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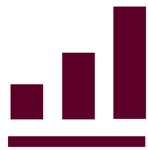

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PERCSPECTIVES ON POLICY

IT IS TIME TO FIX SOCIAL SECURITY

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Something happened a dozen years ago that did not receive enough attention at the time. And unless things change, in another dozen years from now something else will happen that is not receiving enough attention today.

Back in 2010, the Social Security program began running cash flow deficits when benefit payments started to exceed the program's tax revenues. The deficit started off at $37 billion in that first year and is projected to be $121 billion this year, or a fifth of the entire current federal primary deficit. A dozen years from now, the deficits will grow to $599 billion, and more importantly, the Trust Fund will be in its last year of solvency. Thereafter, the Trust Fund will be gone, and program tax revenues will cover only 80% of promised benefits. Under current law, Social Security benefits would then need to be reduced by 20%.

Of course, few think this benefit cut will happen. Our elected representatives will face immense pressure to take actions to restore a balance between Social Security revenues and expenses. But what actions will be available to them?

Policy decisions made under duress are not always the most thoughtful. Still, our elected representatives have been unwilling or unable to take the necessary actions. They exhibit no sense of urgency. In fact, some recent proposals have been to increase Social Security benefits, which would exacerbate the coming problem.

For many years now, the program's trustees have made statements such as the following, "Lawmakers have many policy options that would reduce or eliminate the long-term financing shortfalls in Social Security and Medicare. Taking action sooner rather than later will allow consideration of a broader range of solutions and provide more time to phase in changes so that the public has adequate time to prepare."[1] Despite this clear warning, the last time there was serious discussion about reforming Social Security was during the George W. Bush Administration. At that time, the Social Security Reform Commission was put in place to come up with recommendations. That attempt ended with a commission report and limited legislative momentum.[2]

With the Trust Fund's exhaustion only a little more than a decade away, policy makers still act as if reforming Social Security is tomorrow's problem. But as the Trustees state year after year, the policy options shrink each year they delay. The train wreck is coming, and no one seems to want to do something about it.

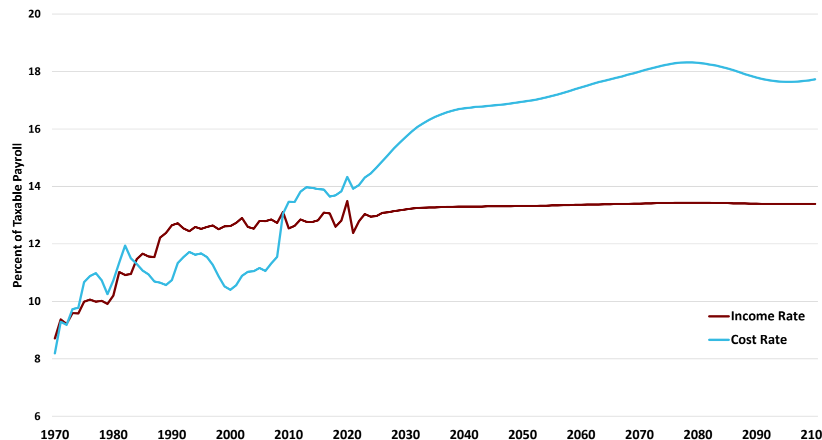
Perhaps the very existence of the Trust Fund provides a sense that reform can wait. The problem is not easy, as our elected representatives face the stark choice of increasing taxes or cutting benefits, neither of which are pleasing to large voting blocks. Scaling back near-term expenditures is not feasible, and the program's crucial role in reducing wealth inequality will be a consideration in the reform debate.

We discuss the role of each of these features – the Trust Fund, the nature of current spending, and Social Security's role in reducing wealth inequality – in consideration of various reforms to the program.

Trust Fund – One might think that more than a decade of large and growing deficits in a program as crucial as Social Security would merit more attention, but the Trust Fund has insulated the program from substantial reform efforts. Unfortunately, the Trust Fund has not insulated the rest of the Federal Budget from running deficits. The Trust Fund has provided a convenient way to account for the accumulated value of past surpluses when tax revenues exceeded the program's expenses, but its provision of accounting services is not the same as providing real resources that can pay benefits. The Social Security deficit is passed straight to the Federal budget, increasing the deficit there.

Figure 1 illustrates the program's income and costs as a percentage of taxable payroll since 1970.

FIGURE 1. SOCIAL SECURITY'S INCOME AND COSTS



The figure combines the Old-Age and Survivor's Insurance and the Disability Insurance programs. As can be seen, the program's tax revenues exceeded its expenditures from 1984 to 2009. These surpluses were the result of the 1983 reforms to the program when new federal workers were covered, scheduled tax increases were moved forward, and taxes were collected on retirees' benefits with higher shares of benefits taxed for higher income retirees. The reforms also gradually raised the full retirement age from 65 to 67 for participants born between 1938 and 1960.

While the Social Security program was collecting surpluses between 1984 and 2009, the unified federal budget only ran surpluses in 1998-2001. This means that for most of those years, the Social Security surpluses funded other spending, kept other taxes lower than they would have been otherwise, and partially covered the general deficit. During those years, the Social Security surpluses were credited to the Trust Fund in the form of special issue government bonds that yield the prevailing interest rates like tradable Treasury bonds. However, when these bonds are required to pay for the program's expenses they are redeemed by the Treasury, which in turn issues new tradable Treasury bonds. In practice, the special issue Trust Fund bonds are translated into additions to the explicit debt held by the public. So, the Trust Fund is providing continued authorization to pay benefits until 2035, but is not exchanging real resources to the Treasury in the way that retirees provide real resources to the market when they cash in stocks and bonds to pay for their living expenses. Meanwhile, the impetus for needed debate and action on reforms is downplayed and delayed.

Scaling Back Near-Term Expenditures is Difficult – As the experience with the 1983 reforms indicate, changing the way benefits are determined – e.g., raising the full retirement age – took years to phase in. It is preferable that structural changes to the benefit formula are announced well in advance so that near-term retirees are not adversely affected and so that younger workers can adjust to any new provisions. The 1983 reforms did bring forward some tax increases and did impose taxes on retirees' benefits. The burden of the former was on workers and the latter was a reduction in the net benefits of some retirees. However, taxation of benefits today are only equal to 3.3% of total benefits paid, and thus this tax does not dramatically reduce net benefits paid by the program.

Because current and near-term retirees have planned their saving and consumption around the expectation they will receive benefits for the duration of their retirement, it is not practical to achieve dramatic expenditure reduction in the short-term. Few of the reforms being discussed now, besides changing the cost of living adjustment, affect current and near-term expenditures. Further, while some of these proposals reduce the COLA, others increase it.

Social Security's Role in Reducing Wealth Inequality - Wealth inequality has grown significantly over the last three decades and there are growing concerns about the diminishing wealth share of the middle class. Standard wealth definitions require that individuals possess a legal claim to any assets included as wealth. Consequently, accrued Social Security benefits are not considered wealth because workers and retirees lack a legal claim to the receipt of those benefits. However, at the beginning of 2022, accrued Social Security benefits were estimated to be $49.9 trillion, or about 33% of the size of conventional measures of household wealth. And, while these accrued benefits may not meet the formal definition of wealth, the existence of these benefits affected the lifecycle savings behavior of current recipients and will affect the savings behavior of current workers.

In other work, PERC has examined how accrued Social Security benefits reduce wealth inequality. Treating accrued Social Security benefits similarly to accrued pension wealth associated with defined

benefit plans, and estimating accrued benefits for households in the Survey of Consumer Finances, we determine the degree to which these accrued benefits reduce wealth inequality. This happens because accrued Social Security benefits are much more evenly distributed than savings wealth. Households in the top 10% of the estimated wealth distribution, excluding Social Security, held 75% of wealth as of 2016, but only 18% of accrued Social Security benefits. Once accrued Social Security benefits are included in a total wealth measure, the percent of total wealth attributable to the same top 10% of household's declines to 64%. Among households headed by respondents 65 years of age and above, the top 10% held about 14% of accrued Social Security benefits and about 70% of the total conventionally measured net worth. The share of a comprehensive measure of total wealth held by these households, including Social Security, declines to 58%.

Given that the presence of the Trust Fund masks the perceived need for reform, that any rapid decrease in expenditures would entail a cut in benefits for current and near-term retirees, and that the program reduces wealth inequality; why consider reform now and, if we do, what reform principles and options should be considered?

Starting the discussion now gives policy makers more flexibility in assessing reform options. It also brings needed attention to the general budget deficits and the mounting federal debt. Announcing reforms now gives younger workers time to plan around the necessary changes. Finally, discussion now helps to frame the reform principles.

Reform Principles – Ultimately, reforming Social Security is about bringing together the cost and income rates presented in Figure 1. Four principles can frame the reform options. First, the program should be self-funded in the long run. Second, the reform burden should be shared across generations. Third, the reform should ensure that benefits are adequate for lower income retirees. Fourth, the reforms should constrain federal expenditure growth, given the current and future predicted deficits and the growing burden of government health care spending.

The first principle means that the program must be fully funded through higher taxes, reduced benefits or a combination of increased taxes and scaled back benefits. The burden can be shared across generations in several ways. As previously alluded to, current and near-term retirees can share the burden through reduced cost of living adjustments. Current workers can share the burden through adjustments that slow the growth in benefits and raise revenues though increasing the taxable maximum.

The Social Security actuaries have scored a range of individual proposals including those that change the COLA, that make the benefit formula more progressive, that increase the retirement age, and that increase revenues. The Committee for a Responsible Federal Budget has taken the Social Security actuaries' evaluations to build a convenient tool that allows users to evaluate a set of changes together.[3]

For example, the following four changes when combined result in long-run revenues that equal long-run costs. In no particular order, the first change indexes the retirement age to longevity after it reaches 67. This would continue the progressively higher full-retirement ages that were part of the 1983 reforms. The second change replaces the COLA adjustment currently based on the Consumer Price Index for all wage earners with the chained CPI. The third change slows the benefit growth for the top half of earners phased-in over the next 40 years. The benefit formula for workers in the bottom half of the lifetime earnings distribution would not be affected. The final change increases the taxable maximum so that 90% of total wages are subject to the payroll tax. Currently, 83% of total wages earned are taxable.

Collectively, these reforms are consistent with the principles outlined above. The finances are shored up, the burden is shared across generations, the monthly benefits paid to the bottom half of the earnings distribution are unaffected, and the program will be similar in size in the future, in terms of its share of the nation's output, to the size it is today.

Reforming Social Security is not high on the agenda for most policy makers. It is viewed as tomorrow's problem. However, as we have seen with policies that are designed to slow climate change, action today on tomorrow's problems is possible. Acting sooner rather than later has the benefit of allowing more options to address the problem, and provides program participants, taxpayers, and businesses more time to prepare for any changes. Perhaps it is past time to convene a new Social Security Reform Commission.

[1]Status of the Social Security and Medicare Programs, 2022, p.7.
[2]PERC Director Emeritus Thomas Saving was a member of the Commission to Strengthen Social Security.
[3]CRFB https://www.crfb.org/socialsecurityreformer/

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