The Economic Status of the Elderly on the Eve of Social Security Reform

Progressive Policy Institute

Timothy M. Smeeding
James P. Smith

November 1998

Contents

About the Progressive Policy Institute

"One person with a belief is a social power equal to ninety-nine who have only interests."

—John Stuart Mill

The mission of the Progressive Policy Institute is to define and promote a new progressive politics for America in the 21st century. Through its research, policies, and perspectives, the Institute is fashioning a new governing philosophy and an agenda for public innovation geared to the Information Age.

This mission arises from the belief that America is ill-served by an obsolete left-right debate that is out of step with the powerful forces re-shaping our society and economy. The Institute advocates a philosophy that adapts the progressive tradition in American politics to the realities of the Information Age and points to a "third way" beyond the liberal impulse to defend the bureaucratic status quo and the conservative bid to simply dismantle government. The Institute envisions government as society's servant, not its master—as a catalyst for a broader civic enterprise controlled by and responsive to the needs of citizens and the communities where they live and work.

The Institute's work rests on three ideals: equal opportunity, mutual responsibility, and self-governing citizens and communities. Building on these cornerstone principles, our work advances five key strategies to equip Americans to confront the challenges of the Information Age:

Restoring the American Dream by accelerating economic growth, expanding opportunity, and enhancing security.

Reconstructing our social order by strengthening families, attacking crime, and empowering the urban poor.

Renewing our democracy by challenging the special interests and returning power to citizens and local institutions.

Defending our common civic ground by affirming the spirit of tolerance and the shared principles that unite us as Americans.

Confronting global disorder by building enduring new international structures of economic and political freedom.

The Progressive Policy Institute is a project of the Progressive Foundation. For further information about the Institute or to order publications, please call or write:

600 Pennsylvania Ave., SE · Suite 400 · Washington, DC 20003
E-mail: ppiinfo@dlcppi.org · WWW: http://www.dlcppi.org/
Phone (202) 547-0001 · Fax (202) 544-5014

Executive Summary

This paper is designed to present a baseline summary of the economic status of the aged in the United States as a prelude to Social Security reform. We review the elements of economic and social well-being of the present United States aged: wealth, health status, and income levels and sources (including Social Security). We also speculate briefly on the future trends in each of these elements, realizing that Social Security will play a lesser role in the future. We pay attention to the large differences in economic well-being between the rich and poor; minorities and majorities; and men and women. And we include a brief section on cross-national comparisons.

Among our most salient findings, we conclude the following:

- Over the past four decades, the economic status of the aged has improved considerably and their poverty rates have been cut by two-thirds, from 35 percent to 11 percent. Still, minorities and older women living alone have poverty rates in excess of 20 percent. Moreover, a much larger fraction of the aged than of the non-aged live right above poverty (between 100 and 125 percent of the poverty line).

- The average economic status of the aged differs sharply depending on marital status, minority status, and age. Widowhood poses a significant economic threat to most older women.

- Around any average level of economic well-being we find vast differences between those at the top and the bottom of the economic spectrum, with even larger differences among the elderly than among the non-elderly. The three-legged stool of Social Security, asset income, and pensions works well only among the top 20 percent of the aged. The bottom 20 percent rely on Social Security for over 80 percent of their income.

- Inequality in wealth holdings is much greater among the aged than are inequalities in income. Many older households have extremely modest levels of accumulated savings, especially financial assets. For example, the median older (aged 70 and older) household has less than $6,500 in financial assets, enough to get by for less than half a year. Health status is also highly unequal and is correlated positively with economic status. A measure of well-being that takes account of all of these factors would show greater inequality than one based on income alone.

- Wealth inequality among the elderly is largely the consequence of past savings decisions. In addition to income, savings are influenced by past health shocks, a desire to leave bequests to one's heirs, and disincentives to private savings provided by asset-tested transfer programs. Social Security also provides disincentives to save among low-income households since replace-

ment rates for these households from Social Security are quite high.

- Social Security benefits are progressive in that they provide relatively higher returns to low-wage earners (versus high-wage earners) in any single year. They are the major form of wealth holding for the lowest half of the overall wealth distribution. Among blacks, Social Security wealth exceeds other forms of wealth up to the 90th percentile of wealth distribution.

- The Social Security benefits scheme also favors married couples, particularly those where only one spouse has worked. In short, the system pays out more than it should when both spouses are alive. But upon the death of one spouse, the program pays out too little, helping produce high poverty rates in old age for survivors. The current system of Social Security also contains large redistributions across generations, in this case to the benefit of the current generation of recipients and at a significant cost to all future generations.

- Comparisons with other nations indicate that the United States faces a fairly modest degree of future Social Security policy adjustment compared to that required by many other nations. The question to be asked is whether or not we can make these changes while maintaining or even improving the program's positive impact on poverty.

We conclude that the legs of the retirement income stool are increasingly unequal. Social Security or Old Age and Survivors Insurance (OASI) plays a very important role in the incomes of many current and future elderly. For a large number of well-to-do Americans, Social Security will become an increasingly smaller source of their economic well-being in old age. On the other hand, restructuring the pay-as-you-go OASI system may further compromise its ability to provide a decent standard of living to the low-income elderly. The poor who currently are on the program and older women, particularly survivors, are especially vulnerable. If baby boomers continue to save at lower overall rates than did their predecessors, economic inequality in old age may be even further exacerbated in the future. It will therefore be important to assess the impact of Social Security reform on economic inequality to increase retirement savings among lower income families.

To further insure against old-age poverty and poor health status, the Social Security system needs a solid lower tier of benefits. At the same time, we need to further strengthen incentives to save and to keep on saving, particularly among lower- and middle -income households, so that they may enjoy a solid three-legged stool of pensions, savings, and OASI in old age.

I. The Economic Status of the Elderly on the Eve of Social Security Reform

This paper presents a conceptual and empirical baseline for the upcoming debate on Social Security reform in the United States. The quadrennial Advisory Council on Social Security (Social Security Administration 1997) recently reported that, unless policy action was taken over the next decade, the nation faces either a benefit reduction of about 40 percent or a tax increase of 2.23 percent of payroll to right the imbalance in the Social Security, i.e. Old Age and Survivors Insurance (OASI) system. A variety of instruments are available to close this budgetary shortfall. Our task is not to choose from among these instruments; such work is reserved for presidential commissions, Congress, and similar bodies. Rather, we seek to describe the current and near-future economic status of the aged and the current impact of Social Security on their economic well-being. In so doing, we draw upon our recent writings on this topic and those of our colleagues.[1]

Throughout this paper we stress the economic heterogeneity of the aged. While "averages" (means, medians) are used to describe economic well-being, they are often a poor indicator because of the wide disparity among various subgroups of the aged classified by gender, race, ethnicity, and health status. This diversity often makes it difficult to adequately describe the well-being of such different groups as 60-year-old retired couples and 80-year-old single women by any one dimension of well-being.

Ultimately, reformers of Social Security will have to decide the program's role in the future economic status of the aged. While it is difficult to predict future levels of earnings, savings, and occupational pensions, future Social Security benefits are likely to meet a smaller fraction of consumption needs. It remains for Congress and the President to decide how this smaller role is played, paying particular attention to those least able to fend for themselves.

We measure well-being by economic resources available to individuals (income and savings). Comparisons are made over time and occasionally across countries regarding the poverty and affluence of the aged. We concentrate both on income comparisons, which provide the single best widely available measure of economic status at a point in time, and on wealth status. As a person ages beyond retirement, reliance on annual income flows is buttressed by reliance on past savings. Thus, wealth is also an important factor in the economic well-being of the aged. Other valid and important measures of economic status, such as consumption, are discussed but their treatment is more circumscribed. We draw on data from several sources including the Census Bureau[2], the new Health and Retirement Study (HRS) and Asset and Health Dynamics among the Oldest Old (AHEAD) surveys of the aged[3], and the Luxembourg Income Study (LIS) database.[4]

The paper moves from concepts of economic well-being to economic heterogeneity among the aged, followed by the components of income and wealth, and finally to Social Security itself. We concentrate on Social Security's redistributive effects and its distributional shortcomings as a safety net—both realities that Social Security reform will need to address.

The economic condition of the aged is a story of both change and variance. While many Americans are enjoying very comfortable retirement years, many others age under a significant threat of economic deprivation. There have been dramatic improvements in the average economic well-being of older Americans over the last several decades, but many still subsist near or below the poverty line. Using both income and wealth as measures of economic well-being, we present a picture of old age filled with both the bright lights of economic security and the dark tones of economic distress. We also attempt to go beyond descriptions of current older Americans to consider the likely economic well-being of the next century's older population. In some form, Social Security will play a lesser but still important role in the economic well-being of future generations.

Finally, it needs to be stressed that this paper deals only with Social Security, i.e. OASI reform. While we may make some mention of Disability Insurance (DI) and Medicare (HI), these programs are not our immediate concern. To the extent that Medicare reform changes its financing pattern, affecting, for instance, out-of-pocket health care expenses, net economic well-being will also be affected. If we should increase the age of OASI entitlement there will be repercussions for the DI system as well. These connections should not be forgotten, but they are not the primary aim of this paper.

II. Measuring the Economic Well-Being of the Aged

Economists have traditionally relied upon disposable personal cash income as the most important indicator of economic well-being for both the aged and the non-aged. Although money income is a useful measure of economic well-being, it serves largely as a proxy for the variable of ultimate interest: consumption. To convert income estimates into well-being measures, we need to take account of three factors. *First*, economic responsibilities can vary substantially among families depending on their characteristics, particularly the number and age of family members. *Second*, many resources of considerable economic value—for example, homeownership and medical insurance—affect consumption but not money income. Thus, two elderly families with similar money incomes could, in fact, have very different levels of economic well-being; and two families that might generally be judged as having similar levels of economic well-being might have very different levels of money income. *Third*, current income may rise above or fall below long-run, or permanent, income. Savings or transfers may cushion consumption from these shocks and weaken the relationship between current income and current consumption.

The first two of these limitations can be overcome at least in part by trying to estimate the income value of non-monetary economic resources and by adjusting measures of income to reflect differences based on family size and other factors. The third can be addressed by annuitizing measures of wealth and estimating their impact on income flows. Decisions about what forms of wealth to include and how to annuitize them make a great difference in the final results. Yet, as people advance in old age, wealth is an increasingly important form of economic well-being, serving as both a source of basic consumption and a means of meeting extraordinary needs. Thus, wealth status may be even more important than the level of Social Security and other forms of regular income in very old age.

In this paper, we do not attempt to annuitize wealth directly but rather consider its potential to finance consumption, given other characteristics of the aged. In a few instances, we do summarize attempts to present current value calculations for future liabilities and benefits of the OASI system, but we do not attempt to create an overall measure of net well-being that combines both income and wealth.

III. Economic Heterogeneity Among the Aged

The foremost fact concerning the economic status of the aged over the past four decades has been their dramatic increase in absolute and relative economic well-being.[5] Over this period, the economic position of older Americans has improved substantially and did so more rapidly than for any other age group. This is not just an American phenomenon; Canadian, German, and Swedish elderly also improved their relative economic status over the past two decades.[6]

Poverty Rates

We illustrate this good news with Table 1 which provides official Census Bureau poverty rates for the elderly population alongside the poverty rate for younger adults and those at the other end of the life cycle—America's children. In 1960, 35 percent of older Americans were poor. Today, less than one in nine older people is below the official poverty line. Since 1960 poverty declined twice as fast among the elderly as it did for other Americans. Even if we take 1970 as our starting point, poverty among the elderly has been cut in

Table 1. Poverty and Near-Poverty Rates among the Entire Population and Subgroups of the Elderly in 1996 [a]

	All Persons		Aged 65 and Over	
Category	Poor (%)	Poor and Near Poor (%)	Poor (%)	Poor and Near Poor (%)
All races and genders	13.7	18.5	10.8	18.4
Men	12.0	16.4	6.8	12.5
All Women	15.4	20.6	13.6	22.7
Living Alone	24.2	33.1	23.1	38.3
All Black Women	31.7	38.4	29.8	40.4
Living Alone	37.4	45.3	47.5	60.2
All Hispanic Women	72.0	40.5	27.7	41.0
Living Alone	42.4	54.3	44.9	68.6
	Aged 65 to 74		Aged 75 and Over	
All races and genders	8.8	15.5	13.3	22.2
Men	5.7	11.5	8.5	13.9
All Women	11.3	18.7	16.3	27.3
Living Alone	na	na	na	na
All Black Women	28.7	39.2	31.2	42.0
Living Alone	na	na	na	na
All Hispanic Women	28.0	41.8	27.3	39.5
Living Alone	na	na	na	na

[a]Estimates show percent of persons poor in each age group using the official United States poverty measure. The near-poor are those below 125 percent of the poverty line.

Source: U.S. Department of Commerce, 1997, Table 2.

half, while the rate of poverty for children has risen by a third and the rate for middle-age adults by over 20 percent. Based on these figures, the aged are the least poverty prone major American age group today.

Table 1 may also understate the good news, because the real poverty rate of the elderly is possibly much lower. If we exclude taxes paid, but add in the value of near-cash benefits that the poor receive (food stamps, public housing), the poverty rate of those aged 65 to 74 would fall by another point. If we also include the implicit rental value of housing, only about 7 percent of the elderly are poor today. Such adjustments are appropriate as they more accurately measure the real economic welfare of the elderly.

A major source of dispute on measuring economic well-being concerns how to incorporate health expenditures and insurance. One approach is to include the insurance value of Medicare and Medicaid. Following this approach, the poverty rate of the elderly would drop to 5 percent. An alternative approach recommended by a recent National Academy of Sciences panel would subtract out-of-pocket health care costs from incomes in determining poverty.[7] If this approach were followed, the poverty rate among the elderly would increase by 8 to 10 percentage points. Some critics have argued that this approach exaggerates poverty rates by only counting health care costs without, including the benefits from the insurance provided. In contrast, the first approach counts the benefits, but ignores the fact that some elderly spend significant fractions of their incomes on health care. The bottom line is that the way in which medical expenses and medical subsidies are treated makes a great deal of difference in the poverty rate among the aged.

Such overall good news should not obscure the equal reality that many older people remain economically vulnerable. One aspect of that vulnerability is that many elderly people have incomes that place them below or right above the poverty line. For example, if we extend the cash income poverty measure slightly upward to include the near poor living below 125 percent of the current poverty line (from $7,500 to about $9,400 per year for a single person in 1996), we add a much larger fraction of the aged than non-aged (Table 1). Similarly, many elderly people have incomes that place them just below the poverty line. They could just as well be labeled the "near middle class." This may be particularly relevant since some people may be below the poverty threshold only because their incomes are temporarily low. They may have savings or other resources to draw on in times of need. In general, longer run measures of income typically indicate smaller fractions of the population who are poor than measures based on annual incomes.

Our intention is not to try to arbitrarily move the poverty rate up or down. Rather, it is to emphasize that one should not become overly fixated with any arbitrarily set line that separates the population into only two groups. But under any reasonable measure, the average elderly person is much better off today than in earlier years.

The vulnerability faced by the elderly is often triggered by certain demographic transitions, particularly extremely poor health or the death of a spouse. For example, consider the most susceptible population—single elderly women (Table 1). Using official statistics, 23 percent of non-married older women are poor, more than twice the rate for all older people; and 38 percent of these women are below 125 percent of poverty. Among widows, poverty rates now run as high as 40 percent in this age range. The prospects for older black or Hispanic single women are particularly bleak, as five in every ten black or Hispanic women living alone are below the official poverty line and 60 to 70 percent are below the 125 percent line.

Treating the elderly—even the low-income elderly—as a single homogeneous group has lost whatever meaning it may have had either analytically or politically. To generalize that only one in every nine older Americans is poor or to point out that half of all single elderly black women living alone are mired in poverty is an equally invalid description of life among older Americans.

Income Status

This section presents some additional salient facts about the level and distribution of income of older-American households during their retirement years. This information relies on data obtained from the AHEAD and HRS Surveys, critically important new surveys funded by the National Institute of Aging (NIA).[8] We also include some data from the U.S. Census Bureau and the Social Security Administra-

tion (SSA)[9] to further illustrate the diversity of economic circumstances among the aged and the sources of their incomes.

Mean and median household incomes stratified by some important demographic characteristics are shown in Table 2.[10] There are many important patterns illustrated in this table. First, there exist wide income disparities across racial and ethnic groups. For example, older black and Hispanic households receive just more than half as much mean income as white households.

Table 2. Mean and Median Household Incomes Among the Elderly, Aged 70 and Over, in 1996 Dollars

	Median	Mean
All Families	$15,624	$23,769
White	17,385	25,803
Black	9,467	13,250
Hispanic	8,943	12,922
Married	24,814	36,500
Female Headed	10,613	13,960
Aged 70 to 74	19,461	27,753
Aged 75 to 80	15,357	24,002
Aged 81 to 85	12,335	19,359
Aged 86 and Over	9,439	13,834

Source: 1994 AHEAD Survey, reported in Smith, "Changing Economic Circumstances," (1997).

Marital status is an even sharper economic distinction than race or ethnicity. The principal risk faced by older households is the loss of a spouse either through divorce, separation, or more commonly death. Men both marry younger women and typically die first, often leaving their wives with few economic resources. This harsh reality is reflected in the quite low economic status of female-headed elderly families, whose incomes average only a bit more than one-third of the incomes of elderly couples.

Finally, there are large disparities across age groups, with the oldest households always faring the worst. In part, this age gradient reflects the increasing frequency of widowhood in older households. But it also results from a significant across-cohort improvement in economic well-being so that, even among the currently retired, younger age groups enjoy higher lifetime incomes than their older counterparts do.

Even these basic comparisons of average and median incomes among subgroups of the elderly indicate that older people should not be treated as an economically homogeneous group. There is an enormous amount of inequality among them, far more than exists between them and the rest of the American population, and more than exists among the non-aged.[11] Table 2 depicts the extent of this inequality with the AHEAD data by listing household incomes at each income percentile relative to those of the median white older household.

The extent of inequality is most clearly displayed by ignoring minority households completely and examining only older, white households. There are many older American households who are doing quite well indeed. One in every ten of them receives more than $40,000 a year, almost three times the income of the median older household. These well-off households can be contrasted with those at the bottom, whose situation is still quite stark. White elderly households at the lowest ten percentile receive only 43 percent as much as the median white elderly household. Among those over age 70, household incomes of those in the top 5 percent of income are nine times larger than those in the bottom 10 percent. Although their incomes are lower at every percentile, Table 2 also shows that similar levels of inequality exist among minority households. If anything, the degree of inequality is even larger among these households, where the gap between those at the top and those at the bottom is greater than the gap for white households.

IV. Sources of Income Differences

The heterogeneity of the American system of income support can be measured over time and across the economic spectrum. Over the past 30 years, the American system of income support for the aged has changed only modestly in nature and scope (Table 3). The traditional "three-legged stool" of Social Security, asset income, and occupational pensions appears intact and is still well supplemented by earnings. Social Security grew in the 1970s, but has leveled off at 40 percent since 1976. Asset income grew to about a quarter of income by the mid-1980s, but fell to 21 percent in 1992. Occupational pensions continue to grow and are now about equal to assets as a proportion of income. Earnings, which slowly declined until the early 1980s, have since stabilized. And there is very little in the way of other incomes for the average American aged person. Other incomes, including private transfers and Supplemental Security Income (SSI), have been only 3 percent of aged incomes since 1982.

While average income amounts among the elderly have changed only slightly over time (Table 3), income types vary substantially across the income distribution at any point in time (Table 4). The bottom quintile in Table 4 includes both the poor and near-poor aged. Here Social Security makes up more than 80 percent of total income. Earn-

Table 3. Average Shares of Income among Households with Heads Aged 65 and Over from Various Sources, Selected Years[a]

Year	Social Security (%)	Asset Income (%)	Pensions (%)	Salary/ Earnings (%)	Welfare Income (%)
1962	31.0	16.0	9.0	28.0	16.0
1967	34.0	15.0	12.0	29.0	10.0
1976	39.0	18.0	16.0	23.0	4.0
1978	38.0	19.0	16.0	23.0	4.0
1980	39.0	22.0	16.0	19.0	4.0
1982	39.0	25.0	15.0	18.0	3.0
1984	38.0	28.0	15.0	16.0	3.0
1986	38.0	26.0	16.0	17.0	3.0
1988	38.0	25.0	17.0	17.0	3.0
1990	36.0	24.0	18.0	18.0	3.0
1992	40.0	21.0	20.0	17.0	3.0

[a]Includes private interhousehold transfers and Supplemental Security Income from 1976 onwards.

Source: Social Security Administration, 1995: 22.

Table 4. Shares of Income among Households with Heads, Aged 65 or Older, in the Lowest and Highest Quintile of Money Income, 1992

	Bottom Quintile	Top Quintile
Social Security	81	20
Asset Income	4	29
Pensions	2	22
Salary/Earnings	1	27
Welfare/Other	12	2

Source: Grad 1995, based on U.S. Bureau of the Census data.

ings, asset income, and occupational pensions contribute negligible amounts of income. In contrast, the top quintile of elders have a solid four-legged stool, relying on assets, pensions, and earnings more than on Social Security. Here, social retirement is only one-fifth of total income. In fact, this contrast across the income scale is crucial for a more complete understanding of the role of Social Security among the aged.

Future Patterns of Income

How might we expect the mix of incomes for the elderly to change as we move into the 21st century? There is evidence that labor force participation rates have bottomed out and are beginning to turn upward at older ages.[12] Coupled with better health in old age, the changeover to a service economy, and additional work incentives, we might expect labor force participation rates for older men to actually increase in the future. However, this change is liable to be modest after age 67 and may involve movements from "career" jobs to part-time "bridge jobs" that span the time between full-time work and full retirement.[13]

Labor force participation rates for older women are where the action is. Most older men are married to women on average five years their junior. And labor force participation rates among older women have been increasing for several decades now. It may well be that in the future the lion's share of earned incomes in households with men aged 70 or over comes from their spouses' salaries.

Clearly, increased labor force participation rates and alternate patterns of work in old age will be increasingly important for economic well-being beyond age 65 or even age 70. Increases in the official age of Social Security receipt will likely push earned income for many to a still higher level. And joint retirement decisions will need to be closely monitored. But not everyone can or will work until age 70 and few will work full time beyond that point. Thus, salaries (or earned income) are liable to remain modest sources of income among the truly old in years to come.

Rising levels of income and entitlement to Social Security, particularly among immigrants but also among the native-born, are liable to make income from SSI or welfare a smaller fraction of income in old age. About 40 percent of elderly SSI recipients are foreign born, and about 70 percent of all aged SSI recipients also have Social Security income.[14] Unless the liquid assets test (of about $3,000 in financial wealth) is removed or greatly liberated, even those with incomes low enough to qualify for SSI will not be able to receive SSI benefits. Without significant changes in the program qualifications, SSI will continue to shrink as a source of income for older persons.

Private or occupational pensions remain one of the great unknowns for future generations of Americans. There has been a clear shift away from defined benefits (DB) and toward defined contribution (DC) pensions. The shift to DC pensions provides a greater opportunity for both income gain and income loss among retirees based on fluctuations in the stock and bond markets. The next generation of the aged, those now at or near retirement age, who have been in DC plans or who have had significant individual pensions (IRAs, 401K's, etc.), have benefitted greatly from the overall bull market of the last 15 years. In contrast, DB pensions are based on salary and years of service, not asset values. The shareholders of companies with DB plans have benefitted from the recent stock market boom far more than have the companies' employees. And some occupational pensions are fixed in nominal terms and decrease in real value as persons age and inflation eats away their buying power. At the same time, coverage and vesting in occupational pensions seem to have peaked in the 1980s and are continuing to stay below peak levels. The receipt and generosity of pensions will be key determinants of the extent to which the elderly will be comfortable in retirement.[15] Unfortunately, it is not possible to predict their future role

with any degree of accuracy.

This leaves two future sources of income for speculation: Social Security and asset income (or income from financial wealth). Given future budgetary constraints, Social Security is not liable to grow as a fraction of income and should, in fact, shrink as an *average* fraction of income in old age. The only uncertainty is the extent of benefit reductions and how they are targeted. This leaves wealth and income from wealth as the major unknown source of economic well-being in old age.

V. Wealth Levels and Inequality

While income remains their basic economic resource, household wealth is an important complementary measure of the elderly's command over economic resources. To describe the wealth position of the elderly, we use a conventional but comprehensive definition of household wealth.[16] Household wealth includes any equity held in all homes, the value of business and other tangible assets, and a very detailed list of financial assets. These financial assets span checking and savings accounts, stocks and bonds, CD's, IRA's, Keoghs, and cash money market funds.

The Basic Facts

Household wealth levels at selected deciles of the full wealth distribution for the AHEAD sample are shown in Table 5.[17] Mean household wealth is almost $178,000 for those households over 70 years old. The principal message from Table 5, however, lies in the extreme diversity in wealth holdings for older populations. Among those age 70 or over, households in the top 5 percent have $670,000 in wealth, about eight times that of the median household.[18] In contrast, those retired households in the bottom 10 percent had less than $200 in household wealth, a small fraction of the average household's holdings. Due to this extreme diversity in wealth holdings, wealth among older populations is significantly overstated by the use of means. For example, in contrast to a mean wealth of $178,000, the average or median older household (the 50th percentile) has only $84,000 in wealth.

The story of relatively modest holdings for the average household, alongside widespread heterogeneity across households, is even more pronounced when financial assets are examined. Financial assets are defined quite broadly, only excluding housing and other real assets. These more liquid assets may be a better index of how many resources a household has on hand to meet emergencies or to draw upon as a source of regular asset income. In liquid asset terms, the typical older household has very few resources indeed. The average (median) household age 70 or over has less

Table 5: Average Wealth by Deciles for Households Aged 70 and Older (in 1996 $)

Deciles	Total Wealth ($)	Financial Assets ($)[a]
10	162	0
30	30,311	541
50	84,206	8,659
70	166,682	41,995
90	415,622	175,341
95	669,974	313,882
mean wealth	177,678	65,116

[a]Financial assets are defined as total wealth minus housing and other real assets.

Source: 1994 AHEAD database, reported in Smith, "Changing Economic Circumstances," 1997.

than $9,000 in all forms of financial wealth, while mean financial wealth is $65,116, seven times larger. In addition to their relatively small amount of financial assets, once again there exists considerable diversity among these households. For example, among households aged 70 or over, those in the bottom 10th percentile have no financial assets at all while those in the top 5 percent have more than $300,000.

These large disparities in wealth holdings among older households translate into correspondingly large disparities when households are stratified by their race or ethnicity. To document their magnitude, Table 6 lists mean and median levels of total and financial household wealth for white, black, and Hispanic households. Race and ethnic disparities are enormous, far outdistancing the income differences among these groups in the population as a whole. For example, for every dollar of wealth an older white household has, black households have 25 cents and Hispanics have 32 cents. These wealth gaps compare to mean racial and ethnic income gaps of about 50 percent among those aged 70 or over (compare Tables 2 and 6).

Table 6. Wealth Levels for Households Aged 70 or Over, by Ethnicity (in 1996 $)

	Whites ($)	Blacks ($)	Hispanics ($)
Total Wealth			
Mean	201,336	50,143	64,091
Median	102,823	18,957	15,586
Financial Assets[a]			
Mean	76,286	5,877	9,126
Median	15,586	0	0

[a]Financial assets are defined as total wealth minus housing and other real assets.

Source: 1994 AHEAD database, reported in Smith, "Changing Economic Circumstances," 1997.

Racial and ethnic disparities are larger still when we concentrate on financial assets only. Neither the average black nor the average Hispanic older household has any financial wealth at all. Even the bottom third of older white families have less than $2,000 in liquid assets at their disposal.[19] Among those at least age 70, for example, black households have only 8 percent of the financial assets of white households. The patterns differ little if we look at those in their pre-retirement years based on the HRS data. The median black or Hispanic household again has zero financial assets.

These then are the basic facts about wealth among older American households. They are characterized by modest wealth holdings for the typical older household, large inequalities in wealth, and very little evidence of any prior savings behavior by poor or even middle-class households.

The Disparity between Income and Savings

Why is there such heterogeneity in wealth accumulation and to what extent does wealth inequality simply match the inequality in income among older households? Do households, even with the same income, save different amounts from their income? To address this central question, Table 7 lists selected percentiles of the distribution of financial, housing, and total net worth for AHEAD households. These distributions are presented separately for households stratified by deciles of their household income. For example, the first row in the table lists the distribution of financial assets for households whose income places them in the lowest income decile.

There are a number of important patterns in this table. First, household income and wealth (and the components of wealth) are strongly positively related, albeit in a highly nonlinear way. Evaluated at any column percentile, financial assets, housing equity, and total net worth all increase *at a more rapid rate than income* as we move toward the higher deciles of household income. To illustrate, median values of total net worth of households in the 7th income decile are about twice that of households in the 5th income decile. At the same time, the income differences between the fifth and sev-

enth decile is only 50 percent. This non-linearity is even stronger in financial assets, where the median financial wealth at the 7th income decile is two-and-one-half times the median financial wealth at the 5th income decile.

Second, many older households have quite modest levels of accumulated savings in their retirement. For example, among older households in the median income decile, the median amount of financial assets is only $6,494. Since this is less than half of their median incomes, the typical retired household has only enough liquid assets to meet its expenses for less than half a year.

Third, and least well known, the amount of diversity in wealth holdings even for older households with the same current income can only be described as enormous. For example, even among those households in the lowest income decile, about 8 percent have net wealth in excess of $100,000. Such households would not be described as poor, even though official government statistics might so label them. At the other end of the spectrum, 10 percent of households in the top decile of household income have accumulated less than $7,000 in financial assets over their lifetimes. Table 7 demonstrates that judging a household's command over resources by its income alone can be quite misleading. It also demonstrates that inadequate household income alone is an insufficient explanation of the variation in wealth accumulation. Even among median income households, total net worth varies from $317,128 among those in the top 5 percent to only $3,247 among the bottom 10 percent. Similarly, the variation in financial assets for median income households runs from $115,811 (the top 5 percent) to $0 (the lowest 10 percent).

Table 7 simultaneously demonstrates how few resources, either in income or wealth, some elderly households have and how many resources other elderly households have in both. Retired households in the lower half of the bottom income decile have essentially no wealth in any form. In sharp contrast, the top 10 percent of the top income decile have more than one-half million dollars in financial assets and more than one million dollars in total net worth. A significant fraction of households in Table 7 do not need Social Security to achieve a good standard of living during their retirement. At the same time, a significant fraction of elderly households

Table 7. Joint Distribution of Income and Wealth (in 1996 $)

Deciles of Household Income[a]	10	30	50	70	90	95
	A. Percentiles of Financial Assets					
1	0	0	0	530	8,658	27,059
3	0	0	1,299	7,576	48,756	102,693
5	0	649	6,494	24,894	81,177	115,811
7	0	5,412	20,781	57,906	183,133	263,011
9	2,165	21,647	53,035	120,140	297,646	418,869
10	7,035	54,118	139,515	270,588	577,975	865,826
	B. Percentiles of Net Housing Equity					
1	0	0	0	21,647	64,941	92,000
3	0	0	16,235	46,541	108,235	162,303
5	0	3,788	43,294	75,765	135,924	176,964
7	0	34,635	59,529	92,000	167,764	216,470
9	0	59,529	86,588	119,059	216,470	324,705
10	19,482	75,765	114,729	173,176	351,763	514,116
	C. Percentiles of Total Net					
1	0	0	4,329	28,141	81,176	119,558
3	0	4,329	29,440	73,772	168,846	243,853
5	3,247	35,068	71,435	119,059	222,964	317,128
7	30,737	69,270	118,084	183,999	372,870	516,781
9	66,024	130,964	207,811	304,602	543,340	791,468
10	120,114	258,140	397,222	663,805	1,083,432	1,395,019

[a]Authors calculations. The income levels at the deciles threshold are (1) $6,595; (3) $10,063; (5) $15,018; (7) $22,241; and (9) $40,796.

Source: 1994 AHEAD surveys.

cannot maintain a decent standard of living on current Social Security benefits alone.

Wealth Summary

Wealth is an important and growing source of economic security among the aged. Wealth is highest for households who are aged 60 to 74. In 1993, household wealth was eight times as large for households aged 65 to 74 compared with households aged less than 35 years old.[20] The households aged 65 to 74 even exceed those aged 45 to 54 by 50 percent in terms of their wealth. Moreover, wealth levels of older households have grown significantly over time. For example, median wealth of households in the 65-to-74-year-old range group grew by 22 percent in real terms between 1983 and 1993.[21]

However, wealth, even more than income, remains unequally distributed across the economic spectrum among the aged. The HRS/AHEAD data panel and other recent panel data-based research has shown that the pattern of increasing income inequality found in the 1980s is reinforced by changes in wealth inequality among these same persons. This finding is not unique to the AHEAD data.[22] By and large, the 1983-1989 Survey of Consumer Finance (SCF)[23], the 1984-1989-1994 Panel Study of Income Dynamics (PSID)[24] joint income and wealth data, and the 1984-1988 Survey of Income and Program Participation (SIPP)[25] data also yield the same major findings for older households:

- The income distribution among older households is more unequal than among the rest of the population, and did not change appreciably over the 1980-1995 period;

- Liquid asset holdings by older households increased in value during the 1980s and 1990s across the entire distribution of wealth, but especially so at the top of the distribution;

- Liquid asset holdings among the bottom 30 percent of older households (ranked by income or wealth) are not large. For example, in the bottom 30 percent of PSID households (ranked by net worth) they grew from $300 to $500 over the 1984-1989 period.

Thus, the patterns observed here are not unique to today's elderly. We predict that other birth cohorts will exhibit similar patterns in older age.[26]

Health as a Factor

While economic resources are key proxies for the well-being of the elderly, there are other non-economic dimensions of people's lives that matter in evaluating how well off they are. In particular, a key risk to successful aging is the prospect of rapid deterioration of health. While important by itself, a health change interacts with levels and changes in household economic resources to create additional dispersion in a complex two-way interaction between economic status and good health.

To illustrate levels and distribution of health status among older

Table 8. Conditional Distribution of Self-Reported Health of Wife by Self-Reported Health of Husband in Households Aged 70 and Older in 1994 (percent distribution)

Husband's Health	Excellent	Very Good	Good	Fair	Poor	All Men
	A. Husband: Ages 70 to 79					
Excellent	25	30	25	12	8	12
Very Good	16	38	23	19	4	24
Good	13	27	35	21	4	33
Fair	13	27	29	21	9	22
Poor	8	15	28	31	18	10
	B. Husband: Ages 80 and Over					
Excellent	31	20	41	5	2	7
Very Good	10	29	26	23	11	20
Good	9	27	30	21	13	29
Fair	6	17	26	39	12	25
Poor	6	18	21	28	27	19

Source: 1994 AHEAD survey.

people, Table 8 lists the self-reported health status of wives, conditional on the self-reported health of their husbands. The final column in this table represents the marginal report of the husband about his health. To illustrate the changes associated with age, Table 8 provides separate distributions for households with husbands aged 70 to 79 and husbands aged 80 and over.

Many older Americans face significant health problems either for themselves or their spouses. Forty-six percent of households with a husband aged 70 to 79 have one spouse in either fair or poor health. This proportion rises to 61 percent when the husband is at least age 80. As was true for income and wealth, there exists wide diversity in health outcomes among older Americans, a diversity that is accentuated by the strong positive correlation in health outcomes among spouses. Among those in their 70s, both spouses are in very good or excellent health in 20 percent of households, while both spouses are in fair or poor health in 12 percent of households.

The positive correlation in health outcomes between spouses is best illustrated by examining the health of women, as related to the health of men. For example, among those households with a man aged 70 to 79, 55 percent of wives report themselves to be in at least very good health when their husbands say that they themselves are in excellent health. Only 20 percent of such wives say that they are in only fair health or worse. However, when the husband is in poor health, fewer than one in four wives is in very good health (or better) while half of them are in fair or poor health. Our basic theme of heterogeneity in the well-being of older Americans is reinforced by the positive correlation in the already heterogenous distributions of income, wealth, and health.

Interrelation between Income, Wealth, and Health: Savings Effects

Why is there so much diversity in wealth holdings among older Americans and why are income, wealth, and health so positively correlated?[27] This question is on the frontier of current research, and a full consensus on what the reasons are and which ones rank highest in importance has not been reached. One reason that can be easily dismissed is that it is the consequence of past financial inheritances.[28] Very few of the households in the AHEAD sample received significant financial inheritances. The reasons instead lie in very different savings rates across households as well as different *ex post* rates of return on those savings. These different savings rates may reflect in part risk aversion, rates of time preference, or liquidity constraints.[29] A particularly promising recent explanation is the disincentives to private savings provided by income transfer programs, especially those in "means-tested" welfare programs like SSI, AFDC, and Medicaid which have strict liquid asset limits for program eligibility.[30]

Two other factors that may affect wealth accumulation of older people are Social Security and health status. One downside of our current Social Security system is shown in Table 9 where income replacement rates from pensions and Social Security for households in their 50s are calculated using 1993 HRS data. These replacement rates represent the fraction of household income that is predicted to be replaced by pensions and Social Security at the time these households are expected to retire.[31] To illustrate with an example, the median household in this age group earns about $36,000. This table shows that the household will receive about $17,000 in Social Security and pensions when it retires, 45.3 percent of its current income.

The important news, however, is the sharply declining replacement rates from Social Security as income rises and the very high rates of Social Security replacement for low-income households. Over 90

Table 9. Predicted Future Income Replacement Rates during Retirement for Households Currently in their 50s[a]

Income Percentile	Pension	Social Security	Pension + Social Security
5	10.8	81.6	92.4
10	13.4	59.1	72.5
20	16.7	42.1	58.8
50	21.3	24.1	45.3
80	21.8	15.4	37.3
90	22.3	11.3	11.5
95	19.6	9.4	29.0

[a]Entries give percent of pre-retirement income received from each source.
Source: HRS sample, as reported in 1993. Smith, 1995.

percent of the current income of those at the bottom 5 percent will be replaced by Social Security and pensions, compared to only 29 percent for those at the top of the distribution. Social Security is clearly responsible for this sharp decline, replacing over 80 percent of the income of those at the bottom and less than 10 percent at the top.

Table 9 understates the actual extent of replacement since it ignores the income-conditioned safety net programs available to older, low-income households, such as SSI and food stamps. It is not an exaggeration to say that these low-income households may be as well off when they retire as they are now. In this sense, current public policy has over-annuitized its transfer programs since many of these households would prefer more money now at the expense of a little less in the future. Most important, the incentives these households have to save for their own retirement is almost nil. One reason that low-income households have accumulated little private wealth of their own may well be that they have little incentive to do so, particularly if those savings will reduce their benefits from SSI, Food Stamps, and Medicaid.

Similarly, health status is also positively correlated with wealth so that inequalities in either tend to reinforce the other. Table 3 illustrates that the cross-sectional association between health and wealth is not trivial. This chart plots median wealth levels against self-reported health status in couples aged 70 and over. When either spouse is examined separately, older individuals who report excellent health have more than three times the wealth of those in poor health. Each step down in health is generally associated with significantly lower wealth. This chart also demonstrates that the health of both spouses appears to be equally important. A decline in the health of either spouse is associated with lower levels of family wealth.[32]

The basic conclusion to be drawn from these findings is that income, wealth, and health (and thus, the ability to work to age 65 or beyond) are all unequally distributed, and that these distributions are positively correlated. A net measure of well-being taking into account each of these factors would show a distribution of well-being more unequal than that found by the distribution of income alone.[33]

VI. The Re-distributive Effects of Social Security and the Safety Net

Social Security has a number of important goals, but the most basic is to provide income security during the retirement years. To achieve that goal, it weighs more heavily its success in providing income security for those at the bottom of the economic strata than whether or not it provides extra income for those who would be well-off in any case. In other words, Social Security must serve some re-distributive function. This re-distributive goal is explicit in the Social Security formula which provides much higher wage replacement at low wages than it does at high wages. To what extent is Social Security achieving its aim of securing a decent standard of living during the retirement years?

One way of addressing this question is to evaluate how Social Security wealth is distributed and how that distribution contrasts with the distribution of traditional household wealth.[34] Future Social Security wealth was calculated for pre-retired households currently in their 50s using the Health and Retirement Survey.[35] Table 10 lists the amount of household and Social Security wealth for sample households at the 10th, median, and 90th percentiles of total household wealth.[36]

Not surprisingly, Social Security wealth is particularly important among low-income households. Households who rank at the bottom 10 percent in total wealth have three times as much wealth in the form of Social Security as they have in all forms of household wealth. For the very poor, in fact, Social Security is basically the only wealth they have. Seventy percent of the wealth of these households rests in their future Social Security checks.

While less extreme, Social Security currently is the number one source of wealth in the portfolio of the median household. The average white house-

Table 10. Predicted Social Security Wealth and Tradtional Household Wealth in HRS Households Currently in their 50s in 1993 (in 1996 $)

Percentile of Total Household Wealth	Traditional Household Wealth ($)[a]	Social Security Wealth ($)
	A. White Households	
10th	23,866	70,564
50th	151,716	155,391
90th	559,423	189,107
	B. Black Households	
10th	7,940	20,905
50th	41,004	103,315
90th	179,206	176,911

[a]Excluding future Social Security benefits.
Source: Smith (1995).

hold in their 50s has more Social Security wealth than household wealth (including their home). The typical black household has more wealth in Social Security than household and pension wealth combined. These large wealth holdings for median households capture the fact that Social Security is at its core a middle-class entitlement. As a proportion of their wealth, Social Security is far less central to those households at the top of the wealth distribution. Compared to the median household, households at the 90th percentile receive about 25 percent more wealth in Social Security but three and one-half times more in household wealth. However, Social Security still transfers almost three times as much wealth to those in the top 10 percent as it transfers to those in the bottom 10 percent.

These facts summarize the political and substantive power of Social Security as a source of future economic well-being. Those on or about to be on Social Security can anticipate receiving a lot of money from OASI, an amount that often dwarfs any other wealth they may ever hope to have. The substantive success here is that Social Security is a successful re-distributive system with relatively larger transfers going to the less well-to-do.

Social Security has been highly successful in helping pull the average household out of poverty over the last 25 years. However, while it has been a boon to many, it has several unsatisfactory features that need be addressed by Social Security reformers. These include its effects on savings (mentioned above), some cohort specific distributional effects, and its limited current value as a safety net device.

Distributional Consequences of Social Security

Comparisons of transfers across levels of economic strata is only one way of evaluating the fairness of the Social Security program. Many features of OASI were designed in the 1930s and 1940s and have changed little since then. Back then, life expectancy was much shorter, couples stayed married, and wives, most of whom were also mothers, did not work outside the home. While society has changed, the Social Security distribution scheme has remained the same, and this has produced a series of distributional consequences that are not easy to understand or defend in the current world of the 1990s. They will be even harder to defend in the future.

To see how antiquated Social Security has become, consider some important results recently published by Constantin Panis and Lee Lillard.[37] In their work, they provide some data on the distributional consequences of Social Security for the average cohort. Their use of an average cohort is important since it recognizes that Social Security is after all a transfer program—taking resources from some households and transferring these same resources to other households. On average, then, the winners and losers must exactly offset each other.

Calculations of the "rate of return" to Social Security contributions are exceedingly difficult to make. While Social Security redistributes toward lifetime low earners in any one year, low earners are likely to live shorter lives than are high earners and thus collect benefits for fewer years. A substantial fraction of some populations, e.g. minority men, may never reach Social Security retirement age and thus will receive no retirement benefits. On the other hand, those who die earlier and are in poorer health are likely to leave survivors who benefit from Social Security or to claim disability benefits. The way that these effects balance out are open to a large degree of speculation. Thus, the estimates presented here are rough and indicative of the net effects on broad population groups, not on specific groups.[38]

Table 11. Losers and Winners from the Social Security Program (present value of benefits—present value of taxes, in 1996 $)

Unmarried Men		Unmarried Women	
Low Income	-25,000	Low Income	+16,000
Middle Income	-52,000	Middle Income	+16,000
High Income	-72,000	High Income	-15,000
One-Earner Couple		Two-Earner Couple	
Low Income	32,000	Low Income	-4,000
Middle Income	60,000	Middle Income	-9,000
High Income	70,000	High Income	-57,000

Source: Panis and Lillard, 1996.

Some of the main results from Panis and Lillard are summarized in Table 11, which lists the differences between the present value of taxes paid (in 1996 dollars) compared to present value of

benefits received for some important demographic subgroups. The positive aspect of the structure of the current program is documented by the fact that the losers are high-income households and the winners are low-income households. This is by no means the only distributional consequence, however, and some of the other patterns are more troublesome.

Unmarried men as a group are among the big losers from Social Security largely because they have relatively low life expectancies and their households receives no spousal benefits. A spouse, traditionally a wife, is entitled to a payment equal to 50 percent of her partner's benefit even if she made no payments into the program. Obviously, single-person households do not receive this payment. But two-earner couples also lose out on this spousal benefit. With two-earner families, both spouses pay money into the system, but they get about the same benefits as if the wife paid nothing at all.

The big gainers from the current Social Security program are in fact one-earner couples. In addition, the program pays too much when both spouses are alive and too little to the surviving spouse, typically the wife. This helps produce the high poverty rates among single, older women, as shown earlier in Table 1.[39] Budget-neutral reforms can be introduced that give couples fewer dollars when both spouses are alive, but more dollars to the surviving spouse. While such a reform would not change the overall benefit structure in Table 11, it would better distribute these benefits over a recipient's life span and this to minimize poverty and maximize the program's safety net value.

Indeed, a majority of the quadrennial Advisory Council on Social Security agreed upon only one change that would substantially increase the future deficit faced by the entire system: an increase in survivors benefits from 67 percent to 75 percent of a couple's combined benefit. Whether this particular recommendation is adopted or another of similar intent, it seems imperative that Social Security reform be designed to improve the economic status of older women, particularly older widows, while at the same time recognizing the implicit redistribution from single earners toward married couples.

Income Security in Old Age: A Comparative International View

Most modern nations face challenges of an aging population that are similar to that of the United States. Almost every one has a pay-as-you-go social retirement scheme that will be put to the financial and political test over the next 30 years. Changes in program outlays and contribution rates must be addressed sooner rather than later. The longer a country waits to make changes the more immediate and severe the impact will be.[40] Each nation also has some mix of occupational pensions, own savings, earnings, and targeted benefits for the poor that helps them meet income security goals. The different mix of these streams of income can be tied to policy goals, just as they are in the United States.

Income security policy goals include preventing poverty in old age; encouraging private savings; encouraging work at older ages; and ensuring desired rates of income replacement in retirement. What differs across countries is the extent to which each of these goals is pursued and the costs incurred. Table 12 summarizes several salient features of retirement income security systems for seven modern nations. Entries in the table address how well various nations meet various policy goals and the financial pressures being brought to bear on each nation as its population ages.

We begin with patterns of work at older ages. Nations with lower overall unemployment rates (United States, Sweden) have the highest rates of labor force participation. Despite the fact that the "standard age of benefit entitlement" for men in each of these countries is 65, large numbers of men are leaving the labor force and taking up Social Security benefits long before reaching this age. In a recent summary of the international evidence, Jon Gruber and Aaron Wise demonstrate that these international differences in work effort are largely due to international differences in the implicit tax placed on work by social programs related to disability and Social Security.[41] Early retirement is costly to Social Security systems, because it adds to the number of years over which benefits are paid. These important results imply that labor force participation rates can be decreased, and increased, by prudent public policy.

In the United States, Germany, and Australia, the decline in labor force withdrawal for men at older ages stopped by 1995, and may even be increasing in Australia and the United States. In Canada and the Netherlands, labor force participation rates continue to decline rapidly at older ages.[42] Sweden promotes mixing social security pensions and work up to age 70, while "bridge"

jobs linking career jobs to full retirement through part-time work are popular in the United States. Given increasing life expectancy at older ages, the changing nature of work, and the need to reduce early retirement, other nations may need to follow the United States, Germany, and Sweden in their efforts to reduce early retirement as a way to lessen the social costs of an aging population.

Poverty rates in old age vary substantially across nations as well. In columns 2 and 3 of Table 12, we calculate the percent of persons age 65 and over with disposable incomes (adjusted for differences in family size) less than 40 or 50 percent of the overall national median disposable income. These levels roughly correspond to those below the United States poverty line (40 percent median line) and the 125 percent near-poverty measure (50 percent median line) shown in Table 1. We also have computed the minimum guaranteed income for a single, older person as a percent of the same adjusted national median income for each nation. These minimum income systems usually involve two items: a flat old age security benefit within the social retirement system and some type of an income or income and asset means-tested general revenue-financed "welfare" benefit for older persons. In the United States, the system involves the result of combining OASI, SSI, and food stamps. In many other nations, the flat old age security benefit (minimum social security benefit) is higher, and the income-tested benefit is higher still. In Sweden, the policy goal is to have a guarantee at or above 60 percent of the median.

These three columns show that poverty rates are inversely related to the minimum old age benefit level. Nations with relatively low minimum benefits (United States, United Kingdom) have relatively higher poverty rates. Other nations with well-targeted, high-participation-rate welfare systems (e.g., Canada) or those with relatively high, lower tier social retirement benefit levels (the Netherlands, Sweden, Germany) have lower overall poverty rates. Australia is unique in that it has no social security system, only a general-revenue-financed, means-tested income support system to prevent old-age poverty. While this system produces only a 7 percent poverty rate at the 40 percent of median income standard, it results in a 29 percent rate at half of the median. And, were we to go up to a 60 percent of median income poverty level, we would find over half of all Australians age 65 or over having incomes below this level.[43] Such a system serves the goal of preventing deep poverty while ignoring the other goal of replacing retirement income.

These data also raise the question of what is meant by the generosity of a program. If Social Security is evaluated based on its replacement of income that people have before retirement—it is a

Table 12. Selected Features of Retirement Income Security Systems in Seven Modern Nations, 1995 (in percent)

Country	Labor Force Participation Rates for Men Aged 55 to 64 in 1995[a]	Poverty Rates among the Aged Circa 1992[b]		Guaranteed Minimum Income for the Aged Circa 1992[c] (percent of median adjusted national income)	Actual and Predicted Social Retirement Pensions as a Percent of GDP[d]		
		40 percent	50 percent		1995	2030	Difference
United States	67	13.4	22.7	34	4.1	6.6	2.5
Germany	56	4.5	8.1	52	11.1	16.5	5.4
United Kingdom	61	10.9	30.5	43	4.5	5.5	1.0
Canada	58	1.5	7.1	56	5.2	9.0	3.8
Australia	60	7.1	28.6	51	2.6	2.9	0.3
The Netherlands	42	3.0	4.4	66	6.0	11.2	5.2
Sweden	70	1.5	6.4	63	11.8	15.0	3.2

[a] Taken from OECD (1996) and OECD Labor Force Statistics database.

[b] Taken from Smeeding (1997, Table 2) and based on the Luxembourg Income Study database. Poverty is defined as percentage of elderly living in households with adjusted disposable income less than the given percent of median adjusted disposable income for all persons. Incomes adjusted by E=0.5 where adjusted DPI=actual DPI divided by household size (s) to the power of E: Adjusted DPI=DPI/s^E.

[c] Taken from Smeeding (1996, Table 1). Minimum benefits as published by the OECD were compared to adjusted median income after adjusting for national price changes. For the United States, the figures include the SSI benefit, plus the OASI disregard, plus food stamps as indicated in the U.S. Congress (1992). For other nations the combination of benefits was determined by OECD. In the Netherlands and Sweden, benefits are adjusted for income taxation. Note that small numbers of elderly can still fall below the minimum income level due to benefit take-up rules or incomplete coverage of social retirement systems.

[d] Taken from OECD (1996, Table 2.3). Assumes continuation of current trends in taxes and outlays for social retirement.

Sources: OECD (1996); Quinn and Smeeding, 1997; Smeeding, 1997, 1996.

generous program indeed. Low-income workers who also receive a spousal benefit may have replacement rates well in excess of 100 percent of their previous incomes. Another definition of generosity is how much income is received relative to the median income of the society. On this basis, as we have seen, the U.S. system appears far less generous than those of other nations. Earnings and income inequality in the United States is much higher than in European countries at all ages.[44] For the American system to achieve the same retirement-age poverty rates as in other countries, it would have to have replacement rates that were well in excess of one for a large subgroup of the aged. These levels of replacement would raise serious questions about such a system's effect on work effort and savings.

The final three columns of Table 12 summarize the Organisation for Economic Co-operation and Development's (OECD) forecast of the financial cost of the social retirement system alone if it were to continue its current level of benefits and participation rates over the next 30 years. Most American analysts are very concerned about the future of our Social Security system, which would require 6.6 percent of GDP in the year 2030. The gap, which must be made up either by benefit reduction or tax increases, is 2.5 percent of GDP. In contrast, the high social retirement benefit nations of Germany, the Netherlands, and Sweden are confronting much higher cost differences while also starting from much higher bases. Canada faces a larger increase (3.8 percent of GDP) from a slightly larger base. Each of these nations relies heavily on its social retirement system to finance old age income support. For the median elderly person, German, Dutch, and Swedish social retirement benefits make up 84, 73, and 90 percent of disposable income, respectively. This compares to about 60 percent to 63 percent in the United States and Canada.[45] According to most analysts, including the OECD[46] and the World Bank[47], these benefit levels cannot be sustained. Because higher employee/employer payroll taxes are not economically or politically feasible, benefit levels must be cut by encouraging later retirement, reducing benefits across the board, or targeting benefits to lower income-groups.

Two nations face a lesser problem: The United Kingdom and Australia. As mentioned earlier, Australia has no social security system, so it faces no explicit age-driven social security deficit problem. The United Kingdom has reduced its future outlays by building a two-tier system: a low (roughly 40 percent of median income), flat tier benefit supplemented by welfare benefits, and an upper tier that allows participants to invest their contributions in private assets, not government securities. Sweden has also recently "privatized" a portion of its social retirement system, but it still faces high expected outlays due to the generosity of the current system and the cost of converting to a privately financed system.

Each of these nations is also encouraging private savings and occupational pensions. In Canada, for instance , where 45 percent of employees are covered by private pensions, there is a call to make private pensions compulsory to avoid the high expected increase in social security outlays.[48] In other countries, such as Germany and the Netherlands, where private pensions often fill in gaps between early retirement and receipt of social security, these pensions may need to assume a larger role in future years.

Summary

Clearly, nations face difficult trade-offs as they confront the retirement of the baby boom. Some, like the United Kingdom, have already made the transition to a privatized system. While this produces a lower future outlay than that found in other nations, a large fraction of its aged rely mainly on the lower tier of benefits and have high-poverty and near-poverty rates.

Canada has overcome its old age poverty problems, by and large, through targeted income-tested supplements to its social security system.[49] Canada still faces a large future social security outlay problem (an increase of 3.8 percent of GDP illustrated in Table 12), but it already has an income security system that protects against high poverty, a starting point for adjusting to cost realities and instituting policies to increase work at older ages.

Germany and the Netherlands face the largest future social security financial liabilities, 5.4 and 5.2 percent of GDP, respectively. Either older workers must continue to work longer or benefits will be drastically reduced. These threatened cutbacks will put pressure on their systems to adjust.

Viewed in this setting, the United States Social Security policy adjustments that need to be undertaken by the year 2030 are relatively mild. The question is whether these changes can include measures that improve the overall anti-poverty effectiveness of the United States system, while maintaining or improving upon its other systemic goals.[50]

VII. Conclusions

The legs of the traditional retirement income stool are increasingly unequal. Social Security plays a very important role in the incomes of many current and future elderly. For a large number of well-to-do Americans, Social Security will become an increasingly smaller source of their economic well-being in old age. The growth of two-earner households, and uncertain factors such as the recent growth in the return on retirement investments will ensure this even if there is no change in Social Security. But there will be a change, in fact, there must be one, to preserve the system's integrity. The sooner the change is made the easier the adjustment costs will be.

This decline in the pay-as-you-go OASI system may involve different investment regimes for the trust fund or for individual participants in the system. But, even if we follow some sort of privatization strategy, there still must be benefit reductions or tax increases to cover projected future shortfalls.

Benefit reductions to remedy the deficit in the pay-as-you-go OASI system should not compromise its ability to provide a decent non-poverty-level standard of living to the low-income elderly, especially those who are already retired. Since two out of every three poor, aged persons are women, these changes should be designed to strengthen, not weaken, the anti-poverty effect of the system on older women, particularly surviving spouses.

If baby boomers continue to save at lower overall rates than their predecessors, economic inequality in old age may be even further exacerbated in the future.[51] It will be important for Social Security reform to assess its impact on economic equality along with other goals, and to explicitly increase retirement savings among lower- and middle- income families.

If we are to further insure against old age poverty and poor health status, there needs to be a solid lower tier to the Social Security system. At the same time, we need to further strengthen incentives to save and keep on saving, particularly among lower- and middle-income households, if we want them to enjoy a solid three-legged stool of pensions, savings, and OASI in old age.

Notes

[1] Timothy M. Smeeding, "Economics: Individual," *Encyclopedia of Aging* 1(New York: Academic Press, 1996): 455-467; and James P. Smith, "The Changing Economic Circumstances of the Elderly: Income, Wealth, and Social Security," *Center for Policy Research Policy Brief* no. 8 (Syracuse, NY: Center for Policy Research, The Maxwell School, Syracuse University, June 1997).

[2] The U.S. Census Bureau (Web site: http://www.census.gov/ipc/www/idbnew.html).

[3] The New Health and Retirement Study(HRS) and Asset and Health Dynamics among the Oldest Old (AHEAD) (Web site: http://www.umich.edu/~hrswww/).

[4] The Luxembourg Income Study (LIS) database (Web site: http://lissy.ceps.lu/index.htm).

[5] Douglas Holtz-Eakin and Timothy Smeeding, "Income, Wealth, and Intergenerational Relations," *The Demography of Aging*, eds. S. Preston and L. Martin (Washington, DC: National Academy of Sciences Press, 1994): 102; Smith, "Changing Economic Circumstances," 1997.

[6] Timothy M. Smeeding, Lee Rainwater, and Barbara Boyle Torrey, *Going to Extremes: Income Inequality, Poverty, and the U.S. Aged in an International Perspective* (Syracuse, NY: Center for Policy Research, The Maxwell School, Syracuse University, June 1995).

[7] Connie Citro and Robert Michael, *Measuring Poverty: A New Approach* (Washington, DC: National Academy of Sciences Press, 1995).

[8] AHEAD includes 6,052 households (8,204 individuals) with at least one person aged 70 or over in 1994. Its principal purpose is to elucidate the relationship between changes in physical and cognitive health in old age and asset decline. In this survey, blacks, Hispanics, and residents of the state of Florida were over sampled at a rate of two to one and follow-ups are planned every two years. An important advantage of AHEAD is that it contains high-quality income and wealth modules. See James P. Smith, "Bequests and Inheritances," *Essays in Honor of F. Thomas Jester,* eds. James P. Smith and Robert Willis (Ann Arbor, MI: University of Michigan Press, 1997); James P. Smith, "Wealth Inequality among Older Americans," *Journal of Gerontology,* 52B (May 1997): 74-81. In particular, a very comprehensive and detailed set of questions was asked to measure household wealth. In addition to housing equity, assets were separated into the following 11 categories: other real estate; vehicles; business equity; IRAs or Keoghs; stocks or mutual funds; checking, savings, or money market funds; CD's, government savings bonds or treasury bills; other bonds; other assets; and other debt.

[9] Social Security Administration, *Social Security Quick Facts* (Washington, DC: U.S. Government Printing Office, 1995); Social Security Administration, *Report of the 1994-1996 Advisory Council on Social Security* (Washington DC: Department of Health and Human Services, 1997).

[10] All nominal values, for both income and wealth, are expressed in 1996 dollars.

[11] Smeeding, *Going to Extremes*, 1995.

[12] Joseph Quinn, "Retirement Trends and Patterns in the 1990s: The End of an Era?" *Public Policy and Aging Report* 18, no. 3 (Summer, 1997); Richard V. Burkhauser and Joseph Quinn, "Social Security Reform: a Budget Neutral Approach to Reducing Older Women's Disproportionate Risk of Poverty," *Center for Policy Research Policy Brief*, no. 2 (Syracuse, NY: The Maxwell School, Syracuse University, 1994).

[13] Quinn, "Retirement Trends," 1990.

[14] Timothy Smeeding, "Improving Supplemental Security Income," *Social Welfare Policy at the Crossroads*, eds. R. Friedland, L. Etheridge, and B. Vladeck (Washington, DC: National Academy of Social Insurance, 1994): 97-107.

[15] Government Accounting Office, *Retirement Income: Implications of Demographic Trends for Social Security and Pension Reform*, GAO/HEHS 97-81 (Washington, DC : U.S. Government Printing Office, July 1997).

[16] James P. Smith, "Racial and Ethnic Differences in Wealth," *Journal of Human Resources*, S185-S183 (1995).

[17] See also Smith, "Changing Economic Circumstances," 1997.

[18] For instance, the income ratio among the elderly from the top 5 percent to the median is less than three times. This is not shown in Table 5, but is included in the notes to Table 7.

[19] This is not shown in Table 6. For additional figures, see Smith, "Changing Economic Circumstances," 1997.

[20] Thomas F. Jester, James P. Smith, and Frank Stafford, "Savings and Wealth Income: Then and Now." Paper presented at the Economics of Aging International Health and Retirement Surveys Conference, Amsterdam, Netherlands, 1997.

[21] Ibid.

[22] Results are found in Holtz-Eakin, "Income, Wealth, and Intergenerational," 1994; Greg Duncan, Willard Rodgers, and Timothy Smeeding, "Whither the Middle Class? A Dynamic View," *Economic Inequality at the Close of the 20th Century*, eds. D. Papdimitriou and E. Wolff (New York: Mac Millan, 1996): 240-271; and, most recently, Eric Hurst, Ming Ching Luoh, and Frank P. Stafford, *Wealth Dynamics of American Families* (Ann Arbor, MI: Institute for Social Research, University of Michigan, August 1996).

[23] Survey of Consumer Finance (SCF) (Web site: http://www.bog.frb.fed.us/pubs/oss/oss2/scfindex.html).

[24] Panel Study of Income Dynamics (PSID) (Web site: http://www.cpr.maxwell.syr.edu/gsoep/equivfil.htm).

[25] Survey of Income and Program Participation (SIPP) (Web site: http://www.sipp.census.gov/sipp/).

[26] Juster, "Savings and Wealth Income," 1997.

[27] For a detailed treatment of this topic, see Smith, "Changing Economic Circumstances," 1997.

[28] James P. Smith, "Bequests and Inheritances," 1997.

[29] Angus Deaton, *Understanding Consumption* (Oxford, UK: Clarendon Press, 1992).

[30] Glenn R. Hubbard, Jonathan Skinner, and Steven Zeldes, "Precautionary Savings and Social Insurance," *Journal of Political Economy* 103, no. 2 (April 1995): 360-399; Jon Gruber and Aaron Yelowitz, "Public Health Insurance and Private Savings," *Institute for Research on Poverty Discussion Paper,* no.1135-97 (Wisconsin, University of Wisconsin, July 1997); and Elizabeth Powers, "Does Means Testing Welfare Discourage Saving? Evidence from the NLS" (Cleveland, OH, Federal Reserve Bank of Cleveland, June 1995).

[31] Smith, "Racial and Ethnic Differences," 1995

[32] To this point nothing in these correlations proves what causes what. Does higher SES improve health or did good health increase income and wealth? Smith's recent research with Kington suggests that at age 50 and over, the dominant causation runs from health to economic status and not the other way around. See James P. Smith and Raynard Kington, "Demographic and Economic Correlates of Health in Old Age," *Demography* 34, no.1 (February 1997): 159-170; and James P. Smith and Raynard Kington, "Race, Socioeconomic Status, and Health in Late Life," *Racial and Ethnic Differences in Health* (Washington, DC: National Academy Press, 1997).

[33] It is worth noting that without the HRS and AHEAD surveys, which provide comprehensive measures of income, wealth, and health on the same survey instrument, we could not have drawn this conclusion. Earlier reviews of the literature on the economics of aging could not draw such a conclusion. See Holtz-Eakin, "Income, Wealth, and Intergenerational Relations," 1994; Michael Hurd, "Research on the Elderly: Economic Status, Retirement, Consumption, and Savings," *Journal of Political Literature*, no. 27 (June 1990); Michael Hurd, "The Economics of Individual Aging," *Handbook of Population and Family Economics,* eds. M. Rosensweig and O. Stack, (Amsterdam, Netherlands: North Holland Press, 1997); Smeeding, "Economics: Individual," 1996.

[34] Social Security wealth is measured by adding up the future stream of benefits due to a retired person and discounting these benefits back to a base year using a low rate of interest. In this way we turn a "flow" variable (Social Security income) into a "stock" variable (Social Security wealth)—which can be compared to traditional measures of wealth such as those shown earlier in Table 5.

[35] For details of this calculation, see Smith, "Racial and Ethnic Differences," 1995.

[36] Constantijn Panis W.A. and Lee A. Lillard, "Social Security: Equity, Adequacy, Reforms," *RAND Working Paper* (Santa Monica, CA: RAND, 1996).

[37] Ibid.

[38] Heritage Foundation, *Social Security's Rate of Return* (Washington DC: Heritage Foundation, January 1998).

[39] Burkhauser, "Social Security Reform," 1994.

[40] Alan Auerbach, "Quantifying the Current U.S. Fiscal Imbalance," *Burch Working Paper,* no. B97-25 (Berkeley, CA: Burch Center, Department of Economics, University of California at Berkeley, May 1997).

[41] Jon Gruber and David Wise, "Social Security Programs Around the World." Paper presented at The Economics of Aging International Health Retirement Surveys Conference, Amsterdam, Netherlands, 1997.

[42] Joseph Quinn and Timothy Smeeding, "Cross National Patterns of Labor Force Withdrawal," (Boston, MA: Boston College and Syracuse, NY: Syracuse University, June 27, 1997).

[43] Timothy Smeeding, "Reshuffling Responsibilities in Old Age: The United States in Comparative Perspective," *Luxembourg Income Study Working Paper* 153 (Luxembourg: Luxembourg Income Study, February 1997).

[44] Peter Gottschalk and Timothy Smeeding, "Cross-National Comparisons of Earnings and Income Inequality," *Journal of Economic Literature,* no. 35 (June 1997).

[45] Smeeding, "Reshuffling Responsibilities," 1997.

[46] Organization for Economic Cooperation & Development, "Aging in OECD Countries: A Critical Policy Challenge," *Social Policy Studies,* no. 20 (Paris, France: Organization for Economic Cooperation & Development, 1996).

[47] World Bank, *The Future of Old Age Security* (Washington, DC: World Bank Press, 1994).

[48] Organization for Economic Cooperation & Development, "Pivate Pensions in OECD Countries: Canada," *Social Policy Studies,* no. 20 (Paris, France: Organizaion for Economic Development, 1995): 49.

[49] David Card and Richard Freeman, eds., *Small Diffences That Matter* (Chicago, IL: University of Chicago Press, 1995).

[50] We should not forget that the United States still faces future public health care costs (particularly from Medicare), that, together with Social Security, will produce an enormous fiscal crisis in the middle of the next century unless steps are taken soon to forestall it. The combined Medicare and Social Security cost adjustments are roughly twice the 2.5 percent of GDP adjustment shown for OASI alone in Table 2.

[51] Juster, "Savings and Welath and Income," 1997.

About the Author

Timothy M. Smeeding, Ph.D. is Professor of Economics and Public Administration at the Maxwell School of Citizenship & Public Affairs, Syracuse University, and is the founding Director of the Center for Policy Research. Dr. Smeeding is also the Director of the Luxembourg Income Study project which he founded in 1983. He has served on several study and administrative committees of the National Academy of Sciences, the National Academy on Aging, and the National Academy of Social Insurance. He is the chair of the council of the National Archive of Computerized Data on Aging. Dr. Smeeding has written or edited eight books and over one hundred research articles dealing with topics related to income, poverty, health economics, and the effects of public policy on at-risk populations.

James P. Smith received his Ph.D. at the University of Chicago in 1972. He holds the RAND Chair in Labor Markets and Demographic Studies and was the director of RAND's Labor and Population Studies Program from 1977-1994. Former Chair of the Panel on Demographic and Economic Impacts of Immigration (1995-1997), Committee on Population, Committee on National Statistics, and National Academy of Sciences, he has also served on the National Advisory Board for the Poverty Institute of Health. He chaired the National Institute on Aging's Ad Hoc Advisory Panel on NIA's Extramural Priorities for Data Collection in Health and Retirement Economics and currently serves on the NIA Data Monitoring Committee for both the Health and Retirement Survey (HRS) and Asset and Health Dynamics of the Oldest-Old (AHEAD). He has also received the National Institutes of Health MERIT Award, the most distinguished honor NIH grants to a researcher.

Acknowledgments

The authors would like to thank the Progressive Policy Institute; the Center for Policy Research at Syracuse; grants from the National Institute on Aging to RAND and Syracuse University for their support; and Will Marshall and Rob Shapiro for comments. However, the authors claim all responsibility for the opinions and conclusions expressed in this paper.