

NASI Event, Chicago

5 September 2018

Henry J. Aaron

What is the most popular thing the U.S. government does? The easy answer is that it runs the Social Security system.

Social Security is the principal source of income for most of the elderly who are not employed and the sole source for about one in five.

It is the largest program of casualty and life insurance in the nation, providing support to people with disabilities and survivors of the death of a breadwinner.

It is a liberal's program managed with a conservative's attention to fiscal management. Maybe that is why large majorities of Democrats, Republicans, and Independents alike support the program.

But, as you may have heard, Social Security faces a projected long-term deficit—scheduled benefits exceed projected revenues. And social and economic developments since the last time Congress passed major Social Security legislation make some structural changes desirable.

The Social Security actuaries have been projecting a shortfall for years, but Congress hasn't done anything about it. So the National Academy of Social Insurance is organizing a series of meetings around the nation to help mobilize public opinion to support action. This is one of those meetings.

We think that the time for action may come soon. There will be a presidential election in a couple of years. That is where mandates for action come from.

I'm going to start by telling you where I am coming from and what I will be trying to do.

I'm a policy analyst who has been studying Social Security for more than fifty years.

Second, I'm a political progressive who understands that when Congress moves to act there will be a debate during which both progressives and conservatives will discover that they have to compromise in order to reach a mutually acceptable agreement. I won't try to describe the form that such an agreement will take. Instead, I'll lay out a plan the progressives can embrace and from which they can negotiate.

.....

For the last thirty five years the Social Security Trustees have reported that the program won't be able to pay some scheduled benefits sometime in the middle third of the 21st century.

For almost that long, the Congressional Budget Office has been warning us that the overall federal budget is on an unsustainable trajectory. Now, with the Trump tax cuts, there can be little doubt.

Some—mostly conservatives—believe that the budget projections prove that the United States can no longer afford to sustain Social Security, Medicare, and other so-called ‘entitlements.’ Some openly acknowledge that, by touting ‘entitlement crisis,’ they hope to cultivate a base willing to scale back—or even replace—all of them.

That campaign has failed—so far. But the game isn’t over. And talk of crisis has made many people very nervous.

Roughly two-thirds of the American public tell pollsters that Social Security is in a state of crisis or faces major problems. Smaller majorities say that they don’t expect to receive some or all currently scheduled Social Security benefits.

Still, solid majorities—progressives, conservatives, and independents alike—say that Social Security is important to them and, even, that they are willing to pay more in taxes to sustain it.

So, let’s take a look at what the projected Social Security shortfall looks like. **[Slide—Explain]**

It illustrates the gap in long-term Social Security financing, as a share of taxable payroll, that, some argue, necessitates cutting Social Security.

Currently, tax revenues earmarked to pay for Social Security cover about 92 percent of total outlays. Interest earnings and withdrawals from reserves fill in the gap. The reserves have been built up mostly over the past 35 years during which revenues exceeded outlays. Those past surpluses were invested in government bonds, the same top quality asset that insurance companies, banks, foreign governments, and others regard as the safest asset in the world.

This situation is projected to prevail until 2034. In that year, projections indicate that the reserves will be depleted. The heavy, solid line on the left shows that all scheduled benefits can be paid with accumulated reserves and projected revenues. In 2034, it drops to the flat line, which shows projected revenues as a percent of taxable payroll. The wavy, dashed line floating above it shows scheduled benefits.

The difference between the wavy line and the solid line after 2034 depicts the projected gap between ‘projected-current-law-revenues-plus-withdrawals-from-reserves’ and the cost of scheduled benefits, shown as a percent of taxable payroll. To close the gap in 2034, without raising taxes, would take an immediate 21 percent benefit cut and a bit more later.

Will reality differ from projections? Of course it will. So, SSA now prepares so-called stochastic projections that show how variations in key assumptions might cause the

depletion date to vary. **[Slide]** Analysts are highly critical of how these stochastic projections are done. But the takeaway is, in my view, indisputable. Trust fund depletion may come a bit earlier or later than 2034. But come it will.

So, what should Congress do? And when should they do it.

The answer to those questions is inescapably political. Progressives and conservatives both must ask themselves what they *want* to have happen *and whether* legislating early or late is more likely to give them what they want.

So, where are the parties now? As far as proposals are concerned, about as far apart as they could be.

Sam Johnson is the Republican chair of the Social Security subcommittee of Ways and Means and Representative. John Larson is the ranking Democrat on the same subcommittee.

Each has introduced a bill that would close the long-term funding gap.

Each would achieve what is called “sustainable solvency,” which means both that total projected revenues equal total projected expenditures over the next seventy-five years—the period over which actuaries measure balance—*and* that revenues will equal or exceed revenues *at the end* of the seventy-five year period.

But agreeing on the goal of sustainable solvency is where similarity of the two plans ends. **[Slide]**

Chairman Johnson’s bill would achieve balance entirely by cutting benefits. In fact, he would cut benefits by 116 percent of the projected gap, leaving room to cut taxes as well.

Larson’s bill would close the gap by raising taxes by 130 percent of the projected gap, leaving room to raise benefits.

Not a lot of common ground here!

As for the question of when to act, bipartisanship is alive and well. Leaders of both parties agree: not now!

The reason is that closing the gaps will take either benefit cuts, which Democrats oppose, or tax increases, which Republicans cannot abide. These aversions are especially intense when elections are impending. And since every year is an election year or the year before an election year, most observers think nothing will be done until the trust fund is nearly depleted and action is inescapable.

Many on the political left think delay actually serves progressive ends. Their reasoning is *straightforward*—and, I believe, *wrong*.

They point out that closing the gap entirely—or even mostly—on the expenditure side when the trust funds are nearly empty would be too brutal.

A 21 percent across-the-board cut is bad enough. But if Congress has shown repeatedly that it doesn't want to cut benefits at all for current retirees or people with disabilities. And it doesn't want to cut benefits if at all possible for those nearing retirement. But if they are protected, then cuts for new claimants would have to be even larger. Surely, the argument runs, Congress would be driven to boost payroll taxes rather than hammer the elderly, widows and widowers, and people with disabilities.

And most on the left would add: 'Well, that's just fine. We want tax increases, not benefit cuts anyway. So, let's wait.'

There is just one problem: this line of argument is wrong. Even more, it is *dangerously* wrong from the standpoint of progressives. Here's why.

Congress can always cut future benefits as much as it wants, whenever it wants, yet spare current beneficiaries and those soon to become beneficiaries. How? By borrowing to permit benefit reductions to be phased in over many years.

At the start of his second term, President George W. Bush appointed a commission that came up with a plan to partially privatize Social Security. That plan would have used government borrowing to sustain current benefits while payroll taxes were diverted into private accounts.

And, of course, at the end of last year Congress did the same thing, showering generous transfers mostly to the comparatively well-to-do—they were called tax cuts—financed by borrowing.

Those who believe that Social Security is a vital national policy should seek a national debate on restoring balance to the Social Security System as soon as it is possible to cut an acceptable deal to restore long-term sustainable balance.

That probably won't be until at least the next presidential administration. But progressives and conservatives both should prepare now to push a national debate on Social Security financing and structural reforms after the 2020 elections. And when that debate comes, Congress should attend to major economic and social developments that make some changes in Social Security desirable.

.....

So, I am going to use the remainder of my time,

- first, to go through developments since 1983, when Congress last passed major Social Security legislation, that signal the need for modest but important changes in Social Security. And,
- second, to lay out a program for restoring Social Security to enduring financial balance that can serve as a template for negotiation.

A few things have happened since the 1983 legislation. **[Slide]** Then, Social Security funding looked to be adequate for 75 years. Now, depletion looms in 16 years.

Preventing that from happening is job 1. Sixteen years to act isn't a crisis. But it is *this* generation's challenge, it is *your* challenge, not your children's.

Second, **[Slide]** earnings inequality has intensified since 1983.

Now, as then, the same proportion of workers—94 percent, to be specific—have all of their earnings covered by the payroll tax. But the *proportion of total earnings* above the earnings cap to which the Social Security tax applies, has nearly doubled—from 10 percent in 1983 to more than 17 percent in 2016.

Third, life expectancy has increased, but very unevenly. **[Slide]** Consider the following, finding courtesy of my Brookings colleagues, Gary Burtless and Barry Bosworth.

Among people born in 1920 who lived to age 50, those in the top income decile lived, on average, 5 years longer than people in the bottom income decile.

Among people born in 1940, twenty years later, the gap widened from 5 to about 11 years. That widening longevity gap has significantly eroded Social Security progressivity, measured over the life cycle.

Fourth, **[Slide]** disposable Social Security benefits—the checks that people get to cash—have lagged behind total worker compensation for three reasons.

- the 1983 legislation reduced replacement rates for most retirees.
- Medicare premiums have risen faster than earnings or benefits. And they are subtracted before Social Security benefit checks are cut.
- and a growing share of worker compensation comes in the form of employer-financed health insurance and other untaxed fringe benefits.

The fifth development **[Slide]** is the nearly complete replacement of private-sector, traditional defined-benefit pensions by 401k plans that pay a benefit as long as the pensioner lives.

Experts disagree on whether, on balance, this swap is a good or a bad thing. But there is no doubt that it places more risk on individual workers. And more risk boosts the importance of the lifetime, inflation-protected annuity that Social Security, almost uniquely, provides.

Finally, **[Slide]** one structural element of Social Security once made more sense than it does now.

Once upon a time, most couples were legally married, and most supplied one person to the paid labor force. In that world, the spouse benefit made sense. As married men and women now work for pay at nearly the same rates, the spouse benefit makes sense to an ever diminishing extent. The proportion of women who receive benefits based on their own earnings rose 20 percentage points between 1998 and 2016, and it is headed up further.

Yet, women continue to shoulder most of the economic and career costs of child-bearing and child-rearing. Social Security does not adequately recognize that contribution.

So, here is the program. It consists of 11 specific proposals.

[Slide] The first four help restore the progressivity that has been lost over the last generation.

These changes involve

- steepening the progressivity of the benefit formula
- gradually increasing the earnings ceiling, to cover 90 percent of earnings,
- broadening the tax base to include rapidly growing—and currently untaxed—elements of compensation, and
- increasing the special minimum benefit, a provision Congress created to help lifetime low earners, but which now serves no one

The fifth **[Slide]** would—at long last—extend Social Security to cover all jobs, public and private.

The sixth **[Slide]** would change the way Social Security benefits are computed to boost the benefit of one parent of each child—a parent of either sex—who takes time out of the paid labor force to raise children.

And the seventh would gradually lower the size of the spouse benefit relative to the primary worker's benefit.

The eighth and ninth **[slide]** would provide a capped benefit increase to people who have been on the beneficiary rolls for an extended period of time—and lift the age until which dependent children in school remain eligible for benefits.

In combination, these nine changes nearly balance Social Security for the next seventy-five years...but they don't quite make it.

And in the later years, they miss by a fairly wide margin, because costs are projected to rise as all of the baby boomers retire and as average longevity, one hopes, rises.

So, **[slide]** the final two items are added revenues—an immediate earmark of revenues from estate and gift taxes *at 2017 rates*—yes, the program calls for rolling back the estate tax exemption increase just enacted. And it includes revenue from payroll tax rate increases later on.

Here is a summary **[slide]** of the impact on program balance of all of these changes taken together. These estimates are not official, but Steve Goss tells me that they are close.

| | Average over 75 years | In 75 th year |
|--|-----------------------|--------------------------|
| Initial balance <small>2017 Trustees Report</small> | -2.83 | -4.50 |
| Impact of program | +2.93 | +4.60 |
| Post-program balance | +0.10 | +0.10 |

They are calculated as if the program takes effect immediately. But, as I said, no immediate action is in the cards. By 2021, the earliest date when action might be feasible, the numbers will have changed. So, the specifics would have to be tweaked in order to achieve average and sustainable balance.

The program I have just described provides a solid position from which progressives can negotiate. Conservatives will have plans of their own. **[Slide]** This plan relies largely, but not entirely, on new revenues to close the funding gap. Senate rules expose Social Security legislation to filibuster. So neither party is likely to win a complete victory. And both party's fingerprints will have to be on any bill that the American public will accept.

It is entirely possible that procrastination may continue until the trust funds are nearly depleted. That would be a shame...for progressives who value Social Security. And for conservatives who value orderly government management.

The time to act is when political balance is restored. That won't come until at least 2021.

[Slide] *Now* is the time for them to commit to leading a debate on how to restore to enduring financial balance America's most popular government program.