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POLICY BRIEF
COVID-19 RESPONSE

How COVID-19 Is Affecting Social Security Benefits, and What to Do about It

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The economic contraction precipitated by the COVID-19 crisis is causing severe problems in Social Security. These problems include further weakening of Social Security finances, as payroll tax collections plunge during the recession, and a sharp decline in benefits for those eligible to begin collecting Social Security old-age benefits two years from now.[1] To their credit, members of Congress are studying this unfolding crisis, and some are stepping forward with proposed responses.[2] Many of these problems have their roots in Social Security law long predating the COVID-19 crisis, and they are simply being exacerbated or exposed by current conditions. Unfortunately, it is too easy for elected officials to react in a way that makes Social Security's various problems even worse, as a recently introduced House bill—H.R. 7499, the Social Security COVID Correction and Equity Act—would do. This policy brief explains the latest crises as well as other persistent problems facing Social Security and offers guidance on how to address them.

SOCIAL SECURITY PROBLEMS EXPOSED AND EXACERBATED BY COVID-19

One long-standing Social Security problem made worse by the COVID-19 crisis is easy to understand. Social Security faces future insolvency, a looming crisis that was already large, getting larger, and becoming increasingly urgent even before the recession hit. I have written at the Mercatus Center's blog, *The Bridge*, on how continued delay in aligning Social Security's benefit and tax schedules will jeopardize the federal government's ability to maintain the program under the financing framework by which it has operated since Franklin D. Roosevelt's time and which has enabled its beneficiaries to have confidence that it will provide income security during retirement.[3] The current recession shrinks Social Security's payroll tax revenue base, rendering its financing shortfall even more immediate and in greater need of prompt correction.

A second problem being exposed by the COVID-19 crisis has origins less well known. Owing to the quirks of Social Security's benefit growth formula, individuals born in 1960 who become eligible to claim retirement benefits in 2022 now face a large, permanent cut in their lifetime Social Security benefits (Andrew Biggs estimates the cut to be about 13 percent).[4] Very simplified, the reason COVID-19 would dramatically cut these retirees' benefits is that Social Security's initial benefit levels are indexed under law to the level of growth in the national Average Wage Index (AWI).[5] Normally, the AWI grows faster than price inflation, which means that initial benefit levels grow in real terms from one cohort of retirees to the next. But this year the AWI is plunging, meaning that without legislative action, one unlucky cohort of retirees will see its Social Security benefits sharply and permanently reduced.

To review the complexities of Social Security's quirky current benefit indexing methods would far exceed the scope of this policy brief. Suffice it to say that Social Security's current indexing methods are problematic, which the recent economic contraction is simply exposing.[6]

One problematic consequence of the current benefit formula, however, is obvious: those born in 1960 don't suddenly have lessened retirement income needs simply because worker wages have plummeted this year. But the current formula would cut their benefits as though they do. What is required to ensure these retirees' income security is protection from price inflation. Tying the growth of Social Security's benefit formula to the AWI thus creates problems from two directions at once: when wages go down, it penalizes retirees by cutting their benefits—and when wages go up faster than price inflation, benefits also go up faster than the prices retirees face, making the system more expensive and pushing it closer to insolvency.[7]

Technical flaws in the current formula cause a number of other problems, too—again, these exceed the scope of this brief. But among them are work and savings disincentives, persistent depression of workers' living standards relative to those of beneficiaries, and increased dependence on Social Security as national earnings grow, rather than decreased dependence, as one would expect from an income insurance program. Given all this, it's no surprise that before Social Security's indexing method was last changed in 1977, Congress's Consultant Panel recommended that Social Security benefit growth be linked to consumer price inflation, not to the AWI—a recommendation that was ignored by federal lawmakers.[8]

The Social Security problems being exposed and exacerbated by the current crisis are real and must be dealt with. Yet these are only the latest of many challenges facing the program. Social Security's costs are growing faster than US economic output, the program stands to impose substantial net income losses on younger workers, quirks in its design undermine personal saving as well as workforce participation by healthy Americans, it depresses the after-tax standards of living of workers relative to beneficiaries, and it contains pockets of regressive income redistribution that operate counter to widely shared goals. The Social Security problems unleashed this year are by no means the only ones that must be solved.

WHAT SHOULD BE DONE NOW?

Permanent benefit cuts of 13 percent for the class of retirees born in 1960 are unfair and unlikely to be acceptable to lawmakers. This raises the question of what, specifically, should be done about the problem. The answer is perhaps best divided into three components:

1. Best options—what would be done if lawmakers sought the best policy outcome and were able to negotiate a comprehensive solution representing a middle ground between policy preferences on opposite sides of the political aisle.
2. Fallback options—a bare minimum of policy changes to avoid sudden benefit cuts, leaving other major problems to be solved soon thereafter.
3. Policy mistakes—damaging mistakes to be avoided in the course of pursuing a short-term fix.

Let's examine the best course first.

The ideal outcome would be bipartisan legislation to make Social Security sustainably solvent while improving equity in the distribution of Social Security benefits. A good bipartisan plan would include the following steps:

- Aligning the program's revenue and spending schedules, which, in order to receive bipartisan support, would likely require a balanced blend of program revenue (tax) increases and moderation of its rate of cost (benefit) growth
- Enabling the program to adequately serve all generations, which requires that current participants make a contribution to the solution so that younger workers aren't stuck with the entire bill for closing the shortfall
- Better targeting of the program's resources on economically vulnerable participants, by slowing the growth of benefits for higher earners and scaling back instances of regressive income redistribution
- Gradually adjusting eligibility criteria to limit the adverse effects of population aging upon tax burdens and annual benefit levels
- Instituting reforms to improve rewards for workforce participation and incentives for personal saving

As it happens, changing Social Security's benefit growth formula so that it grows with price inflation rather than AWI would advance several of these policy objectives simultaneously. It would spare retirees from real benefit cuts in the short run while producing substantial cost savings over the long run. It would lessen tax increases and eligibility age changes otherwise needed, as well as improve intergenerational equity, workforce participation, and savings incentives. It would, however, be a far-reaching change, best debated in the context of considering a comprehensive plan to shore up Social Security's finances.

Assuming that lawmakers cannot agree upon a comprehensive Social Security solution before they feel compelled to act, they will likely turn to the fallback option of a more narrowly targeted benefit fix. One attempt at a fix is included in Section 3 of H.R. 7499.[9] That particular version, however, has technical implications that lawmakers may wish to alter before enacting. For example, the bill would implicitly permit inconsistent methods for determining benefit levels, tethering them to AWI when wages and prices rise but untethering them when wages and prices fall. Whatever solution lawmakers decide upon should reflect a consistent policy for measuring income security needs, rather than an arbitrary decision to protect the purchasing power of some retiree cohorts more than others.

Above all, given Social Security's mounting challenges, it is essential that any legislated solution to COVID-19's effects on benefits not cause unnecessary damage to the program. Legislators may not be able to package a benefit fix within a comprehensive solution to all of Social Security's problems, but they should take care not to combine the fix with provisions that undercut the program's efficacy and financial integrity. At the very least, any legislation to protect retirees from benefit cuts should not be allowed to worsen Social Security's precarious finances. There are many commonsense reforms that could offset the cost of a near-term benefit patch without hastening program insolvency, including technical corrections to the COLA calculation and slowing the growth of benefits for certain high-income workers, high-income nonworking spouses, or both.[10]

DAMAGING MISTAKES TO AVOID

The most important rule when considering any Social Security legislation is the same as when practicing medicine: first, do no harm. Unfortunately, a bill recently introduced in the House of Representatives, H.R. 7499, would do substantial direct damage to Social Security. To begin with, it would finance an array of benefit increases with general government revenues rather than with the dedicated tax revenues of the Social Security system. This maneuver would negate the program's historical financing foundation, whereby Social Security is structured as a benefit earned by workers via their payroll tax contributions, which are held in separate trust funds. If instead a portion of Social Security benefits is financed with income taxes, the connection between the payroll taxes workers pay and the benefits they receive is severed. There is no particular reason why use of this gimmick should stop with this particular benefit increase, for it can be applied just as easily to currently scheduled benefits. Along this road, any reason to continue with a trust fund structure or even with the payroll tax itself would be eliminated, as neither would determine the amount of benefits Social Security pays.

One can certainly make an argument for doing away with our current Social Security financing system and merging it into the general fund to be financed by income taxes. However, such a system would be very different from what Social Security has always been. A fundamental change of this kind should only result from an open, comprehensive debate over the future of Social Security, with the public fully aware of and on board with any such transformation.

Because only about half of Americans pay federal income tax, any system financed by income taxes is inherently one in which many people receive benefits without having to pay in taxes to support them.[11] Accordingly, programs financed from the general fund tend to have eligibility rules very different from current Social Security—for example income tests—as well as more frequent changes in benefit levels. The worst possible choice in this context would be to retain a public facade of Social Security as an earned benefit financed by participant contributions while funneling general revenues through the back door in a manner that invalidates these representations to the public.

H.R. 7499 contains a number of other problematic provisions that should be excluded from a near-term benefit patch. It would cut income taxes on Social Security benefits, a measure which simultaneously reduces Social Security revenues, regressively benefits upper-income seniors, and worsens Social Security's already unequal treatment of different generations.[12] H.R. 7499 also contains a general benefit increase unrelated to the current crisis, which would worsen Social Security finances, further accelerate cost growth, undermine workforce participation and personal savings, and worsen intergenerational inequities. Lawmakers should not use the occasion of a public health crisis to jam through multiple provisions that both weaken Social Security finances and exacerbate its other policy challenges.

That said, H.R. 7499 contains other provisions worth considering at the right time and in the right context. It includes a minimum benefit increase that becomes more generous with each year of work, a good approach to constructing such an increase. It would also increase benefits for surviving spouses, which would target additional system resources to individuals at greater risk of poverty in old age. Such provisions should be on the table in any Social Security reform discussion, though they should be considered only within the context of a plan to make Social Security sustainably solvent on its own terms, without budget gimmicks.

CONCLUSION

Social Security faces a number of intensifying challenges, including its worsening financial outlook as well as quirks in its design that interfere with the advancement of its widely shared policy purposes. Some of these challenges are becoming urgent and immediate owing to the ongoing economic contraction. What Social Security needs most is comprehensive reform to achieve sustainable cost growth and solvency, improve intergenerational equity, repair workforce participation and savings incentives, and mitigate regressive income redistribution. An acceptable outcome would be to protect near-term retirees from sudden benefit cuts, paid for with prudent reforms to other aspects of Social Security. Above all else, lawmakers should avoid further worsening Social Security's financing integrity through hasty and damaging legislation.

ABOUT THE AUTHOR

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NOTES

1. Andrew G. Biggs, "How the Coronavirus Could Permanently Cut Near-Retirees' Social Security Benefits" (Wharton Pension Research Council Working Paper No. 2020-6, Pension Research Council, Wharton School, University of Pennsylvania, Philadelphia, April 3, 2020); see also Nikko Gladstone and Shai Akabas, "COVID-19 May Deplete Social Security Trust Funds This Decade," Bipartisan Policy Center, April 22, 2020, https://bipartisanpolicy.org/blog/covid-19-may-deplete-social-security-trust-funds-this-decade/.

2. The Impact of COVID-19 on Social Security and Its Beneficiaries, Hearing before the Social Security Subcommittee of the House Ways and Means Committee, 116th Cong. (July 17, 2020).

3. Charles Blahous, "Social Security Insolvency Is Rushing toward Us," *The Bridge*, Mercatus Center, April 24, 2020.

4. Andrew G. Biggs, "Coronavirus Recession Could Cut Social Security Benefits for Near-Retirees," Pension Research Council, Wharton School, University of Pennsylvania, April 7, 2020, https://pensionresearchcouncil.wharton.upenn.edu/blog/coronavirus-recession-could-cut-social-security-benefits-for-near-retirees/.

5. "Amounts That Change with Average Wages," Social Security Administration, accessed July 27, 2020, https://www.ssa.gov/OACT/COLA/wageindexed.html.

6. For those who are interested in learning more, a study I previously published with the Mercatus Center delves into some of these issues: Charles P. Blahous, "Understanding Social Security Benefit Adequacy: Myths and Realities of Social Security Replacement Rates" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, 2012).

7. This discussion simplifies the matter somewhat; wage-indexed benefit growth could be affordable with a stable tax rate in a system facing different demographics and with different eligibility rules than those of the United States, but the description above is accurate insofar as it describes the US Social Security system and the demographics and eligibility rules within which it operates.

8. Consultant Panel on Social Security, *Report of the Consultant Panel on Social Security*, 1976. "This Panel gravely doubts the fairness and wisdom of now promising benefits at such a level that we must commit our sons and daughters to a higher tax rate than we ourselves are willing to pay."

9. Social Security COVID Correction and Equity Act, H.R. 7499, 116th Cong. (July 9, 2020).

10. Social Security Administration, "Office of the Chief Actuary's Estimates of Individual Changes Modifying Social Security," https://www.ssa.gov/OACT/solvency/provisions/index.html.

11. Philip Stallworth and Daniel Berger, "The TCJA Is Increasing the Share of American Households Paying No Federal Income Tax," *TaxVox*, Tax Policy Center, September 5, 2018.

12. OASDI Board of Trustees, *The 2020 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, April 2020.