NATIONAL ACADEMY OF SOCIAL INSURANCE

Restoring Social Security to Long-term Balance

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Social Security is the leading source of income for most retired workers and their surviving spouses.[1] Currently, Social Security has three streams of revenue that are dedicated solely to financing benefits and associated administrative costs. Most of the funding comes from mandatory wage contributions made by employees, matched by their employers. The other two streams are interest on reserves held in the Social Security trust funds and revenue from counting benefits as income for the purposes of federal income tax liability. All three of these revenue sources flow into the Social Security trust funds.

To continue to provide adequate benefits over the long term, reforms will be needed. This section will focus on solvency. Other aspects of Social Security policy are addressed in the following three sections of this *Report*, which focus on the gap in retirement wealth, women's retirement security, and disability, respectively.

Policy Challenges

Long-term Solvency

Social Security's trust fund reserves, currently $2.8 trillion, in combination with its annual income, are projected to be able to cover all scheduled benefits over the next 18 years.

When Social Security's annual income exceeds its annual outgo, the excess is held in trust and invested in government obligation bonds until needed. Social Security's trust fund reserves, currently $2.8 trillion, in combination with its 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 projected to be depleted. At that point, incoming revenue 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 beneficiaries then and in the future.

[1] Eighty-four percent of all people over 65 and about 90 percent of surviving spouses over 65 receive income from Social Security. For three-fifths of both of these groups, Social Security makes up over 50 percent of their income. Social Security Administration, 2016, Income of the Population 55 or Older, 2014, Office of Retirement and Disability Policy, Tables 2.A1 , 2.B5, and 9.B3, https://www.ssa.gov/policy/docs/statcomps/income_pop55/.

Over Social Security's history, its actuarial valuation periods – the length of time into the future for which its actuaries project system solvency – 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" – defined by the trust fund as having a positive balance throughout the 75-year projection period with stable or rising reserves – that they fail to achieve any compromise that extends Social Security's solvency.

Key Factors to Keep in Mind When Crafting Social Security Legislation

Achieving long-term solvency is a necessary but not sufficient step in providing retirement security to American workers. As such, solvency is one of several objectives that must be weighed in any successful package of reforms to Social Security. Other factors to keep in mind include the following:

Adequacy of benefits in context of broader retirement system

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 financial resources to maintain their living standards in retirement.[2] This figure is much worse for Americans of color and for people with low incomes. Among working households age 55-64, 62 percent have not been able to accumulate retirement savings equal to or greater than their annual income.[3] Only four in ten have access to a traditional employer pension, which can provide an income stream for life,[4] and these traditional pensions are steadily disappearing from the private sector.[5] As policymakers consider proposals to improve the solvency of the Social Security system, they must recognize that Social Security is the only source of guaranteed, inflation-protected lifetime benefits on which most retirees can rely, absent radical – and historically unprecedented – changes in individuals' private savings habits.

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[2] Alicia H. Munnell, Wenliang Hou, and Anthony Webb, 2014, "NRRI Update Shows Half Still Falling Short," Center for Retirement Research, http://crr.bc.edu/briefs/nrri-update-shows-half-still-falling-short/.
[3] Nari Rhee and Ilana Boivie, 2015, "The Continuing Retirement Savings Crisis," National Institute on Retirement Security, http://www.nirsonline.org/storage/nirs/documents/RSC%202015/final_rsc_2015.pdf.
[4] Ibid.
[5] Barbara A. Butrica, Howard M. Iams, Karen E. Smith, and Eric J. Toder, 2009, "The Disappearing Defined Benefit Pension and Its Potential Impact on the Retirement Incomes of Baby Boomers," Social Security Bulletin 68(3), https://www.ssa.gov/policy/docs/ssb/v69n3/v69n3p1.html.

Earnings-relatedness of benefits

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.[6] A Social Security system with roughly flat benefits just above the poverty level would fail to fulfill its wage-replacement role, and leave middle-class workers and their families financially insecure in retirement, or in the event of disability or premature death. Social Security's political success as social insurance is due to the broad support the program receives from these middle-class workers and their families.[7]

Progressivity, individual equity, and social adequacy

The Social Security system as a whole is hard to characterize in terms of progressivity and regressivity. It is funded by a regressive tax – a flat rate paid by both employers and employees on the first $127,200 of wage earnings in 2017 – to fund benefits based on a progressive formula.[8] The progressivity of the benefit formula used to compute Social Security retirement benefits, in turn, is partly offset by the fact that groups with low socio-economic status have shorter life expectancies at 65 than do those with higher socio-economic status, and hence receive fewer years of retirement benefits, on average.[9] On the other hand, low earners are more likely to become disabled or die prematurely, and thus are more likely to benefit from Social Security's disability protections and survivor protections for their families.

Some observers note that there is reason to increase the progressivity of Social Security to compensate for two trends in inequality: 1) growing inequality in the distribution of income; and 2) growing inequality in

[6] Robert M. Ball, 2000, *Insuring the Essentials: Bob Ball on Social Security*, New York: The Century Foundation.
[7] Andrea Louise Campbell and Kimberly J. Morgan, 2005, "Financing the Welfare State: Elite Politics and the Decline of the Social Insurance Model in America," Studies in American Political Development 19(Fall 2005).
[8] The regressivity of the Social Security contribution tax is partially offset by the Earned Income Tax Credit (EITC), which is intended to offset part of the payroll tax liability for low-income workers. Social Security Administration, Office of Research, Evaluation, and Statistics, 1997, "Social Security Programs in the United States," SSA Publication No. 13-11758, https://www.ssa.gov/policy/docs/progdesc/sspus/.
[9] National Academies of Science, Engineering, and Medicine, 2015, *The Growing Gap in Life Expectancy by Income: Implications for Federal Programs and Policy Responses*, The National Academies Press, p. 78, https://www.nap.edu/download/19015.

Throughout Social Security's history, policymakers have sought to balance individual equity (i.e., that benefit amounts are fair to all contributors based on earnings during their working years) with social adequacy (i.e., that benefits are sufficient for the lowest-wage workers and their families).

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. The contribution structure could be made less regressive by raising or eliminating the cap on earnings subject to Social Security contributions, or by broadening the base to include investment income, as in Medicare. The benefit structure could be made more progressive by increasing benefits for low-income beneficiaries or reducing benefits for high-income beneficiaries.

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The value of social insurance

Social Security does not meet all the wage-replacement needs of a worker's family in the case of his or her disability, death, or retirement. But the protection Social Security does provide is extremely valuable. A 30-year-old worker earning $30,000-$35,000, with a spouse and two young children, has earned Social Security benefits equivalent to over $612,000 of life insurance

[10] Clingman, Michael, Kyle Burkhalter, and Chris Chaplain, 2014, "The Present Value of Expected Lifetime Benefits for a Hypothetical Worker Dying or Becoming Disabled at Age 30," Unpublished memorandum, Baltimore, MD: Social Security Administration, Office of the Chief Actuary. The $631,000 of disability benefits includes $443,000 of Disability Insurance benefits, and $189,000 of Old-Age and Survivors Insurance benefits once the disabled worker reaches the full retirement age.

protection and over $631,000 in disability insurance protection.[10] Most 30-year-old workers do not acquire close to this level of savings in private accounts; today the median retirement account balance is $2,500 for all working-age households.[11] For many low- and moderate-income workers, the foundation for economic security for them and their families in retirement, disability, or death is social insurance, not individual savings. Savings can supplement, but not replace, Social Security's insurance protections – and indeed, this was the original intent of the program.

Policy Options

Several policy options exist to ensure that scheduled Social Security benefits can be paid beyond 2034. A complete reform package may include some combination of revenue increases and benefit reductions, as well as some targeted benefit expansions.

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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.[12] If done gradually, the increases would be smaller than 2.58 percent at the beginning and rise to more than 2.58 percent at the end of the projection period.

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 an 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).[13] If the cuts were introduced gradually, they would be smaller at the beginning, but larger at the end of the projection period. Below are some options for addressing revenues and/or benefits. They are not exhaustive, nor are they recommendations.

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[11] Nari Rhee and Ilana Boivie, 2015, p. 10.
[12] Board of Trustees, 2016, p. 5.
[13] Board of Trustees, 2016, Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds, Washington, DC: Social Security Administration.

A Representative List of Options to Increase Revenue

- 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.[14]
- Expand compensation subject to the payroll tax by taxing health insurance premiums or cafeteria plans.[15]
- Subject investment income to Social Security contributions.[16]

A Representative List of Options to Reduce Scheduled Benefits

- Raise the retirement age to 68, 69, or 70, and/or index the retirement age to longevity.[17]
- Use the Chained Consumer Price Index, which typically grows more slowly than the index currently used, 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 60th 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.[18]
- 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.

[14] Ibid, p. 98.
[15] Kathleen Romig, 2016, "Increasing Payroll Taxes Would Strengthen Social Security," Center on Budget and Policy Priorities, http://www.cbpp.org/research/social-security/increasing-payroll-taxes-would-strengthen-social-security.
[16] Benjamin W. Veghte, 2015, "Social Security in an Era of Rising Inequality: Implications and Policy Responses," Poverty and Public Policy 7(2).
[17] Bipartisan Policy Center, 2016, Securing Our Financial Future: Report of the Commission on Retirement Security and Personal Savings, http://cdn.bipartisanpolicy.org/wp-content/uploads/2016/06/BPC-Retirement-Security-Report.pdf.
[18] Ibid, p. 89. This proposal can be considered either a benefit cut or a benefit increase because it affects different beneficiaries differently. Thus, it is the only single-option method presented here to reallocate benefits while also maintaining net benefits.

A Representative List of Options to Increase Benefits (These will require additional revenue or require other benefits to be reduced.)

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- Increase Social Security's special minimum benefit to pay 125 percent 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 five years.
- Increase all benefits by a certain percentage.
- Establish a new basic minimum benefit.[19]
- Increase survivors benefits to help widows and widowers maintain their standard of living.[20]
- 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.

[19] Ibid.
[20] Ibid.