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Social Security Plans That Reduce Social Security Retirement Benefits Substantially Are Likely to Cut Disability and Survivors Benefits as Well

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Introduction

The Social Security debate now underway has focused primarily on retirement benefits. Much less attention has been paid to how various changes being proposed in the Social Security benefit structure would affect disability and survivors benefits. To assess any Social Security reform plan fully, however, the impact on disability and survivors benefits should be carefully scrutinized.

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This issue is particularly important because Social Security reform proposals that entail large reductions in Social Security retirement benefits generally contain substantial reductions in disability and/or survivors benefits as well. This is a result of the Social Security benefit structure, which uses a common benefit structure to determine monthly benefit levels for retirement, survivors and disability benefits alike.

Various proposals now emerging would shift a portion of Social Security payroll tax revenues from the Social Security trust funds to private individual accounts. Under a number of these proposals, beneficiaries would be guaranteed a "defined benefit" from the Social Security trust fund, as under current law, and receive supplemental income from their individual accounts. Such proposals generally entail quite large reductions in Social Security benefits — those benefits must be cut enough to close the current long-term shortfall in Social Security's finances and then reduced further to make up for the loss of the revenues being diverted from the trust funds to individual accounts. For example, diverting two percentage points of the payroll tax to private accounts, as some proposals do, would nearly double the size of the long-term Social Security shortfall and thus substantially deepen the Social Security benefit reductions required to restore long-term solvency to the system. As a result, proposals that shift revenue from the Social Security trust funds to private accounts generally entail large reductions not only in Social Security retirement benefits, but also in Social Security disability and survivors benefits.

Substantial reductions in disability and survivors benefits pose a particular problem. Although the income from individual accounts may make up for the loss of a substantial portion or all of lost Social Security *retirement* benefits for some individuals, depending on how the stock market performs, the individual's investment decisions, and other factors, income from individual accounts can *not* make up for much of the loss of Social Security disability benefits by workers who become disabled well before retirement age or for the loss of survivors benefits by the spouses and dependents of workers who die well before retirement age. The individual accounts of such workers will not have accumulated sufficient assets to make up for the reduction in disability and survivors benefits.

Aggravating this problem and sharpening the impact of the loss of Social Security disability and survivors benefits is the fact that such benefits often involve multiple benefit payments — they entail payments to dependents as well as to the disabled worker or the surviving spouse of a deceased worker. That a death or disabling accident can trigger Social Security benefit payments to *a number* of individuals rather than just to *one* beneficiary makes it even more difficult for the income from a single individual account to compensate for reductions in disability and survivors benefits.

Legislation Based on the NCRP Plan As An Example

To illustrate this problem, we examine legislation introduced by Senators Judd Gregg and John Breaux and Reps. Jim Kolbe and Charles Stenholm (S. 2313 and H. R. 4824). This legislation is based on a Social Security proposal unveiled this spring by the National Commission on Retirement Policy, a panel of Members of Congress and private citizens.⁽¹⁾ Other plans entailing reductions in Social Security retirement benefits also would affect disability and survivors benefits to various degrees, as the [box](#) below explains.

In issuing its plan, the National Commission on Retirement Policy expressed its intention to protect disability benefits from cuts. Subsequent statements by proponents of this legislation also reflect that intent. For example, at the town hall meeting held to discuss Social Security reform in Albuquerque on July 27, 1998, Rep. Kolbe stated, "... our proposal does not touch the disability or the survivors....we keep [disability] intact; it's exactly as it will be."⁽²⁾

But in drafting the legislation based on this plan, the sponsors of S. 2313 and H. R. 4824 found that despite their strong desire not to cut disability benefits, it was not feasible to institute the large reductions in Social Security retirement benefits their plan entailed without making substantial reductions in disability and survivors benefits as well.⁽³⁾ The only way the NCRP legislation could have made its reductions in Social Security retirement benefits without substantially reducing disability benefits at the same time would have been through measures that would introduce severe inequities and perverse incentives into the Social Security benefit structure.

The NCRP does contain a mitigating provision — it establishes a minimum benefit that would largely or fully shield from these benefit reductions those disabled workers who earned well-below-average wages during their work-years and were employed for most or all of their adult lives before becoming disabled. This provision also would shield survivors of deceased workers who earned very low wages and were employed most of their adult lives, as well as retirees who earned very low wages during their work years. Due to this provision, some retirees, disabled individuals, and survivors of deceased individuals who earned very low wages before retiring, becoming disabled, or dying actually would receive larger Social Security benefits than under current law.

For disabled workers and survivors who would *not* be affected by the minimum benefit provision, however — a group constituting the majority of beneficiaries of disability and survivor benefits — the benefit cuts would be large. For example, when the legislation took full effect, the Social Security disability benefits provided to an individual who had earned average wages before becoming disabled would be reduced nearly 20 percent, as compared to current law.

The legislation includes a provision calling for an expert panel to study and make recommendations concerning possible future changes that could ease the reductions in disability benefits the legislation contains. This panel, however, would face the same dilemmas that led the sponsors of S. 2313 and H.R. 4824 reluctantly to include substantial disability benefit reductions in their bills, since there is no easy solution that eluded the legislation's framers. Moreover, the legislation specifies that any recommendations the panel might make to ease the legislation's disability benefit cuts after the legislation had been enacted would have to be accompanied by recommendations for offsetting reductions elsewhere in the Social Security Disability Insurance program so that disability insurance costs did not rise above the levels to which the legislation had reduced them.

Background on Disability and Survivors Benefits

The Social Security system provides benefits not only to retirees but also to the survivors of workers who die before reaching age 62 and to workers who become disabled before 62 and their dependents.

- Workers who become disabled before they reach retirement, as well as members of these workers' families, are eligible for benefits under the disability insurance program that is part of Social Security.⁽⁴⁾
- Survivors benefits are available to the children of workers who have died before reaching retirement and the spouses of such deceased workers if the spouses

are caring for dependent children, are over 60, or are disabled themselves. Survivors benefits also go to spouses and minor children of workers who die after retiring.

In December 1996, disabled workers and their families comprised more than six million people, or nearly 14 percent of all Social Security beneficiaries. An additional 7.4 million beneficiaries, nearly 17 percent of all Social Security beneficiaries, were survivors and their families. Together, these two components of Social Security account for nearly one-third of Social Security beneficiaries — 13 million to 14 million people.

How Disability and Survivors Benefits are Determined

The level of disability or survivors benefits that beneficiaries receive is determined under the same benefit formula as is used to calculate Social Security retirement benefits. The benefit formula starts with the calculation of a covered worker's "average indexed monthly earnings"; these are the worker's average wages over his or her work career. Wages for each year from the past are indexed by national wage growth to account for wage inflation between the year the worker earned those wages and the year that falls two years before the time the worker becomes eligible for benefits.

For *retirees*, the highest 35 years of wages are indexed in this manner, averaged and divided by 12 to obtain the worker's "average indexed monthly earnings" (known as the worker's AIME). For the *disabled* and *survivors*, a worker's average indexed monthly earnings are calculated using wages for the years between the time the worker turned 21 and the time the worker became disabled or died. For most Social Security beneficiaries, up to five of the years in which the worker had the lowest earnings are disregarded in these calculations.⁽⁵⁾

The worker's average indexed monthly earnings are then used to determine what is known as the worker's "primary insurance amount" or PIA. A worker's monthly Social Security benefit is based on his or her PIA. Specifically, for workers who retire at age 65, for disabled beneficiaries, and for the survivors of workers who die before reaching retirement, the monthly Social Security benefit they receive when they begin drawing benefits *equals* their PIA, rounded down to the next lowest dollar.

Table 1
Determination of a Worker's Monthly Benefit Under Current Law,
for a Worker Becoming Eligible for Benefits in 1998⁷

Formula using worker's Average Indexed Monthly Earnings (AIME)	Worker with AIME of \$972 (Low earner)	Worker with AIME of \$2,162 (Average earner)	Worker with AIME of \$5,225 (Maximum earner)
90% of first \$477	\$429.30	\$429.30	\$429.30

32% of AIME between \$477 and \$2,875	\$158.40	\$539.20	\$767.36
15% of AIME over \$2875			\$352.50
Primary Insurance Amount (PIA)	\$587.70	\$968.50	\$1,549.16
Benefit Level ⁸	\$587.00	\$968.00	\$1,549.00
<p>⁷ Table 1 shows monthly benefit calculations for workers with low earnings, workers with average earnings, and workers with "maximum" earnings. The low earner — the worker with an AIME of \$972 — has an AIME equal to 45 percent of the average earnings level. The "maximum" earner — the earner with an AIME of \$5,225 — has an AIME equal to the maximum earnings subject to the Social Security payroll tax. The earnings levels shown here for low earners and maximum earners are the levels the Social Security Administration uses for illustrative purposes.</p> <p>⁸ The benefit level equals the primary insurance amount rounded down to the next dollar.</p>			

The calculation of the primary insurance amount, which determines the monthly benefit, is done in the same fashion *regardless of whether the beneficiary is a retiree, disabled, or a survivor.*⁽⁶⁾

- For a retiree, a disabled worker, or a survivor of a deceased worker who becomes eligible for Social Security benefits in 1998, the PIA — and hence the monthly Social Security benefit after rounding to the next lowest dollar — equals 90 percent of the worker's average indexed monthly earnings after rounding to the next lowest dollar *if* the worker's AIME does not exceed \$477 a month.
- If the worker's AIME falls between \$477 and \$2,875 a month, the PIA (and, after rounding down, the monthly Social Security benefit) equals 90 percent of the first \$477 of the worker's average indexed monthly earnings, plus 32 percent of the worker's average indexed monthly earnings above \$477.
- For workers with AIMEs exceeding \$2,875, the PIA (and the monthly Social Security benefit after rounding) equals 90 percent of the first \$477 in average indexed monthly earnings, plus 32 percent of the next \$2,398 of those earnings (the amount between \$477 and \$2,875), plus 15 percent of the worker's AIME in excess of \$2,875.

[Table 1](#) shows the monthly benefit calculations for three workers with different levels of average indexed monthly earnings. The "low earner" is an earner with an AIME equal to 45 percent of the average earnings level. A "low earner" retiring in 1998 would have average annual pre-retirement earnings of about \$12,250. An average earner retiring this year would have average annual pre-retirement earnings of just under \$26,000. A maximum earner is one whose average pre-retirement earnings

equal the maximum amount of earnings subject to the Social Security payroll tax. Earnings above this level are neither subject to the payroll tax nor used to calculate an individual's Social Security benefit level.

Provisions of the NCRP Legislation that Affect Disability and Survivors Benefits

Most of the remainder of this paper uses the legislation based on the NCRP proposal, the legislation Senators Gregg and Breaux and Reps. Kolbe and Stenholm have introduced, to illustrate how changes in disability and survivors benefits can be intertwined with changes in Social Security retirement benefits. The major provisions of this legislation that relate to Social Security benefit levels are listed in [Table 2](#). Some of these provisions affect only the retirement portion of Social Security, but others impact disability and survivors benefits as well.

Table 2
Major Social Security Benefit Provisions of H.R. 4824 and S. 2313

Provisions	Effect on Disability and Survivors Benefits
Change the formula for calculating the primary insurance amount	Reduces benefits for most beneficiaries, with a reduction of 18.5 percent for a worker earning average wages before becoming disabled or dying
Minimum benefit provision	Protects the benefits of survivors and disabled workers with low earnings and strong labor force attachment
Modify cost-of-living adjustments so they rise more slowly than the current CPI does	Affects benefits of all beneficiaries, including the disabled and survivors
Reduce the number of "drop-out years" and lengthen the wage averaging period	Reduces survivors benefits
Raise the retirement age	Primarily affects retirement benefits and the benefits of survivors of retired workers
Include state and local employees	No effect
Reduce the spousal benefit	Reduces benefits for some spouses of disabled workers age 62 and over who are not caring for young children

Table 3
Benefit Calculations Under NCRP Legislation and Current Law

Under current law, the monthly benefit equals:	Under H.R. 4824 and S. 2313, when fully phased in, the monthly benefit equals:
90% of first \$477 in average indexed monthly earnings, plus	Same
32% of AIME between \$477 and \$2,875, plus	21.36% of AIME in this bracket, plus
15% of AIME above \$2,875	10.01% of AIME in this bracket

Change in Benefit Determination Formula

One of the major provisions of this legislation would alter the way in which retirement, disability, and survivors benefits are calculated. The legislation calls for changing the computation of a worker's monthly benefit by reducing, by the year 2023, the 32 percent bracket in the formula for computing a worker's primary insurance amount to 21.36 percent, and reducing the 15 percent bracket to 10.01 percent. Thus, an individual's monthly benefit would be calculated by taking 90 percent of the first \$477 of the worker's AIME (in 1998 dollars), the same percentage as under current law, but 21.36 percent of the worker's AIME between \$477 and \$2,875 instead of 32 percent of this amount, and 10.01 percent of the worker's AIME over \$2,875 instead of 15 percent of that amount. The proposed change is shown in [Table 3](#).

For very low-wage earners — those with average indexed monthly earnings of \$477 or less — these changes would have no impact. In fact, very low-wage workers who work most or all years between turning 21 and becoming eligible for benefits would likely receive an increased benefit as a result of the legislation's minimum benefit provision, discussed below in more detail. But for beneficiaries with modestly below-average, average or above-average earnings, as well as for most beneficiaries who earned very low wages but were not employed each year between the time they turned 21 and the time they became eligible for benefits, this change would reduce the monthly Social Security benefit. Because this change in the benefit formula would affect the computation of disability and survivors benefits as well as retirement benefits, it would reduce disability and survivors benefits along with retirement benefits.

For many workers, the impact of this change on disability and survivors benefits would be substantial. An analysis by the Social Security Administration's Chief Actuary shows that this change in the monthly benefit formula would reduce benefits to a disabled Social Security beneficiary who earned average wages, which equal \$27,894 in 1998, by 18.5 percent when the formula change was phased in fully.⁽⁷⁾ (See

Table 4.)

Table 4
Determination of the Monthly Benefit for an Average-Wage Worker Who Becomes Disabled Under H.R. 4824 and S. 2313, When Fully Implemented

Formula Using Worker's Average Indexed Monthly Earnings (AIME)	Average-Wage Worker
90% of first \$477	\$429.30
21.36% of AIME between \$477 and \$2,875 (worker's AIME is \$2,162)	\$359.92
10.01% of AIME over \$2,875	\$0
Monthly benefit under H.R. 4824 and S. 2313	\$789.00
Monthly benefit under current law (see Appendix Table 1)	\$968.00
Reduction in monthly benefit	-\$179.00
Percentage benefit reduction	-18.5 %

Survivors also would face reduced benefits. Under current law, for example, a 60-year-old surviving widow of an average-wage worker is eligible for a monthly benefit of \$692. If H.R. 4824 and S. 2313 were law and fully in effect, such a widow would receive a monthly benefit of \$564. This, too, is a reduction of 18.5 percent.

The percentage reduction in benefits would be smaller than 18.5 percent for workers with below-average wages. (And as noted, some very-low wage workers would be shielded entirely from this benefit reduction or receive a benefit increase due to the legislation's minimum benefit provision.) The benefit reduction would be greater than 18.5 percent for those who had earned above-average wages.

Because the primary insurance amount is calculated in the same manner for all Social Security beneficiaries, these percentage reductions in benefits would be the same regardless of whether the beneficiary is a retiree, a disabled worker or a survivor. The dependents of disabled workers and the families of survivors also would be affected, since their Social Security benefits equal a specified percentage of the worker's PIA. A reduction of a given percentage in a worker's PIA would cause the benefits for these dependents to be cut by the same percentage.

Proponents of partial privatization plans often argue that reducing the basic guaranteed benefit payable to retirees through the Social Security retirement system will not necessarily reduce retirees' total incomes, because the retirees also will secure retirement income from the savings in their individual accounts. Income from these accounts could offset reductions in Social Security benefits; some beneficiaries

would likely come out ahead and others behind, depending on how their investments performed, the costs and fees charged on the accounts, and a number of other factors.

[\(8\)](#)

**Adults Who Have Been Disabled Since Childhood
Would be Affected Most Adversely**

One group for whom private accounts are least likely to compensate for the difference between current Social Security benefit levels and the reduced Social Security benefits available under partial privatization plans such as H. R. 4824 and S. 2313 consists of adults who have been disabled since childhood and who become eligible for Social Security when their parents retire, die, or themselves become disabled. "Disabled adult children," as these individuals are known, are eligible for a Social Security benefit equal to a specified percentage of their parent's primary insurance amount.

Both their parents and these disabled adult children would receive lower Social Security benefits under proposals such as H.R. 4824 and S. 2313 than under current law, because of the changes these bills make in determining a beneficiary's primary insurance amount. The parents of these disabled adult children also would accumulate private accounts to supplement their reduced Social Security retirement benefits. (The disabled adult children themselves will have little or no earnings and thus no significant private accounts of their own.) But while the amounts in the parents' private accounts might be sufficient to make up for a substantial portion or all of the reductions in the parents' Social Security benefits, it is unlikely these accounts would make up for the reduction in the benefits of the disabled adult children as well.

As a result, hardship could ensue. Consider, for example, what would occur after the parents of disabled adult children died. By the time of their deaths, many such parents would have largely or entirely depleted their private accounts. That would leave little or no savings to supplement the reduced Social Security benefits upon which their disabled adult children would have to depend for the rest of their lives.[\(9\)](#)

For the disabled and survivors of workers who die before retirement, however, individual accounts generally would fail to bridge the gap between current benefit levels and the benefits available under partial privatization legislation such as H. R. 4824 and S. 2313. Workers who become disabled or die at a young age will not have accumulated much in their individual accounts, as they will not have contributed to these accounts for that many years. For many of these individuals and their families, the change that H.R. 4824 and S. 2313 would make in the calculation of the monthly benefit would result in a significant reduction in monthly income compared to what they would receive under current law.[\(10\)](#)

Change in Cost-of-Living Adjustments

These estimates of the percentage amounts by which disability and survivors benefits would fall due to the changes H.R. 4824 and S. 2313 would make in computing the primary insurance amounts do not reflect the full extent of the reductions in disability and survivors benefits that would occur under these bills. Additional benefit reductions would result from other changes the bills would make in determining benefit levels, such as changes in the Social Security cost-of-living adjustment.

Under current law, Social Security benefits rise each year by the percentage increase in the Consumer Price Index. H.R. 4824 and S. 2313 would change this; they would adjust Social Security benefits not by the CPI but by a new "Social Security Consumer Price Index" that the legislation would create. The Social Security CPI would equal the regular CPI *minus* an estimate of the amount of "substitution bias" remaining in the regular CPI.

Substitution bias can occur when consumers substitute lower-cost items for higher-cost items as prices change. For example, if the price of beef increases more than the price of chicken, consumers will tend to purchase less beef and more chicken. Because the CPI measures the change in prices of a fixed "market basket" of goods and services, it assumes the quantities of beef and chicken a typical consumer buys do not change each year. The CPI is adjusted once every 10 years for such changes in purchasing patterns, but this process does not capture changes in purchasing patterns on a year-to-year basis within the 10-year intervals. As a result, the index may overstate inflation to some degree.

H.R. 4824 and S. 2313 would require the Bureau of Labor Statistics, the agency that calculates the CPI, to publish annually the amount by which the CPI has been reduced to correct for substitution bias. BLS also would be required to publish an estimate of the amount of substitution bias remaining in the CPI. Under the legislation, the Social Security CPI would equal the CPI (including whatever corrections the BLS has made in it) minus any substitution bias BLS estimates to remain.

The legislation also contains a related requirement — that in calculating the Social Security CPI, the CPI must be reduced *no less than 0.5 percentage points* to compensate for substitution bias, regardless of BLS' estimate of how much substitution bias remains. In April 1998, BLS announced improvements in the CPI that will reduce substitution bias in the index by 0.2 percentage points when the improvements are incorporated in the index in 1999. BLS plans to make additional changes in 2002 that are expected to reduce substitution bias an additional 0.15 percentage points, for a total reduction of 0.35 percentage points.⁽¹¹⁾ BLS is not planning any further changes to adjust for substitution bias; it estimates the adjustments now in process will resolve the substitution bias problem. In the absence of further changes, however, the Social Security CPI that the NCRP legislation establishes would be set approximately 0.15 percentage points below the CPI, as corrected by BLS, to secure the minimum 0.5 percentage point reduction for

substitution bias the legislation requires.[\(12\)](#)

Over time, the effect of such a downward adjustment each year in the cost-of-living adjustment would be to erode the value of Social Security benefits relative to current law. These benefit reductions would tend to be largest for workers who become disabled well before reaching retirement age, since these beneficiaries typically receive benefits for a greater number of years than retirees do.

Table 5
Potential Impact of Cost-of-Living and PIA Changes
in H.R. 4824 and S. 2313 on Disability and Survivors Benefits

Worker with AIME of \$2,083 (\$25,000 per year) who becomes disabled at age 30		
	Current Law	H.R. 4824 and S. 2313
Benefit at age 30	\$943	\$772
Average annual cost-of-living adjustment	2.5 %	2.35%
Benefit at age 60	\$1,978	\$1,550

The provision's impact on a disabled worker who becomes eligible for Social Security at a relatively young age can be seen with an example. Consider a worker with average indexed monthly earnings of \$2,083 (equivalent to average annual earnings of \$25,000 in 1998 dollars) who becomes disabled at age 30. Under current law, the worker's benefit is \$943 a month when he or she begins to draw it. When fully in effect, the provision of H.R. 4824 and S. 2313 that would change the formula for calculating a worker's primary insurance amount would reduce this benefit to \$772 a month, an 18 percent reduction. Now assume that inflation as measured by the CPI averages 2.5 percent per year for the next 30 years and BLS does not introduce additional changes to the CPI to reduce substitution bias, beyond the 0.35 percentage point reductions already scheduled. Under the legislation, the worker's benefit would be raised an average of 2.35 percent per year to compensate for inflation rather than 2.5 percent, because the Social Security cost-of-living adjustment would equal the regular CPI minus 0.15 percentage points. By age 60, this would reduce the worker's benefit an additional four percent, bringing the total reduction in Social Security disability benefits paid at age 60 to 22 percent, compared to the benefit payable under current law. Instead of receiving a disability benefit of \$1,978 per month at age 60 as under current law, the disabled worker would receive \$1,550. (See [Table 5.](#))

Another Change Affecting Survivors Benefits

H.R. 4824 and S. 2313 include another provision that would lower the Social Security benefits of many survivors, although it would not affect the disabled. Under current law, the five years of a beneficiary's lowest earnings are omitted from the calculation of the beneficiary's average indexed monthly earnings. (In Social Security parlance, these are termed "drop-out years.") Under H.R. 4824 and S. 2313, by contrast, the five lowest years of earnings would be counted rather than dropped when computing retirement and survivors benefits. No similar change would be made in computing disability benefits.[\(13\)](#)

Most workers do not have the same earnings each year of their working lives; they have low earnings when they are young and higher earnings when they are older. More than 60 percent of workers take at least one year out to raise children, attend school, or for some other reason, and have zero earnings for one or more years. The provision of current law disregarding the five lowest earning years helps these workers. Including rather than disregarding these five years, as H.R. 4824 and S. 2313 would do, would lower average indexed monthly earnings — and hence monthly Social Security benefits — for many retirees and survivors of deceased workers.

Other proposals to reform Social Security that either reduce the number of drop-out years or average the highest 38 years of earnings when computing retirement benefits, rather than the highest 35 years as under current law, also would lower workers' AIMEs and reduce their benefits. For example, the Social Security plan that Robert Ball has developed would calculate the AIME for retirees using their highest 38 years of earnings. This provision of the Ball plan would reduce benefits modestly for most retirees and most survivors of workers who died after reaching retirement age. Because the Ball plan does not reduce the number of drop-out years, however, this aspect of it should not affect the benefits of the disabled or of survivors of workers who die before reaching retirement age (with the exception of some individuals who become disabled very close to retirement age and some survivors of workers who die very close to retirement age).[\(14\)](#)

Minimum Benefit Provision

Although the majority of disabled and survivor beneficiaries would receive reduced benefits under H.R. 4824 and S. 2313, not all beneficiaries would face cuts. Workers with very low earnings and strong labor force attachment would be protected by a provision in the legislation that provides a guaranteed minimum benefit. This provision would protect some retired, disabled and survivor beneficiaries from part or all of the benefit reductions they otherwise would face under this legislation.

How Other Social Security Plans Would Affect Disability and Survivors Benefits

Other Social Security plans that have been proposed also would affect disability and survivors benefits, although they generally would do so to a lesser degree than H.R. 4824 and S. 2313. For example, the plan introduced by Senators Daniel Patrick Moynihan and Bob Kerrey makes considerably larger reductions in the Social Security cost-of-living adjustment than do H. R. 4824 and S. 2313. Under the Moynihan-Kerrey plan, Social Security benefits would be adjusted each year by the CPI minus one full percentage point. Since disabled beneficiaries and the survivors of workers who die well before retirement age often receive benefits for a longer number of years than retirees do, this reduction in the cost-of-living adjustment would reduce their benefits substantially.

At the same time, the Moynihan-Kerrey plan does *not* contain the change in the basic Social Security benefit formula (i.e., the changes in how the primary insurance amount is calculated) that H.R. 4824 and S. 2313 include. As a result, the *overall* reduction in disability and survivors benefits is smaller under the Moynihan-Kerrey plan than under H.R. 4824 and S. 2313. The Moynihan-Kerrey plan does not need as large Social Security benefit reductions as H.R. 4824 and S. 2313 do because, over time, it diverts much less payroll tax revenue from the Social Security trust funds to individual accounts than H.R. 4824 and S. 2313.

A third plan, fashioned by former Social Security Commissioner Robert Ball, would result in small effects on disability and survivor benefits. The Ball plan modestly lowers the cost-of-living adjustment by requiring the Bureau of Labor Statistics to update every three years, rather than every 10 years, the market basket of goods and services on which the CPI is based. The expected impact of this aspect of the Ball plan on the Social Security cost-of-living adjustment would about the same as the expected impact of the cost-of-living provision of H.R. 4824 and S. 2313. The Ball plan contains no other provisions that have substantial effects on disability or survivors benefits. (The Ball plan contains much smaller Social Security benefit reductions than the Moynihan-Kerrey or NCRP proposals both because it does not divert any trust fund revenues to individual accounts and because it closes a little more than half of the 75-year Social Security financing gap by investing up to half of Social Security reserves in the equities markets and securing higher returns for the Social Security trust funds through this mechanism.)

Another plan that could affect disability and survivors benefits is a plan that Senator Phil Gramm has developed but not yet formally introduced. The Office of the Chief Actuary of the Social Security Administration has analyzed the Gramm plan, which is derived from a proposal by Harvard economist Martin Feldstein. The actuaries found that the revenue the Gramm plan allocates for Social Security disability benefits and benefits for survivors of workers who die before reaching retirement age would be insufficient. The amount that the plan allocates for these benefits is only about two-thirds of the amount the actuaries estimate would be needed to finance these benefits.¹² The consequences of this shortfall are unclear, but

the shortfall would appear to place disability and survivors benefits at some risk unless a future Congress were willing to redirect some of the resources going into individual accounts back to the Social Security trust funds or to raise Social Security payroll taxes, the Social Security disability insurance program would face a financial crunch that could lead to significant reductions in it.

¹² Memorandum from Stephen C. Goss, Deputy Chief Actuary, Social Security Administration, "Considerations in Evaluating the 'Social Security Preservation Act' Proposed by Senator Phil Gramm," April 27, 1998.

Under this provision, workers who become eligible for Social Security benefits after working a minimum of *two* quarters each year between the year in which they turn 21 and the year they become disabled or die are guaranteed a minimum Social Security benefit equal to at least 60 percent of the 1996 poverty line for a single individual, adjusted for inflation. In 1998, this would equal a monthly benefit of \$400. A worker who has worked *four* quarters each year between turning 21 and the year he or she becomes disabled or dies would be guaranteed a minimum benefit equal to 100 percent of the 1996 poverty line for a single individual, as adjusted for inflation.⁽¹⁵⁾ (The 1996 poverty line for a single individual would be adjusted by the Social Security CPI each year through 2009, and by average wage growth in years after that, to determine the poverty line figure used in computing a beneficiary's minimum benefit.⁽¹⁶⁾)

This provision would have a substantial impact on the benefits available to workers who earned very low wages and had strong labor force attachment. If the provision were in effect today, a worker who earned low wages before becoming disabled and who qualified for a minimum benefit equal to 100 percent of the poverty line would be guaranteed a minimum benefit of \$666 a month in 1998. This equals the monthly benefit level that a worker who has earned an average of \$14,600 per year before becoming disabled would receive under current law.

As a result, workers who worked four quarters each year between age 21 and the onset of their disability and who earned average wages of less than \$14,600 would receive higher benefits than under current law.⁽¹⁷⁾ The same would be true for survivors of deceased workers who had a strong labor force attachment and earned average wages of less than \$14,600.⁽¹⁸⁾

This provision would not benefit low earners with substantial periods out of the labor market before becoming disabled or dying, such as some women who lose some years of employment due to child-rearing or some individuals who experience a prolonged period of unemployment due to an economic downturn and become disabled or die fairly soon thereafter.

Finding a Solution: No Easy Answers

In theory, the disability and survivors benefits of most disabled and survivor beneficiaries (including those not shielded by the proposed minimum benefit) could largely be protected from benefit cuts when Social Security retirement benefits are reduced. This could be done by exempting the calculation of survivors and disability benefits from the various changes in the formulas used to calculate Social Security retirement benefits.

In practice, however, using different formulas to calculate Social Security disability and survivors benefits from the formula used to calculate retiree benefits would lead to a highly inequitable distribution of benefits. Under current law, benefits are directly related to a worker's past wages. Most workers who do not collect Social Security until retirement receive a higher monthly benefit than do disabled and survivor beneficiaries, since workers who do not collect benefits until retirement have spent more years in the labor market and typically have seen their earnings rise over time. This would no longer be true if disability and survivors benefits were held harmless while retirement benefits were reduced substantially. If that occurred, a disabled beneficiary could receive substantially higher benefits than a retiree.

For example, if changes are made to the calculation of retirement benefits but disability and survivors benefits continue to be calculated as under current law, a worker who becomes disabled at age 61 would retire with unreduced Social Security benefits while also having accumulated a significant individual account from which to draw supplementary income. Meanwhile, a worker with a similar earnings history who retired at age 65 could have a similar-size individual account but sharply reduced Social Security retirement benefits. The two beneficiaries would have very different total benefit packages, even though both left the labor market within a few years of each other. Such an inequitable structure could prompt a significant number of individuals to leave work earlier and attempt to claim disability benefits.

Implications of Individual Account Plans for the Financing of Benefits for Disabled Workers

The benefits of disabled workers are financed through the Social Security Disability Insurance (DI) trust fund only until workers reach the age of 65. At that point, although the workers' benefit levels remain unchanged, their benefits are financed through Social Security's other trust fund, the Old Age and Survivors Insurance (OASI) trust fund. Any Social Security reform plan that replaces some portion of Social Security retirement benefits with private accounts must take this into consideration, as the Social Security benefits of disabled workers who reach retirement age will still have to be financed through the OASI trust fund. Such a plan must provide adequate resources for the OASI trust fund to fulfill this task. This matter is of particular importance because the individual accounts of workers who become disabled well before retirement age will not have accumulated sufficient funds to provide much supplemental income.

At the same time, if the disability benefit calculation is *not* held harmless while benefit changes such as those in H.R. 4824 and S. 2313 are made, a worker who becomes disabled at a relatively young age would not have much of an individual account to draw upon and could face sharply reduced overall benefits.

In short, changing the calculation of Social Security retirement benefits in the manner that H.R. 4824 and S.2313 do either would result in large reductions in Social Security benefits — and overall income — for many disabled beneficiaries and survivors or would introduce substantial new inequities into the Social Security system.

The drafters of the legislation based on the NCRP plan recognized these complexities. They included a provision in their bills that would allow for later changes to be made in the disability insurance program. Under this provision, the Social Security Board of Trustees, in consultation with the National Council on Disability, would be required to submit to Congress and the President recommendations for statutory adjustments in the disability insurance program by May 31, 2001. H.R. 4824 and S. 2313 state that these recommendations may address such issues as the adequacy of benefits, the relationship of disability benefits to retirement benefits, and the process for determining initial eligibility and continued eligibility for the disability program. If the President approved the recommendations, the President would submit them to Congress for consideration. The bill specifies procedures for resolving differences between the President and the Board if the President does not approve the Board's recommendations. It also requires that the recommendations be provided to Congress within a specified period of time if the Board and the President continue to disagree.

While this provision establishes a mechanism for consideration of possible changes in disability benefits, the fact remains that the disability benefits these bills would write into law would represent substantial reductions from the benefits that current law provides. It would take enactment of subsequent legislation to reverse these reductions.

Moreover, any recommendations to improve disability benefits submitted through this process would have to be made "...without reducing the balance ratio of the Federal Disability Insurance Trust Fund." This means the total cost of the Social Security Disability Insurance program could not increase. Any increases in restorations in Social Security disability benefits for some beneficiaries would have to be matched by offsetting reductions in Social Security disability benefits for other beneficiaries.

In addition, the Social Security trustees and other individuals who would be charged with considering and making recommendations regarding possible changes in disability benefits would face the same dilemma that the authors of H.R. 4824 and S. 2313 confronted; were it possible to shield disability benefits from the large cuts H.R. 4824 and S. 2313 make without introducing serious inequities and perverse incentives into the Social Security system, the authors of these bills would have done so. As the original NCRP report indicated, it was NCRP's goal to avoid such reductions in disability benefits. For these reasons, the provision of H.R. 4824 and S. 2313 calling for the submission of recommendations regarding disability benefits cannot be regarded as a safety clause that would ensure cuts in disability benefits are restored.

Finally, this provision would apply only to disability benefits. The legislation does not contain a similar provision establishing a mechanism for developing recommendations to ease the reductions in Social Security benefits provided to survivors of workers who have died before retiring.

Conclusion

Under the Social Security benefit structure, the formulas used to determine disability and survivors benefits are intertwined with the formula for determining retirement benefits. If Social Security retirement benefits are reduced substantially, as they generally would be under plans that shift a portion of payroll tax revenues from the Social Security trust funds to individual accounts, disability and survivors benefits are likely to be reduced substantially as well.

The legislation based on the proposal developed by the National Commission on Retirement Policy illustrates this problem. Commission members intended

and desired that disability benefits not be reduced as a result of their plan. But despite their efforts and intentions, they were unable to fashion their plan in a manner that would avert substantial reductions in the basic monthly benefits on which many disabled workers and survivors of deceased workers depend.

End Notes:

1. This House bill was originally introduced as H.R. 4256 and then re-introduced as H.R. 4824 to reflect technical corrections and correct some drafting errors in the first bill. S. 2313 was introduced at the same time as H.R. 4256 and does not include these corrections. This analysis assumes the same changes will be made to the Senate bill. The bill numbers for both the House and Senate bills will change when the bills are reintroduced during the next session of Congress.

2. Social Security has two trust funds, the Old Age and Survivors Insurance trust fund, which funds retirement and survivor benefits, and the Disability Insurance trust fund, which funds disability benefits. Both trust funds are projected to become insolvent in coming decades. Because the two trust funds are essentially fungible, Social Security solvency can be restored by making changes that make the overall system solvent and adjusting accordingly the share of Social Security revenues placed in each trust fund. To restore solvency, it is not necessary to reduce disability benefits by some particular amount or percentage. To the degree that disability benefits are shielded, somewhat larger changes likely would be needed in retirement benefits.

3. In theory, the legislation based on the NCRP plan could have left disability and survivors benefits largely untouched. This could have been accomplished by replacing the plan's changes in the Social Security basic benefit formula and in the annual Social Security cost-of-living adjustment with much steeper increases in the age at which workers can retire and receive full Social Security benefits. Raising the age at which beneficiaries can retire and receive full benefits does not affect disability benefit levels or benefits for survivors of workers who die before reaching retirement.

In practice, however, such a change would hold little attraction. The NCRP plan already contains a larger increase in the age at which beneficiaries can retire and receive full benefits than any other major Social Security plan put forward. Of the three rival Social Security plans advanced by members of the 1994-1996 Social Security Advisory Council, the plan that went farthest in raising the age at which individuals can retire and receive full benefits would increase this age from 65 today (and, under current law, 67 starting in 2022) to age 70 by 2083. By contrast, the NCRP plan would raise the age to 70 by 2029 and to approximately 72½ by 2075. The NCRP also would raise the age at which *early* retirees can begin to receive reduced Social Security benefits from 62 to 65 by 2029 and to approximately 67½ by 2075. Replacing those provisions of the NCRP plan that would result in substantial reductions in disability and survivors benefits with provisions requiring still greater increases in the retirement age would entail raising the age at which workers may retire and receive full benefits to levels significantly higher than those the NCRP plan already proposes.

4. To receive Social Security disability benefits, disabled workers must have worked one quarter for each year between the year they turned 21 and the year they become disabled,

with a minimum of six quarters of work. They also must have worked 20 of the 40 quarters before becoming disabled if they become disabled after age 31 and half of the quarters between the time they turn 21 and the time they become disabled if they become disabled before turning 31.

5. For survivors, the lowest five years of wages (known as "drop-out years") are disregarded in the calculation of the AIME unless the worker died before working seven full years, in which case all but the two highest wage years are disregarded in the calculation. For the disabled, depending on the age of the worker at the time of disability and the number of years worked, up to five years in which the worker earned the lowest wages are disregarded in the computation of the AIME. (As an example, if a worker who worked since age 21 becomes disabled at 31, the highest eight years of wages are indexed and averaged to determine the worker's AIME, while the two years with the lowest wages are disregarded.) By omitting from the AIME calculation the years in which the worker earned the least, the Social Security benefit structure ensures that workers who were either unemployed for brief periods or left the labor force for a few years to provide child care, attend college, or for other reasons are not penalized.

6. A disabled worker's benefit is equal to 100 percent of the worker's PIA rounded down to the next dollar. Each dependent of the disabled worker is eligible to receive an additional benefit equal to 50 percent of the worker's PIA. Widows and widowers of deceased workers and minor or disabled children of deceased workers are eligible for a survivor's benefit based on a portion of the deceased worker's PIA. The combined benefits of all beneficiaries in a family (except divorced spouses) cannot exceed a maximum level, or cap.

7. Social Security Administration, "Impact on Low Earners of Proposals to Address Long-Range Social Security Solvency" unpublished report, 1998.

8. See Kilolo Kijakazi and Robert Greenstein, "[How Would Various Social Security Reform Plans Affect Social Security Benefits: An Analysis of the Congressional Research Service Report](#)," Center on Budget and Policy Priorities, September 9, 1998; Peter Diamond, "The Future of Social Security for this Generation and the Next: Proposals Regarding Personal Accounts," Testimony before the Subcommittee on Social Security of the House Committee on Ways and Means, June 18, 1998; and testimony of Henry Aaron before the Senate Committee on the Budget, July 23, 1998.

9. Moreover, whatever might remain in the parents' private account when the parents died would have to supplement the incomes of these adult disabled children over their entire remaining adult lives rather than only during their elderly years. Even significant private accounts would generally be insufficient to make up for the reduction in Social Security benefits these adult disabled children would face over the remainder of their lives.

10. Workers who become disabled only shortly before reaching retirement age would have accumulated more in their individual accounts and thus would receive more income from these accounts.

11. Technically, the substitution bias correction scheduled for 2002 cannot be made in the CPI itself because the data needed to make this correction are not available in a manner that allows them to be reflected in the monthly CPI data. As a result, BLS plans to introduce a second cost-of-living index in 2002 that essentially is the CPI as modified to reflect this

substitution-bias correction.

12. A commission charged with evaluating the CPI and chaired by Michael Boskin concluded in 1996 that the CPI was overstated by approximately 1.1 percentage points per year, with substitution bias accounting for 0.4 percentage points of the total. BLS now estimates that substitution bias causes the index to be overstated by 0.35 percentage points. The change to the CPI scheduled for 1999 will eliminate 0.2 percentage points of this bias, and the introduction of a new cost-of-living index in 2002 will eliminate an additional 0.15 percentage points of bias.

BLS periodically reevaluates and makes changes to the CPI. It is unlikely, however, that the BLS will make corrections for substitution bias that total 0.5 percentage points any time soon. As a result, under H.R. 4824 and S. 2313, the annual Social Security cost-of-living adjustments would be smaller than the CPI, which would result in Social Security benefit reductions compared to current law.

13. Currently, when figuring retirement benefits, the amounts a worker has earned in his or her 35 highest earnings years are indexed, added, and divided by 420 (which equals 35 years times 12 months) to determine the worker's average indexed monthly earnings. Under H. R. 4824 and S. 2313, *all* of a worker's earnings years would be totaled and then divided by 480 (which equals 40 years times 12 months).

For one group of retirees and survivors of retirees, this change could *raise* average indexed monthly earnings and hence Social Security benefits. These are retired workers, and survivors of retired workers, who began working and earning significant wages before age 21 and who worked most or all of the year in nearly every year until they retired. For these workers, more than 40 years of earnings would be totaled when figuring their AIME, but these total earnings would be divided by 40 years times 12 months, rather than by the actual number of years the individual had worked times 12 months. For some of these workers, this would result in a higher AIME, and hence higher benefits, than under current law. The majority of beneficiaries of Social Security retirement and survivors benefits, however, would not benefit from this change and would face lower benefits as a result of inclusion of their lowest-earning years in the benefit computation.

14. In addition to the provisions of H.R. 4824 and S. 2313 discussed here, provisions of these bills and of various other Social Security plans that would raise the age at which full Social Security benefits are paid could affect the benefits of some individuals who become unable to work shortly before reaching that age but are not sufficiently disabled at that point to meet the rather stringent Social Security disability test.

15. The minimum benefit provision also applies to retirees. Retirees would be eligible for a minimum benefit equal to 60 percent of the poverty line if they had worked at least 20 years and to a minimum benefit equal to 100 percent of the poverty line if they had worked at least 40 years. For retirees, the disabled, and survivors alike, once the benefit level of an individual receiving the minimum benefit has initially been set, the benefit would be adjusted for inflation in subsequent years by the Social Security CPI, just as all other Social Security benefits would be.

16. Between enactment of the legislation and 2009, the minimum benefit would equal modestly less than 60 percent to 100 percent of the poverty line, due to use of the Social Security CPI rather than the regular CPI to adjust the 1996 poverty line for a single individual.

The Census Bureau adjusts the poverty line each year in accordance with the regular CPI; the Social Security CPI would rise more slowly than the regular CPI. After 2009, the poverty line figure used to calculate the minimum benefit would be adjusted by average wage growth, rather than by the Social Security CPI. Average wages are expected to rise somewhat faster than the regular CPI since they generally have done so in the past. This means that the minimum benefit eventually would be set somewhat higher than 60 percent to 100 percent of the poverty line.

17. Under Social Security law, a worker does not have to work every quarter of the year to receive credit for four quarters of work for the year. A worker who earns \$700 in a year is credited with one quarter of work. A worker who earns at least \$2,800 in the year is credited with four quarters for that year. These earnings levels are indexed for inflation.

18. The minimum benefit provision of the NCRP plan also flattens Social Security benefits across the lower part of the wage scale. Workers who had enough quarters of work to receive the minimum benefit and whose average indexed earnings over their work careers were between \$2,760 and \$19,000 on an annual basis (measured in 1998 dollars) would all receive the same Social Security benefit level.

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