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SOCIAL SECURITY

Making Smarter Decisions Is Critical to Mitigating Retirement Risks Women Face

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Social Security is a critical piece of the financial foundation for nearly every woman. The program provides a modest amount of income for one's retirement years. Without this vital resource, millions of elderly women would fall below the poverty line and become dependent on welfare and other charitable programs.

But Social Security is largely misunderstood by a large swath of consumers and, surprisingly, by a fairly high number of financial professionals in tax, accountancy, and financial advisory disciplines.

This article showcases how necessary Social Security is to women's retirement income plans and financial security. It explores some of the more pronounced hurdles women face in their ability to create sufficient income throughout retirement, and it specifically discusses how the gender wage gap and the "mom gap" impact women's benefits. Further, this article describes the additional consequences that can result for women due to claiming Social Security too early. These consequences can be particularly dire when their husbands claim before reaching Social Security's full retirement age (FRA), because, for married women, financial security is largely tied to how their husbands claim benefits.

In this era of shouldering one's own retirement, women need to make better and smarter financial decisions. For many women, getting the claim for Social Security right will be the most important retirement income decision they make.

KEY TERMS

AIME: Average Indexed Monthly Earnings is one's highest 35 years of wages, indexed for wage inflation, then averaged, and used as the basis for one's benefit calculation.

FICA: The Federal Insurance Contributions Act is a U.S payroll tax deducted to fund the Social Security and Medicare programs.

FRA: Full Retirement Age is the age when an individual reaches a specific age that Social Security deems them to be retired, from 66 to 67 in two-month increments.

PIA: Primary Insurance Amount is the calculated value of one's Social Security retirement benefit at FRA.

TWB: The Taxable Wage Base is the highest amount of income upon which FICA taxes for Social Security are collected. In 2020, TWB is $137,700.

SOCIAL SECURITY ORIGINALLY PROTECTED ONLY WORKERS, NOT WOMEN

Social Security turns 85 years old in August 2020. Despite what you may read, it is among the most successful of all government programs. One of the most important benefits Social Security offers is a modest level of financial protection to men and women for as long as they live.

In the 1930s, the biggest concern for aged women was that they would outlive their husbands and need ongoing financial protection. But the 1935 Social Security Act did not include protections for widows or wives. It only provided retirement benefits for individual workers. Women were generally not part of covered employment in the 1920s and 1930s. They were wives, mothers, farmers, and domestic workers; and both agricultural workers and domestic workers were specifically excluded from Social Security.

Recognizing that protecting women must be addressed, the government passed the Social Security Amendments of 1939, which added payments to wives and minor children of retired workers as well as survivor benefits for a covered worker's family in the case of premature death.

By the time Social Security began issuing payments in 1940, it had transformed from a retirement program for workers into a family-based economic security program.[1] It addressed one of the key financial risks that most women then faced: losing 100 percent of their income when their husbands die.

WOMEN FACE COMPLEX RETIREMENT CHALLENGES

There are obvious—and less obvious—risks that financially affect modern women more than men. Two common risks are the wage gap and the mom gap. These two situations can significantly impact a woman's ability to stay in her home and put food on the table throughout retirement.

The wage gap. Women historically have worked in lower-paying jobs and careers than men, and when they do the same work as men, they generally earn less than men. This wage gap leaves them vulnerable with regard to retirement income.

The mom gap. For most women, motherhood is a financially costly endeavor. The mom gap results from the years women spend at home raising families, either unemployed or underemployed. The mom gap has financial implications for saving for retirement and paying for retirement.

Each individual woman will, of course, have her own set of financial balls to juggle, and Social Security does not, cannot, and was not designed to make up for insufficient planning.

Women today must face the fact that responsibility for funding their own retirements sits squarely on their own shoulders. Although they can't change the past, women can learn to make the best Social Security claiming decisions for the long run. Indeed, it is critical that each woman engages more fully in her claiming decision, because her retirement security most likely depends upon it.

WOMEN ARE NOT ALL THE SAME

When it comes to planning for retirement, there are no standard situations. Each woman's life and situation is unique and the result of an individual journey. Social Security acknowledges and addresses unique paths by looking at women in one of four categories: individual workers, married women, eligible divorced women, and widows. Widows are further considered by age and if they have minor children to care for. Same-sex married or divorced women and widows are afforded the same rules as women married to men. These distinctions become important when trying to figure out how and when to claim Social Security, and how much of a benefit a woman will receive.

For a single woman, it is relatively easy to make a smart Social Security claiming decision. But married women face more complex financial situations, and the role their husbands play is often the critical cog in their Social Security claims.

THE WAGE GAP SETS UP WOMEN FOR FINANCIAL FRAILTY

Nearly all women face the gender wage gap. It's a fact that women get paid less for the same jobs as men. Current data show that white women get paid almost 82 percent of their male counterparts; African-American and Hispanic women are paid an average of 63 percent of white males.[2]

This wage gap is more detrimental than we may realize. Not only does less pay for the same job make it more difficult to make ends meet while working, but it significantly reduces Social Security benefits for women in their retirement years.

Women have earned lower wages than men for as long as we can look back. The wage-gap reality stems from a combination of the following:

- The types of jobs women historically were allowed to hold
- Choosing lower-paid professions such as teaching, nursing, and social work—"traditionally female jobs"
- Being paid less for the same jobs at every level
- Needing flexibility to raise children or taking on part-time work to support the family

The net effect of women having an overall lower wage history is nearly $4,000 in annual Social Security income shortfall per woman. In 2018, the average Social Security benefit was $1,297/month for women versus $1,626/month for men—a 20-percent deficit.[3]

Furthermore, and more disturbing, is that the spread between average benefits is widening. In 2009, there was a $300 difference between the average monthly benefit payment for men versus women. In 2018, the gap widened to $330. This $330 gap might not seem a lot to some, but it proves to be pivotal for a majority of women.

AN ILLUSTRATION: IMPACT OF THE WAGE GAP ON SOCIAL SECURITY BENEFITS

Let's assume the following: a man and a woman work full time at the same job for 35 years beginning in 1985 and ending in 2019. The man has earned the taxable wage base (TWB) every year. The woman has earned 18 percent less (the average wage gap). Table 1 shows the differences that result in the average indexed monthly earnings (AIME)—the basis for the calculation of Social Security benefits—and the primary insurance amount (PIA)—the monthly benefit at full retirement age—for these two people.

Over a 30-year retirement, this shortfall translates to a whopping $113,000 less in benefits (not adjusted for cost-of-living allowance or COLA) for her, just as a result of the working woman's wage gap.[4]

Table 1

WAGE GAP IMPACT ON MONTHLY SOCIAL SECURITY INCOME

	Him	Her
AIME	$11,618	$9,527
PIA (2020)	$3,283	$2,969
Differential		–10%

THE MOM GAP: MOTHERHOOD CARRIES A PERMANENT FINANCIAL PENALTY

Sadly, society tends to underestimate the real personal cost of becoming a mother, rearing the children, and managing the household. Regardless of education level or career, women have either needed to stay home to raise their children or have chosen to do so. Research by the Pew Research Center reveals that roughly 27 percent of all mothers with children stay at home versus between 3 percent and 6 percent of fathers. This has been the norm for the past 30 years.[5]

The effects on monthly household income are obvious: The mother will have less income. Either the couple decide that one income is sufficient or they make choices to curtail their lifestyle. What is not evident is the long-term implications to the mother's Social Security benefit.

Mothers commonly step out of the workforce for five years when they have small children. Continuing with the hypothetical example from above, the following illustrates the potential impact of taking just five years away from the workforce:

- Each parent works for 10 years, earning the TWB from 1985 through 1994.
- She then steps out of her career for five years.
- She returns at her previous salary, and works another 20 years. Her salary increases at a flat 3-percent annual raise.
- His salary is capped each year at the TWB.

In 2019, after 35 years, this couple retires. Table 2 shows the results of the mom gap on AIME and PIA.

The consequence of that one decision is that a woman's Social Security benefit has been reduced 14 percent. She'll receive about $168,000 less than her husband over a 30-year retirement because the couple decided to have mom stay at home for five years.[6]

WORKING LONGER IS IMPORTANT TO CONSIDER

One option this couple may have is to continue working another five years. This allows her to replace all five zeros on her work record. Assuming they each do so, and assuming their wages continue to grow at 3 percent per year, his PIA changes little, to about $3,300 per month (an additional $20 per month). In the mom's case, her benefit improves significantly, but it still falls short of what her earnings would have been had she stayed in the work force continually. In this example, replacing the five zeroes with higher earnings yields a PIA of $3,023, closing her shortfall to $280 per month, or about $100,000 over her 30-year retirement.[7]

A MORE REALISTIC LOOK AT MOTHERHOOD AND SOCIAL SECURITY

Another common scenario for mothers is to take five years away from the work force, then return to work, but at a reduced pay structure (either part-time or to a lower-paying job) for the next 10 years. She then again steps back out from the workforce to be home with teenagers or to assume caregiving responsibilities for elderly parents. This scenario also has dramatic implications on a woman's Social Security benefits.

If we apply this scenario to our example couple, we see that the husband's wages were at the TWB, so again, his PIA is $3,283. Although she does qualify for benefits on her own work record (she has paid FICA taxes for at least 40 quarters), her work history includes only 20 years of real wages. Therefore, her PIA is $2,146. It is greater than half of his, so she will receive only her own benefit. But, it's 35 percent less ($1,137 per month) than if she had worked at the TWB for 35 years. That translates to more than $400,000 less over her planned 30-year retirement.[8]

CONSEQUENCES FOR NOT GETTING SOCIAL SECURITY CLAIMING RIGHT

It is sometimes necessary for women to step out of the work force before FRA, perhaps to assist someone else with care, because of a job loss, or because they want to retire with a spouse who is a few years older. And sometimes they begin taking Social Security early simply because they know they can start claiming Social Security at age 62.

But the fact of the matter is that claiming early puts her in a precarious position in her oldest and most vulnerable years. Let's look at two additional situations where not optimizing Social Security at the point of retirement can be a financial mistake for women:

Claiming early dramatically reduces Social Security capital

Taking a claim at 62 reduces social capital by 30 percent (for those with FRA of 67). Unless a woman has sizeable financial resources for retirement, she should seriously consider whether she can afford to forego that extra 30 percent.

But we see women claim early as a general practice. Many time their claims to start with an older husband's retirement claim. Other women claimed early under

Table 2

MOM GAP IMPLICATIONS ON SOCIAL SECURITY RETIREMENT INCOME

	Him	Her
AIME	$11,618	$8,505
PIA (2020)	$3,283	$2,816
Monthly Difference		–$467
Differential		–14%

the now-closed file and suspend with the restricted application strategy. Since 2000, the average age of women claiming Social Security has increased from 63.8 years to 64.7, indicating a positive trend. More dramatically, the share of women who claim at 62 has fallen from 52 percent to 31 percent. Still, overall, 54.6 percent of women claim before FRA.[9]

Claiming early eats into the retirement portfolio and results in smaller monthly benefits that may make a big difference in the latter years of life. Whether entering retirement before FRA is necessary or a choice, women need to assess all the alternatives and consider the financial impacts.

A husband's Social Security claiming decisions directly impact his wife—twice

In more than 52 percent of marriages, the wife is younger than the husband,[10] and many married women decide to retire when their husbands retire. It makes sense—they want to spend time together in the early (and often better) years of retirement.

Retiring early should not be a reason to start Social Security, but most people do just that. They retire from their jobs on Friday and claim Social Security on Monday. However, when a married man who is the higher earner decides to claim early, his Social Security capital also is reduced by up to 30 percent. In many cases, this man should strongly consider waiting until age 70 in order to maximize monthly income.

Yet, only 4.5 percent of men claim at age 70 or older.[11] In fact, in 2018, 49.7 percent of men claimed their Social Security benefit before FRA: 27.4 percent claimed at age 62. Only 19 percent claimed at FRA, and another 16.7 percent were disability conversions at FRA; 10.1 percent claimed between FRA and age 70.

The trends appear to be moving in a positive direction, but the fact remains that, by claiming benefits early, married men likely lock their wives into living with less Social Security income while they are both alive and if he leaves her widowed. Because women have greater longevity than men, women are the ones who bear the brunt of these untimely decisions by risking financial discomfort in their oldest decades.

IMPACT OF AN EARLY CLAIM ON THE HOUSEHOLD BALANCE SHEET

When a couple decides to retire at the same time, and the wife is younger than the husband, the claiming of Social Security benefits early can move a household from overfunded to constrained. The following hypothetical scenario helps illustrate how important it is to understand the consequences of an early claim on a retirement income strategy:

- John and Janet plan to retire when John is 65 and Janet is 62.
- They both work today; he earns $150,000 a year, and she earns $98,000 a year.
- Their total financial capital is $1.85 million.
- They save 10 percent per year in tax-deferred employer retirement plans.

They can certainly choose to retire when John is 65. But do they need to turn on Social Security at the same time?

Assume his PIA is $2,500 and hers is $1,800. When we look at their household balance sheet and consider the fundedness of their retirement income plan, waiting until FRA to claim Social Security yields an overfunded result: C/FC = 3.4 percent, below the 3.5-percent target,[12] and their overall financial capital and social capital are projected to last about 30 years.

However, they want to claim early to avoid withdrawing more from their personal portfolio in the early years of their retirement. As a result:

- John's benefit will be reduced about 13 percent to his new monthly payment of $2,167.
- Janet will take a full 30-percent cut on her monthly benefit. Instead of $1,800, her monthly payment will be $1,260.

All else being equal, by claiming Social Security early, this household drops from overfunded to constrained, and its 30 years of retirement income drops to just over 25 years. Between retiring early at age 62, and the strong possibility of living well into her 90s, this decision can be a costly one for Janet, especially during her oldest years.[13]

WIDOWHOOD AND FINANCIAL SECURITY

If John dies before Janet (he's older and actuarily more likely to die earlier), Janet will be in a precarious financial situation if she lives into her 90s. With significantly smaller Social Security payments, it's likely this couple will tap the portfolio from time to time so they can enjoy more out of retirement. Or they may have any number of unplanned medical or other expenditures. Regardless, his decision to claim early, and her decision to leave her job at age 62 and claim the least amount, put the overall household in a more tenuous financial position even while both are alive.

If John dies first, Janet becomes a surviving spouse and is eligible to receive his Social Security payment, which is the higher of the two. Instead of receiving her $1,260, she'll receive his $2,167, but the overall household income from Social Security drops from $3,427 to $2,167. She is left to manage her expenses with household Social Security income reduced by more than one-third (37 percent). She'll need to make up for this lost income out of her portfolio or by reducing her expenses.

The bottom line: A married woman faces a greater risk of financial insecurity in her old age based on the decision her husband made decades ago with his own Social Security claim.

CONCLUSION: WE CAN DO BETTER FOR WOMEN

A woman's financial security is often compromised by a series of unfortunate events:

- She earns less during her career because of the wage gap.
- If she becomes a mother, her Social Security benefits are smaller because of the mom gap.
- On average, she outlives her husband.
- She often accepts a lower Social Security benefit by claiming early.
- Her husband also claims early, reducing their retirement income while they both are alive and putting her in jeopardy if she becomes a widow.

The result is that she enters retirement with a less financially secure foundation and her final years in retirement may be financially fragile. Keep in mind that:

- 65 percent of Social Security beneficiaries older than age 85 are women
- 70 percent of Social Security beneficiaries older than age 90 are women
- 84 percent of the 66,000 centenarians receiving Social Security are women

Women on average live longer than men, and in old age their assets often are depleted by managing the needs of their ailing husbands and by decisions made decades earlier. By the time a woman becomes an elderly, unmarried female, will she be among the 46 percent who rely on Social Security for at least 90 percent of their income?

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ENDNOTES

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3. OASDI Current Pay Benefits, Table 5.A1.1, as of December 31, 2018. https://www.ssa.gov/policy/docs/statcomps/supplement/2019/5a.pdf.
4. Author's calculations based on Social Security's taxable wage base for years 1985–2019.
5. Gretchen Livingston, "Stay-at-home Moms and Dads Account for about one-in-five U.S. parents" (September 24, 2018), https://www.pewresearch.org/fact-tank/2018/09/24/stay-at-home-moms-and-dads-account-for-about-one-in-five-u-s-parents/.
6. Author's calculations.
7. Author's calculations.
8. Author's calculations.
9. Social Security Administration, Master Beneficiary Record. Table 6.B5. Data through December 2018.
10. U.S. Current Population Survey, ages of heterosexual married couples, 2013.
11. See endnote 9.
12. C/FC is consumption divided by financial capital. This is a key metric in the RMA® curriculum.
13. Author's illustration and estimates.

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