Social Security: Options for the Future

Discussion of Henry J. Aaron’s Reform Proposal

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What is the purpose of Social Security?

- Insures against outliving one’s savings.
  - Of particular importance to middle- and working-class household with limited savings.
    - 401(k)-type plans will provide under $8,000/year for a typical 65-year-old couple.
    - More than half of workers have no private pension plan.
    - 34 percent of the workforce does not have savings specifically set aside for retirement.
  - Provides return not sensitive to equity or bond market fluctuations – valued more than ever after the Great Recession.

- Insures against the possibility one cannot work or an early death will leave one’s family with insufficient income.

- Fiscal instability of Social Security under current law threatens both of these vital roles.
Social Security and the modern economy

- **Demographic changes**
  - Life expectancies are increasing, but largely among higher income:
    - Aaron plan appropriately improves the progressivity of the benefit formula and boosts the minimum benefit.
    - Should better target benefit increases to long-lived through means-testing.

- **Inequality**
  - Higher income workers are the most likely to receive benefits like healthcare – including this compensation in the tax base is sensible.
  - Recent growth of capital share among those at the top of the income distribution – maybe not tax them for Social Security but Medicare.

- **Rising, cyclical role of DI**
  - DI applications rise with the unemployment rate; few subsequently leave DI.
  - Reform should consider ways to encourage exit when possible.
Thinking carefully about tax increases

- Universality and a tight linkage between benefits and taxes are hallmarks of Social Security.
  - Efforts to raise revenues without increasing benefits (necessary for solvency) weaken this link.
  - Tread carefully!

- General revenues will be part of the solvency equation.
  - No need to name specific taxes like the Gift and Estate Tax – only further complicates comprehensive tax reform.
“Social Security is Grenada; Medicare is Vietnam.”
- Douglas Holtz-Eakin, former Director, CBO

- Entitlement spending is growing, not because of increased generosity but because of population aging and health cost increases.
- Entitlement solvency hinges on bending the health-care cost curve.
  - Medicare has been a leader here - reforms to payments and reformed benefit structures in Medicare could do more to hold down its future costs.
- Our entitlements (with some benefit reform) are affordable, but starting with massive tax cuts does not help us keep these promises.