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SOCIAL SECURITY'S CRUELEST CUT
Bush's proposal slashes benefits for family members of workers who die before retirement

by William Spriggs and David Ratner

President Bush's plan to change Social Security includes benefit cuts for the surviving family members of workers who die before retirement. The president's plan recommends a 9.4% benefit cut—a loss of $3,009 (in today's dollars) in annual benefits—for the family of a typical worker who is now 25 but who will die at age 45. These cuts in benefits will take place through the adoption of the Pozen index for Social Security benefits, a plan put forth by Robert Pozen of the president's Commission to Strengthen Social Security and that has been en-dorsed by President Bush. Despite the income losses the Pozen plan would mean for many surviving family members, the debate over changing Social Security has largely ignored these proposed cuts.

Slashing the benefits to survivors and the disabled would have significant effects. Men in their twenties have a 3-in-10 chance of becoming disabled before reaching retirement. Roughly one of those three disabled men will die before reaching retirement. An additional 10% of men in between the ages of 20 and 29 will die before reaching retirement. All of these workers and their families will see benefit cuts as a result of the proposed Social Security changes. Perhaps even more troubling is the fact that such changes are completely unnecessary—the Social Security Trustees project that the Social Security system will be able to meet all scheduled benefits through 2041.

Social Security's formal name is Old Age, Survivors, and Disability Insurance. As the name suggests, it is a comprehensive insurance program that protects American workers—and the family members who depend on that worker's earnings—should they be unable to perform a regular job because of old age, death, or disability.

In 1939, President Roosevelt described the crucial role of Social Security:

These amendments to the Act represent another tremendous step forward in providing greater security for the people of this country. This is especially true in the case of the federal old age insurance system which has now been converted into a system of old age and survivors' insurance providing lifetime family

security instead of only individual old age security to the workers in insured occupations. In addition to the worker himself, millions of widows and orphans will now be afforded some degree of protection in the event of his death whether before or after his retirement.[1]

Today, about 55% of Social Security recipients—over half of the beneficiaries—are disabled workers or family members of disabled, retired, or deceased workers and retirees. In December 2003, 6.8 million of the 47 million Americans receiving Social Security benefits received survivor benefits; 1.9 million of these beneficiaries were children. The average widowed parent with two surviving minor children currently receives an annual benefit of $22,572.

Family members of workers are covered through the same benefit formula that covers the worker directly. The worker's benefit is calculated as the Primary Insurance Amount (PIA). Families may receive a maximum of an additional 90% of the worker's PIA. The president's proposal to change the PIA formula, therefore, directly leads to cuts in survivor benefits for families.

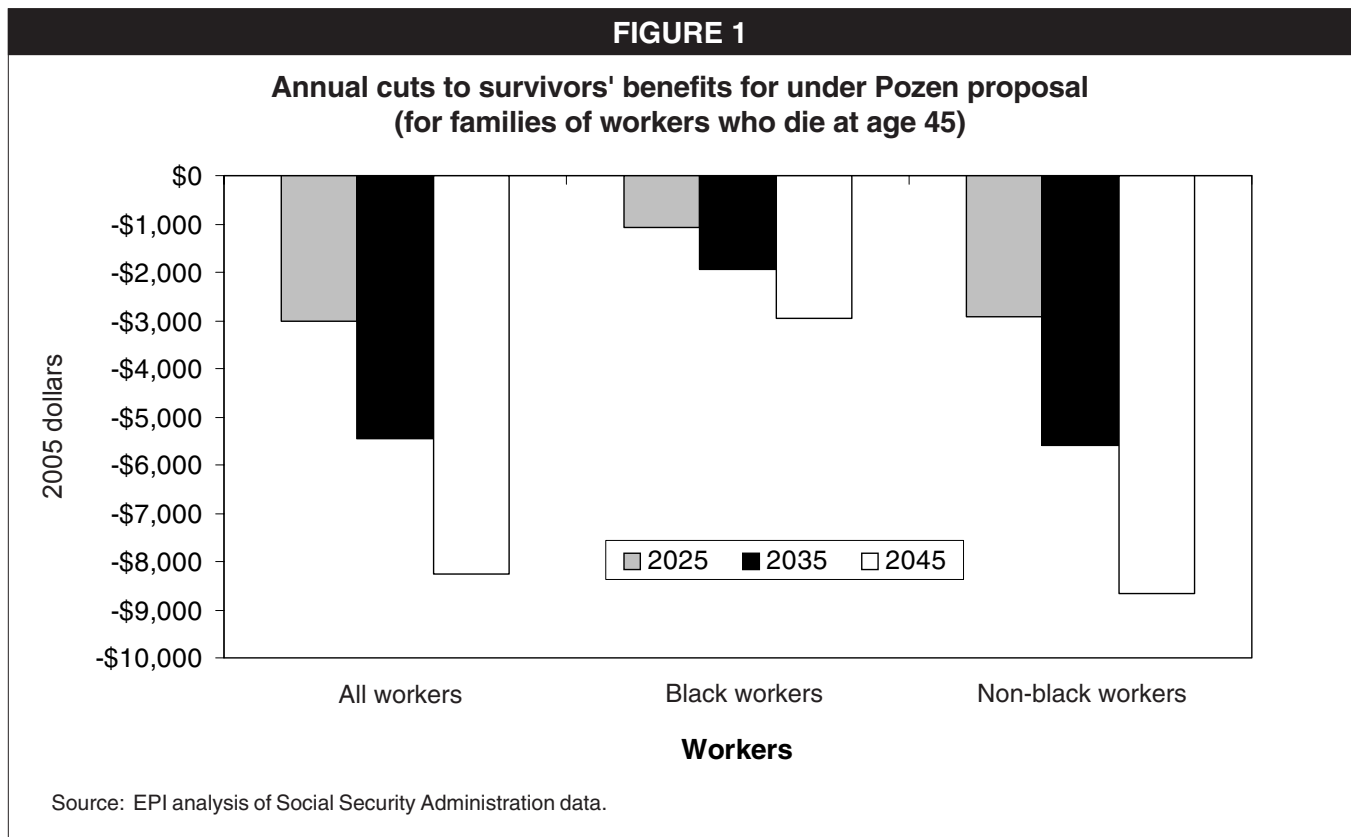## African American families are particularly hurt by Pozen's proposal

The Pozen proposal cuts projected Social Security benefits by taking advantage of the fact that average wages have grown (and will continue to grow) faster than prices. Because the gap between wages and prices grows over time, the benefit cuts under the Pozen plan deepen over time. Under the Pozen proposal, about 6% of workers who earn enough to get the maximum Social Security benefit will have their future benefits calculated using pure price indexing (currently those earning more than $90,000 a year would receive the maximum benefit). The benefit cuts are largest for these workers with the highest earnings. Roughly the bottom 30% of earners—but, importantly, not the bottom 30% of Social Security *beneficiaries*—will have their benefits calculated using the current method of wage indexing. And the remaining workers—the roughly 64% of those between the bottom and the top of the earning scale—will have their benefits cut, with those at the lower end facing smaller cuts than those at the higher end.

The odds of early death are related to income, and because of income, they are related to race. Because African Americans have a lower median income than whites, they are more likely to die at a younger age, and therefore more likely than whites to receive survivor benefits. While African Americans are 11.5% of workers paying into Social Security, they are 13.2% of survivor beneficiaries.

At age 45, the average annual earnings of African Americans who die are much lower than the average annual earnings up to age 45 of those workers who will go on living. The annual cuts in benefits for families of black workers and non-black workers who die at age 45 are compared in **Figure 1** (see **Table 1** for additional data on workers who die at 25, 35, 55, and 65).

The figure shows cuts in annual benefits for a family receiving the maximum family benefit. Because the average age of a surviving spouse with children is in the 40s (for African Americans and whites), the figure concentrates on the benefit cuts to a family where the worker has died at age 45. The benefits shown in the figure are based on the average earnings record of workers who died in their 40s (see the Technical Appendix for an explanation of the data).

Based on the average earnings of black workers who die in their 40s, the figure shows that the families of

FIGURE 1

**Annual cuts to survivors' benefits for under Pozen proposal
(for families of workers who die at age 45)**

Source: EPI analysis of Social Security Administration data.

black workers who die at age 45 will face progressively deeper annual drops in income. Under the Pozen plan, the families of these workers will see their benefits decline by $1,064 in today's dollars in 2025 (for a worker currently age 25), $1,937 in 2035 (someone currently age 15), and $2,944 in 2045 (for a worker currently age five). Cuts made in 2025 and 2035 will occur even though the Social Security Trustees anticipate that the Social Security system will be able to meet all promised benefit levels. Thus, Pozen's proposal is worse for these families than doing nothing to change the system.

Oddly, President Bush has suggested the need to privatize Social Security benefits because African Americans have shorter life expectancies. He has also argued that private accounts provide necessary options for retirement for those currently in their 20s. Yet, he proposes to cut the survivor benefits of today's 25-year-old African American workers.

For non-black workers, the cuts are higher in dollar amount, because non-black workers make more money, on average. The family members of non-black workers who die at age 45 will face cuts in 2025 (today's 25-year-old worker) of $2,916 in annual income, in 2035 (someone currently age 15) of $5,585, and in 2045 (today's five-year-olds) of $8,659.

TABLE 1
Pozen plan's effect on survivor benefits (in real 2005 dollars)

Year of death		All workers	Black workers	Non-black workers
Average workers who are deceased at age 25				
2025	Percent cut	0.0%	0.0%	0.0%
	Yearly cut to income	$0	$0	$0
2035	Percent cut	0.0%	0.0%	0.0%
	Yearly cut to income	$0	$0	$0
2045	Percent cut	0.0%	0.0%	0.0%
	Yearly cut to income	$0	$0	$0
Average workers who are deceased at age 35				
2025	Percent cut	2.7%	0.0%	3.7%
	Yearly cut to income	$613	$0	$856
2035	Percent cut	4.5%	0.0%	6.0%
	Yearly cut to income	$1,118	$0	$1,559
2045	Percent cut	6.2%	0.0%	8.2%
	Yearly cut to income	$1,706	$0	$2,373
Average workers who are deceased at age 45				
2025	Percent cut	9.4%	4.4%	8.8%
	Yearly cut to income	$3,009	$1,064	$2,916
2035	Percent cut	15.3%	7.2%	15.1%
	Yearly cut to income	$5,462	$1,937	$5,585
2045	Percent cut	20.7%	9.8%	21.0%
	Yearly cut to income	$8,273	$2,944	$8,659
Average workers who are deceased at age 55				
2025	Percent cut	7.0%	8.4%	6.4%
	Yearly cut to income	$2,402	$2,556	$2,202
2035	Percent cut	14.1%	13.8%	13.7%
	Yearly cut to income	$5,344	$4,641	$5,251
2045	Percent cut	20.6%	18.7%	20.5%
	Yearly cut to income	$8,731	$7,032	$8,759
Average workers who are deceased at age 65				
2025	Percent cut	6.5%	7.8%	6.8%
	Yearly cut to income	$2,358	$2,256	$2,509
2035	Percent cut	12.1%	12.7%	11.5%
	Yearly cut to income	$4,864	$4,098	$4,708
2045	Percent cut	19.8%	17.2%	19.6%
	Yearly cut to income	$8,874	$6,211	$8,921

Source: Economic Policy Institute analysis of SSA data.

Private accounts in the context of the Pozen plan

These dramatic cuts for families who benefit from Social Security's survivor insurance will be difficult to recoup through private accounts. The president's proposal for private accounts calls for taking back the amount the worker borrowed from Social Security to place in the private account, plus 3% interest plus inflation. So while the stock market may perform well, on average, over a 30-year period, those who die before retirement may do so when the market is down and leave their families in debt. Furthermore, private accounts are likely to be inadequate to meet the needs of the surviving parent caring for children while also providing support to the surviving parent in retirement, as the current system provides.

The president has also failed to explain the property rights of the private accounts. Under the current Social Security insurance coverage, all children of a worker are covered, even if the children are from a previous relationship, or the children do not reside with the parent. With the changes to Social Security, however, it is possible that if the worker has remarried and dies, many state laws would grant the current spouse all rights to a private account, leaving the children of a previous relationship with no access to the funds.

This lack of detail concerning the far-reaching effects of private accounts suggests how little President Bush has thought through Social Security's privatization. In addition, despite the president's claims that over-hauling Social Security will help African Americans, the Bush-endorsed Pozen plan actually slashes benefits to families of black workers who die before retirement age. These unnecessary changes convert the Social Security system from its current status as an insurance program for the families of American workers to a system of private savings—a system America rejected when it transformed the program in 1939 to what it is today.

Technical Appendix

In order to model benefit cuts under the Pozen progressive price-indexing plan for workers who become deceased in the future, we use estimates produced by the Social Security Administration (SSA) Office of Policy of earnings of deceased workers in "Earnings of Black and Non-black Workers Who Died or Became Disabled in 1996 and 1997."[2] That paper uses data from the 1996 1% Continuous Work History sample for deceased workers and indexes earnings in each year to 1996 using the Average Wage Index. This creates estimates for average indexed career earnings for workers who die before claiming retirement benefits.[3] The SSA calculates estimates for 10-year age groups and for black, non-black, and all workers. We take the midpoint of the age groups as the age of our hypothetical average deceased worker. Finally, the SSA divides the career indexed earnings by average tenure to create average annual indexed earnings. Therefore, spouses and families of deceased workers may claim benefits off of this worker's projected benefit level.

Since earnings are in 1996 "real" wage terms, we use the same Average Wage Index to inflate earnings for future years. After inflating these indexed earnings to a specific year, we use this estimate as the basis for computing a family benefit. First, an estimate of the Social Security benefit to which this worker would be entitled is computed by taking the average annual indexed earnings for each age group and dividing it by 12 to create monthly averages. Then, we apply the current-law PIA and Pozen plan benefit formulas.

Pozen plan benefit formula

In order to calculate PIAs under Pozen's progressive price indexing, we use the SSA's estimates for the new bend points and bend-point factors. Progressive price indexing works as follows.

1) Calculate the reduction imposed on the maximum wage earner under pure price indexation. For the maximum earner, this results in a reduction of:

$$\left(\frac{\%\,\Delta CPI}{\%\,\Delta AWI}\right)^{t}$$

where t is the number of years that price indexation is in effect (from 2012 until the year of eligibility).

2) Generate a new bend point at the 30th percentile of individual wage earners in each year. Call this BP-PPI for the progressive price-indexing bend point.

3) Reduce the 0.32 factor that applies between BP-PPI and BP2 and the 0.15 factor that applies for all earnings after BP2 by a new reduction factor that will preserve the benefit cut of pure pricing indexation for the maximum earner. This results in a phased-in, "sliding scale" price indexing.

Now, the PIA-PPI is calculated as follows:

(1) 90% of all income up to the first bend point (BP1)

(2) 32% of income between BP1 and the new BP-PPI

(3) 32%*x of income between BP-PPI and BP2

(4) 15%*x for all income above BP2,

In the above calculation, x is a reduction factor assigned to preserve the pure price-indexed cut for maximum earners. For our purposes, we have used the bend points and bend point factors used by the SSA solvency memorandum to Robert Pozen.[4] Note that as opposed to using bend points corresponding to the year the worker turns 62, we use bend points for the year the worker dies.[5]

Estimating survivor's benefits

Finally, to impute potential survivor's benefits, we calculate the maximum family benefit for each worker's family. The maximum benefit affords the family between 150% and 190% of the worker's PIA, which is roughly attained if a worker is survived by a spouse and a child. Workers survived only by a spouse, who would draw benefits at age 62 unless they cared for a child under age 16, would be smaller than for a widow caring for two children. The maximum family benefit formula is a function of the deceased worker's PIA and is similar in structure to the traditional PIA formula. The family maximum formula consists of three bend points at different levels of the PIA. The bend points for 2005 are $801, $1,156, and $1,508 (call them FM1, FM2, FM3, respectively) and are indexed by the change in the average wage index for future years. So, for each year, we index the bend points to the appropriate level and calculate:

(1) 150% up to FM1,

(2)   272% from FM1 to FM2,

(3) 134% from FM2 to FM3,

(4) 175% above FM3.

We subject both the current-law PIA and the Pozen-plan PIA to the family maximum formula to determine the effects of the Pozen plan. Once we have determined the difference in benefits, we deflate that value to 2005 dollars using the Social Security Trustees' assumptions for price increases.

Endnotes

1.   Presidential Statement on Signing Some Amendments to the Social Security Act—August 11, 1939. Social Security Administration Web site, accessed June 16, 2005. < http://www.ssa.gov/history/fdrstmts.html#1939b >

2.   Diez, Greg. 2000. "Earnings of Black and Non-black Workers Who Died or Became Disabled in 1996 and 1997." Social Security Administration, Office of Policy. Baltimore, Md.: SSA.

3.   The average indexed earnings in this calculation is different than the typical AIME used to calculate retirement benefits.

4.   Goss, Stephen C. 2005. "Estimated Financial Effects of a Comprehensive Social Security Reform Proposal Including Progressive Price Indexing." Baltimore, Md.: Social Security Administration, Office of the Chief Actuary.

5.   For detailed information on the effect of Pozen's plan on retirement benefits of current workers, see Spriggs and Ratner, "Pozen indexing slashes Social Security benefits for current workers." Issue Brief No. 209. Washington, D.C.: Economic Policy Institute.