

What Every Worker Needs to Know About an Unreformed Social Security System

Statement before the
Subcommittee on Social Security
Committee on Ways and Means
United States House of Representatives

July 29, 2014

C. Eugene Steuerle
Institute Fellow and Richard B. Fisher chair at the Urban Institute

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Social Security reform is inevitable because of its imbalances. Still, today's workers almost certainly will get higher benefits than today's retirees. Even so, delayed reform is a threat to the ability of today's and tomorrow's workers to prepare better for their retirement.

In this testimony I would like to focus on the fairness, efficiency, and adequacy questions that arise almost no matter how much growth Congress maintains in Social Security. In particular, I wish to address three troubling aspects of an otherwise very successful program:

- **Unequal Justice:** ways that Social Security fails to provide equal justice under the law, at times allocating benefits and discriminating in ways that would be considered illegal in the private sector;
- **Middle Age Retirement:** the consequences for today's workers and older retirees of lower economic growth, employment, personal income, and resources for those who really are old when Social Security, the flagship of our social welfare system, devotes ever larger shares of its resources to middle-age rather than old age; and
- **The Impact on the Young:** how Social Security's (and Medicare's) design imposes ever lower returns on each generation of retirees and how each year that reform is delayed adds to the burden older generations pass onto younger ones.

In a newly published book, *Dead Men Ruling*, I argue that many of our budgetary and economic problems arise from continual efforts to fight yesterday's battles. Let me apply that lesson to the evolution of our old age programs. After three quarters of a century of continual growth as a share of GDP, these programs have largely succeeded in their core mission of providing basic protections to most, though not all, older people. But they have done this at times in a haphazard, unfair, and inefficient way—issues that have been dodged in most Social Security debates and reforms. More problematic, their eternal automatic growth—for example, lifetime Social Security and Medicare benefits for new retirees today are more than three times what they were for those retiring in 1960—is not conditioned on any assessment of the needs of the public or of the elderly themselves. Not child poverty. Not the crimping of education programs. Not ways that the youth of today are falling behind. Not growth in the incidence of Alzheimer's or autism. Not the rise in the percent of the population that will be truly old, say, in the last five years of life. Not new opportunities to invest in different forms of technology or infrastructure.

I conclude that not only can Social Security's problems be fixed, they can be fixed in a way that provides greater flexibility to respond to new needs and opportunities and yet provides even stronger protection to the poor, the middle class, and the truly old. Moreover,

these gains can be attained regardless of whether Congress enacts tax increases, benefit reductions, or both. And I remind you that one fix doesn't require either tax rate increases or annual benefit cuts: simply encouraging people to work longer so we reduce Social Security's increasingly negative impact on our employment rate and on the revenues workers provide.

Unequal Justice

Social Security redistributes in many ways as a result of its broad array of benefit features and of program changes that have occurred over the years. Only some are progressive. Others are regressive (box 1). And many fail to provide equal justice—that is, equal treatment of those similarly situated.

The following are among the most telling and unfair of these redistributions:¹

- Working single parents (often abandoned mothers) are forced to pay for spousal and survivor benefits that others can and they cannot receive. If they haven't been married to any one individual for at least ten years, they often receive at least \$100,000 fewer lifetime benefits than some spouses who don't work, pay fewer or no Social Security tax, and raise no children.
- Two-earner couples (e.g., two persons earning \$40,000 a year each) can also receive more than \$100,000 fewer benefits than one-earner couples (e.g., a couple with one earner at \$80,000 a year) who have the same lifetime earnings and pay the same tax.
- A person who mistakenly divorces at nine years and eleven months likely will get more than a \$100,000 fewer dollars of benefits than one who divorces at ten years and one month.
- A person who works 40 years for \$30,000 will get tens of thousands of dollars fewer benefits than someone with the same lifetime earnings, but works 30 years at \$40,000.
- Older men (and some women) begetting children receive unique access to tens of thousands of dollars of lifetime dependent benefits not available to most other parents.

¹ These redistributions are reviewed in Steuerle, Smith, and Quakenbush (2013); Favreault, Sammartino, and Steuerle (2002); and Steuerle and Spiro (1999).

Box 1

Progressive and Regressive Aspects of Social Security's Redistribution

1. *Pay as You Go Financing* redistributes from younger to older generations. Benefits are based on earnings history rather than contributions, and each succeeding cohort of workers has faced higher average lifetime OASDI tax rates than the cohorts already retired.
2. *The Progressive Benefit Formula* redistributes from high lifetime earners to low earners. The first dollar of indexed earnings contributes more to one's final benefit than the last dollar.
3. *Forced annuitization*—the requirement to claim benefits as a perpetual stream of payments on or after reaching the eligibility age rather than as a lump sum—redistributes from those with shorter lifespans to those with longer lifespans because those who live longer in retirement get benefits for more years.
4. *Disability insurance* redistributes from the healthy to the less healthy.
5. *Spousal, and survivor benefits* redistribute to married couples (and in the largest amounts to the spouses of the richest workers) from never-married households and those with marriages too short to qualify for such auxiliary benefits. No additional tax is paid to receive those benefits.
6. *Benefits to dependents* of the elderly, disabled, or deceased redistribute from smaller families to larger families and from most families to those with older parents.
7. *The crediting only a limited number of years of contributions* toward workers' benefits effectively redistributes from longer-term workers (those who work more than 35 years) to shorter-term workers (Steuerle and Spiro 1999).

One can remove many of these inequities while at the same time maintaining or increasing the progressivity of the overall system. For instance, a good minimum benefit could provide a higher benefit to those with greater needs, while a bump up in benefits in later years could deal with the additional threats facing the very old.

Middle Age Retirement

People today retire for about a decade longer than they did when Social Security first started paying benefits (figure 1).

Some argue that we needed and continue to need to provide ever more years of retirement support to make the system more progressive. This is like arguing that money should be thrown off the highest roof in a city to solve poverty. Actually, increasing years in retirement has not been a progressive policy at all. Though lower income individuals on average have higher mortality rates, they are also more likely to claim disability benefits, and those benefits are not reduced when the retirement ages increases. In the end, the biggest winners of this multi-decade policy have been people like the witnesses at this table and members of Congress, who, as a result of the failure to adjust more than a tiny bit over the past three quarters of a century, now get at least \$300,000 or more in additional lifetime benefits. The person who dies before age 62 gets nothing more in benefits but pays higher taxes while alive.

But there are other consequences when people work for many fewer years. When baby boomers and women were entering the workforce, the effect on the economy as a whole was hidden. But now that the baby boomers are retiring and women's employment rate has reached a stage of maturity, the Congressional Budget Office and others predict a decline the nation's overall employment rate and a corresponding decline in the rate of growth of GDP and of personal income (CBO 2014). Among other directly related consequences, people now save for many fewer years and withdraw their savings for many more.

For individuals such early retirement creates a real threat for when old age really does hit (box 2). What looks adequate when in good health in the early 60s may be quite inadequate when in one's 80s or 90s. The average couple will see at least one spouse living to about age 90, and many individuals will live years beyond 90.

Projections show that within a couple of decades close to one-third of the adult population will be on Social Security. That number excludes other adults who rely on other government assistance. The retirement of so many people, in turn, this has a significant effect on revenues. For instance, our analysis at the Urban Institute shows that the biggest effect on the U.S. budget from early retirement is not on Social Security but on income tax revenues (Butrica, Smith, and Steuerle 2006).

Social Security is a flagship of the nation's social welfare system. It sets norms and expectations that reverberate everywhere. Yet in past Social Security reforms, these effects on GDP, employment, and income tax revenues were barely taken into consideration, if at all.

Any future Social Security reform must deal with this issue. There is no financial system, public or private, that can provide so many years of retirement for such a large share of the population without severe repercussions both for individuals' well-being in retirement and for the workers upon whose backs the system depends for support.

Box 2

What Does “Aging” Mean?

The term “aging” is constantly misused. A society does not get older when its people live longer even if the average chronological age rises. Only a decline in the birth rate leads to an increase in the share of the population, say, in their last one-seventh or last ten years of life. Social Security has never really adjusted its earliest retirement age upward for longer lives (it only adjusted the earliest retirement age downward). Yet it tells people they are “old”—qualify for “old age” insurance—when they hit age 62 even though today that means an average remaining life expectancy of about 20 years and even higher for the healthy and future retirees.

As baby boomers retire, they will indeed add to the numbers of those who would be considered old by some appropriate measure, such as those in the last ten or fifteen years of life. But the very large growth in percent of the population eligible for “old age” insurance in the century from 1935 when the Social Security system was first adopted, to 2035, when the baby boomers will be “old” by Social Security’s definition, has nothing to do with any real “aging” of the population. In 1935, about 6 percent of the population was age 65 or older. By 2035, 23 percent of Americans will be at least age 62, the earliest age one can collect benefits under current law.

The Impact on the Young

For many years now, I have led a team of researchers at the Urban Institute to calculate lifetime benefits and taxes for both Social Security and Medicare.² These numbers are shown below (figure 2). Three points stand out:

First, lifetime Social Security and Medicare benefits in 2010 already approximated \$1 million for a couple with average incomes throughout their working lives, in no small part due to numbers of years of benefits. And those benefits currently grow on average by about \$18,000 a year, so that by 2030 a couple can expect to receive an extra \$1/3 million relative to one retiring in 2010. Outside of interest on the debt, Congress and Administration have decided indirectly that all the growth in government spending in the next couple of decades will go for retirement and health programs, mainly Social Security and Medicare.

Second, the rate of return on contributions falls continually for each generation. For Social Security, future generations will get back less than they put in, though, there is a simple

² For background on these calculations, see <http://www.urban.org/socialsecurity/lifetimebenefits.cfm>

reason for this. Every expansion of our system of support for the elderly has required older workers to contribute at a higher tax rate only for some or no years of their working lives, whereas the youngest must contribute at that higher rate for their entire working lives.

One caution. Calculations of lifetime benefits and taxes for Social Security and Medicare often lead to debates over how much people are “owed” based on what they “paid in” to Social Security and Medicare. But in fact, Social Security and Medicare are transfer systems from young to old, and always have been, with transferors and transferees. We may feel that because we transferred money to our parents, our kids, in turn, owe us. But we must also consider how much they can afford, and government should spend on this task, relative to other current needs for themselves and their children. Imagine a one-family society, where three kids support their parents, but then those three kids have only two children of their own. What the second generation of three kids gave the first generation of parents informs us only slightly about what the third generation of two children can do or should be required to do to support the second generation, especially given all the other changes also taking place in society.

The calculation of benefits and taxes do allow us to make a judgment as to whether the allocation of future burdens meets standards of fairness and efficiency across generations.

Third, though by many measures many new retirees will now get back less in lifetime Social Security benefits than they contributed in lifetime taxes to Social Security, plus some modest rate of return (in figure 2, calculated at 2 percent real), the law still provides substantial windfalls to older workers by shifting substantial Medicare costs to the young. However, even there, the same long-term dynamic must play out in dealing with imbalances; that is, the more windfalls given to middle-age and older workers as they retire, the more that must be paid in the form of fewer benefits or higher taxes by younger workers and their children.

Every year of delay effectively involves a decision that older generations will not pay the cost through a lower rate of benefit growth or a higher tax rate. But the young—those already scheduled to get less—will bear an ever higher share of the cost of getting this system back into order.

This creates some interesting distributional consequences as well. Earlier I presented many of the progressive and regressive features of Social Security, features that in combination make the old age part of the system barely progressive if at all. It turns out that the shift of burdens to future generations has its largest impact on groups, like blacks, who historically had larger families, and to more recently immigrated citizens, like Hispanics. That is, these groups have comprised smaller shares of the higher return, windfall generations, and will comprise a

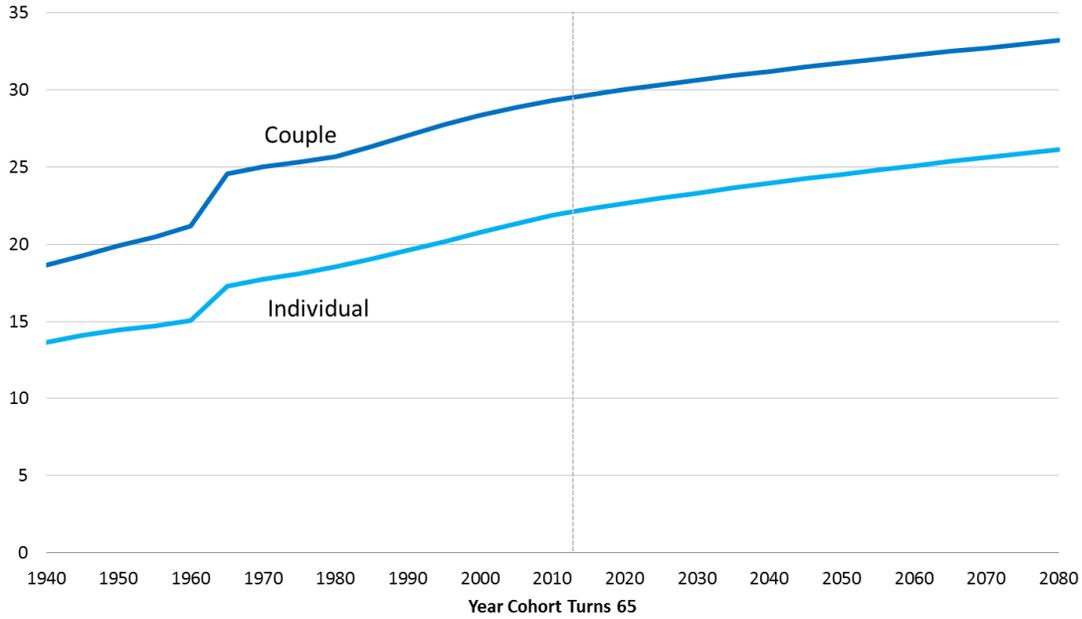
larger share of the lower-return populations of the future (Steuerle, Smith, and Quakenbush 2013).

Summary

In summary, each year of delay in reforming Social Security:

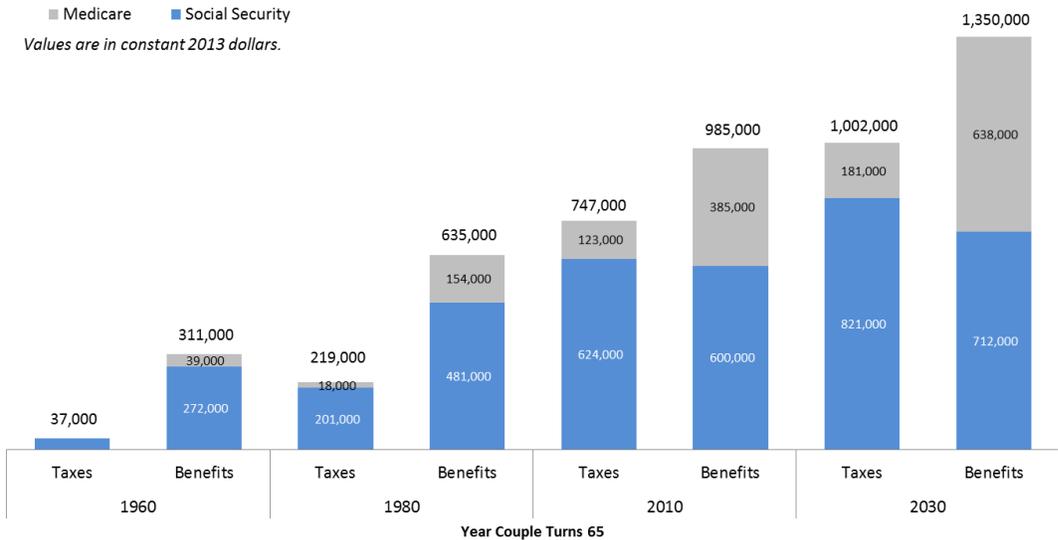
- Continues a system of unequal justice for single heads of household, two-earner couples, and others;
- Misleads yet another cohort to believe that what looks to be adequate for retirement at age 62 or 65 will be sufficient by age 85, 90, or 95;
- Decreases the share of old age supports given to the truly old rather than those who are middle aged;
- Adds to the pressure for government to invest ever less in education, the young, and the basic functions of government;
- Adds to the nonemployment rate in the economy, with further repercussions for personal income, income tax revenues, the benefits that Social Security and Medicare can pay at any given tax rate, and the sustainability of government policy more generally; and
- Increases the burden that is shifted to the young and to people of color who will form a more preponderant part of future populations.

Figure 1. Expected Years of Retirement Benefits, Earliest Retirement Age Couple (at least one partner living) and Individuals



Notes: Calculations based on mortality data from the 2013 OASDI Trustees' Report. Calculations for a couple assume that at least one partner is still living. ERA was set at 62 for women in 1956 and men in 1961. C. E. Steuerle and C. Quakenbush, Urban Institute 2013.

Figure 2. Lifetime Social Security and Medicare Taxes and Benefits at Age 65 Married Couple Earning the Average Wage (\$44,800 each in 2013 dollars)



Source: C. E. Steuerle and C. Quakenbush, Urban Institute, 2013. Based on earlier work with Adam Carasso and Stephanie Rennane. Calculations based on data from Social Security and CMS trustees reports and supplements. Totals are expected present values at age 65 and assume a constant 2 percent real discount rate.

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