Strengthening Social Security for all

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How do you strengthen Social Security in a time of budget austerity? The obvious answer is by making do with less and targeting benefits to those who need them most. But I’m going to take a contrarian stance and argue for expanding benefits across the board—or, rather, restoring benefits that were cut in the last round of reforms.

My rationale is simple: Americans need Social Security more than ever, and they’re willing to pay for it.

Polls have consistently shown that Americans strongly prefer raising taxes over cutting benefits as a way to close the projected shortfall and strengthen the program. The most popular option is raising taxes on high earners, but Americans prefer to close the gap on the revenue side even if asked to pay more themselves (see, for example, Reno and Lavery 2009; Hess, Hayes, and Hartmann 2011).

*Are Social Security benefits adequate?* In retirement policy, “adequacy” can suggest a relative threshold, such as the ability to maintain the same standard of living in retirement, or an absolute one, such as living above poverty (Smith, Stein, and Turner 2010). The United States lags behind most high-income countries when adequacy is measured either way (see, for example, OECD 2012, tables A7, A8, and A9).

Nevertheless, thanks to the expansion of Social Security coverage and benefits through most of its history, the poverty rate of seniors, once appallingly high, approached that of working-age families.¹ Though the standard of living of

¹ Using the Supplemental Poverty Measure (SPM), which, among other things, takes into account out-of-pocket health costs, the poverty rate of adults age 65 and older in 2011 was 15.1 percent, slightly lower than the poverty rate of adults age 18 to 64 (15.5 percent). In 2010, the poverty rate for seniors was slightly higher than that of working-age adults (15.9 percent vs. 15.2 percent) (U.S. Census Bureau 2011 and 2012). Historical statistics based on the Supplemental Poverty Measure are not available. However, the poverty rate measured using the official poverty thresholds spiked dramatically for working age adults in the Great Recession and its aftermath (Shierholz and Gould
retirees remained modest, at least each generation until recently fared better than the last.

Then three things happened: Social Security benefits were cut beginning in the early 1980s; around the same time, 401(k) plans began replacing secure pensions; and the housing bubble burst (Munnell et al. 2007 and 2012). This last event triggered the Great Recession, which perversely ushered in a climate of budget austerity.

Younger households are the worst off. The Center for Retirement Research at Boston College estimates that 62 percent of GenXers in their 30s are at risk of seeing a significant drop in living standards at retirement, compared with 44 percent of baby boomers in their 50s (Munnell et al. 2012). Unless something is done to shore up retirement incomes, baby boomers will represent a high point in retirement security—albeit not a lofty one.

Part of the reason younger workers are in big trouble is that benefits are still being cut. The enactment of the Social Security Amendments of 1983, which amounted to a 19 percent benefit cut for the average worker according to NASI estimates, are still being phased in as the “normal retirement age” (the age for unreduced Social Security benefits) rises from 65 to 67 (Reno, Bethell, and Walker 2011). An increase in the normal retirement age is equivalent to an across-the-board benefit cut for workers retiring at any given age.

As a result, the income replacement rate for the prototypical “medium earner” retiring at 65 has fallen from 49 percent in 1982 to 41 percent today—and is scheduled to drop to 36 percent as the normal retirement age rises from 66 to 67 (Social Security Trustees 2012). The problem is exacerbated by rising Medicare premiums, which are deducted directly from benefits.

We badly need to shore up Social Security benefits, and not just for low-income beneficiaries.

This is not to ignore the fact that the Great Recession and weak recovery have had an impact on Social Security’s finances. The projected 75-year shortfall grew from less than 2.0 percent of taxable payroll in 2007 to around 2.7 percent in 2012, according to the Social Security actuaries (Social Security Trustees 2007 and 2012).

As a practical matter, this means that progressives’ quick fix—scraping the cap on taxable earnings—is no longer enough to close the shortfall. Depending on whether you count the additional taxable earnings toward benefits, this would
close the shortfall by 1.9 to 2.3 percent of payroll (Goss 2012 and Social Security Administration 2012a).²

Other forms of base broadening help, but not enough.³ Thus, a gradual increase in the payroll tax rate is also called for, not just to provide needed revenues, but also to give everyone a stake in strengthening the system.

Policies to foster full employment and faster wage growth, including a higher minimum wage, would help Social Security’s finances. So would encouraging immigration. However, it would take years for these policies to be factored into projections.

We also shouldn’t count on investing the trust fund in risky assets, if for no other reason than the fact that shortfalls caused by market downturns will inevitably be politicized, as we have learned from the example of public pensions.

This is why we need a payroll tax increase. This used to be a fairly frequent occurrence, but the rate has remained the same for over 20 years (Social Security Administration 2012c). A gradual increase can be accommodated by real wage growth. An increase of a tenth of a percentage point every five years, sufficient to offset projected improvements in life expectancy, would do little to slow the projected rise in living standards (author’s calculations based on Social Security Trustees 2012).⁴

This assumes, of course, that we need to close the shortfall. We do, though the situation isn’t urgent, and doing it right matters more than doing it fast.

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² The lower estimate assumes earnings would be counted toward benefits at a 5 percent rate.

³ Taxing salary reduction plans would decrease the shortfall by around 0.2 percent of taxable payroll (Social Security Administration 2012b). Covering all new state and local government workers would also make a modest contribution toward closing the shortfall, but it is unlikely that public employee unions would support such a move at a time when public pension plans are underfunded and under attack.

⁴ Between 2012 and 2086, life expectancy at age 65 is projected to increase from 18.8 years to 23.0 years (or 22 percent) for men, and from 20.8 years to 24.6 years (18 percent) for women. Gradually increasing the tax rate by 0.1 percentage point every five years would raise the tax rate from 6.2 percent to 7.7 percent over the same period, a 24 percent increase. Real wages net of Social Security taxes are projected to increase by 141 percent over the same period. With a gradual increase in the Social Security tax rate from 12.4 percent to 15.4 percent (including both the employer and employee contribution), net real wages would still increase by 133 percent (author’s calculations based on Social Security Trustees 2012).
By my rough calculations, base broadening measures, including “scrapping the cap,” combined with a gradual increase in the payroll tax rate, are sufficient to not only close the shortfall but also restore some of the benefits cut in 1983. Specifically, “scrapping the cap,” taxing salary reduction plans, and slowly increasing the tax rate as described earlier gives us enough revenue to freeze the retirement age at 66 and raise the first multiplier in the benefit formula to 100 percent:

<table>
<thead>
<tr>
<th>Change as % of payroll</th>
<th>Change as % of payroll</th>
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<tbody>
<tr>
<td>Revenues</td>
<td></td>
</tr>
<tr>
<td>Gradually eliminate cap, add 5% bend point</td>
<td>1.9</td>
</tr>
<tr>
<td>Raise tax rate by 0.1 percentage point every 5 years</td>
<td>1.4</td>
</tr>
<tr>
<td>Interaction effect of eliminating cap and raising rate</td>
<td>0.3</td>
</tr>
<tr>
<td>Treat salary reduction plans like 401(k)s</td>
<td>0.2</td>
</tr>
<tr>
<td>Benefits</td>
<td></td>
</tr>
<tr>
<td>Freeze normal retirement age at 66</td>
<td>-0.5</td>
</tr>
<tr>
<td>Raise first multiplier in benefit formula to 100%</td>
<td>-0.5</td>
</tr>
<tr>
<td>Actuarial balance</td>
<td></td>
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<tr>
<td>TOTAL</td>
<td>0.1</td>
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</tbody>
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Since Social Security can pay scheduled benefits for decades to come, calls to action are usually framed as “small cuts now rather than big cuts later,” or sometimes, among Democrats, “better us than them.” Proposed cuts are usually combined with targeted increases for the poorest poor or the oldest old to create a package that can technically be called “progressive” even if heavily weighted toward cuts.

The same people who want a leaner but more “progressive” Social Security often show less concern about the cost-efficiency and progressivity of other government programs, including tax subsidies for retirement savings. One explanation for this double standard is that benefit cuts are intended to forestall tax increases for the wealthy. Thus, the Bowles-Simpson plan, which called on the “most fortunate” to do their part for Social Security, proposed progressive cuts that spared only a few of the poorest beneficiaries, while only modestly

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5 Raising the first multiplier in the benefit formula from 90 percent to 100 percent is an alternative to lowering the normal retirement age back to 65. The two options would have a roughly equal impact on the average retiree, but there are some advantages to raising the multiplier that will be discussed later.
increasing the cap on taxable earnings (National Commission on Fiscal Responsibility and Reform 2010; Goss 2010).

What often gets lost, even among reformers with a stronger claim to the “progressive” label, is that targeted benefit increases, combined with across-the-board cuts, will, if repeated, gradually transform Social Security from a social insurance program to a safety net program. And it’s an unfortunate truism that “programs for the poor become poor programs.”

Rather than allowing Social Security to turn into Supplemental Security Income (SSI), progressives should use a reverse strategy: tying the well-being of disadvantaged groups to that of the broader population. Thus, for example, we might peg SSI benefits to the first bend point in the Social Security benefit formula. This would not only immediately increase SSI benefits, but also hitch them to rising wages and living standards.

If the goal is to restore benefits cut in the last round of reforms, why not start by lowering the normal retirement age to 65? That’s certainly an option. But given growing disparities in life expectancy as well as policymakers’ preoccupation with increasing the labor force participation of older workers, a fairer and perhaps more politically realistic alternative would be to increase the first multiplier in the benefit formula from 90 percent to 100 percent.6 This would increase benefits by around $900 a year for most participants, which would constitute a larger percentage increase for low earners.7

Recently, two similar across-the-board measures have been proposed as part of broader reform packages: Senator Tom Harkin (D-Iowa) has suggested raising the first bend point by 15 percent, and two initiatives led by groups representing women and people of color proposed increasing benefits by 5 percent of the average benefit (Harkin 2012; Estes, O’Neill, and Hartmann 2012; Rockeymoore and Lui 2011). Both would result in slightly smaller dollar amounts than increasing the first multiplier to 100 percent, but the second option is somewhat more progressive, since even workers with very low earnings would fully benefit. However, a 100 percent replacement rate for earnings below the first bend point has an intuitive appeal.

Is this a realistic plan?

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6 Though the normal retirement age has little impact on when people actually retire, some policymakers may be reluctant to champion reforms that appear to encourage earlier retirement.

7 Gains in life expectancy have been concentrated in the top half of the earnings distribution (Waldron 2007). Thus, giving a larger percentage increase to low earners helps maintain the progressivity of lifetime benefits.
I started off by saying that Americans need Social Security and are willing to pay for it.

Though this is true of the vast majority of Americans, a small minority disagree. They have been successful at convincing opinion leaders that rising life expectancy has created an entitlements crisis that necessitates benefit cuts, especially in the form of a higher retirement or eligibility age.

In fact, stagnating wages, rising inequality, and slower population growth are all bigger factors in the emergence of Social Security’s projected shortfall, while Medicare’s biggest challenge is economy-wide health cost inflation (Morrissey 2011).

Social Security is a much more effective way to ensure retirement security than tax-subsidized retirement savings. It also has helpful macroeconomic properties. Unlike Medicare costs, which are projected to mount, Social Security costs will level off at around 6 percent of GDP after the retirement of the Baby Boomers (up from around 5 percent today) (Social Security Trustees 2012).

My plan is in many ways quite conservative:

- It’s paid for.
- It doesn’t ensure that all beneficiaries have incomes above the poverty line (though it does reduce poverty).
- And all it aims to do is restore some of the benefits cut in the last round of reforms.

If it is unrealistic, this says more about the political climate today than any economic constraints we might face.

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8 Social Security is an automatic stabilizer because benefit outlays increase when some workers who lose their jobs during recessions decide to retire. Because monthly benefits are adjusted for earlier retirement to equalize lifetime benefits, this doesn’t have a large impact on the system’s long-term finances, but the timing of payments helps stabilize the economy. Social Security is also helpful when the economy is at less than full employment because it is mostly a pay-as-you-go system (redistributing from current workers to current retirees and other beneficiaries) and beneficiaries tend to spend their income more quickly than workers. In comparison, advance-funded pension and savings programs tend to reduce aggregate demand.
References


