

Statement of

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on

Reforming Social Security Benefits

*House Ways and Means Committee
Subcommittee on Social Security*

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In this testimony, I would like to focus mainly on one essential point: Social Security benefit reform is required, regardless of the current imbalances in the system and the level of taxes that are eventually raised to support the system.

Why? Despite Social Security's great success, its growth in lifetime benefits and taxes over time has been decreasingly targeted at its four major goals:

- financial support for those with limited resources,
- financial protection against the risks of old age,
- incentives for the work and saving that provide the revenues undergirding the system, and
- equal justice under the law.

Simply put, the benefit side of Social Security was designed for a different era, a period when many new workers were entering, not leaving, the workforce, and when there was a different (though, even then, stereotyped) view of the family. Many of these issues stretch well beyond Social Security. In particular, putting close to a third of all adults on Social Security reduces personal income, the growth rate of GDP, the ability of the elderly to support themselves when they are truly old, and the income tax and other revenues that support all government programs (not just Social Security). It also adds to the decreasing ability of our failed private retirement systems to provide an adequate additional leg of support for Americans.

Especially in Social Security's early history, many people thought the program was highly progressive, in large part because its benefit formula provided higher replacement wages for those with lower lifetime incomes and then, a bit later, because it provided disability insurance. Over time, however, the system has been found to have many forms of redistribution, some of which are fairly regressive. Many features violate basic equity and efficiency principles without serving any fundamental purpose well.

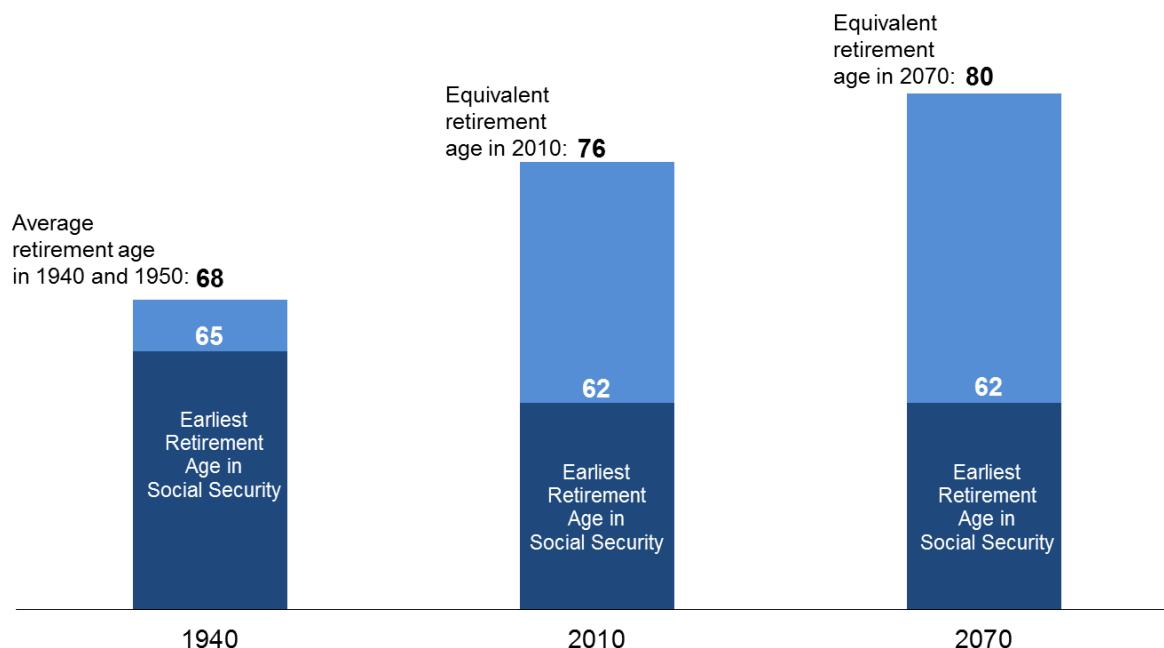
To give you some examples of how far the system has moved from its fundamental purposes, consider the following:

Social Security now provides about \$579,000 worth of benefits (\$966,000 if one includes Medicare) to the newly retiring average-wage couple in 2013. Benefits will rise toward \$700,000 (\$1.4 million) for couples in their mid-40s today, even while programs for their children are scheduled to be cut.

Social Security has morphed into a middle-age retirement system. Typical couples are receiving close to three decades of benefits, while individuals retire on average at least a decade longer than they did when the system was first established. For a couple retiring today at age 62, benefits are expected to last about 28 years.

In 1940 and 1950, the average worker retired at about age 68. To live for an equivalent number of years on Social Security, a person would retire at age 76 today and age 80 in 2070 (figure 1). Instead, the average worker today retires at age 63 to 64.

Figure1: Equivalent Retirement Ages in Social Security



Source: The Urban Institute, 2013. Based on data from the Social Security Administration, Birth Cohort Tables.

By constantly increasing benefits to middle-age retirees, at least as defined by life expectancy, smaller and smaller shares of Social Security benefits are being devoted to the elderly (figure 2). This threatens the well-being of the truly elderly by encouraging them to spend their retirement income too soon.

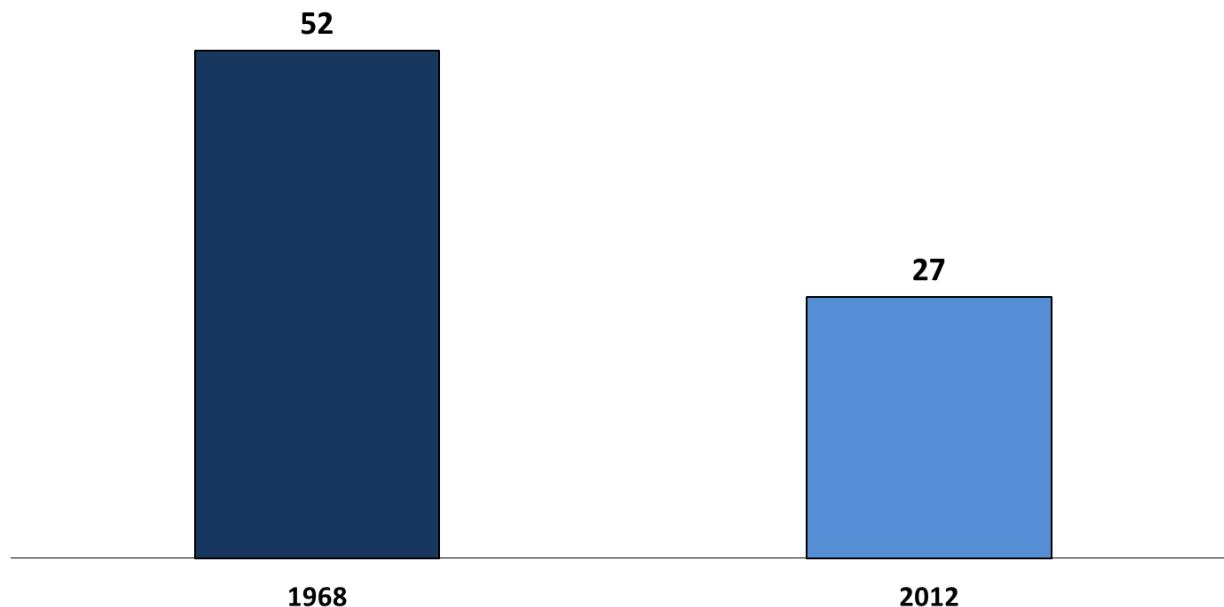
Soon close to a third of adults will be on Social Security, retiring on average for a third of their adult lives. This simply is not sustainable, no matter how well intentioned.

While Social Security did a good job reducing poverty in its early years, it has made only modest progress recently, despite spending hundreds of billions of dollars more over that time.

The program discourages work among older Americans at the very time they have become a highly underused source of human capital in the economy. Those work implications for national income and other revenue collections should be included when future Social Security reforms are undertaken. The failure to provide equal justice permeates the system. The existing structure discriminates against the working single head of household, the couple with relatively equal earnings between spouses, the long-term worker, and parents who start child-bearing in their 20s or 30s, among others. How can one engage in reform while perpetuating for all eternity a system that requires abandoned mothers to support spousal and survivor benefits for which they do not qualify, while providing differentials—often of hundreds of thousands of dollars of lifetime benefits—to families based solely on the age separation of the spouses, the age at which workers have children, whether a divorcee gets a divorce decree after nine years and 11 months or ten years and one month, the number of spouses a spouse has, or whether spouses' incomes are evenly or unevenly split?

At the same time, the lack of private retirement assets leaves many households quite vulnerable, especially as they approach truly old age. Many of these problems overlap. Saving declines because people retire in what used to be among their peak saving years. For instance, when a person retires for 20 years versus 15, he spends both five fewer years saving and five more years spending down his or society's savings.

Figure 2: Percentage of Men's Social Security Benefits Going to Men With Less Than 10 Years Remaining Life Expectancy



Notes: Calculations from the Social Security Administration's 2012 Annual Statistical Supplement. C.E. Steuerle and Caleb Quakenbush, The Urban Institute, 2013.

A Bipartisan Way Forward: Beyond Debating the “Box”

Those limitations lead logically to four types of benefit reforms:

- improving benefits for those with fewer means while restricting automatic growth in benefits where needs are least;
- adjusting benefits so they are more concentrated in older ages, both to improve protections and to encourage employment;
- removing many sources of inequity and inefficiency in the system that penalize beneficiaries ranging from low-income abandoned mothers to long-term workers; and
- reforming private pensions so they better protect the majority of workers who today end up with little in private retirement benefits.

Unfortunately, benefit design has been hard to interject into a Social Security debate largely proceeding on the basis of being “for the box” or “against the box,” without regard to its

contents or size. The contents themselves deserve scrutiny to see how well each piece adheres to various principles of public policy and finance.

How might one break through the stalemate to try to find areas of mutual agreement? While I applaud the efforts of the Simpson/Bowles Commission and the Bipartisan Policy Commission and generally would favor their compromises over current law, I believe we can go much further in fixing this system if we start with a basic set of principles and follow them to their logical conclusion.

In particular, I very much encourage you to engage Social Security reform in a way that goes beyond what former presidential press secretary James Brady, among others, called the BOGGSAT method—a “bunch of guys and gals sitting around a table” [extended definition mine].

Looking through the political veil, it appears that disagreement centers largely on whether restoring balance is achieved through tax increases or a slowdown in benefit growth. Whether benefit cut or tax increase, those costs inevitably will be assessed mainly on above-average-income individuals, who pay most of the taxes and get most of the benefits. Therefore, that debate should not prevent proceeding in the following order:

First, consider reforms aimed at meeting Social Security’s primary purposes: providing greater protections for those truly old or with limited resources; supporting the work and saving base that undergird the system; and providing more equal justice for those suffering needless discrimination in the system, like single heads of household and longer-term workers. Some of those fixes cost money, and some raise money; don’t try to address trust fund and distributional consequences in each and every change.

Second, further adjust minimum benefits and the rate schedule and indexing of that schedule over time to achieve final cost and distributional goals. For instance, for those with higher incomes, cap benefits or use limited wage indexing; for middle-income workers, add another rate or extend the length of a rate bracket. The extent of these adjustments will also depend upon the tax rate and base structure agreed upon.

In table 2, I offer a combination of reforms that, if followed in steps, would much better meet the various goals of increasing progressivity, providing better protections for the old and those with lower lifetime incomes, providing better incentives for work and saving, and removing many of the ways in which the system provides unequal justice.

Background on Lifetime Benefits

In considering reform, I suggest examining the extent of benefits (and taxes) within Social Security—or, more broadly, within Social Security and Medicare—on the basis of lifetime benefits (and taxes), as opposed to making tradeoffs that would not be obvious when decisions about annual benefits, retirement age, indexing of benefits, premium cost for Medicare, and other features are considered separately.

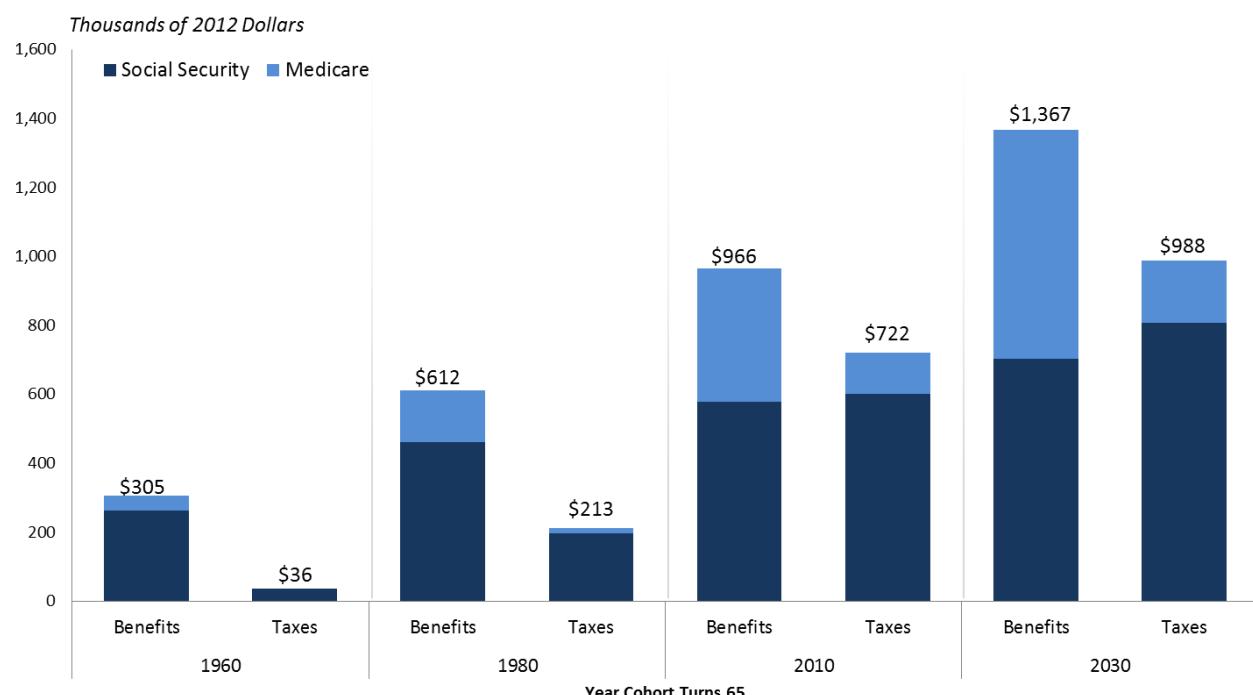
Here I define “lifetime benefits” as the value, at age 65, of Social Security and Medicare benefits as if the necessary monies were sitting in a 401(k) account that would earn interest but be drawn upon over retirement years. In today’s dollars, lifetime benefits for an average-income couple have risen from about \$305,000 in 1960 to \$966,000 today (\$579,000 in Social Security and \$387,000 in Medicare; see figure 3). Add in the backup insurance most of us have if we go

into a nursing home for any extended period, and the total approaches \$1 million per couple. Over the next two decades, the benefits grow by about \$401,000, or an average of more than \$20,000 a year.¹

Note that this automatic benefit growth occurs at the same time that the spending on children and on the nonelderly is largely scheduled to stagnate or decline.

When looked at from this perspective, it is not hard to conclude that we simply cannot provide a very large portion of the population significant growth in packages of benefits that for many already are at the \$1 million level or more, without severe consequences for our children and working families. These pressures play out on the broader budget not just because of the allocation of total spending but because Social Security (and government health insurance) in its present form encourages an increase in adult nonemployment (by encouraging an ever larger percentage of adults to retire) at the very time when the country is looking to increase the employment rate.

**Figure 3: Social Security and Expected* Medicare Benefits and Taxes
Average Wage, Two-Earner Couple (\$44,600 each in 2012)**



*Notes: Expected rather than realized benefits. The "average" wage profiles are those hypothetical profiles used by the Social Security Administration in its analyses. Lifetime amounts are rounded and discounted to present value at age 65 using a 2 percent real interest rate and adjusted for mortality. Projections based on intermediate assumptions of the 2012 OASDI and HI/SMI Trustees Reports. Medicare benefits are net of premiums. Includes Medicare Part D.

Source: Caleb Quakenbush and C. Eugene Steuerle, The Urban Institute, 2012. Based on earlier work with Adam Carasso and Stephanie Rennane.

¹ C. Eugene Steuerle and Caleb Quakenbush, "Social Security and Medicare Taxes and Benefits Over a Lifetime: 2012 Update," <http://www.urban.org/publications/412660.html>. Based on earlier work done with Stephanie Rennane.

Conclusion

Reform of the Social Security benefit structure should be proceed on the basis of principles and goals related to adequacy, protections in old age, encouragement of work to protect the tax base on which programs like this depend, and equal justice under the law for those equally situated. Many features of current law violate basic principles of public finance without promoting other worthy goals in an effective or well-targeted manner.

Without being wedded to exact details, I have laid out in some detail how to go beyond the types of options put forward by the various commissions constrained in various ways, including staffing. In particular, I warn against the problems created when evaluating each design feature based on its budgetary or distributional effect. One should not support a provision throwing money off a roof in a poor part of a city just because it is progressive nor oppose an increase in benefits for the poor because by itself it would increase spending. After deciding the basic benefit base, one can go back through and achieve budgetary and distributional targets by further adjusting items, such as the benefit rate structure and minimum benefits.

In many ways, the process I am suggesting to you today largely follows the logic I applied to taxation when serving as the economic coordinator of the Treasury effort that led to the bipartisan-supported Tax Reform Act of 1986, and my testimony before the Simpson/Bowles Commission on how to engage tax reform as part of its broader budgetary reform.²

² Both the author and various researchers at the Urban Institute have over time advised and testified to these commissions on design of options and on various budgetary effects of both spending and tax proposals.

Table 1: Examples of Social Security's Redistributive Features

Feature	Redistribution
Progressive benefit formula	High earners to low earners (Higher replacement rates for workers with lower lifetime earnings)
PAYGO financing	Younger to older generations and larger families to smaller families (Benefits based on earnings history, not contributions; tax rate has increased over time, shifting burden disproportionately to younger families and families with disproportionate numbers in younger generations)
Forced annuitization	Short-lived to long-lived (Those with shorter life expectancies will pay into the system but receive benefits for fewer or no years)
Disability Insurance	Healthy to unhealthy
Spousal and survivor benefits	Unmarried to married (Spouses pay no additional taxes for these benefits; single workers do not pay lower taxes and are not entitled to these benefits)
Dependent benefits	Smaller families to larger families
Crediting only limited number of years of contributions towards benefits	Long careers to shorter careers (Adults who work more than 35 years are not compensated for more years of contributions)

Table 2: Steps to Reform Social Security
Stage One

Improve Adequacy for the Poorest and Most Vulnerable

- Provide a solid wage-indexed minimum benefit (not just the token one in many bills), indexed for inflation. The minimum should provide something like one that scales up by 2 percentage points per year of work from 80 percent of an individual wage-indexed poverty-level income at 10 years of work, to 100 percent with 20 or so years of work, to 140 percent with 40 or more years of work.
- Give minimum “earnings” credit and “years of work” credit for child-raising years—for example, an additional credit of \$10,000 of earnings for years spent raising a child under age 10. (This has been found to be a primary way of protecting the spouses for whom spousal and survivor benefits were intended but were unfairly and poorly targeted.)
- Back up this system by restoring the asset limits that used to apply in SSI (though, because assets and income are easy to transfer, do not depend upon SSI to deal with most distributional issues.)

Remove Impediments to Work and Threats to Adequacy in Old Age

- Over and above retirement-age adjustments already scheduled, index the retirement ages (in my example) or ages (in current law) so that the number of years of support does not automatically increase as life expectancy increases. Similarly, index various age-70 cutoffs in the system. (This is a stricter index than applied in other reform proposals, which continue to increase years of support over time, benefiting higher-income individuals more than lower-income ones.)
- Further increase the earliest retirement age by an additional 1 month a year for 36 years. (On net, this does not reduce lifetime benefits, and it moves the system back toward old-age rather than middle-age insurance.)
- Further backload to later ages whatever lifetime benefits are provided by lowering up-front benefits in exchange for higher benefits later. Such backloading is even more required if the COLA adjustment is lowered and problems like dementia continue to arise. One way to do this is to wage index benefits post retirement but then provide an equivalent actuarial reduction in the initial benefit level. Alternatively, provide periodic adjustments along the same order of magnitude. (Though this is meant to be roughly actuarially neutral; the goal is to protect better the very old, provide more resources when problems like dementia increase, and to further encourage the work required to support Social Security and other government programs.)
- Make clearer the option to get a better annuity, for instance, by declaring the retirement age at which maximum benefits are attained as age 70 (indexed), with appropriate actuarial reductions (similar to what is achieved through delayed retirement credits) for

those who take their benefits before then. (This is basically current law, but better understood.)

- Offer partial retirement options, as well as options to exchange money for a higher annuity to the extent already allowed in current law. (Workers now can buy the higher annuity by deferring Social Security receipt, but the relationship is poorly understood.)
- Eliminate the earnings test. (This test sends very confused signals to beneficiaries and discourages work for many who view it incorrectly as a tax.)
- If the full retirement age and gradual increase in the earliest retirement age are accepted, drop all reference to a “normal” retirement age.

Improve Equity and Efficiency

- Over a 30-year period, gradually adopt private pension equity rules on treatment of spouses and survivors.
 - A mandated survivors annuity is paid for out of the worker’s annuity. The survivor’s annuity must be at least 75 percent of the worker’s annuity.
 - Benefit sharing is required upon divorce, based on years of marriage.
- As in the private pension system, whatever spousal or survivor’s benefit is provided, make an actuarial age adjustments to account for the different ages of the spouses. (This provision’s purpose holds even in absence of the previous reform and is intended to remove the sources of discrimination against those who marry someone near to their own age.)
- Over the same 30-year period, gradually cap the level of existing free spousal and survivor benefits—those not paid for through actuarial adjustment. (The monies saved from these reforms are spent to partly support a better minimum benefit system and improvements through possible rate restructuring to help those below median benefit levels, as discussed below, and generally have been found to significantly reduce old-age poverty.)
- Change the benefit formula so it counts all years of work. (This removes some of the discrimination against long-term workers, adds to work incentives, and removes some of the discrimination, for those who delay benefit receipt, between those who work and pay taxes and those who do not.)
- Eliminate dependent benefits associated with old-age insurance, which go only to those (usually men) who decide to have children late in life, an unintended purpose of the system.

Stage Two

Re-examine Package to Insure Adequacy Goals

- Ensure that this combination of changes increases average benefits in all lifetime income ranges below the median by readjusting the minimum benefit (and first rates and

brackets) in the benefit formula. This could require some rate changes in existing brackets, a new fourth rate, or a lengthening or shortening of a middle bracket. It may also require more than one adjustment over time, depending upon how changes are phased in. For instance, it was my intent to use the gradual changes in spousal and survivor benefits to help pay for this more progressive overall system.

Achieve and Guarantee Long-Term Balance

- Maintain long-term balance even after any reform is enacted through automatic adjustments in retirement age, maximum benefits, or reduced wage indexing above median benefit levels whenever the system is projected to be out of long-term balance in more than five straight annual reports. For instance, cap all growth in expected lifetime benefits for a couple with combined Social Security and Medicare benefits of more than \$1 million or, say, \$700,000 in Social Security.
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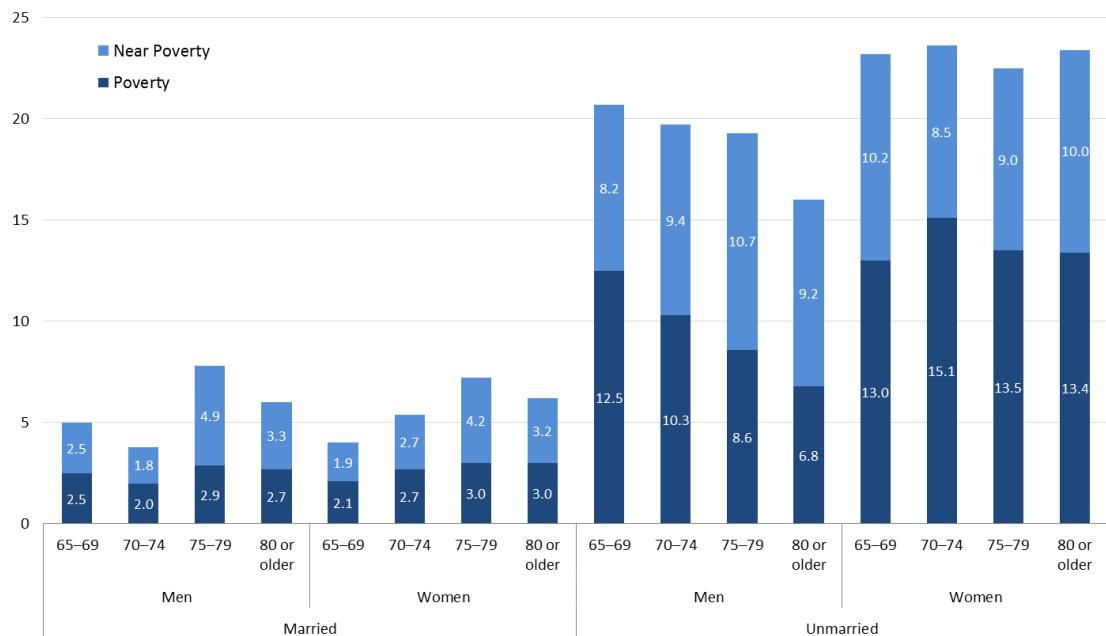
Relationship to Revenues

- The benefit package here suggested would add to revenues because of the additional work the reforms would generate.
 - The extent to which overall benefit growth rates are slowed will depend upon what tax changes are also implemented. That is, these benefit changes would create a much fairer, progressive, and efficient system regardless of whether it becomes larger, smaller, or the same overall size as now. For instance, I also favor an increase in the share of compensation subject to tax because of continual expansion in both the employee benefits avoiding Social Security tax and in the share of earnings above a taxable maximum. Thus, this type of benefit reform analysis could be done at different revenue levels.
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Private Pension Reform

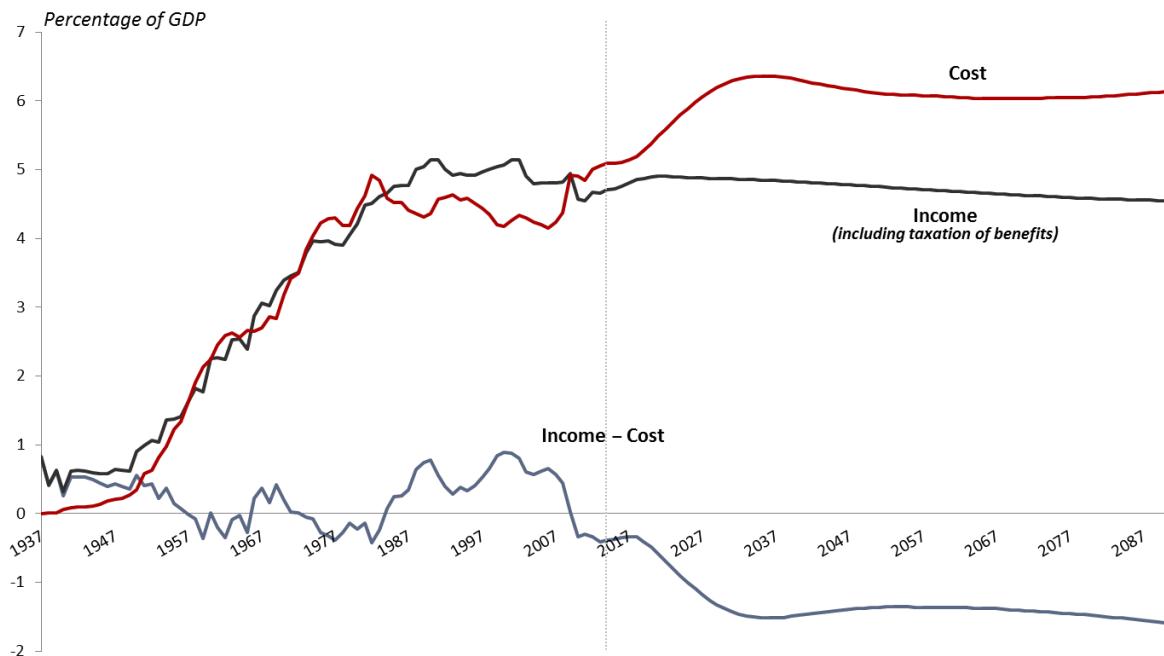
- Back up the Social Security reform with a private pension reform that makes receipt of many types of pension benefits dependent upon some minimum employer contribution for almost all workers, along with a higher savers' credit and an opt-out provision for employee contributions (like the SIMPLE Plan, only with more teeth). Provide additional incentives for private pension and retirement plans that set a minimum contribution level for each worker, and provide additional disincentives for those plans that do not set such a minimum. Among the incentives that can be considered are enhanced savers' credit and removal of complicated discrimination rules for plans providing such a minimum. Among the disincentives would be a lower or unindexed level of maximum contribution for plans not meeting the new standards.
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Share of Aged Social Security Beneficiaries with Low Income, by Gender, Marital Status, and Age, 2010



Social Security Administration, 2010. "Income of the Population 55 or Older" Table 11.3.

Social Security Cost and Income, Excluding Interest



Source: Data from 2012 OASDI Trustees' Report and Statistical Supplement. Projections assume Intermediate Cost Scenario. Yearly income only. Caleb Quakenbush and C. Eugene Steuerle, The Urban Institute, 2012. Based on earlier work with Stephanie Rennane.