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# Strengthening Social Security for the Long Run

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Summary

In policy discussions regarding the long-term financing of Social Security, the reforms enacted in 1983 often are held up as a model of balanced political compromise. But that is not exactly what happened. Only the short-term reforms, aimed at getting the program safely through the 1980s, contained a mix of changes that affected contributors and beneficiaries more or less evenly. The piece that Congress added to address the remaining long-term shortfall was not a compromise: it was solely a benefit cut that is still being phased in today. This brief describes the actions taken in 1983; examines why there is growing concern about the inadequacy of Social Security benefits going forward; documents the strong public support for maintaining and improving the program; suggests some ways in which benefit adequacy can be modestly enhanced at affordable cost; and outlines an example of a 75-year financing plan to strengthen Social Security for the long run.

## What happened in 1983?

Social Security faced an immediate funding crisis in 1983 for the first and only time in its history. The crisis was caused by short-term economic conditions – the runaway inflation, high unemployment, and slower than anticipated wage growth of the late 1970s and early 1980s.

Automatic cost-of-living adjustments (COLAs) were added to Social Security in 1972, and the first such adjustment took effect in 1975. COLAs were designed to maintain the purchasing power of benefits as the cost of living rose. They did that for beneficiaries, but a flaw in the formula caused benefits for individuals becoming newly eligible to rise faster than intended. In 1977, Congress corrected that over-indexing problem. Then the nation encountered the extraordinarily high inflation of the late 1970s and early 1980s, coupled with high unemployment and slow wage growth. For four years running, 1979 through 1982, prices grew faster than average wages, and Social Security's outgo for benefits plus COLAs outpaced income from Federal Insurance Contributions Act (FICA) contributions.[1] By 1981 it was clear that, in the absence of action, the program could not pay all benefits due in 1983.

In May 1981 the Reagan administration proposed large near-term cuts in retirement and disability benefits. Congressional leaders on both sides of the aisle quickly and overwhelmingly rejected that

1 The 1983 amendments included a provision safeguarding against this happening in the future, by limiting benefit increases to the lesser of wage or price increases, under certain conditions.

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plan. The President then proposed a bipartisan commission to address the problem, and Speaker of the House Tip O'Neill (D-MA) accepted this idea. The National Commission on Social Security Reform, chaired by Alan Greenspan, was instructed to issue recommendations by December 31, 1982, after the 1982 mid-term elections.

## The short-term deal

The Greenspan Commission did not reach an agreement before the deadline. It did, however, agree on the size of the short-term problem. Between $150 and $200 billion in new income and/or reduced outgo was needed to securely finance Social Security through 1989 (National Commission, 1983). In 1990 the Social Security FICA rate for employers and employees was already scheduled by law to rise to 6.2 percent (Table 1). The 1990s also would bring favorable demographics as the larger-than-average baby boom generation (born between 1946 and 1964) would be reaching their peak earnings years. Their FICA contributions would be more than enough to cover the cost of benefits payable to the smaller-than-average Depression-era generation that would be collecting benefits.

**Table 1. Social Security Contribution Rates Before and After the 1983 Amendments (Percent of earnings for employees and employers, each)**

| Year | Prior Law | 1983 Amendments |
|---|---|---|
| 1983 | 5.40 | 5.40 |
| 1984 | ″ | 5.70 |
| 1985 | 5.70 | ″ |
| 1986 | ″ | ″ |
| 1987 | ″ | ″ |
| 1988 | ″ | 6.06 |
| 1989 | ″ | ″ |
| 1990 and thereafter | 6.20 | 6.20 |

Source: Svahn and Ross, 1983.

After President Reagan extended the commission's deadline by two weeks, a subgroup of commission members led by former Social Security Commissioner Robert M. Ball (representing Speaker O'Neill) began secret meetings with White House Chief of Staff James A. Baker. The subgroup of negotiators included Senators Daniel Patrick Moynihan (D-NY) and Robert Dole (R-KS) and the chairman, Alan Greenspan. As proxies for Reagan and O'Neill, Baker and Ball developed a bipartisan agreement to avert the short-term crisis. The Greenspan Commission then accepted their plan.

The plan extended Social Security coverage to newly hired federal employees and to employees of nonprofit organizations. The new coverage strengthened Social Security finances in the near term because contributions from those workers would start immediately; eventually the newly covered workers would also become entitled to benefits. The plan also prohibited state and local governments already participating in the program from terminating coverage of their workers.

The changes that affected beneficiaries called for delaying by six months the cost-of-living adjustment due in July 1983 (thus affecting COLAs in all future years) and taxing benefits paid to upper-income beneficiaries with the proceeds to be credited to the Social Security trust fund. From a budget perspective, the latter change could be seen as either a revenue increase or a benefit cut. From a social insurance perspective – which emphasizes consequences for contributors, on the one hand, and beneficiaries on the other – the change in tax treatment is experienced as a reduction in net income for the beneficiaries who are affected.

On the contributor side, the commission called for increasing the tax rate for the self-employed and speeding up increases in Social Security FICA taxes that were already scheduled in the 1980s (as shown in Table 1). It also recommended a lump-sum contribution from the government in its role as employer, to pay for past service credits for members of the armed forces.

The commission's short-term plan was subsequently enacted by Congress. Its impact on short-term finances is detailed in Table 2. Of the changes:

- 16 percent of the solution came from the coverage extension affecting new contributors and future beneficiaries;
- 39 percent came from net benefit reductions affecting beneficiaries; and
- 45 percent came from new contributions from workers, employers, the self-employed, and the government in its role as employer of military personnel.

**Table 2. Impact of 1983 Legislation on Near-Term Social Security Finances, 1983-1989**

| Provision | Change in Funds (billions) | Percent of Solution |
|---|---|---|
| **Net funding goal for 1983-1989** | **$166.2** | **100** |
| **Coverage extensions** | **26.0** | **16** |
| Cover new federal employees | 9.4 | |
| Cover non-profit employees | 12.4 | |
| Prohibit state and local terminations | 4.2 | |
| **Changes affecting beneficiaries** | **64.6** | **39** |
| Delay COLA by 6 months | 39.4 | |
| Make up to half of benefits taxable if income exceeds threshold | 26.6 | |
| Other reductions | 0.3 | |
| Benefit increases | -1.7 | |
| **Changes affecting contributors** | **74.0** | **44** |
| Accelerate scheduled FICA rate increases during the 1980s | 39.4 | |
| Increase self-employment rate and adjust self-employment taxable income | 18.5 | |
| Accelerate federal payments for military service credits | 16.1 | |
| **Other: Payments to trust funds for uncashed checks** | **1.6** | **1** |

Source: Svahn and Ross, 1983.

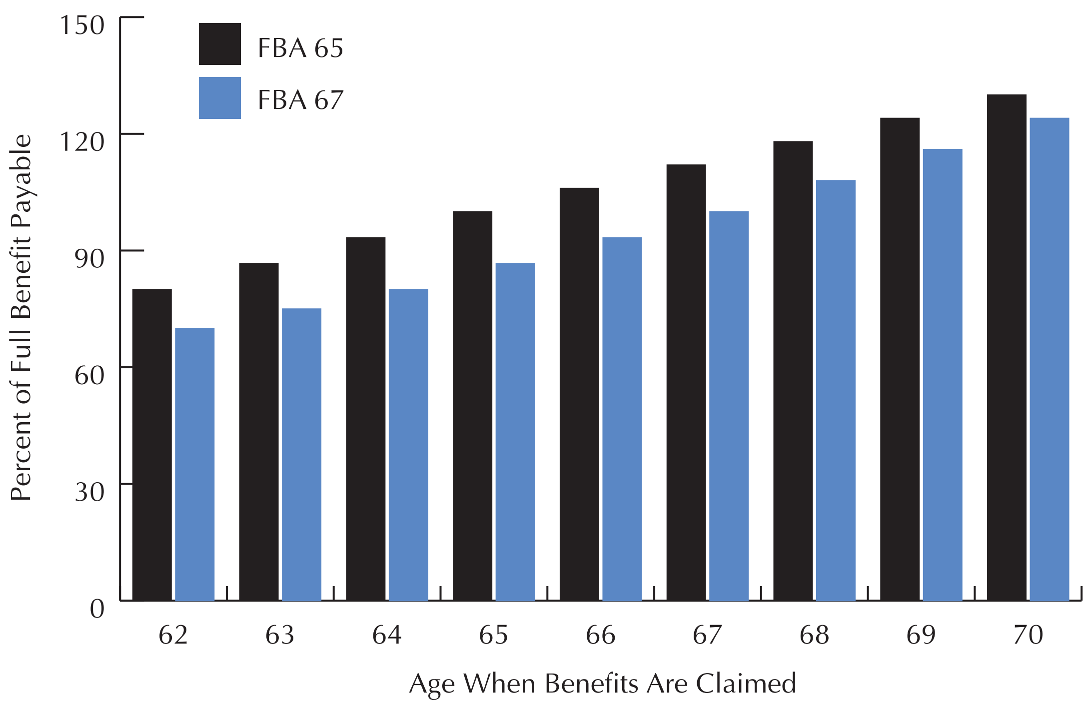
## *Resolution of the long-term impasse*

Social Security's actuaries estimated that the short-term package would eliminate about two-thirds of the projected long-term shortfall expected to develop over the next 75 years. The total shortfall was estimated to be 2.09 percent of taxable payroll (that is, of earnings covered by the Social Security system) over that period. The Greenspan Commission could not agree on how to eliminate the remaining third of the long-term shortfall, which was due largely to demographics: lower birth rates, the retirement of baby boomers, and gradual increases in average life expectancy. Five of the Democrats on the commission, led by Ball, recommended scheduling a FICA rate increase to take effect in 2010 as the boomers began to retire. Republicans and one Democrat recommended reducing future benefits by gradually increasing the age at which full retirement benefits would be paid (National Commission, 1983; Ball, 2010).

The long-term impasse remained when the commission's recommendations went to Congress. Speaker O'Neill maintained that the projected long-term shortfall did not need to be addressed immediately (Ball, 2010). He considered it far more urgent to enact the short-term package to ensure that all benefits would be paid on time in 1983 and for decades thereafter. However, others argued that Congress would be remiss not to address also the long-term needs of the program. If further action were to be taken, O'Neill favored Ball's proposal to schedule a FICA rate increase in 2010 (Ball, 2010). However, in deliberations in the House, Social Security Subcommittee Chairman Jake J. Pickle (D-TX), Ways and Means Committee Chairman Dan Rostenkowski (D-IL), and other Democrats supported increasing the full-benefit retirement age from 65 to 67, with the change to be phased in during the first quarter of the 21st century. Congress adopted the retirement-age increase, and it became part of the Social Security Amendments of 1983 that President Reagan signed into law. The completed package not only met the immediate crisis facing the program, but also resulted in building up a substantial reserve available for the first decades of the retirement of the baby boom generation.

The increase in the full-benefit age has the effect of an across-the-board cut in retirement benefits at any age benefits are claimed, as illustrated in Figure 1. For example, when the full-benefit age was 65, benefits claimed at 62 were reduced to 80 percent of the full amount. In 2022, when the full-benefit age is raised to 67, benefits claimed at 62 will be reduced to 70 percent of the full amount. When the full-benefit age is 67, benefits claimed at ages 62-66 will be about 12-14

**Figure 1. Increase in Full-Benefit Age (FBA) Lowers Benefits at Any Age They Are Claimed**




FBA-65 benefit adjustments are for persons born in 1936.

FBA-67 adjustments are for those born in 1960 or later.

Source: Reno, 2008.

percent lower than they would have been without this change in the law (Reno, 2007). Similarly, at older ages benefits will also be lower than they would have been without the increase in the full-benefit age.

With the increase in the full-benefit age included, the law's combined impact on long-term finances is detailed in Table 3. The long-term savings were derived as follows:

- 20 percent from coverage extensions affecting new contributors and beneficiaries;
- 70 percent from net reductions affecting beneficiaries; and
- 10 percent from contribution increases from workers, employers, the self-employed and the government in its role as employer of military personnel.

**Table 3. Impact of 1983 Legislation on Long-Term (75-year) Balance (Balance expressed as a percent of taxable payroll)**

| Provision | Change to the balance | Percent of solution |
|---|---|---|
| **Long-term balance (shortfall)** | **-2.09** | |
| **Coverage extensions** | **0.44** | **20** |
| **Changes affecting beneficiaries** | **1.48** | **70** |
| Delay COLA by 6 months | 0.30 | |
| Tax up to half of benefits if income exceeds threshold | 0.61 | |
| Raise full-benefit age from 65 to 67 | 0.71 | |
| Eliminate "windfall" benefits | 0.04 | |
| Increase delayed retirement credits and modify earnings test | -0.11 | |
| Increase benefits for widowed and divorced spouses | -0.07 | |
| **Changes affecting contributors** | **0.22** | **10** |
| Accelerate scheduled FICA tax rate increases in the 1980s | 0.03 | |
| Increase self-employment (SE) tax rate and adjust SE taxable income | 0.16 | |
| Cover employee contributions to 401(k)s | 0.03 | |
| **Total effect of all the provisions** | ***2.09** | **100** |

*The total differs from the sum of the individual provisions because of interaction effects.

Source: Svahn and Ross, 1983.

To recap, the Greenspan Commission's solution for the short-term was a reasonably balanced mix of contribution increases and reductions in benefits to get Social Security safely through the 1980s. To address the remaining long-term shortfall, Congress then added a further benefit reduction in the form of increasing the full-benefit age to 67, but did not provide any new balancing contributions from workers and employers to help address 21st century demographic challenges. Now, with the long-term benefit reductions starting to be felt by a growing segment of older Americans, it is timely to consider whether Social Security benefits will be adequate going forward.

# Should benefit inadequacy be a concern?

In contemplating the need to strengthen Social Security for the long run, there are at least three reasons to be concerned about the inadequacy of benefits going forward. First, benefits today are quite modest, yet they are the main source of income for most of the elderly. Second, benefits as a percent of prior earnings are projected to decline in the future. Third, other sources of retirement income are becoming less secure and less adequate.

## *Social Security benefits today are modest*

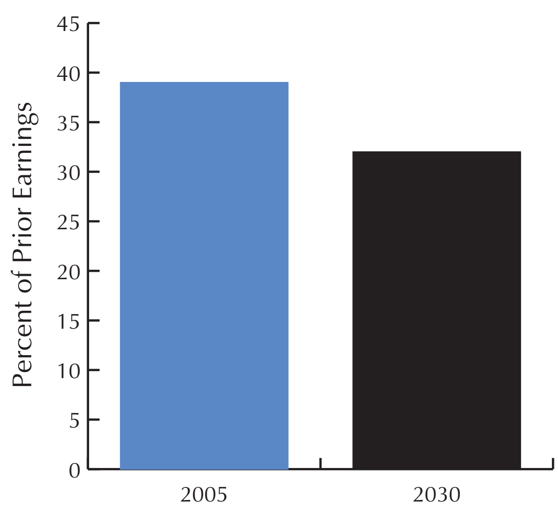
The average annual benefit in 2010 is about $14,000 – much less than is needed to maintain an adequate standard of living in most areas of the country. For example, an elderly renter living alone typically needs about $20,330 a year to make ends meet, according to a newly developed Elder Economic Security Standard (Wider Opportunities for Women, 2010). Today a full-time worker being paid the federal minimum wage and retiring at age 62 would receive a monthly benefit ($680) that falls short of meeting the poverty line ($902) by about 25 percent (Social Security Administration, 2010a).

Although benefits are modest, they are the largest source of income for the great majority of the elderly. For 64 percent of elderly beneficiaries, Social Security provides more than half their total income; for 34 percent, benefits constitute almost all (90 percent or more) of their income (Social Security Administration, 2010b).

## *Replacement rates will decline*

Social Security benefits are intended to replace a percent of prior earnings. Replacement rates have been fairly stable for the past 25 years, but net replacement rates are now declining and will continue to decline in the future, for two reasons.

**Figure 2. Social Security Replacement Rate, 2005 and 2035**
**Average Earner at Age 65**
**After Medicare Part B Premium**




Source: Munnell and Sass, 2006.

First, the scheduled increase in the age of eligibility for full benefits from 65 to 67 will gradually lower benefits at any age when they are claimed, as previously noted. Second, Medicare Part B premiums (deducted directly from benefits) will take a bigger bite because premiums go up with the cost of health care, which is projected to rise faster than Social Security benefits.

Social Security benefits for an average earner retiring at age 65 in 2005 replaced 39 percent of prior earnings after Medicare premiums were deducted. By 2030 this net replacement rate is projected to drop to 32 percent (Figure 2).

### *Other sources of retirement income are becoming less secure*

Social Security was never intended to be a complete retirement program, but rather to provide a base upon which wage-earners could build. It has long been thought of as one leg of a three-legged stool, with pensions and personal savings serving as the other two legs. Today, however, Social Security is the only leg of the stool that remains sturdy.

Defined-benefit pension plan coverage has declined to about 20 percent of the private-sector workforce as many of these plans have been frozen, scaled back, phased out, or put at risk as the result of corporate mergers and bankruptcies (U.S. Bureau of Labor Statistics, 2008). The alternatives increasingly preferred by employers – defined-contribution plans, such as 401(k)s, which shift financial responsibility and risk to employees – have had a similarly troubled history. Many such plans, often modest in size to begin with, have lost value because of stock-market volatility, cutbacks in employers' matching contributions, and early withdrawals by workers, with the result that many individuals' 401(k) accounts contain insufficient funds to yield meaningful lifetime annuities.

Personal savings, chronically low in the United States for many years, have suffered further from the recent collapse of the housing market, because home equity has traditionally been a principal form of personal savings. The deep recession and stubbornly high unemployment have made matters worse, particularly for laid-off workers in their 50s, who face the possibility of not recovering their earning power and thus being unable to save toward retirement. In many cases this creates pressure to claim Social Security earlier than they had planned, and therefore at permanently reduced benefit levels.

In contrast to the other two legs of the retirement stool, Social Security is clearly a success. In its 75-year history it has never missed a payment. Without it, nearly one out of every two elderly Americans would be impoverished today; with it, about one in ten is poor (Van de Water and Sherman, 2010). Unlike the other two legs of the three-legged retirement stool, Social Security protects young families as well. About 9 percent of all children live in families that derive part of their income from Social Security. The program lifts 1.3 million children out of poverty and eases the depth of poverty for another 1.5 million children (Lavery and Reno, 2008). Social Security has been and continues to be an important source of economic stability for the broad middle class of Americans.

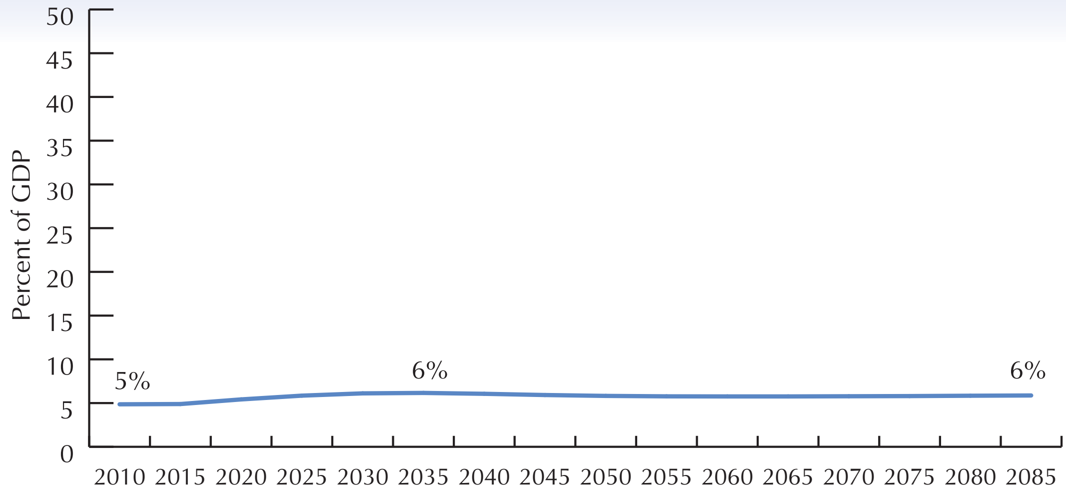
In an economic environment marked by increasing financial risk and insecurity, Social Security has remained stable and secure. But its projected long-term financing shortfall and the declining adequacy of future benefits clearly merit attention (Reno and Lavery, 2009).

## Can we afford to strengthen Social Security?

A widely accepted way to assess the Social Security program's affordability is to compare benefits scheduled under current law with the size of the entire economy at the time when benefits are to be paid. According to the 2010 report of the Social Security Trustees, Social Security benefits are now 4.8 percent of the economy, or gross domestic product (GDP), and are projected to rise to 6.1 percent in 2035 and then remain at roughly 6.0 percent for the rest of the next 75 years (Figure 3). This modest increase between now and 2035 is smaller than the growth in spending for public education that occurred when the boomers were children (Reno, 2008).

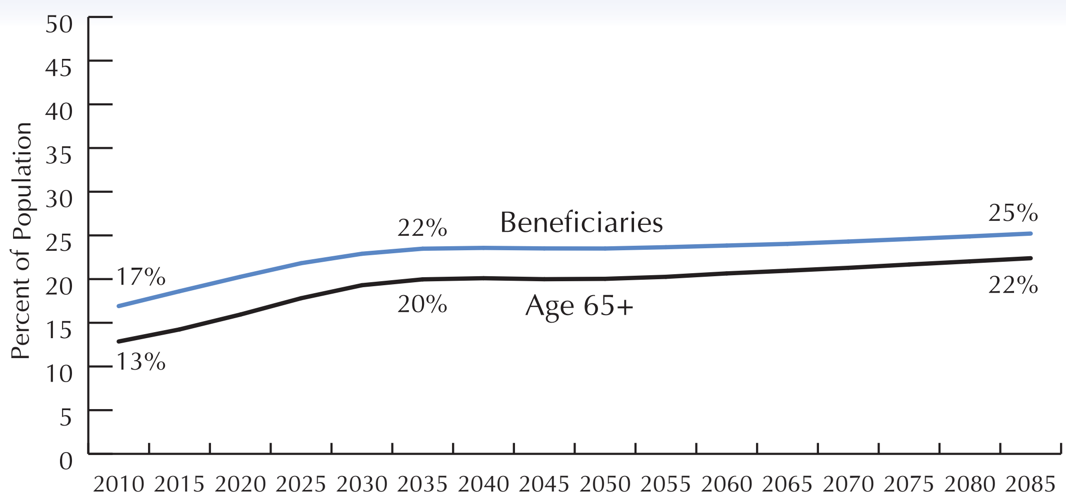
In assessing the affordability of Social Security, it is useful to distinguish it from Medicare and Medicaid, which are projected to grow much faster due to the rapid rise in spending for U.S. health care that occurs in both public programs and privately insured care. In sharp contrast, Social Security spending is relatively stable as a share of the national economy – despite the increasing numbers of Americans who will depend on benefits in the future (Figure 4).

**Figure 3. Social Security as a Percent of the Economy (GDP), 2010–2085**




Source: Board of Trustees, 2010.

**Figure 4. Percent of the Population Receiving Social Security and Percent Age 65+, 2010–2085**




Source: Board of Trustees, 2010.

The share of the population that is over age 65 will increase from about 13 percent today to about 20 percent in 2035 and then will gradually increase to about 22 percent by 2085. The beneficiary share of the population is a bit larger than the age 65+ population because some people under age 65 receive disability and survivor benefits. Beneficiaries as a portion of the U.S. population will increase from about one in six Americans today to about one in four 75 years from now.

One reason why Social Security remains a relatively stable share of the economy even as more people rely on the benefits is that the change in the full-benefit age will lower the benefits of a growing share of older Americans going forward. By 2050 all beneficiaries under the age of 90 will have their benefits based on the increased full-benefit age of 67. In brief, this aspect of the 1983 amendments is only beginning to be felt.

## Americans support Social Security—and are willing to pay for it.

A recent survey by the National Academy of Social Insurance and the Rockefeller Foundation found that Americans are willing to pay for Social Security for several reasons: because they value it for themselves (72 percent), for their families (75 percent), and for the security and stability it provides to millions of retired and disabled Americans and to the children and widowed spouses of deceased workers (87 percent). Moreover, this strong support cuts across party lines. Large majorities of Democrats, Republicans, and independents say they are willing to pay for Social Security for each of these reasons (Table 4).

**Table 4. Reason Why I Don't Mind Paying Social Security Taxes**

*Please tell me if you agree or disagree with the statement:*
*I don't mind paying Social Security taxes because:*

| Reason why I don't mind paying Social Security taxes | Total | Democrats | Independents | Republicans |
|---|---|---|---|---|
| | Percent who strongly or somewhat agree | | | |
| I know that I will be receiving the benefits when I retire. | 72 | 84 | 69 | 63 |
| I know that if my parents, grandparents, or other family members did not receive Social Security, I would have to support them in their retirement. | 75 | 82 | 76 | 68 |
| It provides security and stability to millions of retired Americans, the disabled, and children and widowed spouses of deceased workers. | 87 | 93 | 85 | 81 |

Source: Social Security Survey sponsored by the National Academy of Social Insurance and the Rockefeller Foundation, July-August 2009. N=1488.

In the strongest statement of support, 93 percent of Democrats, 85 percent of independents, and 81 percent of Republicans say they don't mind paying Social Security taxes because of the stability and support the benefits provide to millions of retired Americans, disabled persons, and children and widowed spouses of deceased workers.

### *In a weak economy, Americans want to strengthen Social Security*

In the face of federal deficits and short-term economic hardship, Americans want to strengthen Social Security. In response to a survey question about how Social Security policy should respond to the economic downturn, Americans favor strengthening Social Security over cutting both taxes and spending (including Social Security) by more than a two-to-one margin (66 percent vs. 28 percent) (Table 5). Democrats favor strengthening Social Security over cutting taxes and spending by more than a five-to-one margin (82 percent vs. 15 percent), independents do so by a two-to-one margin (64 percent vs. 29 percent), and Republicans are almost even on the question (47 percent vs. 45 percent).

**Table 5. Two Views on the Economy and Social Security**

| Which statement comes closest to your view? | Total | Democrats | Independents | Republicans |
|---|---|---|---|---|
| Total percent | 100 | 100 | 100 | 100 |
| Some people say that with our economy in crisis and our national deficit reaching $2 trillion, we should focus on ways to cut taxes and government spending, including things like Social Security. | 28 | 15 | 29 | 45 |
| Others say that with the economic crisis and the stock market crash, it's more important than ever to strengthen Social Security to make sure that retirees and the disabled can count on secure benefits for generations to come. | 66 | 82 | 64 | 47 |
| Both, neither, don't know | 5 | 3 | 7 | 8 |

Source: Social Security survey sponsored by the National Academy of Social Insurance and the Rockefeller Foundation, July-August 2009.

## Americans would rather pay more than see benefits cut

Opinion polls over the years have found that working Americans would rather pay somewhat more for Social Security than see benefits cut. In the recent NASI poll, fully 77 percent of Americans agree that it is critical to preserve Social Security for future generations, even if it means increasing working Americans' contributions to Social Security. Agreement comes from all political affiliations. Those who agreed with this position include 87 percent of Democrats, 75 percent of independents, and 67 percent of Republicans (Table 6). The responses are similar when asked whether it is critical to preserve the system for future generations "even if it means raising wealthy Americans' contributions to Social Security."

**Table 6. Preserve Social Security Even If We Have to Pay More**

| *It is critical that we preserve Social Security for future generations …* | Total | Democrats | Independents | Republicans |
|---|---|---|---|---|
| | Percent who strongly or somewhat agree | | | |
| … even if it means increasing working Americans' contributions to Social Security taxes. | 77 | 87 | 75 | 67 |
| … even if it means raising wealthy Americans' contributions to Social Security. | 74 | 94 | 71 | 56 |

Source: Social Security survey sponsored by the National Academy of Social Insurance and the Rockefeller Foundation, July-August 2009.

## Younger adults would rather pay more than get less in the future

An AARP survey released in August 2010 found that 85 percent of adults oppose cutting Social Security to reduce the deficit, and 72 percent "strongly" oppose doing so. Of adults under age 50, most (57 percent) would prefer to pay more into Social Security to get current benefit levels when they retire, rather than paying the same amount as today but getting less in benefits. Half of Americans believe the average benefit is too low and 80 percent say that Social Security alleviates the financial burden of taking care of their parents (AARP, 2010).

### *America Speaks* finds that Americans oppose benefit cuts

On June 26, 2010, the *America Speaks* civic engagement project sought to gauge public opinion on options for reducing the federal budget deficit. In 57 town hall meetings around the country, about 3,500 citizens were given background information and an opportunity to discuss policy options with peers before expressing their preferences. In the final tally, no option to reduce Social Security benefits received support from a majority of participants. A majority (60 percent) was willing to raise the taxable earnings cap to cover 90 percent of earnings; and 50 percent of participants were willing to increase FICA contributions to improve the solvency of the Social Security program (Table 7).

**Table 7. Social Security Options: *America Speaks***

| Proposal | Percent Support |
|---|---|
| Raise full-benefit age to 69 | 39 |
| Limit Increase in starting benefits | 24 |
| Lower measure of inflation | 24 |
| Raise FICA contribution rate — total | 50 |
| To 13.4% | 20 |
| To 14.4% | 30 |
| Raise cap to cover 90% of earnings | 60 |
| Create personal savings accounts | 17 |
| No change | 13 |

Source: *America Speaks,* 2010.

### *The conventional wisdom is wrong*

Daniel Franklin of the Benenson Strategy Group, which conducted the NASI Social Security poll, reported:

> "What we're seeing overall… is that the conventional wisdom among Washington elites does not match the attitudes of the public. For years, the media and pundits have drummed up concerns of a crisis that will require cutting back on our commitment to retirement security. As the economic crisis has eroded the government's fiscal position, this talk has increased. But Americans look at the insecurity they're seeing all around and take the opposite approach. Social Security, for 75 years, has provided Americans with the sense that they will be protected against the vicissitudes of the economy, the market, and their own fortunes. Their response to this recent moment of insecurity is not to pull back from our responsibility to one another, but in fact to double down." (Franklin, 2010)

## Steps to improve the adequacy of Social Security benefits

NASI's recent report, *Fixing Social Security: Adequate Benefits, Adequate Financing*, suggests many ways to improve Social Security benefits and includes estimates from Social Security actuaries of the cost of making such changes (Reno and Lavery, 2009). By way of example, we highlight here two relatively low-cost changes that would improve economic security for families with children and for seniors who have very low benefits after a lifetime of work.

### *College access for children of disabled and deceased workers*

Social Security pays benefits to children of disabled, deceased or retired workers until age 18 (or 19, if still attending high school). In the past such benefits continued until age 22 if the child was a student in college or vocational school, but Congress ended these student benefits in 1981 as part of its initial attempt to address Social Security's short-term funding crisis. Subsequent research has shown that student benefits helped low-income young adults move up the economic ladder.

Restoring the student benefit for children of disabled or deceased workers would cost an estimated 0.07 percent of taxable payroll over 75 years. The cost might be at least partially offset by the increased future earning power (and contributions to Social Security) of the young adults who gain higher education with the help of the benefits (Hertel-Fernandez, 2010).

### *Raise the income floor for vulnerable elders*

Individuals who work long careers at low pay are financially vulnerable in retirement because they are unlikely to have been able to save much or to have a private pension. A special minimum benefit was enacted in the 1970s to provide more adequate benefits than those provided by the regular benefit formula to long-service, low-paid workers. But because this benefit was not indexed to keep pace with wage growth, it no longer fulfills that role. One option would update this special minimum benefit to 125 percent of the poverty line for someone who has worked 30 years and retires at the full benefit age. To keep the new floor up to date, the initial benefit would be linked to wage growth and would be inflation-protected thereafter. All benefit improvements would go to individuals with substantial work records who currently receive below-average benefits. This change would cost an estimated 0.13 percent of taxable payroll over 75 years.

Together, these two changes – restoring student benefits and updating the special minimum benefit -- would cost 0.20 percent of taxable payroll.

## A 75-year financing plan

According to the 2010 report of its trustees, the Social Security system faces a long-term deficit of 1.92 percent of taxable payroll. Covering this projected shortfall and paying for modest improvements of the kind described above would require revenue increases equal to somewhat more than 2 percent of taxable payroll.

The NASI report, *Fixing Social Security: Adequate Benefits, Adequate Financing*, includes many options to increase revenues to strengthen Social Security (Reno and Lavery, 2009). We offer an illustrative three-part plan here. Each element of the plan has precedent in the history of Social Security policy. The first two elements broaden the Social Security contribution base and the third schedules a future contribution rate increase.

### *Lift the contribution cap to cover 90 percent of earnings*

Workers and their employers pay Social Security (FICA) contributions on earnings up to a cap ($106,800 in 2010). High-end earnings have traditionally not been subject to FICA because Social Security benefits are based on the earnings from which Social Security contributions were paid, and it has not seemed reasonable to pay Social Security benefits on extremely high earned incomes.

Accordingly, in 1977 Congress set a goal of collecting contributions on 90 percent of all earnings in covered employment. Legislation in 1977 made *ad hoc* adjustments in the cap so that it covered 90 percent of earnings in 1981 and then indexed the cap to keep pace with the growth in average earnings thereafter. However, because the earnings of those who make more than the cap have risen much faster in recent decades than the earnings of others, the share of earnings covered by the cap has gradually declined. Today, only about 83 percent of earnings is subject to FICA (Romig and Mulvey, 2009). About 6 percent of all workers earn more than the cap. Gradually lifting the cap over a 10-year period to again cover 90 percent of earnings would increase revenues by about 0.75 percent of taxable payroll, thereby eliminating about 39 percent of the projected long-term shortfall.

## *Treat all salary-reduction plans like 401(k)s*

In 1983, salary reduction plans under section 401(k) of the Internal Revenue Code were very new. The Greenspan Commission considered the tax treatment of employee contributions to these plans and recommended that such contributions be treated as covered wages for Social Security and Medicare purposes. The Commission stated that "any salary deferred under a plan meeting the requirements of section 401(k) should be considered in exactly the same manner as cash remuneration," and further noted: "This proposal will not produce significant additional income to the [Social Security and Medicare] programs currently, because not many of these salary-reduction plans have yet been put into effect. However, if [this] recommendation is not followed, it is quite probable that many such plans will be instituted and that, in the absence of the action recommended, considerable decreases in… tax income to the trust funds and in benefit credits would result" (National Commission, 1983). Congress adopted the Greenspan Commission's recommendation in 1983. Employee contributions to 401(k) plans are exempt from income taxes, but are subject to FICA contributions for Social Security and Medicare and are countable earnings for calculating Social Security benefits.

Since 1983, salary reduction plans for other purposes – such as medical spending accounts, dependent care accounts, and commuting costs – have become more widespread. Treating all employee contributions to salary reduction plans in the same way as 401(k) contributions would reduce Social Security's long-term shortfall by an estimated 0.25 percent of taxable payroll, or 13 percent, while also increasing the earnings used to calculate the Social Security benefits of affected workers. Taken together, these two changes would eliminate about half of the program's projected long-term deficit.

## *Schedule future rate increase(s)*

Throughout most of Social Security's 75-year history, Congress has scheduled one or more future FICA rate increases to maintain the program in long-term balance. For example, the 1972 and 1973 amendments scheduled tax increases as far out as 2011. The 1977 and 1983 amendments moved up the out-year increases, but still scheduled an increase for 1990. The 1990 rate (6.2 percent) is still in effect today. A good case can be made for reviving the practice of scheduling out-year revenue increases. Because policymakers use a 75-year framework to evaluate Social Security's financial status, it makes sense to put in place a 75-year contribution plan.

While Social Security does not need higher contributions now, policymakers could act now to schedule rate increases at specific points in the future when, according to the Trustees' forecast, additional funds would strengthen the program – such as in, say, 12 or 15 years, when the program will begin to draw down its trust fund reserves (projected in 2025), and again in, say, 40 or even 60 years. The rate increases could be scheduled to achieve specific goals. For example, it may be desirable to avoid drawing down the trust fund reserves so that interest remains a permanent source of income. (Interest accounted for 15 percent of Social Security's total income in 2009.) To continue interest as a permanent source of income would reduce the amount that would need to be raised from workers' contributions from earnings. If Congress desired to offset the impact of a rate increase on low-wage workers, amendments could be enacted to adjust the earned income tax credit (EITC).[2] And if it turns out that the rate increase is not needed, future legislators could reduce or cancel the scheduled increase.

2 The purpose of the EITC when it was enacted in 1975 was to increase the return from work for low-paid workers by offsetting Social Security and Medicare taxes, while maintaining the workers' participation in and entitlement to social insurance benefits.

In brief, it is possible to design a financing plan for Social Security that is broadly affordable, consistent with Social Security's history and principles, and capable of strengthening the program for the long run – freeing policymakers to consider strategies to improve the adequacy of Social Security benefits rather than cutting them.

## Conclusion: A time of opportunity

As confirmed in public opinion surveys, Americans would rather strengthen Social Security than see the program eroded by further benefit cuts. The public, regardless of political affiliation, recognizes that Social Security is more important now than ever. As Americans live through a time of great economic uncertainty, they want to reinforce rather than weaken the one sturdy leg of the three-legged retirement stool.

In seeking ways to balance Social Security's long-term finances today, it is useful to revisit the Social Security Amendments of 1983. At that time, only the short-term reforms, aimed at getting the program through the 1980s, were a compromise that affected contributors and beneficiaries more or less evenly. The added piece for the long term was not a compromise; it lowered monthly incomes for future beneficiaries but did not call for any new contributions from workers or employers. Today, working Americans say they are willing to pay for Social Security and would rather pay more than see benefits cut further.

Adopting targeted adequacy improvements and a 75-year financing plan to pay for future benefits would be affordable and would reflect the expressed views of the American people. Such changes would:

- Secure Social Security for the future;
- Provide peace of mind to workers of all ages that they can count on the program to be there for them and their children; and
- Demonstrate that Washington is listening to what Americans say they want.

Social Security's long-term funding challenge can be met—and in ways that give Americans greater confidence in their own future.

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