Social Security:
Evaluating Policy Reforms

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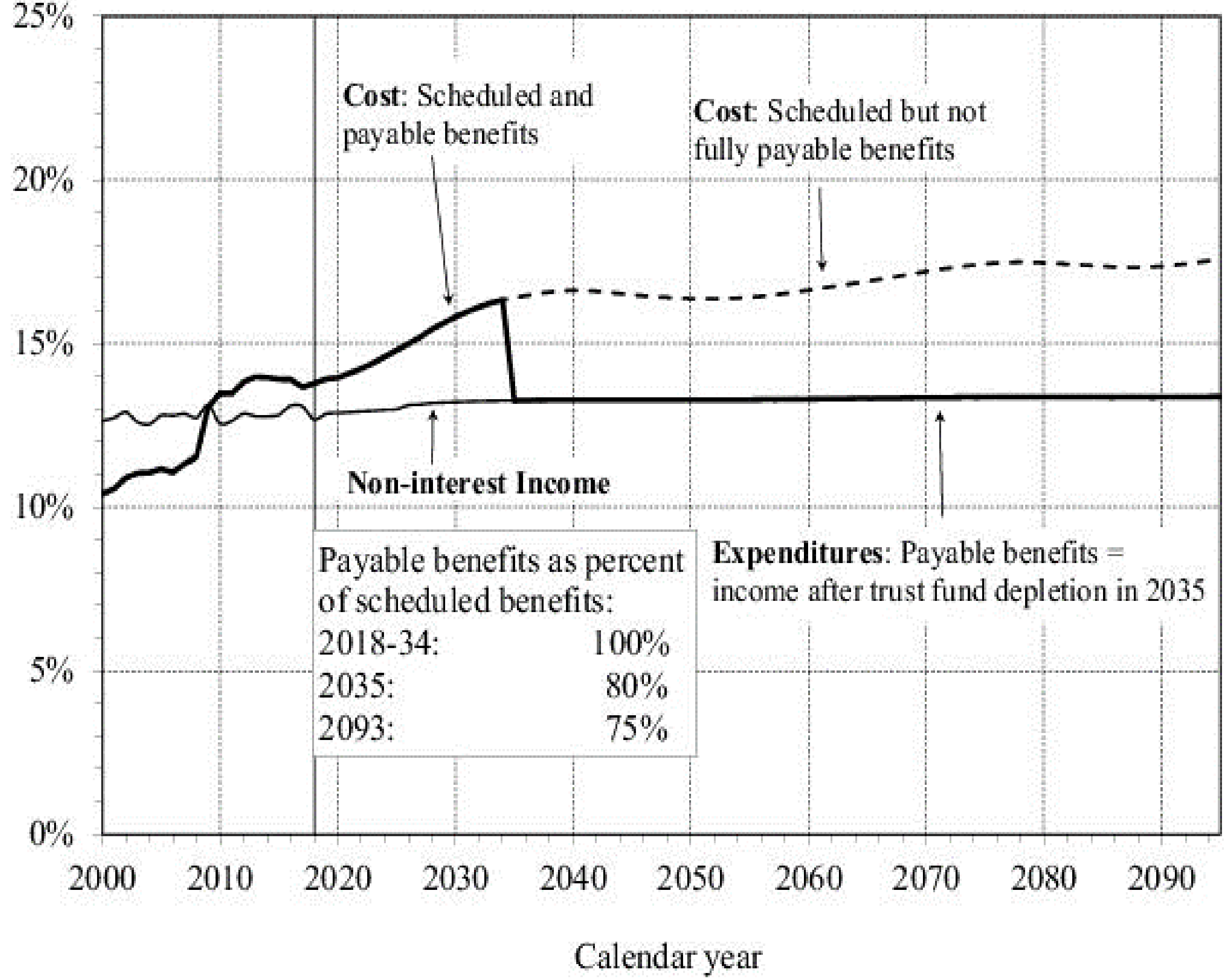
Things that Would Be Fixed in a Perfect Policy World

1) Actuarial imbalance (long term = 75 yrs)
2) Structural (permanent) imbalance
3) Excess cost growth
4) Inequitable treatment of younger generations
5) Work and saving disincentives
6) Haphazard, ineffective, and sometimes unfair/regresssive income redistribution

Issues 1&2: The Social Security Financing Shortfall

(Income, Costs and Expenditures Expressed as a % of US Workers' Taxable Wages)



Time Is Running Out to Maintain Solvency

(Requirements to maintain solvency of hypothetical combined trust funds for 75 yrs)

Choices today:

1) Payroll tax rate 12.4% → 15.1%
2) Cut benefits 17% for all beneficiaries, including those already collecting
3) Reduce scheduled benefits 20% for future beneficiaries
4) Combination of above approaches

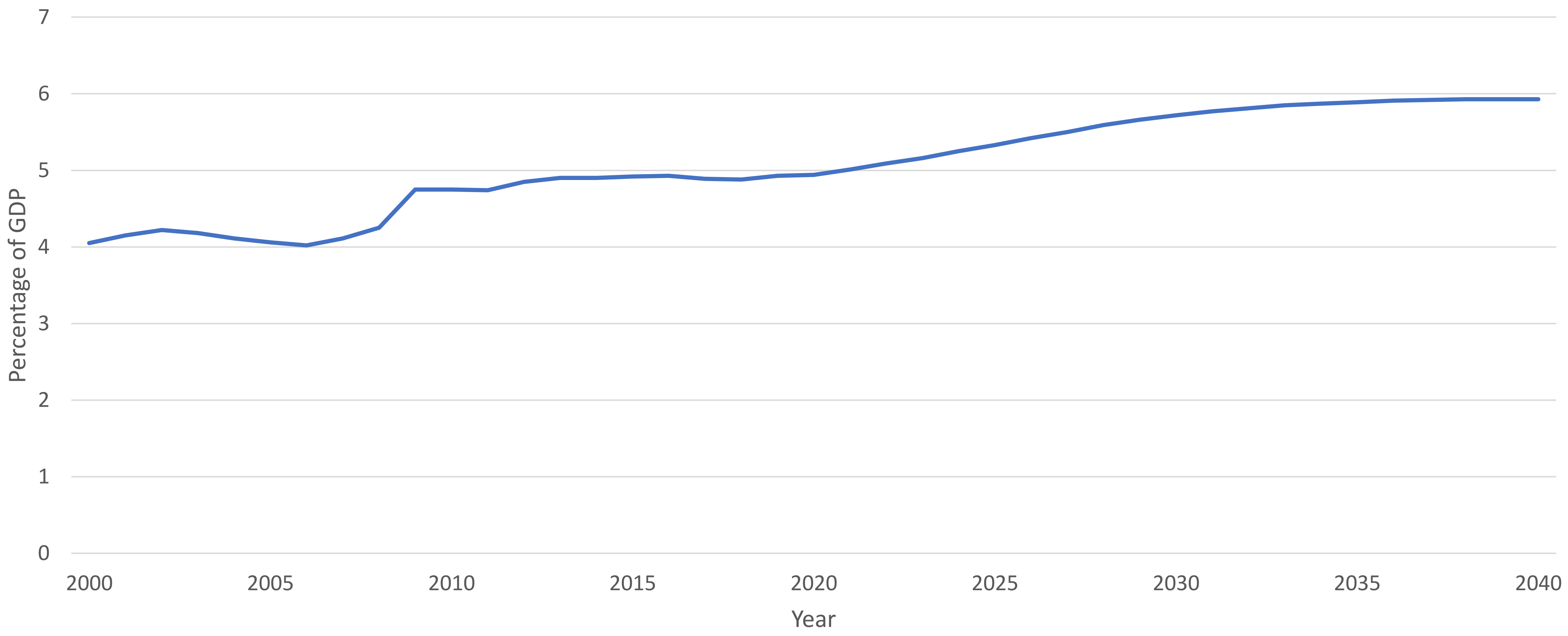
Repairs today already require total changes much more severe than those enacted in 1983.

Choices in 2035:

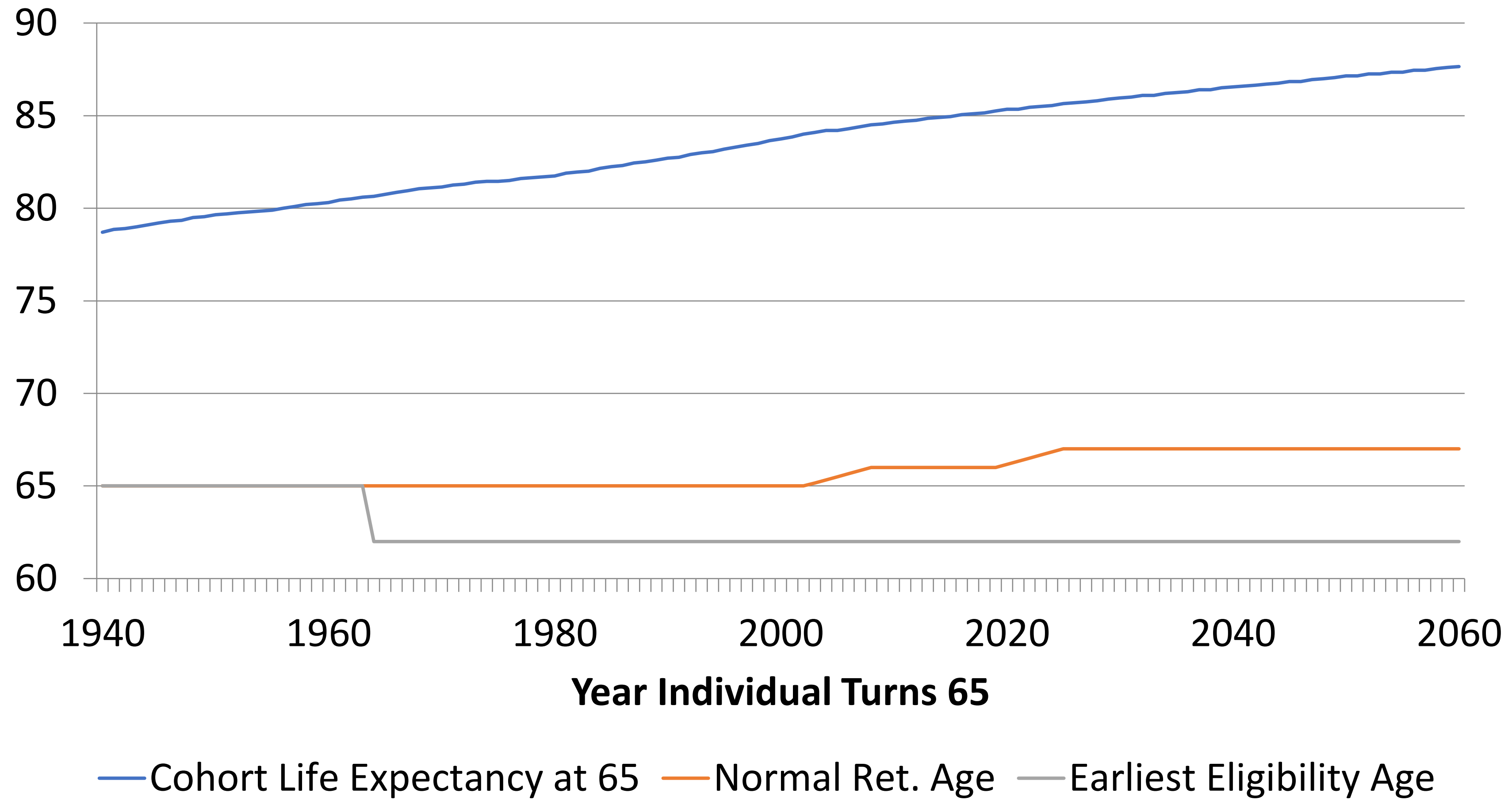
1) Payroll tax rate 12.4% → 16.1%
2) Cut benefits 23% for all beneficiaries, including those already collecting
3) Required reductions if confined to future beneficiaries > 100%!

Issue 3: Soc. Sec. Costs Rising Faster than Economic Output

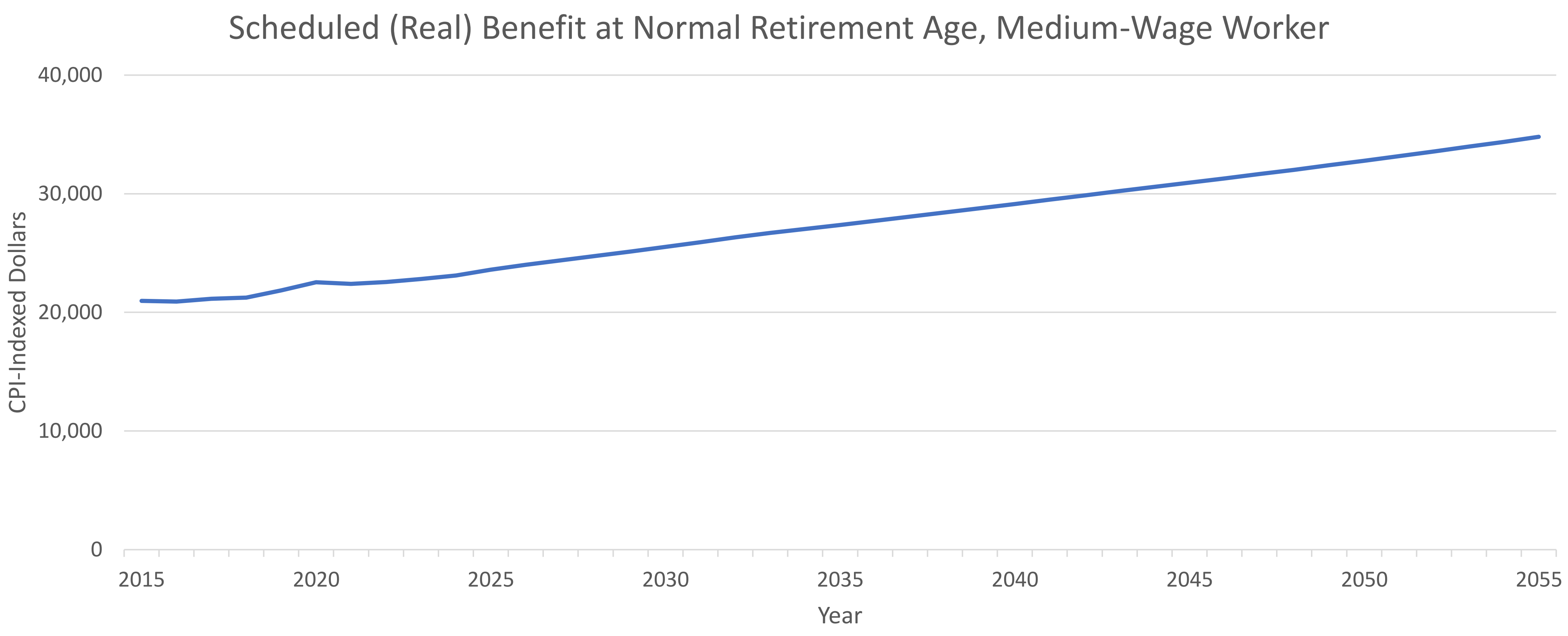
(Combined Program Costs as a % of GDP)



Eligibility Ages Don't Reflect Population Aging, So Individuals Are Collecting Benefits for Longer

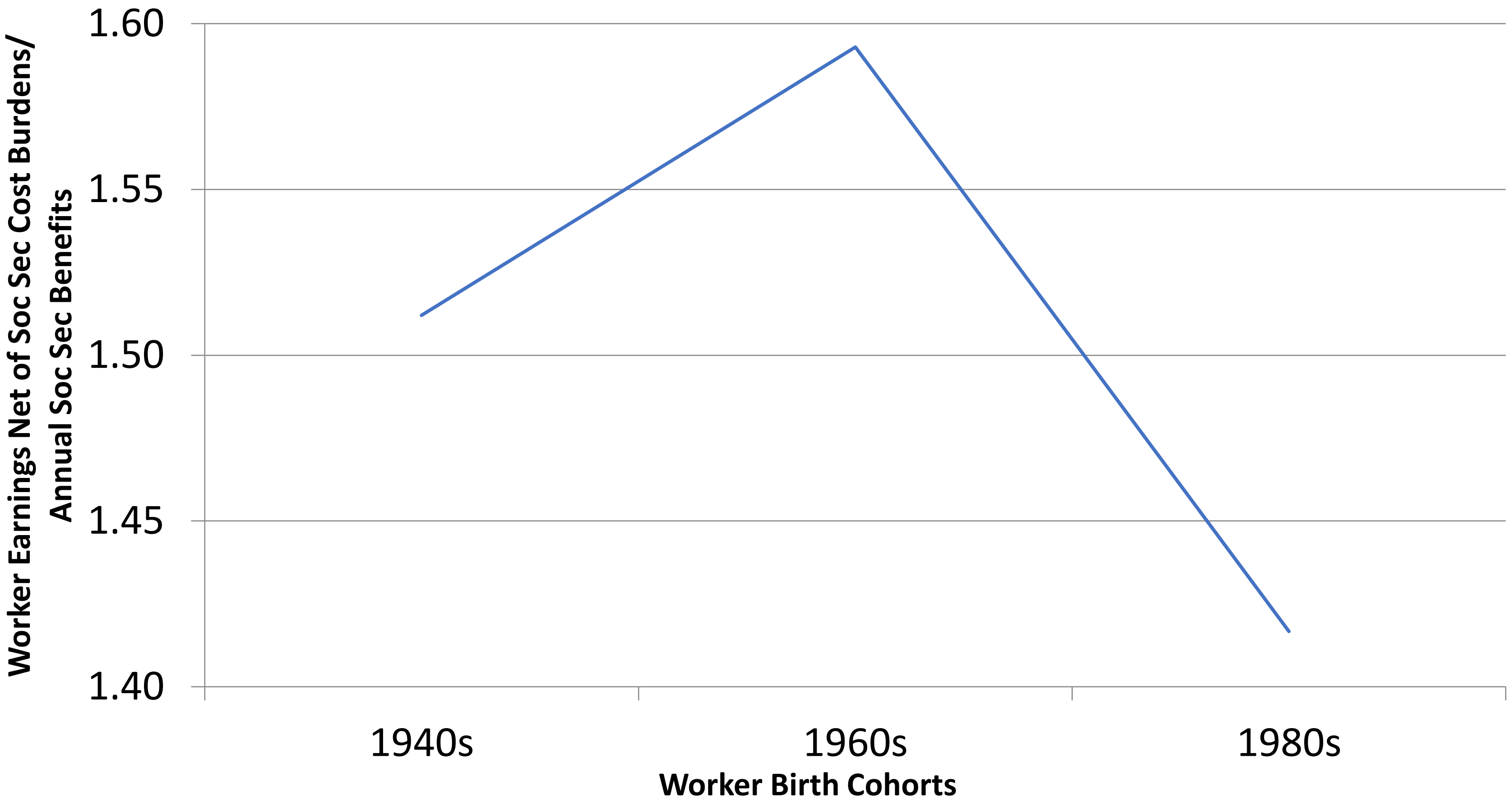


Soc. Sec Pays Rising Benefits Per Capita



Benefit & Cost Growth Rates Lowering Younger Workers' Standards of Living Relative to Retiree Beneficiaries

(Median ratio of CPI-adjusted earnings (net of Soc Sec costs) ages 22-61, to scheduled Soc Sec benefits)



Sources: CBO, Trustees' Report

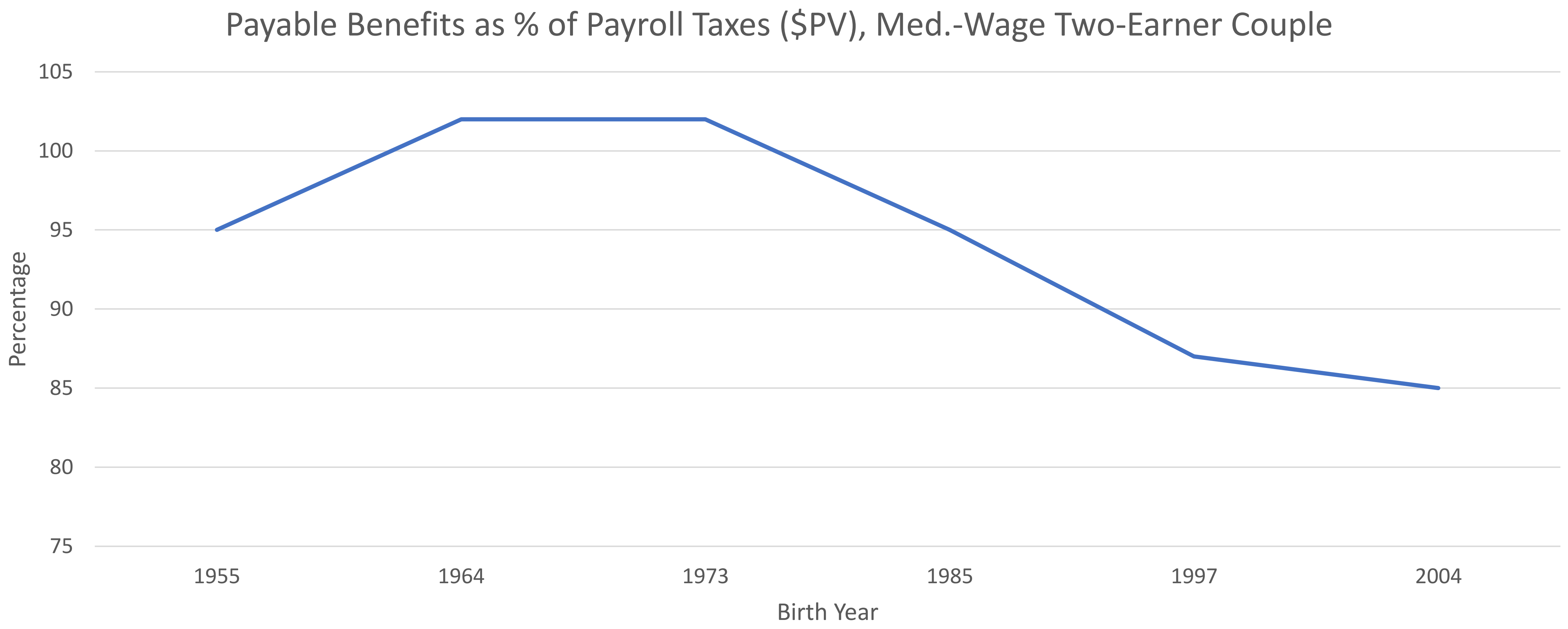
Issue 4: Younger Generations Losing Net Income through Soc. Sec.

Actuarial Shortfall Consists Primarily of Benefits Exceeding Taxes for Those Already in the System

(All quantities given as a % of future worker wages)

a) Cost of financing future benefits for current participants	**7.0%**
b) Surplus tax income paid by current/past participants to date (current trust fund)	0.2%
c) Projected future tax income from current participants	3.4%
d) <u>Net income loss for those now entering the workforce</u>, if currently scheduled benefits are paid (= a – b – c)	<u>3.4% (of wages)</u>

If Current Participants Do Not Contribute to Solution, Younger Generations Pay More Than They Receive



Note: This graph understates actual declines in money's worth for later generations because it only accounts for payroll tax contributions. It does not model incidence of tax burdens of financing 2011-12 general revenue subsidies or redemptions of trust fund assets.

Issue 5: Work Disincentives

Social Security's benefit formula is characterized by <u>two key features</u>:

-- Benefits are based on <u>average</u> (indexed) career earnings over 35 years.

-- It is <u>progressive</u>, paying higher returns at lower earnings levels.

<u>Consequences</u>:

-- After working >35 yrs, there is <u>little added benefit</u> for continued work, so people stop.

-- A sporadic high-wage worker is <u>indistinguishable</u> from a career low-wage worker, so both gain.

-- Also creates inequities for those moving in/out of coverage, necessitating adjustments like WEP.

Also, actuarial adjustments for early/delayed benefit claims do not account for additional payroll taxes paid while working: this is another reason <u>working seniors often pay substantial additional taxes without seeing an increase in lifetime benefits</u>.

<u>Consider changing</u>: PIA formula, early/late claim adjustments, lump sums, earnings test, "paid up" status.

Savings Disincentives

Most economists find Soc Sec lowers net national saving.

To the extent Soc Sec taxes rise, individuals' abilities to save are reduced. To the extent Soc Sec benefits grow, incentives to save for retirement are also reduced. Empirical observations confirm this.

Retirement experts generally recommend saving enough to finance total retirement income equal to ~70-80% of pre-retirement earnings.

CBO reports that for workers born in the 1960s, Social Security by itself replaces 80% of real earnings from ages 22-61 on average, for those in the lowest income quintile.

Policy makers must determine the optimal balance between Social Security (mandatory/no saving), and other retirement income sources (personal discretion/net saving).

Issue 6: Redistribution Poorly Targeted for Need

The System Does not Reliably Distinguish Low-Income Households

Examples:

1) High-income one-earner couples receive higher rates of return than medium-income two-earner couples or single heads of household, despite progressive benefit formula.

2) Of individuals defined as having “very low” income and 20 years of earnings:

-- 38% are also entitled to benefits based on a higher-earner’s contributions

-- 16% are subject to WEP offset (i.e., have other income as a state/local worker)

-- 21% are foreign born (i.e., likely earned other wages abroad that aren’t tracked)

-- only 31% are actually likely to be primary workers in low-income households

However, because the system misidentifies all such individuals as low-income people due to their incomplete earnings histories, it redistributes income in their favor.

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