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SOCIAL SECURITY

Do We Need a Grand Bargain?

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Despite having run large cash-flow surpluses for decades and despite being disallowed by law from paying benefits in excess of what current receipts and past surpluses allow, Social Security is often dragged into discussions of "grand bargains" to reduce long-run projected budget deficits.

GOP proposals for Social Security reform generally call for benefit reductions and no revenue increases. President Obama's recent budget proposals have unfortunately also included benefit cuts with no new revenue dedicated specifically to Social Security (though there is significant new revenue overall in his proposals).

In the context of Social Security reform and retirement security policy in general, however, this formula of targeting long-run actuarial balance for Social Security primarily through benefit cuts makes little sense, either substantively or politically. Substantively, the 401(k) revolution has been considerably less than even a qualified success, with inequality of retirement assets growing over time. Politically, recent polls confirm that Americans do not want lower Social Security benefits and are even willing to pay for keeping benefits at current levels (or even higher). In a 2013 Pew Research Center poll, 87 percent of the respondents thought Social Security spending should remain the same or be raised. A poll by the National Academy of Social Insurance also suggests strong support for maintaining Social Security benefits. Furthermore, this poll shows that 82 percent of Americans support increasing Social Security taxes on workers and 87 percent support raising taxes on the wealthy. Americans value Social Security and are willing to pay for it.

Proposals for Social Security reform include using "chained" CPI to calculate annual cost-of-living adjustments, increasing the "normal" retirement age, increasing the eligibility age, and privatization. Let's examine each of these in turn.

Reducing Social Security benefits by adopting the "chained" CPI to calculate its annual COLA: This change to Social Security's cost-of-living adjustments (COLA) is by far the largest current political threat to beneficiaries. It was included on the GOP "menu" of trade-offs for which they would agree to raise the debt ceiling and has been included in President Obama's recent budgets.

The way this proposal works is to reduce Social Security benefits by indexing its COLA to the chained CPI-U rather than to the current, unchained, CPI-W for all urban consumers. For more on the economics of chaining price indices, see this. Adopting the chained CPI is a guaranteed benefit cut for recipients of 0.25 percentage points or more each year, cumulating over one's retirement. Because the benefit cuts are larger for older recipients (because the cut is cumulative), the president has proposed a benefit enhancement that would be phased-in over 10 years beginning at age 76. Some other proposals to adopt the chained CPI do not include this benefit enhancement.

While this is often described by its proponents as a technical fix, it completely fails on these terms. The chained CPI is in no way a more accurate measure of price increases facing the Social Security benefit population. The purpose of this option is to reduce Social Security benefits, period. The benefit reductions fall hardest on the "oldest old," which also tends to be a much poorer population. Even with the benefit enhancement, there is no guarantee that low-income elderly would not be moved into poverty or near-poverty.

Increasing the "normal" retirement age: A constant in debates over Social Security is the call to raise the "normal" retirement age (the age at which full benefits can be claimed). Currently, the normal retirement age is rising and is set to settle at 67 in 2022.

In June 2010, then–House Minority Leader John Boehner suggested raising the normal retirement age from 67 to 70. This is a perennial among conservative policy analysts, and has recently been taken up by the Business Roundtable.

This policy option is often based on the observation that average lifespans are rising. But longevity gains account for a relatively small part of the shortfall that has developed in Social Security's long-run actuarial outlook since the last reform in 1983 was instituted. This policy option also ignores the fact that there are widening differentials in longevity improvements based on socioeconomic status. Workers in the top half of the earnings distribution have seen their lifespans increase significantly, while those in the bottom half have not.

An important, and often not well-understood, fact is that this option would reduce *lifetime* benefits for all workers. But it would also reduce the *annual* Social Security benefits for lower-earning workers who cannot postpone retirement.

Increasing the eligibility age: Increasing the eligibility age for *Medicare* from 65 to 67 has long been floated as a key component of a "grand bargain." It was an item on the menu of policy changes that were offered in exchange for a debt ceiling increase, and was explicitly mentioned in a letter from Speaker Boehner to President Obama during the "fiscal cliff" negotiations at the end of 2012.

While fewer policymakers have committed to raising the earliest eligibility age (the earliest age at which Social Security retirement benefits can be claimed) for Social Security (as opposed to the "normal" retirement age as described above), it is also an oft-recommended change from those seeking to cut Social Security. The Committee for a Responsible Federal Budget (CRFB), for example, has endorsed an increase in the Social Security earliest eligibility age from 62 to 63 or 64 (and indexed to longevity improvement).

This recommendation again seems to be based on observations that average lifespans are rising, combined with a biased view from policymakers that work has generally become less physically demanding over time, and that this delay of retirement will hence not constitute a significant hardship for many workers. These are assumptions that may well describe the working life of policy wonks advocating for this change, but they are not representative of the larger American workforce.

For one, as noted above, gains in lifespan are driven predominantly by the top half of the earnings distribution. Further, a significant number of workers actually still would face great hardship if they had to delay Social Security receipt because they work at physically demanding jobs. Finally, age discrimination on the part of employers may hurt the ability of older workers to delay retirement.

Some proposals to raise the earliest eligibility age include changes to disability insurance to accommodate workers who cannot continue to work past 62, so some potential cost savings from this change are eroded. It is not clear that any money is saved for all the workers who can postpone retirement because their benefits will be higher when they do decide to retire. Any savings achieved will likely come from denying benefits to those who cannot continue working past 62—poorer and less-healthy workers with shorter lifespans.

Privatization: Privatization is not a part of the current debate on Social Security, but it remains a priority among conservatives, and has enjoyed surprising sympathy even from Democratic administrations in the not-so-distant past.

Partial privatization of Social Security was seriously proposed by the 1994-1996 Advisory Council on Social Security in two of the three plans developed. A few years later the President's Commission to Strengthen Social Security offered three models for partial privatization. President George W. Bush proposed a Social Security plan with individual accounts in his 2005 State of the Union address (the plan was introduced in the House by Rep. Paul Ryan, R-Wis.). And as recently as 2010, Ryan, then the ranking minority member of the House Budget Committee, called for partial privatization in his *Roadmap for America's Future*.

Most Social Security privatization proposals involve creating individual accounts (IAs) modeled on a 401(k) plan. Part of a worker's payroll tax would be diverted from the Social Security trust fund into the IAs; the worker would then be responsible for directing the investment of the IA funds. The traditional Social Security benefit would be significantly reduced, and retirement benefits would be the sum of the reduced traditional benefits and the annuity payment from the IA.

Advocates of Social Security privatization argue that such plans generally achieve 75-year solvency for Social Security and would lead to higher Social Security benefits. However, the proponents of such plans often ignore key facts. The

first are the costs of transitioning to the new IA plan. New IA plans would apply to neither current Social Security recipients nor workers within 10 or 15 years of the normal retirement age. Since Social Security is run mainly as a pay-as-you-go system, the diversion of some payroll tax revenue to IAs would leave a funding gap for current benefit payments (as much as $2 trillion, depending on the specific plan). This money would have to be borrowed, thus making the debt situation worse.

The second is that investment returns are not guaranteed. Benefit simulations of various Social Security IA plans suggest that benefits could be considerably lower than current-law Social Security benefits for most Social Security recipients. The main reason is stock and bond returns fluctuate, and the pattern of these fluctuations over the course of a working career has a large impact on the benefit level in retirement—a stock market crash just before retirement could wipe out a considerable chunk of retirement assets. Further, fees and management costs of individual accounts will claim a significantly larger share of private accounts than administrative costs claim on traditional Social Security benefits.