*National Academy of Social Insurance*
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# *Social Insurance: Opportunities and Challenges Facing the New Leadership and the American People*

*Session: "Reforming Social Security in an Era Of Inequality: Insurance vs. Private Accounts*

*Discussion: Academy Report to the New Administration – Restoring Social Security to Long-term Balance*

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# OVERVIEW:

- Purpose of Academy Report:
  - Provide a balanced and unbiased assessment of the challenges facing Social Security and policy options
  - Provide proper context, history and goals
  - Provide options – but not recommendations – for changes in revenues and benefits
  - Educate on the history and importance of Social Security

# CONTEXT:

- Social Security is the leading source of income for retired workers and their surviving spouses
- Currently, Social Security has three streams of revenue that are dedicated solely to financing benefits and associated administrative costs
- Most the funding comes from mandatory contributions on wages, matched by employers. The other two streams are interest on reserves and revenue from counting benefits as income for purposes of federal income tax liability
- To continue to provide adequate benefits over the long term, reforms will be needed
- Such reforms may affect both benefit adequacy and solvency

# POLICY CHALLENGES:

- Social Security's trust fund reserves and annual income are projected to be able to cover all scheduled benefits over the next 18 years
- If Congress does not act before 2034, the reserves are expected to be depleted, and revenue continuing to come into the funds would cover about 79 percent of scheduled benefits and administrative costs in that year (declining to 74 percent of benefits by 2090)
- By law, Social Security cannot deficit spend, i.e. it cannot pay benefits in excess of its income and reserves
- Hence without legislative action, there would be an immediate 21 percent cut in benefits in 2034, and automatic cuts would affect all current and future beneficiaries

# KEY FACTORS TO KEEP IN MIND: VALUATION PERIOD

- Over Social Security's history, actuarial valuation periods have been as short as 30 years and as long as 80 years
- Since 1965, Social Security's Board of Trustees has used a 75-year valuation period
- All else being equal, ensuring the solvency of the system over longer periods is preferable to ensuring solvency over shorter periods
- ***But policymakers should not become so fixated on achieving "sustainable solvency" – as defined by the trust fund's having a positive balance throughout the 75-year projection period with trust fund reserves stable or rising at the end of the period – that they fail to achieve any compromise that extends Social Security's solvency***

# KEY FACTORS TO KEEP IN MIND: ADEQUACY OF BENEFITS

- Currently, even if scheduled Social Security benefits were to be paid out in full, 52 percent of households would still be at risk of not having enough to maintain their living standards in retirement
- Among working households age 55-64, 62 percent have not been able to accumulate retirement savings equal to or greater than their annual income
- Only four in ten have access to a defined-benefit pension, and these traditional employer pensions are steadily disappearing
- Social Security will increasingly become the only source of guaranteed inflation protected lifetime benefits on which most retirees can rely, absent major changes in individuals' private savings habits today

# KEY FACTORS TO KEEP IN MIND: BENEFITS TIED TO EARNINGS

- Some proposals would replace the current progressive, earnings-related benefit formula with a nearly-flat benefit regardless of earnings
- Such reforms violate one of the core principles of today's social insurance programs: earnings-related benefits
- A Social Security system with roughly flat benefits just above the poverty level would fail to fulfill its wage-replacement role, and could leave middle-class workers and their families financially insecure in retirement, disability or premature death

# KEY FACTORS TO KEEP IN MIND: PROGRESSIVITY & SOCIAL EQUITY

- The Social Security system as a whole is neither highly progressive nor regressive
- It is funded by a regressive tax – a flat rate paid by both employers and employees on up to the first $127,200 of wage earnings in 2017 – to fund benefits based on a progressive formula
- Progressive effect of benefit formula is partly offset by the fact that groups with low socio-economic status have shorter life expectancies at 65, and hence receive fewer years of retirement benefits, on average
- Progressivity of Social Security further attenuated by recent stark increase in life expectancy differential by income
- On the other hand, low earners are more likely to become disabled, and thus are more likely to benefit from Social Security's disability protections

# KEY FACTORS TO KEEP IN MIND: PROGRESSIVITY & SOCIAL EQUITY

- Some observers note that there is reason to increase the progressivity of Social Security to compensate for two secular trends in inequality:
  - 1) growing inequality in the distribution of income; and
  - 2) growing inequality in longevity by income, or in other words, high earners living longer than low earners
- The latter trend increases the lifetime Social Security benefits of high earners relative to those of low earners
- Greater progressivity in Social Security could be achieved by making changes to either contributions or benefits

# POLICY OPTIONS

- Achieving 75-year solvency solely via an increase in Social Security contributions would impose a significant additional tax burden on workers and their employers
- If done via an across-the-board increase in payroll taxes under the existing tax cap of $127,200, achieving 75-year solvency purely through revenue increases would require the equivalent of an immediate and permanent payroll tax rate increase of 2.58 percentage points – from the current 12.4 percent to 14.98 percent
- Relying solely on benefit reductions to achieve solvency would compromise Social Security’s goal of providing a foundation of economic security in retirement
- If done in across-the-board fashion, the equivalent of an immediate cut of 16 percent for all current and future beneficiaries would be required (or about 19 percent if the cuts were applied only to those becoming initially eligible in 2016 or later)

# OPTIONS TO INCREASE REVENUES

(Not exhaustive, nor are they recommendations – result of group compromise)

- Lift the taxable earnings cap (which is $127,200 in 2017) until it covers 90% of all earnings, or completely eliminate the taxable earnings cap
- Gradually raise the tax rate for workers and employers
- Dedicate a new source of revenue, such as the estate tax, a new wealth tax, a financial transactions tax or a surtax on adjusted gross income in excess of $1 million
- Increase taxes on benefits for high income beneficiaries
- Expand compensation subject to the payroll tax by taxing health insurance premiums or cafeteria plans
- Subject investment income to Social Security contributions

# OPTIONS TO REDUCE BENEFITS

(Not exhaustive, nor are they recommendations – result of group compromise)

- Raise the retirement age to 68, 69 or 70, and/or index the retirement age to longevity
- Use the Chained Consumer Price Index to calculate annual cost-of-living increases
- Change the benefit formula so that individuals with higher earnings receive lower benefits. Specifically, this could be designed to reduce benefits for those with earnings above the 60$^{th}$ percentile (or about $51,000 in career average earnings)
- Change the benefit formula to boost benefits at the bottom and reduce them in the middle and top of the income spectrum
- Implement an annual benefit formula calculation to provide a relatively higher replacement rate to low-income earners who work for many years compared to high-income workers who work for fewer years

# OPTIONS TO INCREASE BENEFITS

(Not exhaustive, nor are they recommendations – will require funding offsets, again, result of group compromise)

- Increase Social Security's special minimum benefit to pay 125% of the poverty level at full retirement age for someone who has worked 30 years or more
- Increase monthly benefits for beneficiaries beginning at age 85
- Provide Social Security earnings credits to parents with young children for up to 5 years
- Increase the first bend point by 10 percent and the first percentage factor to 95 percent
- Establish a basic minimum benefit
- Increase survivors benefits to help widows and widowers maintain their standard of living
- Reinstate student benefits until age 22 for children of deceased or disabled workers if the child is in college or vocational school
- Use the Consumer Price Index for the elderly to calculate annual cost-of-living adjustments

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