In 1973 Congress passed legislation requiring that Social Security benefits be adjusted annually according to changes in the Consumer Price Index (CPI). The intent of this provision was to insure that adjustments in benefits would be made on a regular basis and that Social Security recipients, most of whom were elderly and retired, would not suffer a decrease in real benefits during inflationary periods. Since 1973 the combination of rapid inflation, slow growth in real wages, unemployment and an increased elderly population has strained the Social Security system’s financial resources to the point where the solvency of the Social Security system has been threatened. Recent reforms have included a one-time six-month postponement of the cost-of-living adjustment.

Concern over the system’s financial status has led to consideration of several alternative means of adjusting Social Security benefits to reflect changes in the cost of living. Critics of the current system charge that the Consumer Price Index overstates increases in the cost of living for the elderly, so that the current system overcompensates them for inflation and puts an undue burden on the wage-earners whose taxes finance Social Security. Some argue that the rate of increase in Social Security benefits should simply be slowed in order to reduce the system’s costs. Others argue that an index based specifically on the living costs of the elderly should be used. Another recommendation is that changes in Social Security benefits be tied to the wages of the system’s working contributors.

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Whether one views the Social Security system as a social insurance program, a mandatory retirement savings program, an earnings replacement program, or an income redistribution program, it is important to consider the impact of any modifications in the benefit determination scheme not just on the solvency of the system, but also on the over-all income distribution and incidence of poverty among the elderly. In this paper, we focus on the latter concern. We estimate the effects of alternative indexing schemes for Social Security benefits on the incomes of the elderly, giving particular attention to income distribution and poverty rates under different indexing schemes.

Briefly summarizing our findings, we conclude that proposed minor modifications in the indexing scheme for Social Security benefits would not have a large impact on the distribution of income among recipients. A relatively large decline in real benefits resulting from a significant slowdown in benefit increases would, however, measurably increase income inequality among the elderly. More striking is the finding that even a small decline in the rate of indexing would have a substantial impact on official poverty rates among the elderly. A tradeoff clearly exists between reducing the growth of the Social Security system's expenditures by slowing benefit increases and the prevalence of poverty among the elderly.

This paper consists of three sections. The first describes the incomes of older Americans in the period from 1970 to 1976, using data from the Retirement History Survey conducted by the Social Security Administration. In the second section we use these data to make quantitative estimates of the impacts of alternative indexing schemes for Social Security benefits on the incomes of the elderly and on the significance of these results for future modifications in Social Security policy.

INCOMES OF THE ELDERLY

This study uses data from the Retirement History Survey (RHS) conducted by the Social Security Administration during the 1970s. The survey is based on a nationally representative sample of Americans aged 60–65 years in 1971. For purposes of this study only respondents who remained in the survey through 1977 and who received Old Age and Survivor benefits from Social Security between 1970 and 1976 were included, yielding a sample of nearly 8000