

Changing Social Security to Achieve Long-Term Solvency and Make Other Improvements – A Discussion Paper

Introduction

When the term began I had hopes that there would, by now, be a fleshed out plan from the Administration – one containing a comprehensive approach to Social Security’s long-term financing dilemma. Had that occurred we could at this concluding stage of the course explore the key issues within that plan’s framework, reviewing the Administration’s policy choices and major alternatives. But there is no full plan on the table, simply a Presidential initiative with the theme: “A Social Security crisis is imminent and establishing personal accounts is a key component of any solution.”

In the absence of a concrete plan, I have prepared this short paper to assist and organize our discussion of Social Security’s future. It begins with a series of background observations. It then turns to the subject of personal (or private) accounts to which the President has given salience. Next it reviews some of the most likely program changes that would (unlike personal accounts) directly address the program’s long-term “deficit.” That section is followed by one sketching benefit changes with aims other than reducing Social Security expenditures that have been included in recent “reform” proposals. The paper concludes with some reflections on the role that specific terms and concepts play in debates over Social Security’s future.

I. Some Important Background Points

A. Achieving solvency

The standard actuarial analysis employed in Social Security’s annual Trustees’ reports reveals a large long-term deficit. For the past decade these projections have placed that deficit around 2% of taxable payroll. In other words, achieving balance or solvency measured this way would require raising annual revenue by 2% over the figure generated by current law, cutting program costs by that amount, or some combination of the two.¹ An asserted failure of vision in the last iteration of Social Security reform, which took place a bit more than two decades ago, is that it did not escape this definition of solvency. The “sustainability” insight demands an even more distant time horizon or at least analysis of the revenue-cost dynamic toward the end of the conventional seventy-five year period. This is because program revenue and benefits can be in balance when viewed against a fixed number of years, but, if at the end of that period costs are climbing and revenues shrinking, identical projections done a year or two later will show a deficit. Diamond and Orszag (see I.E below) refer to this as the “terminal-year problem.”² Enacting a Social Security tax rate increase of 2% would achieve actuarial balance, as traditionally measured, but would not produce sustainable solvency.

Social Security is close to unique among government programs in having built into its legislation such a mechanism for regular exposure and review of projected future expenditures and associated revenue requirements. Furthermore, its dedicated funding base brings a rare discipline to that analysis. As noted below, Medicare poses more serious long-term fiscal challenges, but the two parts of Medicare that threaten most explosive growth (SMI parts B and D, the latter the new drug benefit program not taking effect until 2006) are, according to that program's Trustees report for 2005, in actuarial balance. The reason? Medicare Parts B and D (unlike Medicare Part A and Social Security) are funded by a draw on General Revenues and premiums paid by those it covers. Those parts of Medicare are seen and said to be in long-term balance because the governing legislation allows the Trustees to assume that transfers from General Revenues and premiums will continue to increase, year by year, covering that year's costs, no matter how high they climb.³ Are they in fiscal balance? Technically, perhaps; sustainably, no.

B. The importance of acting sooner rather than later

Social Security is less than seventy-five years old. What grounds are there for imagining that today's projections of how its current law will function over the next seventy-five years will be any more accurate than those underlying the original legislation or more recent revisions? Annual Trustees' reports not only caution about the uncertainties underlying their actuarial figures,⁴ but routinely represent a range of possible futures by offering not one but three seventy-five year projections. While the one labeled "intermediate" commands greatest attention, the current report also contains a "low-cost" or optimistic projection which shows the program in actuarial balance, as well as a truly bleak "high-cost" one.

In this course we have seen how Social Security has been deeply affected by economic and social changes that were invisible to forecasters in 1935, 1950, and even 1983. Surely, the most carefully crafted present "reforms" will similarly confront unforeseen challenges. Does this not point toward a "wait and see" approach? My short answer is "no." It is one thing for Congress attempt to legislate responsibly for Social Security's future, with realistic acknowledgment that future developments will invariably require future changes, quite another to fail to legislate even though the best forecasts indicate a future problem. However, because of the certainty of unforeseen challenges I believe that Social Security changes should be made within a framework that is while stable (not requiring constant legislative adjustment) not so rigid as to make future adjustments either politically difficult or unnecessarily arbitrary.

Why not wait to act until that problem is closer at hand so that its dimensions will, presumably, be more clearly visible. As the Comptroller General recently explained to a Committee of Congress, the issue is one of intergenerational equity and adequate forewarning:

While the crisis is not immediate, it is important to act soon if we are to avoid having to unfairly burden future generations with the program's rising costs and give these individuals time to make necessary adjustments to their retirement planning.⁵

Assuming that solvency requires downward adjustment of the program's benefit formulae and higher taxes in some combination the greater the delay on implementation the more that burden is concentrated on younger workers and future cohorts of beneficiaries, with those who fall in both categories taking a double hit.

C. The relationship between the Social Security reserve and the Federal deficit

The reform package recommended by the Greenspan Commission and enacted by Congress in 1983 avoided the then-quite-imminent Social Security insolvency with a package of tax increases and long-term benefit reductions. As intended, these resulted in a prolonged period of growing surplus or reserves. That growth continues. The 1983 amendments represented a modest shift from "pay as you go" to "advance" funding. Despite proposals to put the Social Security reserves in a "lockbox" or take them off the Federal budget the temptation to use them to reduce the apparent size of the Federal deficit during the presidencies of Reagan and Bush senior and to increase the apparent size of the budget surplus under Clinton proved irresistible. As a consequence on top of all the debt the Federal government now owes third parties, it owes the Social Security trust funds roughly \$1.7 trillion. (During 2004 \$89 billion, 12% of program revenue, came from interest payments on that debt.⁶) This indebtedness will climb by another \$2 trillion until a year or two or three before 2020 when annual program costs will begin to exceed annual program revenue. At that point, as the director of the Congressional Budget Office noted in recent testimony before the Senate Special Committee on Aging: "The Social Security system will ... have to redeem the government bonds held in its trust funds. But where will the Treasury find the money to pay for those bonds? Will policymakers cut back other spending in the budget? Will they raise taxes? Or will they borrow more?" Having used the Social Security surplus for decades to support other expenditures the Federal government will have to begin "repaying" that debt.⁷

One of the asserted advantages of personal accounts invested in the private sector is that advance funding in that form will not present future Congresses with the temptation to make temporary use of the assets for other purposes.

D. The far greater challenges posed by Medicare (and Medicaid)

The 2005 Trustees Report on Medicare summarized its future as follows:

Medicare expenditures represented 2.6 percent of GDP in 2004. With the additional benefits provided in the new Part D program, total Medicare spending is projected to be 3.3 percent of GDP in 2006. It increases to about 7.5 percent of GDP by 2035 under the intermediate assumptions and to 13.6 percent of GDP by the end of the 75-year period.⁸

A sentence that concluded the comparable paragraph in the 2004 Report read: "To put these shares of GDP in perspective, over the last 50 years, total Federal income tax receipts have averaged 11 percent of GDP."⁹

The Congressional Budget Office projections of Social Security show it rising from its current level (between 4 and 5% GDP) to between 6 and 7% seventy-five years out, roughly half the projected Medicare figure. In March 15, 2005 testimony before the

Senate Special Committee on Aging, Alan Greenspan noted simply: “The [funding] shortfall in Medicare is calculated at several multiples of the one in Social Security.”

E. Framework for analysis and comparison

A book by Diamond and Orszag, published last year,¹⁰ provides a very helpful framework for approaching these issues: The authors not only offer thorough analysis of the Social Security financing challenge, but suggest ways of thinking about how best to share the burden of meeting it. Their framework leads to a three-part plan containing a balance of revenue increases and "benefit adjustments." (I'll not try to summarize their justifications for it, but simply nominate the book for your summer reading list.) Two closely related factors that shape the Diamond-Orszag plan are the increased and continually increasing life expectancy for seniors and the inequality within that increase (much greater longevity improvement for high income than for low income workers). Diamond and Orszag don't favor benefit adjustment in the form of further shifts in the "full retirement age." Instead they propose reducing the prospective PIA formula for those 59 and younger, automatically each year, based on the increase in long-term cost to the program caused by improvement in the life expectancy for the average worker at full retirement age. (Actually, pursuing a pervasive “balance the pain” approach they would divide the impact between PIA reduction and an upward adjustment of the Social Security tax rate.) The widening gap between life expectancy for higher income and lower income retirees furnishes justification for a proposed reduction in the top band multiplier in the PIA formula from 15% to 10%. Other features of their plan are shaped in response to increases in earnings inequality. They note: “In 1983 ... 10 percent of earnings were untaxed because they were above the taxable minimum. In 2002, in contrast, the share of earnings above the maximum was about 15 percent.”¹¹ The final factor influencing their plan they term “legacy costs” – the costs that must be borne by present and future workers because earlier cohorts of Social Security recipients were and are paid benefits in excess of those financed by their own contributions.¹²

Changes that will solve Social Security’s financing challenge entail options that appear politically unpalatable. In comparing those options and persuading the public of a particular course of action, having an understandable framework or set of criteria is critical. And the starting premise can be determinative. Some enter the current policy debate with the conviction (not necessarily expressed) that the degree of income and generational transfer embedded in this social insurance program is undesirable. This leads them to favor solutions producing a tighter relationship between each worker’s pay-in and his or her ultimate lifetime benefits. Others would have the program do even more for low earnings workers. These groups are not likely to favor the same set of measures for achieving program solvency.

F. Social Security and gender

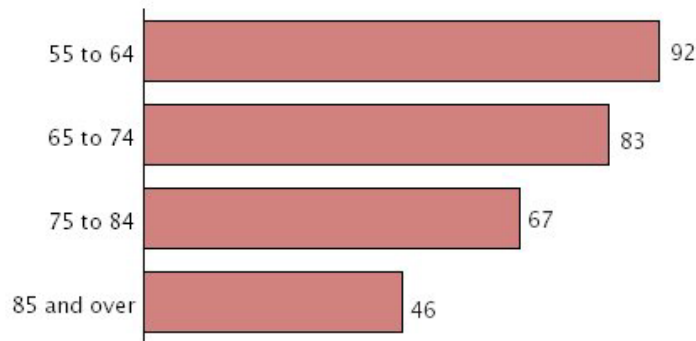
As we have seen in this course, Social Security is a different program for men and women. That means that significant program changes are likely to have a differential impact.

To begin, women live longer than men. That is not only true for those generations currently 50 and older; it appears almost certain to hold true for the generations following directly behind.

Figure 1¹³

Sex Ratio of People 55 Years and Over by Age: 2002

(Men per 100 women)



Source: U.S. Census Bureau, Annual Demographic Supplement to the March 2002 Current Population Survey.

The preceding chart (Figure 1) shows the declining ratio of men to women in ascending age cohorts. In the same year, 2002, the life expectancy for a 40-year-old male was 4.1 years shorter than that for a 40-year-old female; and the male-female life expectancy gap at 30 was 4.7 years. (The disparity was greater for Blacks than the population generally.)¹⁴

It follows as a straightforward consequence that Social Security benefits paid to those over age 60 (widow and widower benefits) or those over age 62 (old-age insurance or retirement benefits and spouse benefits) are received by more women than men. The ratio of men to women on the Social Security benefit rolls declines as age increases in close parallel with the chart above.¹⁵ And since these are benefits one cannot outlive, indeed benefits that are adjusted upward over time as living costs rise, differences in longevity translate directly to differences in benefits received. On average, the same monthly benefit amount will have greater value for a woman than for a man because it will be paid over several more years. But, of course, men and women do not, on average, have the same benefit amount.

The average monthly benefit paid women in December 2002 (averaging across all benefit types) was 75% that paid men.¹⁶ A principal source of the disparity is obvious. Because of their direct tie to the individual's history of earnings over an extended period, Social Security's retirement benefit amounts are dramatically lower for women than they are for men. In December 2002, the average retired worker benefit for women was 76.8% that for men.¹⁷ Over the years during which current beneficiaries compiled their Social Security earnings records, women received lower earnings than men, were more frequently engaged in part-time rather full-time employment, and spent more years out of covered employment.¹⁸ (As you know, Social Security retirement benefits are based on indexed covered earnings over a 35-year period. With a period of potential work that can stretch from before age 22 past age 62, this formula will exclude five or more low or no

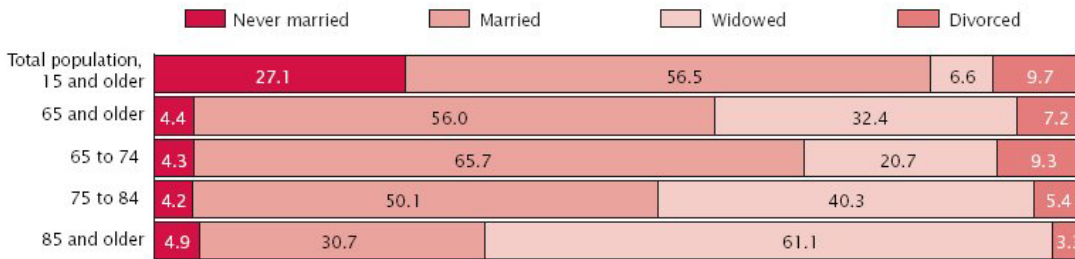
earnings years; but a lengthy period devoted to child rearing, care for adult relatives, or other non-market activity has direct impact on benefit amount.)

Since past and present marital relationships can be the basis for Social Security benefits, the distribution of marital status among those close to or past the age of eligibility is significant, with death of one partner becoming an factor of growing importance with increased age.

Figure 2¹⁹

Marital Status: 2000

(Percent distribution. Data based on sample. For information on confidentiality protection, sampling error, nonsampling error, and definitions, see www.census.gov/prod/cen2000/doc/sf4.pdf)

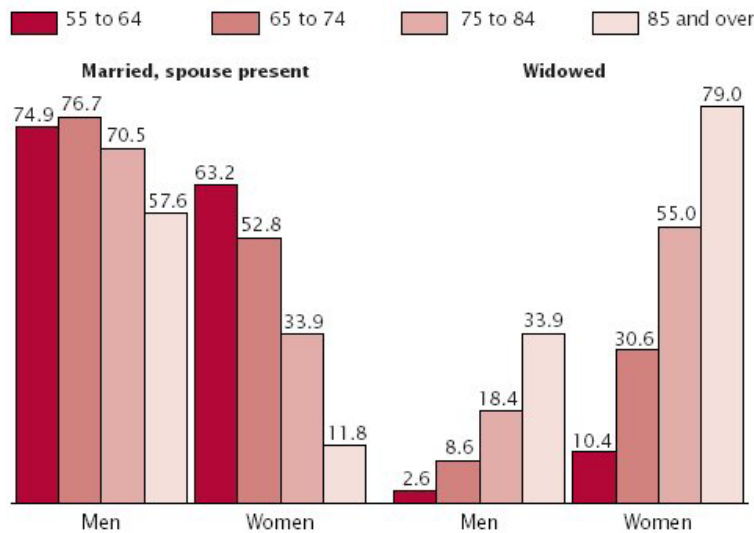


Source: U.S. Census Bureau, Census 2000 special tabulation.

Because of their greater longevity and the typical age gap between spouses²⁰ women are far more likely than men to fall in the widowed category. Nearly 4 out of 5 women 85 and over are widows as are over half of those 75-84. See Figure 3. The percentage of seniors living alone increases with age. In the population 65 and over as a whole, the number of women who live alone is three times the number of men.

Figure 3²¹

Percent of People 55 Years and Over Who Were Married With Spouse Present or Widowed by Age and Sex: 2002



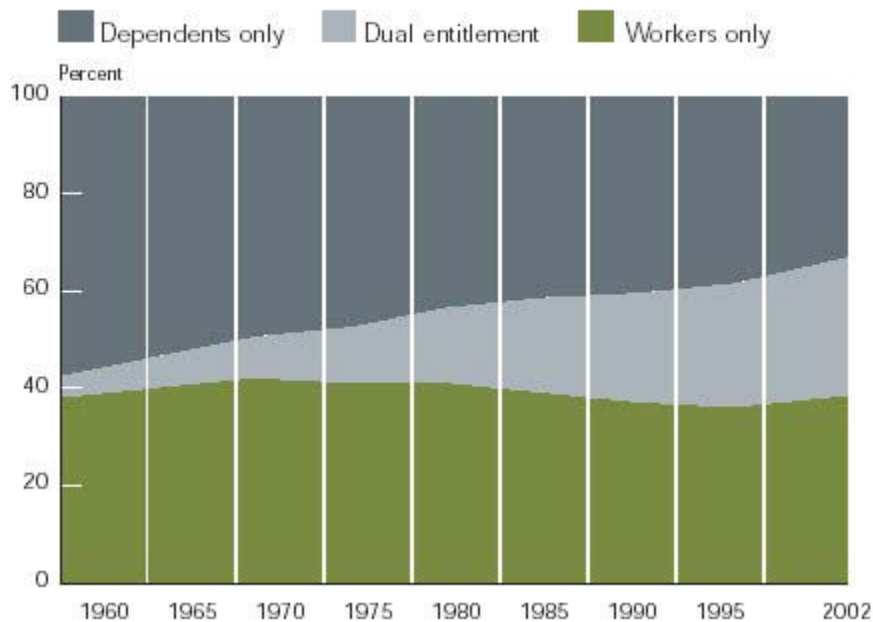
Source: U.S. Census Bureau, Annual Demographic Supplement to the March 2002 Current Population Survey.

Implications of these demographic realities for Social Security revision

Due to increased labor force participation by women the percentage of women above Social Security's age of eligibility receiving retired worker benefits has steadily grown. While this has reduced the number of women receiving spouse benefits alone, because of the terms on which benefits are available to spouses, particularly the formula which furnishes a widow benefits totaling those of her deceased husband, the principal effect has been an increase in the number of "dually entitled" beneficiaries. See Figure 4.

Figure 4²²

Women aged 62 or older, by basis of entitlement, selected years



Women who have never been married or whose only marriage did not last 10 years are not eligible for wife or widow benefits. Nor are those whose own retired worker benefits exceed those payable on the account of their deceased husband or a deceased former husband divorced after 10 or more years. It is the case, however, that those groups represent a relatively small fraction of older women. The greater number of women receiving retired worker benefits alone are those with a living husband (or former husband). For them it is either the earnings of that husband or the amount of their own retirement benefits that precludes receipt of wife benefits. In short, these are women who will in future years, more likely than not, become dually entitled – when they are widowed if not before. The average benefit paid to women receiving widow benefits (either widow benefits alone or, more dramatically still, widow benefits along with their own retired worker benefits) is substantially higher than that for women receiving only a retired worker benefit.²³

In sum, any partial shift of retirement benefits and their spousal derivatives from the current progressive benefit program to a strictly contributory scheme will disproportionately disadvantage women. Since women are, on average, more totally

dependent then men on Social Security, prospective benefit reductions will seemingly have greater impact on them. Furthermore, treatment of marriage and divorce, as well as spouse survivorship rights, both within Social Security and within any new personal account scheme has particular importance for women.

As important as spouse and surviving spouse benefits are to older women as a class and even to some of the most vulnerable among them, as we observed earlier in this course the law governing allocation of benefits (that is the eligibility rules and the formulae setting the amount) is rife with arbitrariness and inequity. To observe that abolition or even dramatic curtailment of spouse benefits would have serious negative consequences for women is not to embrace the status quo, let alone to advocate increasing the flow of benefits through that system.

G. Social Security and ethnicity

Social Security can be conceived of as consisting of three components: a) one providing pensions to retired workers and their surviving spouses; b) one providing life insurance to younger workers with families; and c) one insuring against premature inability to earn because of a physical or mental impairment. The relative importance of these components is quite different for blacks and other minorities than for whites.

Of the whites receiving Social Security benefits in 2002, three-quarters were retired workers or surviving spouses.²⁴ Nearly six in ten new benefits awarded whites that year fell in those categories; the comparable figure for blacks was only four in ten. Death and disability strike young black workers disproportionately with the result that a quarter of the Social Security benefits awarded blacks in 2002 were based on disability. More than one in ten went to children of deceased workers.²⁵ The comparable figures for whites were significantly less. Blacks, who comprise 13 percent of the working-age population, are 17 percent of DI recipients. Black children comprise 15 percent of the population under 18, but 22 percent or more of the recipients of child survivor benefits.²⁶

Assertions that minorities are disadvantaged by Social Security typically focus only on Social Security's retirement pension piece, arguing that since minorities have shorter life expectancies on average they receive smaller returns. The New York Times recently reported that "White House official and Republican strategists" had "begun a push to persuade African-Americans and Hispanics that Social Security, long thought to be of benefit to them, is a bad deal."²⁷ In the context of a campaign for a personal account "carve out" this strikes me as misleading. To begin, the earnings gap between minority and majority workers is large, and the progressive benefit structure of Social Security, on average, delivers higher returns to any group with lower incomes. When one includes the disability and survivors benefit components of Social Security, available evidence persuades me that Social Security's rate of return is higher for blacks and much higher for Hispanics than it is for non-Hispanic whites.

H. Other groups with distinct interests in Social Security (and thus Social Security reform)

1. Young, old, and in-between

Those who reached retirement age in the early 1980s received, and members of that cohort who are still alive continue to receive, a large net transfer. Their benefit levels far exceed any pensions their contributions plus interest would have funded. That was not true for the cohort reaching retirement age in 1990 nor will it be true for those retiring this year or ten years from now. Under current law workers born after 1936 are, on average, scheduled to receive benefits that represent less than a market rate of return on their tax contributions.²⁸ Issues of intergenerational transfer and fairness surround all options for Social Security's future. Consider, for example, how the option of leaving the current law in place unchanged would affect those currently thirty and younger (i.e. born after 1974 and hitting the age of 67 in 2041 or later). After paying the same levels of tax as their parents' generation now in their fifties (whose life expectancies predict death before 2041) this younger group would retire to benefits 20 to 30 percent below the nominal amount held out by today's statutory formula on account of inadequate program revenues projected for the point of their retirement and thereafter.

Concern about disrupting the plans of those with relatively few years before retirement and related political considerations, however, leads most solvency proposals to exempt not only current recipients but older workers as well from benefit adjustments. Such restraint inevitably shifts more of the burden of change onto younger cohorts. That is the principal reason why delay has consequences for intergenerational equity.

2. High-earnings, medium-earnings, and low-earnings workers

On both its tax and benefit sides Social Security treats higher income workers and lower income workers differently. Its tax bite is lighter for those whose earnings exceed the annual earnings base (\$90,000 for 2005) and those for whom earnings are not the sole source of income – groups with a lot of overlap. On the other hand, these regressive features are counterbalanced by a benefit formula that provides better replacement rates for low than for medium earnings history retirees, and better replacement rates for those with average earnings histories than for those with higher ones. The Federal income treatment of benefits reflects a similar progressive tilt.

Changes to Social Security designed to increase revenues or reduce long-term benefits almost invariably threaten the current balance between equity (comparable returns on contribution) and adequacy (higher return to those in greater need).

II. Possible Changes – Personal Accounts

The President is committed to adding personal accounts as a voluntary Social Security offset (sometimes referred to as a “carve out”), i.e. those making the choice would pay a reduced Social Security tax and ultimately receive reduced Social Security retirement benefits. (Other plans have proposed adding government encouraged and administered personal accounts on top of Social Security.) Under the President's proposal workers

would have the option of directing a portion of their Social Security tax into a personal retirement account.

There are, of course, threshold questions such as whether some form of government-induced, regulated, and administered personal retirement account system should be added to Social Security either on top of or as a partial substitute for current benefits. There is the further question whether such a change is desirable in the context of concern over the program's long-term solvency. (Few proponents of personal accounts contend that they represent a solution to the solvency problem. Personal accounts are viewed alternatively as: a) an important component of any solvency solution that includes prospective benefit reductions, b) a sideshow or distraction, or c) a step in the wrong direction. Assuming a commitment to personal accounts, however, there remain myriad issues of detail.

Of particular pertinence to this course are the issues concerning the interaction between "voluntary" accounts and "traditional Social Security." Important details of any personal account scheme include:

- What voluntary means? Can the individual worker decide whether to allocate sums to a personal account each year (and if so how much) or are these to be irreversible one-time elections? The President's proposal appears to be the latter.
- How much can one allocate to this account each year? And is this allocation on top of or a "carve out" from current Social Security taxes? The President's proposed plan would ramp up to an allocation of 4% of covered earnings "carved out" of Social Security taxes, subject to an initial maximum of \$1,000. The 2001 Commission report offered three different plans: Model 1 (2% of covered earnings), Model 2 (4% of covered earnings subject to a \$1,000 cap), and Model 3 (a worker contribution of 1% of covered earnings on top of the Social Security tax, to be matched by a Government contribution of 2.5%).

How are traditional OAI benefits to be adjusted for those who have opted for personal accounts? The dominant approach being discussed is an offset (often termed a "clawback") based on a hypothetical or "shadow" account. At the time for calculation of Social Security benefits the sums diverted to the individual's personal account increased by some stipulated interest rate compounded would be converted into a hypothetical annuity. The amount of that hypothetical annuity would then be subtracted from the person's Social Security benefit. If you think the current PIA formula is hard to understand, consider trying to work this one through.

With a voluntary account scheme workers will have to understand all of this well enough to decide whether to participate or leave all their contributions within Social Security. The percentage rate underlying this clawback is a critical parameter. The lower it is set the more attractive personal accounts will seem (thus, increasing the incentive for workers to establish one), but lower rates also mean reduced long-term savings to the Social Security system through the addition of personal accounts. If the rate is set lower than the yield of the Federal bonds held by the Social Security trust funds, the difference can be viewed as an implicit subsidy of personal accounts and at odds with the "higher return" rationale for such a plan. The clawback in the President's proposal uses an interest rate of 3% above inflation. The three options set out in the 2001 Commission report used rates of 3.5% (Model 1), 2% (Model 2), and 2.5% (Model 3) above inflation.

A person electing to establish a personal account will realize higher total benefits if and only if the personal account realizes a better net return than assumed in the clawback shadow account. A study by a Yale economist released this month concludes that a significant fraction of personal accounts are not likely to achieve sufficient returns to offset the corresponding Social benefit reductions if premised on a 3% above inflation interest figure.²⁹

Other important features of a personal account plan include all the details of administration, fees, and permitted range of investment choices. The closest existing approximation of the scheme the President has in mind is the Thrift Savings Plan (TSP) available to Federal employees and members of the military.³⁰ The TSP is, however, a supplementary personal account program not an offset to Federal pensions or Social Security. Moreover, while it may offer a relevant model, there are numerous dimensions for disagreement, discussion, and, if implemented, individual decision-making. Less conspicuous in the current debate are a series of “ownership” questions.

A. Spousal rights

We looked closely at spouse benefits in the course. What rights will the non-contributing spouse have in a worker’s personal account? Assuming the recommendations of the President’s Commission of 2001 are followed, spousal rights will be even more concrete than they are in the Thrift Savings Plan (where they are, in general, more robust than with private sector retirement pensions). The Commission Report states: “All account balances attributable to contributions during marriage, and all earnings on account balances brought into marriage, should be divided equally in the event of divorce.”³¹ It goes on to recommend that the personal account payout for all married individuals be in the form of a “two-thirds joint and survivor annuity” unless “both spouses agree.”³²

B. Pre-retirement access

The President has explicitly embraced his Commission’s recommendation on this point. The White House Document entitled “Strengthening Social Security for the 21st Century” (February 2005) states: “American workers who choose personal retirement accounts would not be allowed to make withdrawals from, take loans from, or borrow against their accounts prior to retirement.” (I trust you appreciate from our inspection of Social Security’s evolving approach to the definition of retirement and retirement age the complex of issues buried in this principle.) Should the worker die before retirement, however, the heirs would have immediate access.³³

C. Payout options

The 2001 Commission Report also recommends limits on the form in which the account balance can be withdrawn upon retirement, preventing the holder, in most cases, from taking it out as a lump sum.³⁴ As noted above the rules governing payout options would presumably, in the case of a married couple, take account of the circumstances of both spouses not simply the account holder.

D. Dealing with the immediate impact of the reduced Social Security tax (FICA/SECA) payments

The offsetting reduction in Social Security benefits based on making payments into a personal account (clawback) lies well off in the future. The oldest workers permitted to contribute under the President's proposal will be 54, eight years from the Social Security age of eligibility, twelve years from their full retirement age under current law. Substantial reductions in Social Security payout as a consequence of private accounts would not come until years later as younger workers hit retirement age. Meanwhile, every dollar going into a private account will be a dollar not available to cover program outflows. That gives rise to "transition costs" ("investment costs" to supporters), the need to find additional revenue (or benefit reductions) for Social Security to replace the lost taxes.

E. Implications for the non-pension components of Social Security

As you know from this course Social Security does far more than provide old-age pensions. The implications of substituting a personal retirement account for a portion of "traditional" Social Security remain unclear in general, but particularly unsettling is the seeming inattention to what this might mean for a young covered worker who experiences an accident or injury that prevents future employment (DI) or who dies leaving children, a surviving spouse, or dependent parent (Survivors benefits). Social Security insures against such misfortunes through the same framework with which it provides a foundation for old-age income security. Currently, over one in ten new recipients of old-age benefits are not shifting from employment but rather transferring from Social Security's disability insurance program. Slightly more than 1 out of four individuals who receive Social Security payments are someone other than the worker on whose earnings those payments are based. (26.68%) And those payments total nearly one-fourth of the annual distribution of benefits by the program. (24.31%).³⁵ Vague assurances that the changes proposed for the program's old-age benefits will not affect these other elements are ultimately unpersuasive because of how integrally Social Security's different benefits are linked.³⁶ The same PIA-based benefit formula and similar coverage thresholds apply across all program components. It is nearly impossible to "reform" Social Security's old-age pension without also attending to disability, dependents, and survivors benefits. Furthermore, given the very limited political space available for adjusting Social Security's future revenues and future commitments in pursuit of long-term solvency and sustainability, it seems unwise to ignore these non-pension components.

III. Changes That Address Social Security's Long-Term Fiscal Imbalance

As suggested above, standing alone any personal account scheme that involves an immediate reduction in Social Security tax payments increases rather than diminishes the imbalance between the program's projected revenues and projected payout for a period of several decades. The benefit reductions from elections of personal accounts lie too far in the future to mitigate the negative effects of the program's shift from surplus generator to net payor around 2017 (or whatever the cash flow reversal year turns out to be) or the

exhaustion of the program's nominal reserves before the turn of the century. Consequently, if it is to address the solvency problem, a personal account proposal must be bundled with some combination of net downward adjustment of the program's benefit provisions (beyond those accompanying payments into personal accounts) and revenue increases. Since the President has ruled out a prospective tax rate increase (though apparently not the raising or removing the cap on earnings subject to the tax), the Administration's emphasis is on the benefit side.

A. Reducing future benefit payments

1. Price indexing replacing earnings indexing

While the President has not tabled a solvency plan, the Model 2 scheme presented by the President's Commission, which most closely resembles his personal account proposal, offers one likely indication of the program adjustments his Administration will seek to bundle with it. In that model the principal source of prospective benefit reduction is a shift in the PIA formula. For the current earnings indexing, it would substitute price indexing. In all likelihood those 55 and older would be shielded from the change, but for those younger the current PIA formula would have superimposed on it an adjustment of the percentage multipliers for successive cohorts. Here is how a footnote in the 2001 Commission Report explains this solution: "[T]he policy would be implemented by multiplying the PIA bend point factors (the bend points would remain indexed to wages) by the ratio of the Consumer Price Index to the Average Wage Index in successive years."³⁷

As presented by the Commission this would not constitute a "benefit reduction" since the revised formula would generate benefits for future retirees with the same "purchasing power" or better in comparison with those received by today's beneficiaries. In the Commission's words: "The new price-indexing policy slows the growth in future benefits. But, it ensures that future retirees will receive inflation-adjusted benefits that are at least as high as the benefits received by today's retirees."³⁸

This approach rejects the policy of maintaining stable replacement rates or ratios that underlies the 1977 "decoupled" benefit formula. Measured in replacement rate terms the change would constitute a major reduction for future retirees. Rather than providing retirement benefits in a relatively stable ratio to pre-retirement earnings (albeit different for those at different earnings levels) this proposed change would lead to steadily declining ratios – assuming, of course, that wages continue to grow faster than prices. Proponents argue that earnings-indexing represents unsustainable benefit growth and a shift to price-indexing, since it provides future retirees with benefits of comparable purchasing, is not a benefit cut.³⁹

Low-income workers would, of course, be most threatened by this change. Anticipating the concern, the Commission's Model 2 package includes an increase in the minimum benefit for steadily employed low-income workers "relative to the price indexed benefit level." The target is a benefit significantly above the poverty level for "a 30-year minimum wage worker."

One member of the 2001 Commission, Robert Pozen, has achieved visibility this past month (March 2005) with a plan he has labeled “progressive indexation.” It would retain wage indexing for low-earnings workers, shift to price indexing for the highest group, and employ a blend of the two for those with average indexed earnings in the middle.⁴⁰

2. Alternative avenues toward fiscal relief through reducing benefits for future retirees

Other forms of future benefit reduction receiving attention in the current political debate include: a) continuing the upward adjustment of full retirement age beyond age 67 and/or speeding up the increase to 67, b) automatically decreasing the PIA as life expectancies increase (longevity indexing). Additional options put forward in recent years are: a) shifting to a less generous and arguably more accurate COLA adjustment, b) changing the PIA formula to include more years, c) reducing the multipliers in the PIA formula for the top band(s).

B. Increasing program revenues

The nicely balanced proposal advanced in the book by Diamond and Orszag⁴¹ includes tax rate increases, which as noted above the President has categorically ruled out. An alternative way to increase revenue from the Social Security tax would be to raise or remove the cap on earnings subject to it. Many have urged bringing those state and local government employees who still remain outside Social Security under the program.

The two model plans in the 2001 commission report that achieved or approached solvency while adding personal accounts turned to general revenues to cover program short-falls. In significant part those short-falls were, under Models 2 and 3, the product of their shifting Social Security tax revenues from the funding of current benefits to advance funding of personal accounts. This allowed those supporting Model 2 to argue that these general revenue infusions might be viewed in loan-like terms:

In order to maintain the ability to pay benefits throughout the 75-yr period, addition revenue would likely be needed (in years 2025 through 2054 under the assumptions used for these estimates). The Reform Model would provide for transfers from the General Fund of the Treasury in amounts needed for such years. However, because of substantial expected cash flow surpluses later in the period, and beyond, these transfers could be repaid.⁴²

The Pozen plan (see III.A.1 above) explicitly calls for General Fund transfers totaling \$1.9 trillion in present value between 2030 and 2078, estimated to produce a trust fund balance of \$200 billion and positive cash flow by 2078.⁴³

IV. Other Program Changes Likely to Be Bundled

A. Surviving spouse benefits

Two of the three plans put forward by the President’s Commission recommended a change in the benefits for widows and widowers, a change that would assure the survivor a benefit equal to 75% of the combined Social Security payments received by the couple while both were alive. We discussed such a plan under Topic 4. As I noted then, current

law falls short of that amount. It provides somewhere between 66% (a shift from 100% of PIA plus a spouse benefit of 50% to a surviving spouse or retired worker amount of 100%) and 50% (the case when both spouses had similar earnings records and were therefore receiving near equal PIAs). These percentages vary, of course, if the spouses begin benefits at ages other than their respective FRAs. Two of the models sketched in the President's Commission Report would increase the survivor's benefit to 75% of the pre-death benefits of the couple. No further details were furnished.⁴⁴

B. Benefits for low-earnings workers

Any package of changes including future benefit reduction poses the greatest threat to those whose earnings have little or no margin for additional retirement savings. The current Social Security formula has two forms of special protection for low-earnings workers: a) a PIA formula that provides higher earnings replacement for those with low average indexed monthly earnings, and b) a special minimum for those with long years of low earnings. Even so it generates benefits that fall below the poverty threshold for a single person household (65 or over). The gap is particularly pronounced for those who, often without choice, commence their benefits at age 62. Model 2 of the 2001 Commission report, while generally reducing earnings replacement by a shift to price indexing, contained an enhanced special minimum for low-earnings workers, aimed ultimately at delivering a benefit equal to 120% of the poverty level to a 30-year minimum wage worker. Model 3 included a similar feature with a 100% target.⁴⁵

V. *The Rhetoric of Reform*

Since the program's birth, success at establishing the language and the concepts framing Social Security features and options has held immense political importance. As hard choices about the program have thrust themselves upon Congress, those who proved able to define the starting point and units of measurement attained the upper hand. Since the political environment surrounding Social Security finds cuts unpopular, if not inconceivable, finding a way to present change as stability provides enormous advantage. Success in framing analysis of future benefits in terms of "replacement rate" helped establish wage-indexing in 1977.⁴⁶ The prospective benefit reduction enacted in 1983 was packaged as a gradual increase in what is now termed the "full retirement age."

It is, thus, not surprising that disputes over terminology continue to surface in the current debate.⁴⁷ Negative public sentiment about "privatizing Social Security" has led the Administration to insist that the President be understood as proposing "personal accounts" and opponents with equal persistence to characterize the President's plan as one of "private accounts." The President has not yet succeeded in building public or political acceptance of the terms or concepts within which his preferred package of changes (still largely unrevealed) can be viewed as not only palatable but desirable. The commission he established during his first term failed to reach consensus on a single plan or rhetorical/conceptual approach around which bi-partisan support could be built. So long as the debate remains stuck at the level of whether or not there is a "crisis," there is, I fear, little hope of responsible legislative action.

¹ See Board of Trustees, Federal Old-Age and Survivors Insurance and Disability Insurance, *2004 Annual Report* II.D, at 10.

² Peter A. Diamond & Peter R. Orszag, *Saving Social Security: A Balanced Approach* 34-35 (2004). Of all the recent writing about Social Security's financing challenge and options, this book receives my top recommendation.

³ See Boards of Trustees, Federal Hospital Insurance and Supplemental Medical Insurance Trust Funds, *2005 Annual Report* 21-24.

⁴ This year's report, like those before, notes:

The actual future income and expenditures of the OASI and DI Trust Funds depend on many factors, including the size and characteristics of the population receiving benefits, the level of monthly benefit amounts, the size of the work force, and the level of workers' earnings. These factors will depend in turn upon future birth rates, death rates, immigration, marriage and divorce rates, retirement-age patterns, disability incidence and termination rates, productivity gains, wage increases, inflation, and many other demographic, economic, and program-specific factors.

Board of Trustees, *supra* note 1, at 6.

⁵ GAO Report: *Social Security: Criteria for Evaluating Social Security Reform Proposals*, T-HEHS-99-94, at 4. (Mar. 25, 1999).

⁶ Board of Trustees, *supra* note 1, at 4.

⁷ Douglas Holtz-Eakin, Director, Congressional Budget Office, Statement before the Special Committee on Aging, United States Senate 2-3 (Feb. 3, 2005).

⁸ Boards of Trustees, *supra* note 3, II.D, at 8.

⁹ Boards of Trustees, Federal Hospital Insurance and Supplemental Medical Insurance Trust Funds, *2004 Annual Report* I.E, at 6.

¹⁰ Diamond & Orszag, *supra* note 2.

¹¹ *Id.* at 84.

¹² *Id.* at 88.

¹³ Denise Smith, *The Older Population in the United States: March 2002*, at 1 (Census Bureau 2003). See also Lisa Hertzfel & Annetta Smith, *The 65 and Over Population: 2000*, at 3 (Census Bureau 2001).

¹⁴ Elizabeth Arias, *United States Life Tables, 2002*, at 53 National Vital Statistics Reports, No. 6, 3 (National Center for Health Statistics 2004).

¹⁵ In December 2002, the number of male Social Security recipients per 100 female recipients was 85.5 for the age range 65-74, 66.6 for the age range 75-84, and 41.3 for the range 85 and above. See Social Security Administration, *Annual Statistical Supplement, 2003*, Table 5.A10.

¹⁶ \$750.00 for women compared to \$1,007.20 for men. *Id.*

¹⁷ \$773.90 for women compared to \$1,008.10 for men. *Id.*

¹⁸ See P. Levine, O. Mitchell, & J. Phillips, *A Benefit of One's Own: Older Women's Entitlement to Social Security Retirement*, 67 Soc. Sec. Bull. 47 (2000).

¹⁹ Yvonne Gist & Lisa Hertzfel, *We the People: Aging in the United States 2* (Census Bureau 2004).

²⁰ While the gap is narrowing the median age at which women first marry is nearly two years younger than the median age at which men first marry. See Jason Fields, *America's Families and Living Arrangements: 2003*, at 12 (Census Bureau 2004).

²¹ Denise Smith, *The Older Population in the United States: March 2002*, at 3 (Census Bureau 2003).

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- ²² Social Security Administration, *Fast Facts and Figures About Social Security* 22 (2003).
- ²³ See *Annual Statistical Supplement*, *supra* note 10, Table 5.A15.
- ²⁴ See *id.* Table 5.A1.
- ²⁵ See *id.* Table 6.A3.
- ²⁶ See Diamond & Orszag, *supra* note 2, at 174-75.
- ²⁷ Edmund L. Andrews, *G.O.P. Courts Blacks and Hispanics on Social Security*, *New York Times*, March 20, 2005, at A 24.
- ²⁸ Diamond & Orszag, *supra* note 2, at 70-72. This is not to say that the proposition holds for all individuals within a given retirement cohort. I've not done the figures, but I wager that the special minimum PIA for steadily employed low-income workers delivers an above-market rate of return. Those visited by disability or death at a young age also realize a positive benefit to contribution ratio, and for all covered workers the return in the form of OAI is enhanced by Social Security's insurance against these other contingencies.
- ²⁹ See <http://irrationalexuberance.com/> The report by Robert J. Schiller is summarized in the Washington Post for March 19, 2005. Jonathan Weisman, *Retirement Accounts Questioned Paper Challenges Expected Benefits*, *Washington Post*, March 19, 2005, at E 1.
- ³⁰ For more information about the TSP go to <http://www.tsp.gov/>
- ³¹ President's Commission to Strengthen Social Security, *Strengthening Social Security and Creating Personal Wealth for All Americans* 53 (2001).
- ³² *Id.* at 54.
- ³³ See President's Commission, *supra* note 26, at 50.
- ³⁴ See *id.* at 51.
- ³⁵ See *Annual Statistical Supplement*, *supra* note 10, Table 4.A5, Table 5.A1.
- ³⁶ The President indicated in a January interview with the Washington Post that his reform plan did not entail changes in Social Security disability or survivors benefits. Jim VandeHei & Michael A. Fletcher, *Bush Says Election Ratified Iraq Policy; No U.S. Troop Withdrawal Date Is Set*, *Washington Post*, January 16, 2005, at A 1.
- ³⁷ President's Commission, *supra* note 26, at 109, n. 42.
- ³⁸ *Id.* at 109.
- ³⁹ As I wrote years ago, about the 1977 benefit formula revision: "If future benefits are compared to present payments or to the gross national product, wage-indexing appears to commit the system to growth whereas price-indexing yields stability. On the other hand, when the criterion of replacement rate is used, wage-indexing appears to maintain a stable benefit level while price-indexing leads to gradual shrinkage – higher benefits but lower replacements rates. Supporters of the 1977 Congressional wage-indexing scheme characterized it as the path of stability; opponents viewed it as a commitment to benefit growth. Both were right." Peter W. Martin, *The Art of Decoupling: Keeping Social Security's Promise Up-to-Date*, 65 *Cornell L. Rev.* 748, 788 (1980) (citations omitted).
- ⁴⁰ Pozen's plan is detailed in a memorandum to him dated Feb. 10, 2005 from SSA's chief actuary Stephen Goss. http://www.ssa.gov/OACT/solvency/RPozen_20050210.pdf (hereinafter Goss memo). It was mentioned by the President at a March 16 press conference and has begun to receive considerable attention. See Charles Stein, *Pozen's Social Security fix sparks buzz*, *The Boston Globe*, March 17, 2005; Edmund L. Andrews, *Republicans Consider Slowing Benefits Growth for Most*, *New York Times*, March 25, 2005.
- ⁴¹ Diamond & Orszag, *supra* note 2.

⁴² President's Commission, *supra* note 26, at 110.

⁴³ See Goss memo, *supra* note 39, at 7 and Table 1a.

⁴⁴ See President's Commission, *supra* note 26, at 97.

⁴⁵ *Id.* at 14.

⁴⁶ Martha Derthick, *Policymaking for Social Security* 405 (1979).

⁴⁷ See Robin Toner, *It's 'Private' vs. 'Personal' in Social Security Debate*, New York Times, March 22, 2005.