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# PRINCIPLES OF EQUITY AND SPOUSES' AND SURVIVORS' BENEFITS

Dr. C. Eugene Steuerle

glad that we have these four speakers to tell us.

First is Eugene Steuerle,** I cannot think of a better person to outline the broad outlines of the picture. Dr. Steuerle is such and even-handed and nonpartisan fellow that he managed to serve under four presidents on the Treasury Department; and he knows so much about taxes that even his name means taxes in German.

## PRINCIPLES OF EQUITY AND SPOUSES' AND SURVIVORS' BENEFITS

*Dr. C. Eugene Steuerle*

DR. STEUERLE: In talking about equity towards individuals and towards women and men, there is one dominating figure that I want to note. Under the current budget, under President Clinton's proposal and under all Republican proposals in Congress right now, spending, on Social Security, Medicare and Medicaid, would rise over the course of the next 60 years, from about 40 percent to about 80 percent of revenues.[2] (The last item, Medicaid, is dominated by growth in costs of long term care.) These numbers do not include long-term care tax credits, Federal expenditures for civil service and military retirees and several other items. Basically, we have a Federal budget that is destined, at least under current law, to be spent almost entirely on the elderly or near elderly.[3]

I am on the leading edge of the "Baby Boom" population as I was born in 1946. I grew up with a lot of people — whether conservative or liberal — who were very idealistic about what the Federal Government should do. I now live with a generation whose one bequest (whether intended or not) to future generations is a Federal Government devoted almost solely to its consumption in

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[2] *See* Eugene Steuerle, *Put U.S. Needs Before Boomers*, NEWSDAY, May 18, 1999, *available in* 1999 WL 8172406.

[3] *See* Robert H. Binstock, *Public Policies on Aging in the Twenty-First Century*, 9 STAN. L. & POL'Y REV. 311 (1998).

retirement. In fact, the level of promises in Social Security and health care together is so great that the average income couple retiring today is promised, in today's dollars, a little over $500,000 in Social Security and Medicare benefits.[4] Many of the people in this room are promised close to $1 million in Social Security and Medicare benefits for themselves and their spouses.[5] This comes about partly because they can expect to get benefits, on average, for about twenty-five years, until the longer living of the two dies.[6]

Now, to the equity issues within the system. My comments can be succinctly summarized as follows:

1) The treatment of the family within Social Security should follow from a set of basic principles. There are two principles that I emphasize. The first relates to meeting needs or achieving progressivity. For spouses who are divorced persons the reformed Social Security system should attempt to achieve the goal of meeting needs by using minimum benefit formulas and adjusting its rate structure. The second principle is equal justice or horizontal equity. With respect to couples, this principle emphasizes that couples should share more or less equally in Social Security benefits that they accrue for their years together;

2) The treatment of family in today's Social Security program involves a number of clear-cut inequities and distortions precisely because it does not flow from a set of principles;

3) Any reform creates winners and losers, and the fear of creating losers locks Social Security into a partially antiquated structure toward whom we might be sympathetic;

4) For married, separated, divorced and widowed persons, conditions in society have changed dramatically over the past few decades; and

5) Finally, in the case of individual accounts and U.S.A.

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[4] *See* Eugene Steuerle, *Boomers Can Do Better Than Impoverishing Young*, HOUS. CHRON., June 1, 1999, *available in* 1999 WL 3993459.

[5] *Id.*

[6] *See Review of Proposal to Revise Social Security: The Impact of Social Security on Today's Children: Statement Before the Subcomm. on Social Security. on Ways and Means*, 106th Cong. 87-121 (1999) (statement of Eugene Steuerle, Senior Fellow, Urban Institute).

accounts, they can be easily split at the time of divorce to try to meet the goal of horizontal equity or fairness but they generally are not designed to meet goals of redistribution according to need.

Let me repeat the two equity principles that I stated should apply to Social Security and define its treatment of the family. The first is the horizontal goal of equal justice: individuals in equal circumstances should be treated the same. In the case of divorce, for instance, this generally means that married couples should share fairly in any accrual of assets during the time of their marriage together. Given the time constraint, I have dodged defining the word "accrual" which, as you might guess, can become quite complicated. The second principle is that benefits should be related to need. Here, I refer to what is called a vertical equity principle. Social Security, after all, exists primarily to protect the truly old against poverty. This leads to such features as the progressive benefit formula and to a proposal that I suggested as a Commissioner on the National Commission on Retirement Policy: a wage-indexed minimum benefit that would ensure that almost all of the elderly would be kept out of both absolute and relative poverty.

It is important that these two principles not be confused. For example, a guarantee that a divorced person share fairly in the assets that derive from his or her former marriage may have nothing at all to do with need or progressivity but it still may be fair. Similarly, there are many poor elderly whose condition has nothing to do with marriage or divorce, so that granting extra benefits to someone simply because he or she is divorced or married could turn out to be progressive but neither fair nor well targeted.

Today's Social Security approach, I would argue, can be likened to the following: think of a major metropolitan city in which there are many people on the ground who are poor. The Government responds to this poverty situation by taking a basket of money, climbing on to the roof of a building and then throwing the money off. Indeed, some of the money does reach the poor, but some of it also falls into the penthouses of rich people along the way, and much more falls into the hands of middle class people who also happen to be on the ground or living on intervening floors with balconies. Nonetheless, the poor do receive a fair amount of the money, so that reform opponents point out, reform would cut back or, at least, reduce some of the money gathered by some of the people who are poor on the ground.

Now, here are some examples of how Social Security treats families today. The more evenly couples' earnings are split, the more Social Security reduces their benefits. For example, if one couple's earnings are split $28,800 and $28,800 rather than $57,600 and zero, then the former will get substantially lower benefits than the latter. The differential is even larger when there is a survivor than when both spouses are alive. Table 1 demonstrates the different levels of benefits for families with exactly the same income and exactly the same contributions to Social Security.

**Table 1: Two Earner Couples with Identical Contributions Can Receive Different Benefits**[7]

(Annual Benefits for Couples Turning 65 in 1995, in Constant 1993 Dollars)

| | **One Earner Couple,** husband earns maximum wage subject to OASI tax ($57,600 in 1993) | **Two-Earner Couple,** each earns half of maximum taxable wage ($28,800 in 1993) |
|---|---|---|
| Benefit When Both Spouses are Alive | 20,399 | 18,229 |
| Benefit When only One Spouse is Alive | 13,599 | $9,115 |

At the margin many secondary workers get absolutely nothing for their additional contributions to Social Security. (See Table 2.) For instance, for an average-wage wife of a high-wage husband the net increase in benefits as a percentage of the net increase in contributions is almost zero (actually 2.5 percent). This is a much lower rate of return, by the way, than the highest income workers get for their additional contributions to Social Security.

[7] Couples are assumed to be the same age and to retire at age 65.

**Table 2: Effects of Alternative Retirement Decisions on Value of OASI[8]**

(Workers Turning 65 in 1995; Amounts in Thousands of Constant 1993 Dollars)

| Retirement Decision | MALE WORKER | | | FEMALE WORKER | | |
|---|---|---|---|---|---|---|
| | Low Wage | Average Wage | High Wage | Low Wage | Average Wage | High Wage |
| **Retire at 62** | | | | | | |
| Change in benefits | -0.2 | -0.5 | -4.6 | -3.6 | -6.2 | -13.3 |
| Change in contributions | -3.2 | -7.2 | -17.7 | -3.3 | -7.3 | -17.9 |
| Net Gain (+), or Loss (-) | +3.1 | +6.7 | +13.1 | -0.3 | +1.1 | +4.6 |
| **Retire at 67** | | | | | | |
| Change in benefits | +0.4 | -2.8 | -8.0 | +0.5 | -1.7 | -4.3 |
| Change in contributions | +2.0 | +4.3 | +10.5 | +2.0 | +4.5 | +10.9 |
| Net Gain (+), or Loss (-) | -1.6 | -7.2 | -18.5 | -1.5 | -6.2 | -15.2 |
| Net OASI tax rate on wages after 65 | 8.7% | 17.6% | 18.8% | 8.0% | 14.6% | 14.8% |
| **Retire at 70** | | | | | | |
| Change in benefits | +1.0 | -7.4 | -22.5 | +1.5 | -4.7 | -13.9 |
| Change in contributions | +4.6 | +10.2 | +24.7 | +4.9 | +10.8 | +26.1 |
| Net Gain (+), or Loss (-) | -3.6 | -17.6 | -47.2 | -3.4 | -15.5 | -40.0 |
| Net OASI tax rate on wages after 65 | 8.3% | 18.4% | 20.3% | 7.4% | 15.3% | 16.3% |

8 Table reflects change in actuarial present value of OASI benefits and taxes to retirement at age 65. All amounts are converted to present value at age 62, using 2 percent real interest rate. Includes impact on worker's benefits only. Those who delay retirement are assumed to register to begin receiving OASI benefits immediately at age 65. Includes both employer and employee portions of OASI payroll tax. Projections are based on intermediate assumptions in 1993 OASDI Board of Trustees report. Assumes OASI tax rate is set at 10.65 percent after 1992.

If a spouse divorces a worker after nine years, 11 months and 27 days of marriage the spouse gets absolutely nothing from Social Security in auxiliary benefits and is entitled to no share of the worker's benefits. On the other hand, if a worker gathers five spouses over the course of a life, each for ten years and one day of marriage, then each of the spouses is entitled to up to hundreds of thousands of dollars in Social Security benefits simply because of the marriages.[9] Social Security grants substantially more benefits to couples whose ages are widely separated more than to those who happen to be closer in age.[10] If a single head of household raises children and works for 40 years at $10,000 a year and contributes every year to Social Security, he or she will be entitled to substantially fewer Social Security benefits than a spouse or a divorced person who never works, never raises children, and never contributes to Social Security, as long as that spouse happens to be married to a rich worker for ten years or more.

Why do these inequities and anomalies arise? They are the consequence of formulas — for both spousal benefits and benefits for divorced persons — which are poorly targeted and fail to address either of the two issues at stake: (a) the well-being of the divorced spouses, or of anyone else, for that matter and (b) the right of each spouse to share in the fruit of the household's labors and earnings during the years of marriage.

Now, what typically stymies reform — this has been mentioned in the other panels — is that reform inevitably creates winners and losers. In practice, Congress does not like to identify losers along the way to reforming a system. The way Congress often does reform is to put patches on the system. It identifies some new group which arouses sympathy and then puts another patch on the system to add new benefits without, necessarily, taking anything away from other groups. If you then try to reform a system according to a set of principles, however, you will find some people who are

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9 *See Legal Separation Isn't Necessary to Draw Benefits*, COURIER-J. (Louisville, KY), March 7, 1999, at 02h.

10 *See Hearing Before the Senate Special Committee on Aging Women and Social Security Revision*, 106th Cong. (1999) (statement of Eugene Steuerle, Senior Fellow, Urban Institute), *available in* LEXIS-CIS Congressional Universe.

moderately sympathetic who will face some reduction in benefits even though you have other more sympathetic people who have increases in benefits.

If we were able to follow principles, in spite of political incentives to the contrary, how would it work? I would argue that we consider combining the type of minimum benefit I suggested to the National Commission on Retirement Policy with a system of either earnings sharing or benefit sharing for couples — assuming we can deal with the complication of the latter change. Earnings or benefit sharing would approximately prorate the benefits of either spouse according to the share of normal work life of the couple's work life together. The combined reform might involve some capping of a spouse's or survivor's benefits, since these benefits give the largest windfalls to the spouses of the richest workers regardless of their contribution to the system and regardless of whether they raise children. As a consequence of those reforms, the system would no longer provide greater benefits to couples simply because their ages were farther apart rather than closer together.

A final issue I want to raise has to do with the individual account or the U.S.A. Account Proposal, the so-called privatization of the system, whether it is on an add-on or subtraction method. I think this debate is often confused. The individual account or U.S.A. account can be designed to meet my second principle, that is, it can be easily designed to try to allocate shares of assets in accounts between members of couples. Thus it can meet the horizontal goals very well. However, it is not well designed, for the most part, to meet vertical goals or to deal with the needs of those who do not save adequately and those who, for a variety of other reasons, end up to be poor at retirement. For those issues you need to rely on other provisions such as minimum benefits.

What confuses matters, however, is that many people look at reforms one at a time. For example, if all that happens is that individual accounts were to replace part of the existing system, then there probably would be a decrease in progressivity and perhaps a decrease in benefits for low-income people. On the other hand, you could increase progressivity if you are willing to combine provisions, for instance, if you are willing to do some individual accounts but you are also willing to beef up a minimum benefit to help the poor.