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A PLAN TO BURY SOCIAL SECURITY, NOT TO STRENGTHEN IT

The Fiscal Commission Finds a Solution that Could Be Worse than Doing Nothing

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Under the plan released December 1, 2010 by the co-chairs of President Obama's National Commission on Fiscal Responsibility and Reform, most workers, including most low earners and workers approaching retirement, would see significant cuts in Social Security benefits. Even current retirees would see cuts due to a proposed reduction in the annual cost-of-living adjustment.

According to an analysis of the plan by Social Security's chief actuary (Goss 2010a), middle-class workers with average earnings over the course of their careers (around $43,084 in 2010) would see a 22% cut in benefits by the end of the 75-year projection period, not significantly different from the 23.5% cut in benefits these workers would face in 2085 if *nothing* were done to shore up Social Security's finances.

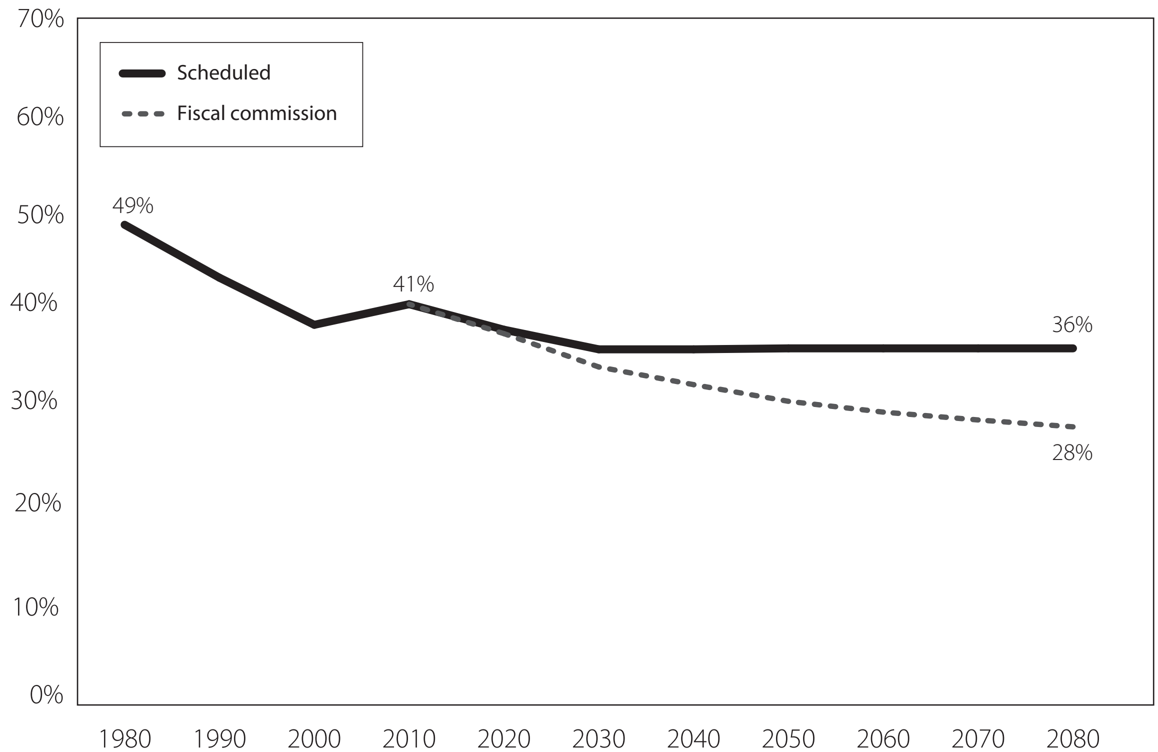
Because these cuts would fall on top of earlier cuts implemented in 1983, including a gradual increase in the normal retirement age from 65 to 67, the share of a middle-class worker's pre-retirement earnings replaced by Social Security would fall from 49% in 1980 to 28% in 2080 if the worker retired at 65 (see **Figure A**). If anything, this understates the problem, since most workers retire before age 65.

Deep cuts in Social Security reduce support for the system, especially among young workers and high-income workers, who face the largest cuts. Those earning 160% of the average wage (meaning they earn $68,934 in 2010) would see a 35% cut in benefits by 2080 under the co-chairs' plan. Combining in the cuts implemented in 1983, the replacement rate would fall from 48% in 1980 to 20% in 2080 (see **Figure B**). Those earning the taxable maximum – $106,800 in 2010 – would face an even larger cut of 41%.

Though workers earning $68,934 are classified as "high earners" by Social Security, in most other policy discussions they are solidly middle class. For example, President Obama has pledged not to increase taxes on "middle-class" workers earning less than $200,000 a year. These and other upper-income workers still depend on Social Security for a significant portion of their income after 65. For seniors in the top income quintile, Social Security contributes more than any other income source besides job earnings, and Social Security is becoming even more important as secure employer pensions become scarce.

FIGURE A

Replacement rate for scaled *medium* earner ($43,084 in 2010)
Social Security as a share of pre-retirement earnings, retirement at 65



Sources: EPI analysis of Social Security Administration data. Does not include possible hardship exemption which would exempt up to 20% of retirees from increases in the early and normal retirement ages.

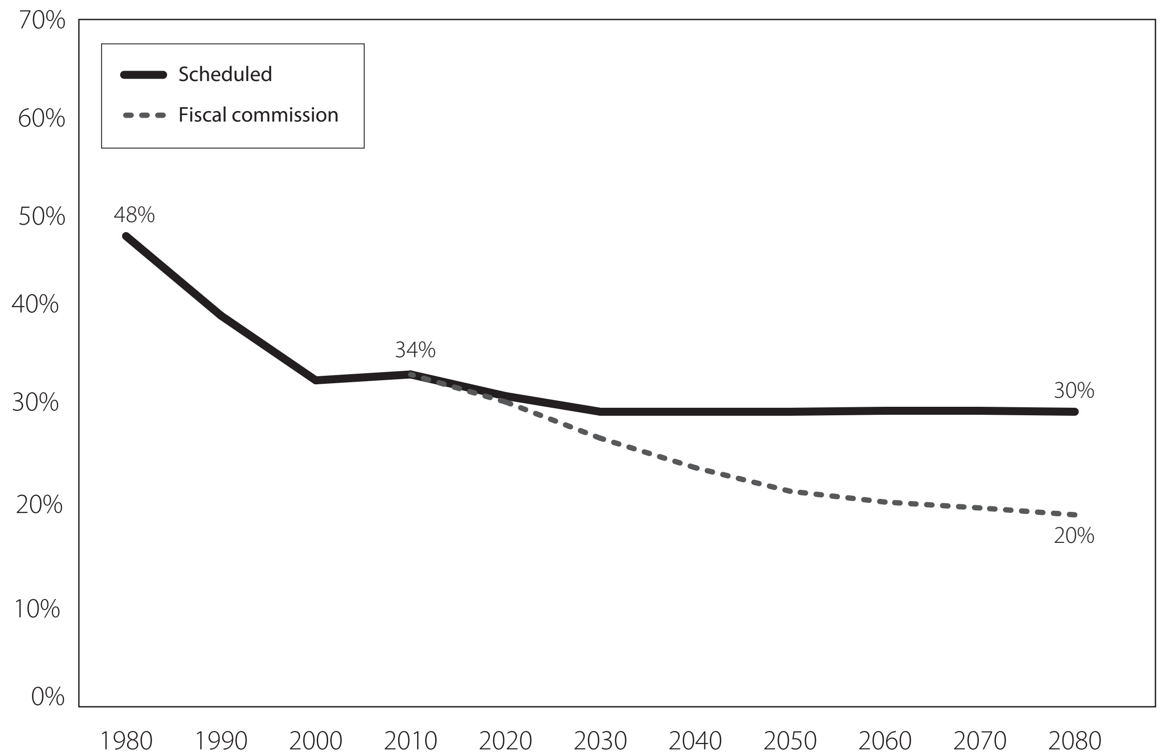
In spite of the fact that the payroll tax rate is the same for all income groups up to $106,800 and falls to zero after that, Social Security is modestly redistributive because of its progressive benefit structure – high earners help pay for the benefits of low earners (though this is partly offset by a growing disparity in life expectancy, i.e., high earners also live longer). Yet Social Security remains popular among high earners, and the Fiscal Commission cuts would undermine the program by restructuring it from a universal system popular across income groups to one targeted more toward lower-income workers.

Some have called the commission's plan a "progressive" fix for Social Security because it calls for a minimum retirement benefit that is 25% above the federal poverty line in 2009. However, over time, this minimum benefit would be eroded by other changes proposed in the plan, and low earners (those with career earnings of around $19,000, or about 45% of the average) would eventually see a 12% *cut* in benefits. As a result, the replacement rate for these workers falls from 66% in 1980 to 55% today to 43% in 2080 (see **Figure C**). The Fiscal Commission plan does improve benefits for some *very* low earners (those making $10,771 a year in 2010); they would end up with 15% higher benefits in 2080.

FIGURE B

Replacement rate for scaled *high* earner ($68,934 in 2010)

Social Security as a share of pre-retirement earnings, retirement at 65



Sources: EPI analysis of Social Security Administration data. Does not include possible hardship exemption which would exempt up to 20% of retirees from increases in the early and normal retirement ages.

The co-chairs' goals for Social Security

In an earlier draft of the Fiscal Commission's plan, its co-chairs Erskine Bowles and Alan Simpson listed the following goals (Bowles and Simpson 2010):

- "Strengthen Social Security for the long haul by returning the system to sustainable solvency."
- "Prevent the 22% across the board benefit cut projected to occur in 2037."
- "Reduce elderly poverty by putting into place a new, effective special minimum benefit."
- "Enable system to continue to provide for a secure retirement as the population grows older and Americans live longer."
- "Reform Social Security for its own sake, not for deficit reduction."

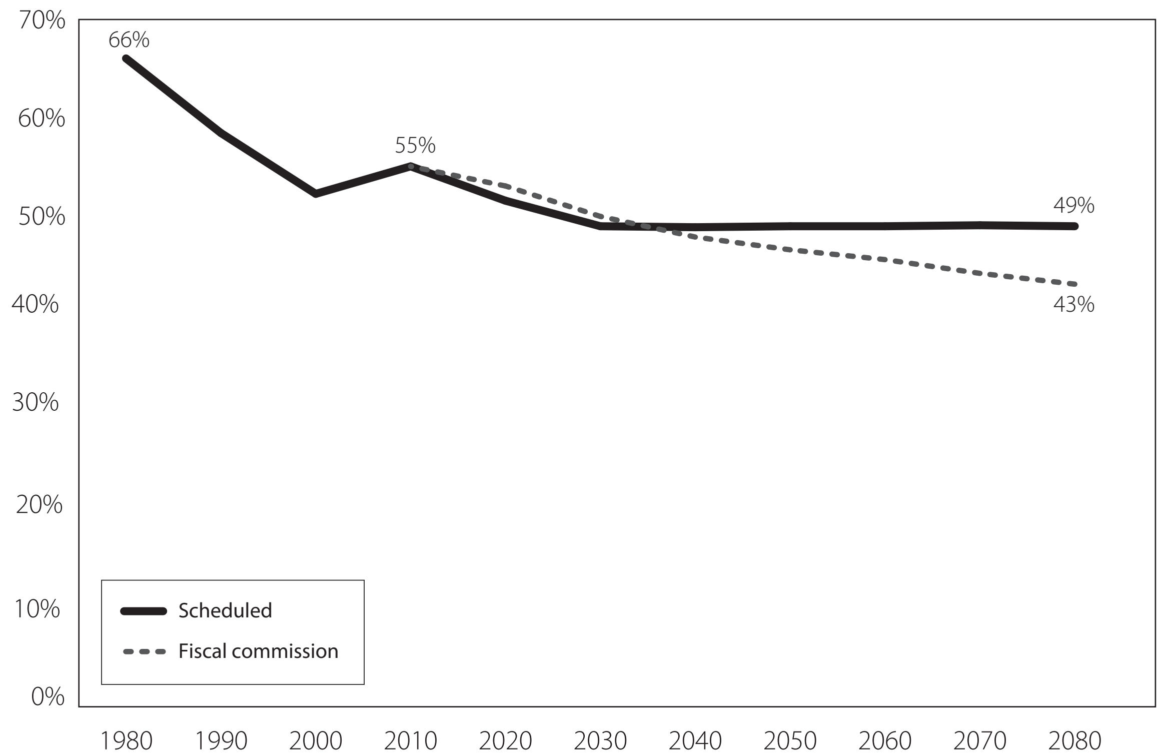
Though the plan does achieve long-term solvency, it falls short of other stated goals, notably that of providing for a secure retirement, and it meets other goals only if they are interpreted very narrowly.

In addition to its seven main provisions (discussed below), the plan suggests that the Social Security Administration "better inform" beneficiaries of retirement options and that a "broad dialogue" occur on the importance of personal retirement savings. These provisions are not discussed here since they do not affect the value of lifetime benefits.

FIGURE C

Replacement rate for scaled *low* earner ($19,388 in 2010)

Social Security as a share of pre-retirement earnings, retirement at 65



Sources: EPI analysis of Social Security Administration data. Does not include possible hardship exemption which would exempt up to 20% of retirees from increases in the early and normal retirement ages.

Overall, the plan would reduce the benefits of the majority of workers while increasing them for certain low earners. While it is true that the plan would eliminate the 75-year shortfall projected by the Social Security Board of Trustees (the shortfall is 1.92% of taxable payroll under the trustees' "intermediate scenario," and the co-chairs' plan would improve the long-term balance by 2.22% of taxable payroll), roughly three-fourths of the shortfall is closed through net benefit cuts.

The co-chairs claim that the plan would prevent the 22% across-the-board benefit cut projected to occur when the trust fund is exhausted in 2037, but their plan only delays the middle-class cuts while increasing them for many other workers. Since it is likely that Congress will act to shore up revenues before the trust fund is exhausted in 2037, it is more accurate to say that the Fiscal Commission plan would ensure that these cuts take place.

It is not clear whether the plan would actually reduce elderly poverty, as claimed, since it would raise the benefits of a few very low-income workers while reducing those of a larger group of workers only slightly higher up the income scale. Since the plan would also reduce the Social Security benefits of middle-class workers by 22%, and since more than half of Americans are already at risk of seeing a significant drop in their standard of living at retirement, the authors cannot claim that their plan would "continue to provide for a secure retirement."

Certain provisions would strengthen Social Security financing and improve benefits for vulnerable workers, but these do not go far enough. In particular, the proposal to raise the cap on taxable earnings is long overdue and has strong support among voters across the political spectrum, but the co-chairs allow *35 years* for raising the cap (in an initial draft the co-chairs cited the need to *prevent* a rapid buildup of the trust fund as a reason to phase-in raising the cap over so long a period).

The co-chairs' plan for Social Security

1. ***Increase in normal retirement age***. The plan would raise the age at which workers are eligible for full retirement benefits by one month every two years, starting with workers born in 1960 or after. The normal retirement age is currently scheduled to rise to 67 for workers in that group; the Fiscal Commission plan would raise it in monthly increments to 68 for workers born in 1984, to 69 for workers born in 2008, and so on. By the end of the 75-year projection period, it would be 69 years and 6 months.

   To quantify the impact of raising the age at which a worker receives full benefits, let's assume that all workers retire at age 65. The scheduled increase in the normal retirement age from 65 to 67, currently underway, amounts to a 13% reduction in benefits. Increasing the age to 69 and 6 months amounts to a 30% cut (and a 21% cut compared to current law). This provision would affect all income groups equally and would reduce the projected 75-year shortfall by 21% (0.41% of taxable payroll).

   The early eligibility age, currently 62, would rise to 64 in tandem with the increase in the normal retirement age. But because workers would receive higher monthly benefits when forced to delay retirement, their lifetime benefits would be roughly the same as under current law.

   The plan proposes a "hardship exemption" that would protect up to 20% of beneficiaries from the increases in the early and normal retirement ages. Those eligible would include workers in physically demanding jobs, workers managing chronic health problems or caring for family members with health problems, and older workers who have lost their jobs and are unlikely to find another. Given that qualifying for disability benefits is already a highly subjective and administratively cumbersome process, it will be a challenge to design protections for these affected workers. Probably due to a lack of specificity, Social Security's chief actuary has not provided an actuarial assessment of the hardship exemption proposed by the Fiscal Commission co-chairs, though he has analyzed a broader exemption that would fully or partially exempt a larger group of workers from the retirement age increase (Goss 2010b).

2. ***Change in benefit formula.*** The plan would gradually reduce the percentages of average earnings (the "multiples") used in benefit calculations and introduce a new income bracket (a "bend point") in order to reduce benefits. Under the current formula, the "primary insurance amount" – the monthly benefit a retiree receives if he or she retires at the normal retirement age – is calculated by multiplying the first $761 in average indexed monthly earnings by 90%, earnings between $761 and $4,586 by 32%, and earnings between $4,586 and $8,900 by 15%. The Fiscal Commission plan introduces a new bend point at the 50th percentile, i.e., it breaks down the middle range into two ranges, $761-$3,113 and $3,113-$4,586, and gradually reduces the upper multipliers to 30%, 15%, and 10% over 40 years. Only workers earning less than $761 a month, or $9,132 a year, are completely unaffected by these cuts. This provision would reduce the projected 75-year shortfall by around 45% (0.86% of taxable payroll).

3. ***Smaller cost-of-living adjustment.*** The plan would reduce the cost-of-living adjustment (COLA) by 0.3% per year by basing it on a different price index than the consumer price index currently used. This cut adds up to a reduction in benefits by about 3% for workers who have been retired for 10 years and by about 6% for workers who have been retired for 20 years. The cut would be implemented immediately and would have the biggest impact on the oldest beneficiaries, who have often exhausted other means of support. This provision would reduce the projected 75-year shortfall by around 26% (0.50% of taxable payroll).

4. *Benefit "bump" after 20 years.* To partly offset the COLA cut for the oldest beneficiaries, the plan would increase benefits by an amount equal to 1% of average workers' indexed earnings 20 years after they first became eligible for retirement benefits, then an additional 1% per year for four years. But the "bump" would offset less than one-third of the reduced COLA. The early eligibility age is currently 62 (so the bump would initially take effect between ages 82 and 86), but the early eligibility age would increase under the plan along with the normal retirement age. This provision would increase the projected 75-year shortfall by around 8% (0.15% of taxable payroll).

5. *Increase in minimum benefit.* A minimum benefit equal to 125% of the poverty line (a benefit equal to $1,128 per month in 2009) for 30-year workers would increase benefits for some low earners. Low-income workers with fewer years of coverage could also receive somewhat higher benefits, but the change would have the biggest impact on long-career workers with very low wages, as opposed to low-wage workers with intermittent work histories due to unemployment or time for care-giving. This provision would increase the projected 75-year shortfall by around 8% (0.15% of taxable payroll).

6. *Increase in taxable earnings cap.* Earnings in 2010 above $106,800 (the amount rises each year with average wages) are currently not subject to Social Security payroll taxes. Roughly 16% of earnings fell above the cap in 2008, up from 10% in 1983, and the plan would gradually raise the taxable earnings cap to cover 90% of earnings over 35 years. In any given year, approximately 6% of workers have earnings above the cap (21% would be affected at some point in their lives). These high-income workers would pay higher taxes but would also receive higher benefits. A study by the Congressional Research Service found that eliminating the cap altogether and immediately (rather than raising it gradually, as Bowles and Simpson propose) would nearly eliminate Social Security's projected shortfall, with the typical affected worker paying 3% higher taxes and receiving 2% higher benefits (Mulvey 2010). In contrast, gradually lifting the cap as proposed by the Fiscal Commission co-chairs would reduce the projected 75-year shortfall by around 35% (0.67% of taxable payroll).

7. *Coverage of newly hired state and local government employees after 2020.* This provision would reduce the projected 75-year shortfall by around 8% (0.16% of taxable payroll).

Conclusion

The Center for Retirement Research estimates that the average household age 32-64 should have $90,000 more in retirement savings and pension benefits than it does now to be on track to maintain its standard of living in retirement (Retirement USA 2010). This retirement income deficit totals $6.6 trillion across households and assumes no additional cuts to Social Security beyond those introduced in 1983. The Social Security path proposed by the Fiscal Commission would deepen this enormous shortfall and exacerbate retirement insecurity. The commission's proposed increases in Medicare premiums and cost-sharing would only compound the problem.

Social Security is not driving the federal deficit, a point acknowledged by the co-chairs of the deficit commission, but if their goal nevertheless is to "strengthen Social Security for the long haul by returning the system to sustainable solvency," they could recommend that the cap on taxable earnings be eliminated immediately.

Cutting the benefits of a popular and successful program is a perverse way to strengthen it. Mr. Bowles and Sen. Simpson are not proposing these cuts because Social Security is increasingly unaffordable. To the contrary, since the cuts would be implemented over a period when real wages are projected to more than double, the co-chairs should explain why they believe it is necessary to devote a shrinking share of a growing economy to retirement security.

Sources

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