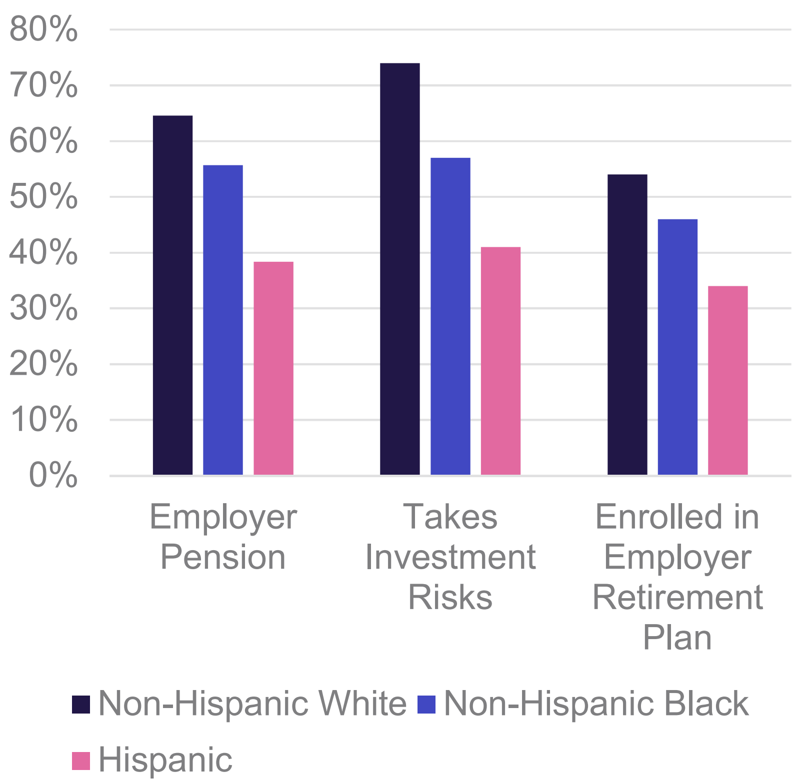
Programs to Promote Retirement Savings

- Employer-Sponsored Pension Plans
  - Social policy sets setting pension plan regulations, which may affect an employer's willingness to offer a plan, the type of plan offered, and other plan provisions, as well as providing tax incentives for saving
  - Shift from defined benefit to defined contribution has placed greater responsibility for retirement saving to workers from employers
- Individual Retirement Accounts (IRAs)
  - First introduced in 1974 to provide a retirement savings plan for workers not covered by an employer-sponsored plan
  - Taxed similarly to employer-sponsored 401(k) defined contribution, but have lower contribution limits
  - Individuals are required to begin making withdrawals no later than age 72
  - Roth IRAs and auto-IRA programs
- Policies for Low-Income Savers
  - Evidence suggests that these programs have not been effective

Defined Benefit vs Defined Contribution Plans

- Defined benefit plans:
  - Employee receives a regular benefit payment from retirement until death
  - Benefit calculated based on earnings and tenure and benefit structure often has age-based effects that can encourage retirement at specific ages
  - First regulated under 1974 Employee Retirement Income Security Act, which established minimum funding requirements and set up the Pension Benefit Guarantee Corporation (PBGC) to insure benefits against plan insolvency
- Defined contribution plans:
  - The employer and/or employee make contributions to a retirement account
  - The employee determines where contributions are invested, choosing from a set of investment options selected by the firm
  - Employee contributions are exempt from income taxation, and investment earnings accrue tax-free
  - Withdrawals subject to income tax and penalty for withdrawing before age 59½
  - Accounts are portable
  - Individuals are required to begin making withdrawals no later than age 72

Racial-Ethnic Differences in Pension Access and Investment Risk



- There are large differences by race in the proportions of workers with access to employer pensions and retirement
- Differential access to employer pensions are related to differences in firm size, proportion of employees in full-time and part-time jobs, and occupational segregation
- For those who depend on retirement savings, there are large racial differences in willingness to take investment risks

Source: Butrica & Johnson (2010)

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Adequacy of Retirement Savings

- U.S. federal government provides $250 billion per year in tax incentives for retirement saving through defined contribution plans and IRAs
- Active debate within the literature whether households are saving adequately
  - By some measures households are saving too little; however, other measures suggest that most households have adequate savings
- Measures of adequacy:
  - Life cycle models of optimal levels of saving
  - Maintenance of standard of living in retirement
  - Changes in consumption
  - Smoothing of consumption between payments

Health Insurance

- Employer-provided retirement plans
  - Workers with access to retiree health insurance through their employer retire substantially earlier than other workers, which suggests government policies to increase access to health insurance could facilitate retirement.
- Medicare
  - Provides health insurance to people age 65 or older and to SSDI beneficiaries
  - Significant cost-sharing can lead to high out-of-pocket expenses, thus most beneficiaries have additional coverage, such as a Medicare Advantage or secondary plan
  - Effect on retirement is unclear
- The Affordable Care Act
  - Expanded access to health insurance coverage through expanded Medicaid eligibility and subsidies for purchasing insurance
  - Little evidence of an effect on retirement decisions