

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.

Considering entitlements more broadly

▣ “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.