Social Security Brief
June 2011 • No. 37
NATIONAL ACADEMY OF SOCIAL INSURANCE

Social Security Beneficiaries Face 19% Cut; New Revenue Can Restore Balance

By Virginia P. Reno, Thomas N. Bethell, and Elisa A. Walker

Summary

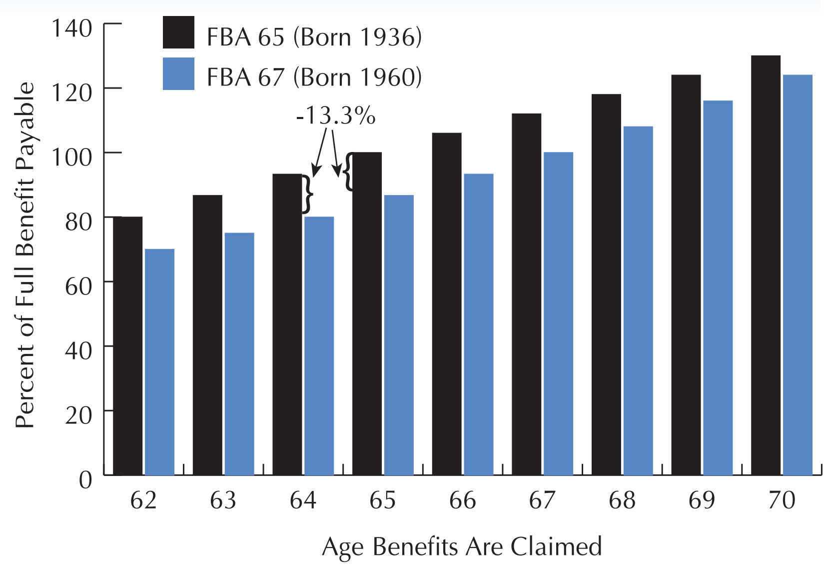
The Social Security legislation of 1983 achieved the important goal of remedying a short-term financing crisis and keeping the program solvent. But for the long term, it scheduled far more in benefit cuts than in new revenues for the 21st century. Those benefit cuts are only beginning to be felt. People reaching age 65 in 2025 will get retirement benefits for the rest of their lives that are about 19 percent lower than they would have been without the 1983 reductions. Cutting benefits further, as some people propose, could undermine the adequacy of Social Security benefits going forward and jeopardize the basic economic security of older Americans. There are alternatives that merit consideration. Modest benefit improvements and revenue increases are affordable, have broad public support, and can close Social Security's long-term financing shortfall without further benefit cuts.

Benefits are being cut by 19 percent.

The changes enacted in 1983 will ultimately lower Social Security benefits for retirees by an average of 19 percent. Those changes include:

- Gradually raising the full-benefit retirement age from 65 to 67 (13.3 percent cut)
- Taxing part of benefit income (5.1 percent cut)
- Delaying the cost-of-living adjustment (COLA) by 6 months (1.4 percent cut).

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



Source: Authors' calculations based on Office of the Chief Actuary, 2011a.

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Retirement age increase: The age of eligibility for full benefits is gradually increasing from 65 to 67; it is now 66 and will be 67 for workers born after 1959. The increase lowers benefits at any age they are claimed. As shown in Figure 1, when the full-benefit age (FBA) was 65, Social Security paid a retiree 100 percent of his or her basic benefit at that age. When the FBA is 67, the benefit claimed at 65 is reduced to 86.7 percent of the full amount – 13.3 percent lower than it would have been had the FBA remained at 65.

When the full-benefit age increases from 65 to 67, the benefit claimed at 65 is cut by 13.3 percent.

Taxation of benefits: Under the 1983 law, up to half of Social Security benefits are subject to personal income taxes for couples with countable income above $32,000 and singles with more than $25,000.[1] The revenues are returned to the Social Security trust funds. More beneficiaries will pay such taxes as incomes grow over time because the thresholds are not adjusted to take wage or price increases into account. This change reduces net benefits by about 5.1 percent, on average, over the next 75 years.[2]

Six-month COLA delay: Before 1983, retirees were entitled to their first COLA for June of the year they reached age 62. Under the 1983 change, retirees become entitled to their first COLA for December of the year they reach age 62. This is a permanent half-year COLA delay. With COLAs assumed to be 2.8 percent annually in the future, the half-year delay means that annual benefits in the future will be about 1.4 percent lower on average than they would have been.

The 1983 changes lower benefits by 19 percent on average. By 2050 almost all of the elderly will have experienced the full 19 percent reduction in Social Security income.

The three changes together lower benefits by 19 percent.[3] The first two cuts are phasing in gradually. The 13.3 percent cut affects new retirees born in 1960 and later; they will begin reaching age 65 in 2025 and age 90 in 2050. By then almost all of the elderly will have experienced the full 19 percent reduction in Social Security income.

Benefit cuts are not being balanced with new contributions.

The 1983 changes are often described as a balanced plan of benefit cuts and contribution increases. But that is not the case for the long run: the benefit cuts taking place in this century were not balanced by any new contributions. Workers today pay 6.2 percent of their earnings, and employers pay an equal amount, up to a cap of $106,800 under the Federal Insurance Contributions Act (FICA). This rate was enacted in 1977 and took effect in 1990. The 6.2 percent rate remains unchanged despite the increase in Social Security commitments as boomers retire. In the past lawmakers typically adjusted the schedule of future contribution rates to balance commitments.

Recent commissions call for more cuts.

In November 2010, the Bipartisan Policy Center's Debt Reduction Task Force, chaired by Pete Domenici and Alice Rivlin, proposed additional benefit cuts: shifting to a COLA that will grow more slowly than the price increases actually experienced by the elderly, and lowering future benefits as average life expectancy increases.[4] Similarly, the co-chairs of the National Commission on Fiscal Responsibility and Reform, Erskine Bowles and Alan Simpson, proposed to reduce the COLA and raise the full-benefit retirement age; they would also change the benefit formula to lower future benefits for all workers with lifetime earnings above the median ($37,000 a year in 2010) and for many workers making less than the median.[5] Added to the 19 percent cuts already in law, such proposals raise concerns about Social Security benefit adequacy and the future economic security of older Americans.

Proposals for more cuts — on top of the 19 percent cuts already in law — raise concerns about the future economic security of older Americans.

More cuts risk undercutting basic security for older Americans.

Monthly Social Security benefits are modest, an average of $1,166, or about $14,000 a year – considerably less than is required to maintain an adequate standard of living in most areas of the country.[6] Most elderly beneficiaries have little significant income other than Social Security. Two in three count on benefits to provide half or more of their total income. For fully a third of all elderly beneficiaries, Social Security is 90 percent or more of their income.

Monthly Social Security benefits are modest…Two in three elderly beneficiaries count on Social Security for half or more of their total income. For one in three, Social Security is 90 percent or more of their income.

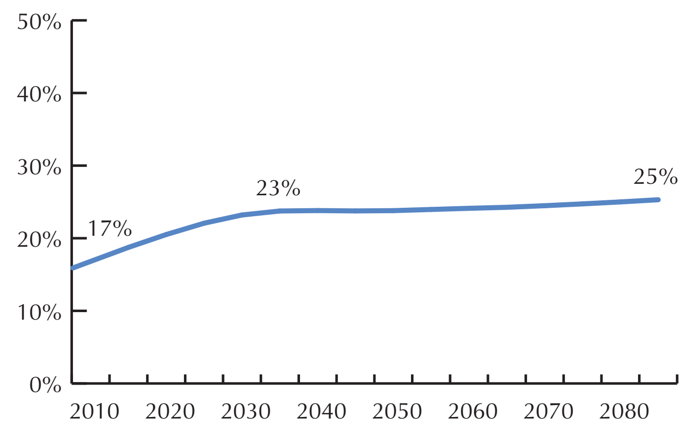
Most elderly beneficiaries lack other pension benefits. Coverage under traditional defined benefit pension plans has fallen precipitously in recent decades and now includes less than 20 percent of the private sector workforce. Defined contribution plans such as 401(k) plans not only shift risk to workers but are also subject to the vagaries of the stock market and fail in most cases to accumulate sufficient wealth to be converted to annuities capable of protecting workers against outliving their resources. Few private sector plans of any kind are protected against inflation. Consequently, for most seniors Social Security will be their only source of retirement income that is unaffected by the stock market and that provides lifetime benefits fully protected against inflation.[7]

Rising Medicare premiums will take a growing bite out of future benefits and rising out-of-pocket spending for health care generally will challenge seniors' capacity to make ends meet. Adding even more benefit cuts to those already in law risks undercutting beneficiaries' basic economic security as they grow older – reducing their buying power, jeopardizing their ability to pay bills and stay in their own homes, and increasing their risk of impoverishment and reliance on family members or welfare for basic necessities.

Social Security is affordable.

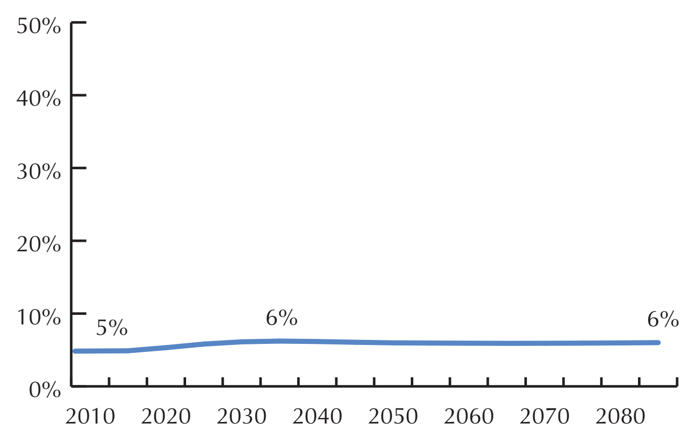
The idea that Social Security needs to be cut seems to rest on the fact that more Americans will receive benefits because more will be over age 65. This demographic fact is true (Figure 2). But it does not address whether benefits are affordable. For that, we can compare scheduled benefits to the size of the economy when the benefits are to be paid (Figure 3). With the cuts already in law, Social

Figure 2. Social Security Beneficiaries as a Percent of the Population
2010-2085



Source: Board of Trustees, 2011: Tables V.A2 and IV.B2.

Figure 3. Social Security Outgo as a Percent of the Economy (GDP)
2010-2085



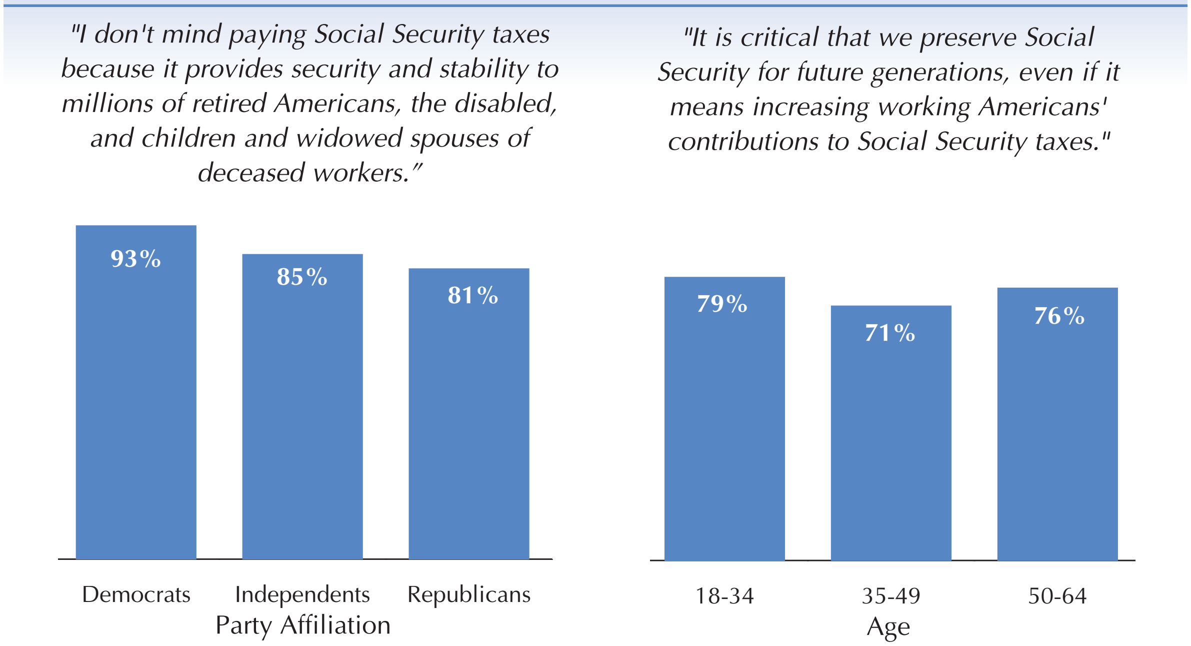
Source: Board of Trustees, 2011: Table VI.F4.

Security outgo will increase from 4.8 percent to 6.1 percent of gross domestic product (GDP) between 2010 and 2035 as boomers move through retirement. That increase due to boomers' retirement is smaller than the increase in the share of the economy spent on public education when boomers were children.[8] After 2035, as long-term cuts phase in, Social Security is projected to remain stable at about 6.0 percent of GDP for the rest of the next 75 years. In brief, with the cuts already in law, Social Security remains stable and affordable even as more Americans will collect benefits.

Americans would rather pay more than see benefits cut.

Americans count on Social Security and appreciate its value for themselves, their families, and others. The large majority (87 percent) of all Americans agree that they don't mind paying for Social Security because of the security and stability it provides to millions of retired and disabled Americans and children and widowed spouses of deceased workers. This support cuts across party lines: those willing to pay for this reason include 93 percent of Democrats, 81 percent of Republicans, and 85 percent of independents (Figure 4). Support also cuts across age groups. Americans under age 65 say they want to preserve Social Security for future generations even if it means increasing working Americans' contributions to Social Security (Figure 4).

Figure 4: Percent Agreeing:



Source: Gregory et al., 2010. Social Security Survey sponsored by the National Academy of Social Insurance and the Rockefeller Foundation, July-August 2009. N=1488.

Notably, a polling expert from the Benenson Strategy Group, which conducted the NASI survey cited above, concluded:

> "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."[9]

Options to strengthen Social Security

Recent commission reports and NASI's own research point to ways to improve and pay for Social Security. Below we briefly describe three ways to improve benefits and three ways to broaden the FICA base, which would be sound policy even if revenues were not needed. We then consider goals for a 75-year financing plan and some revenue options to meet them. Figure 5 shows the effect of each option on Social Security's 75-year balance. Benefit improvements increase the shortfall; other options reduce or eliminate it.

Improve benefits

Many proposals to improve benefits warrant consideration. The following three are relatively low-cost, have precedent in Social Security policy, and are not difficult to administer.[10] The three together would increase the program's 75-year shortfall by 18 percent.

- ***Update the special minimum benefit*** to ensure that low-income workers can retire at age 62 after 30 years of work without facing the prospect of impoverishment. A special minimum benefit was enacted in the 1970s to ensure that low-paid workers would receive a benefit meeting a basic criterion of adequacy, but because the benefit was not indexed to keep pace with wage growth, it is no longer effective. Both the Debt Reduction Task Force and the co-chairs of the Fiscal Commission proposed to improve the minimum benefit (but did so primarily to mitigate some of the effects of their proposed benefit cuts).

- ***Restore benefits for children of disabled or deceased workers until age 22 while they are in college or vocational school.*** Enacted in 1965, this benefit helped many students finish college or vocational training and increase their earning power. The benefit was phased out in 1981. Restoring it would create opportunities for disadvantaged young adults and help make the American workforce more competitive.[11]

- ***Improve benefits for the oldest old.*** People become increasingly reliant on Social Security as they grow older. One option would be to increase benefits by the same dollar amount for all beneficiaries at age 85, with the increase to equal a percentage – such as 5 percent – of the average retired worker benefit paid in the prior year.[12] Both the task force and the commission co-chairs recommended a similar change (but, again, to mitigate some of the effects of the benefit cuts they proposed).

Broaden the FICA base

The following three changes reflect the intent of Congress in the past and are supported by recent commissions. Together they reduce the shortfall by more than 50 percent.

- ***Restore the cap on earnings subject to Social Security contributions so that it once again covers 90 percent of earnings, phased in over 10 years.*** When Congress last adjusted the cap in 1977, it intended to cover 90 percent of earnings and provided for the cap to rise automatically with increases in average wages. Today the cap falls short of covering 90 percent of earnings because the 6 percent of workers who earn more

> *Broadening the FICA base reflects the intent of Congress and is supported by recent commissions.*

than the cap have had more rapid wage growth than other workers. Both the task force and the commission co-chairs recommended lifting the cap to cover 90 percent of earnings, but would phase it in very gradually over nearly four decades.[13]

- ***Cover newly hired state and local government employees*** who are not already covered by Social Security, starting in 2020. Both the task force and the commission co-chairs called for this change, as did past Advisory Councils on Social Security.[14] It follows the precedent Congress set in 1983 by covering newly hired federal employees.

- ***Treat contributions to all salary reduction plans as covered earnings for Social Security.*** The task force recommended this change, which is consistent with 1983 legislation that treated employee contributions to 401(k) plans as covered earnings for Social Security.

Adopt a long-term revenue plan

Reasonable goals for a long-term revenue plan would include preserving trust fund reserves – thereby maintaining interest earnings as a permanent source of trust fund income – and ensuring that revenues will be adequate to finance benefit commitments for 75 years and beyond. Interest provided 15 percent of trust fund income in 2010. Maintaining reserves and interest income is a far more prudent approach than depleting reserves and then raising contribution rates to levels higher than would have been needed had reserves and interest income remained stable. Long-term revenue options include scheduling future FICA increases, dedicating more progressive revenues to Social Security, or both.

Scheduling future FICA increases: Throughout most of Social Security's history, lawmakers have scheduled future FICA rate increases to meet future benefit commitments. Only since 1990 have no future FICA rate increases been scheduled. As shown in Figure 4, working Americans are willing to pay more if necessary to secure Social Security for the future. One example of many possible FICA options follows:

- ***Schedule a gradual FICA rate increase over 20 years.*** To avoid abrupt changes, Congress could increase the FICA rate by 1/20th of one percent over 20 years for employers and employees each, beginning in 2015. By 2035, the rate would be 7.2 percent for both workers and employers. For a worker making about $53,000 in 2015, the increase would be about 50 cents a week.[15]

Adding progressive revenues: Some early framers of Social Security believed that when the system was fully mature, with almost all workers covered and almost all elders eligible for benefits, partial funding from more progressive taxes would be warranted. The FICA revenue base is now only about 37 percent of GDP. Sources not taxed for Social Security include asset income, realized capital gains, transfers of wealth, and employee compensation in the form of non-taxable fringe benefits. Allocating more progressive taxes to Social Security can be justified in light of Social Security's contribution to the common good:

- It strengthens the economy by stabilizing purchasing power in beneficiaries' communities during good times and bad;

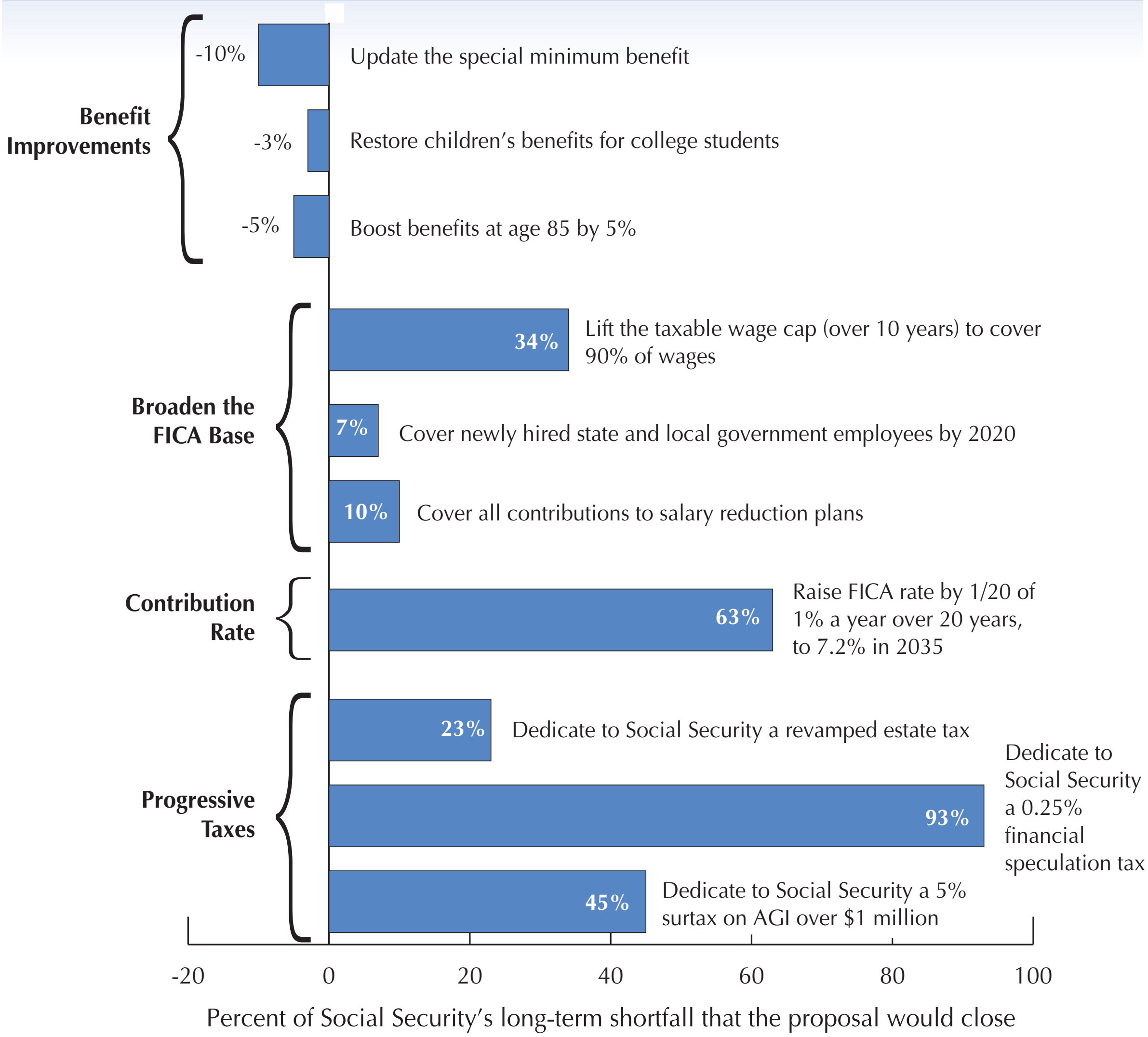
- It stabilizes families over the lifecycle, enabling seniors to live independently and young families to focus resources on their children; and

- By pooling risks broadly, it delivers security throughout old age and insures young families against the tragedy of a worker's death or disability far more efficiently than individuals could do on their own.

Three of many possible options for allocating progressive revenues to Social Security include:

- ***Dedicate to Social Security a revamped estate tax.*** Apply a 45 percent rate to the portion of estates in excess of $3.5 million for individuals ($7 million for couples) and direct it to the common good by strengthening Social Security.[16]
- ***Dedicate to Social Security a 0.25 percent financial speculation tax*** on the purchase and sale of publicly traded stock, credit swap derivatives, and other financial instruments.[17]
- ***Dedicate to Social Security a 5 percent surtax on adjusted gross income in excess of $1 million.***

Figure 5. Options to Improve and Pay for Social Security
Effect on Long-Term Shortfall



Source: Goss, Wade, and Chaplain, 2009; Office of the Chief Actuary, 2011b.

As Figure 5 shows:

- Modest benefit improvements for three vulnerable groups – low-paid workers, students who have lost parental support due to death or disability, and the oldest old – would increase the program's long-term shortfall by 18 percent.
- Three ways to broaden the Social Security revenue base – which are endorsed by expert advisory groups – would reduce the long-term shortfall by 51 percent.
- Carefully timed contribution rate increases in the future and/or dedicating more progressive revenues to Social Security could complete a 75-year revenue plan that eliminates the long-term shortfall and pays for desired benefit improvements.

Conclusion

Social Security benefits are already being cut more than many people may realize. Cutting them further could jeopardize older Americans' most basic economic protection, and is not necessary to preserve Social Security for future generations. Other alternatives merit consideration by policymakers: modest benefit improvements and revenue increases are affordable, have broad public support, and can close Social Security's long-term financing shortfall without further benefit cuts.

Social Security benefits are already being cut more than many people may realize. Cutting benefits is not necessary to preserve Social Security for future generations.

Endnotes

1 Countable income for the taxation of benefits is defined as adjusted gross income plus half of Social Security benefits and certain nontaxable interest. Social Security Administration (SSA), 2011.

2 Total benefits over the next 75 years are 15.78% of taxable payroll (all wages paid in covered employment), while income taxes paid by beneficiaries on those benefits are 0.80% of taxable payroll. Thus, these income taxes amount to 5.1% of total benefits, meaning that the taxation of benefits reduces benefits by an average of 5.1%. Board of Trustees, 2010: Table IV.B4.

3 The combined effect of 19% is estimated by multiplying the effects of the three changes: 1.00 - (0.866 x 0.949 x 0.986) = 1.00 – 0.81 = 19% reduction.

4 Veghte et al., 2011.

5 Reno and Walker, 2011.

6 For example, an elderly renter living alone typically needs at least $20,000 a year to make ends meet, according to an Elder Economic Security Standard developed by Wider Opportunities for Women in 2010. A full-time worker being paid the federal minimum wage and retiring at age 62 in December 2009 received a monthly benefit of $667, about 27% below the poverty line ($903 in 2010). SSA, 2011b; Wider

Opportunities for Women, 2010; SSA, 2011c: Table 2.A26; U.S. Department of Health and Human Services, 2010.

7 Gregory et al., 2010.

8 Reno, 2007.

9 Franklin, 2010.

10 For a discussion of these and other options, see NASI's report, *Fixing Social Security: Adequate Benefits, Adequate Financing* (Reno and Lavery, 2009).

11 Hertel-Fernandez, 2010.

12 This suggestion is illustrative; other options to improve benefits for the oldest old warrant consideration. For example, a case can be made that benefits should increase continually with age, because living standards are rising and the old should share in the gains that they helped make possible. Benefits could be adjusted not only to keep up with prices but, at some specified age (e.g., 75), and to some extent, with wages as well. This approach would help offset the decline of savings and other resources that most people experience as they age.

13 Both the Fiscal Commission co-chairs and the Debt Reduction Task Force called for increasing the taxable maximum by an additional 2% per year until 90% of wages are covered. This would take approximately 38 years and would close about 27% of Social Security's projected long-term shortfall; a 10-year time frame would close about 34% of the shortfall. Goss, 2010a and 2010b; Office of the Chief Actuary, 2011b.

14 Goss, 2010a and 2010b; Advisory Council on Social Security, 1997 and 1979.

15 Reno and Lavery, 2009: pg. 14.

16 Reno and Lavery, 2009: pg. 19.

17 Baker, 2011; Center for Economic and Policy Research, 2011 (testimonials from political leaders, business leaders, opinion leaders and economists, and academic references).

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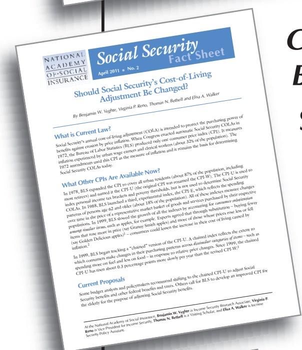

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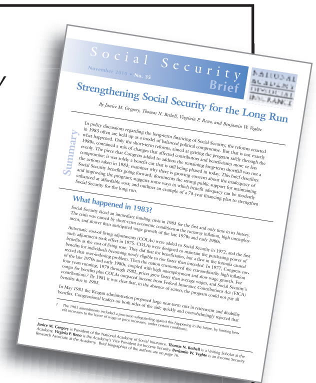

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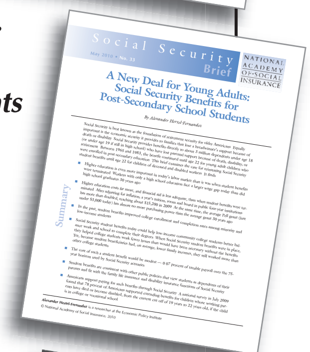

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Production of this fact sheet was supported by the Ford Foundation as part of its initiative on Building Economic Security Over a Lifetime, which focuses on promoting social protection programs that help low-income families achieve economic stability, and by the Rockefeller Foundation's Campaign for American Workers, which focuses on policies to increase economic security within the U.S. workforce, particularly among poor and vulnerable workers.

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