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

Introduction

Throughout the first half of his presidency, President Bush pressed the need for “Social Security reform.” In his first term he appointed a Social Security Commission and charged it with devising a path to sustainability that would include individually funded accounts. The commission issued a report in December 2001, but failed to endorse a single plan. At the beginning of his second term, the President led conversations on “Strengthening Social Security” across the country. By then he spoke less of a particular plan, but of the urgent need to solve the program’s fiscal problem and some ideas he had put before Congress, including optional “personal savings accounts” for younger workers. Said he about those in the legislative branch, of both parties, “[I]f they've got a better idea, bring them forward.” But consensus failed to emerge and by late 2005 the topic had largely disappeared from both public view and political exchange. In Omaha, where one of Presidential conversations took place, the World-Herald marked its anniversary with this summary of what happened to the initiative:

By July, the issue had begun to slide. Republicans were split, Democrats were united against privatization, and polls showed the president's public support had flagged. Bush was on vacation for most of August. Hurricane Katrina hit at the end of August, blowing away the last chance for change.

In 2006 President Bush nominated Andrew Biggs, a strong proponent of personal accounts, to serve as SSA Deputy Commissioner. When the Senate Finance Committee failed to hold confirmation hearings, the President placed Biggs in the post through an April 2007 recess appointment. While the gesture expressed the Administration’s continuing commitment to a particular version of Social Security reform, it also signaled failure to achieve necessary support. Later in 2007 the House of Representatives weighed in by voting to strike funding for the Deputy Commissioner’s position pending Senate confirmation.

Will serious political attention to Social Security’s challenges resume after this next national election? One can hope so. To date Social Security has not been a salient topic in the campaigns for presidential nomination. The candidates do speak of the program and its importance, but none has outlined a clear position on the policy choices that bear on its future.

In the absence of a specific proposal under active consideration, 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 Bush gave 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 seventy-five year projections have placed the size of that deficit at 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. 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” critique points toward 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. Program revenue and benefits can be in balance when viewed against a fixed number of years, so the argument goes, 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.F below) refer to this as the “terminal-year problem.” Enacting a Social Security tax rate increase of 2% (1% on both employees and employers) would achieve actuarial balance, as traditionally measured, but it 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 being the new drug benefit program that took effect in January of 2006) are, according to that program’s Trustees report for 2008, in actuarial balance. How can that be said? 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. Is Medicare in fiscal balance? Technically, yes; realistically and 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 the program’s 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, 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 most recent 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. A 2004 Congressional Budget Office projection of Social Security expenditures and revenues estimated a much smaller long-term deficit than the program trustees, further illustrating the degree of speculation involved in predicting the effects of economic and demographic changes over three-quarters of a century.\

Any number of events or forces, ranging from changes in immigration policy to economic collapse, wars or pandemics, could change Social Security’s future in defiance of today’s best estimates. 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 recommend a “wait and see” approach? My short answer is “no.” It is one thing for Congress to 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 politically difficult or to force them to be unnecessarily arbitrary.

Why not wait to act until Social Security’s fiscal shortfall is closer at hand so that its dimensions will, presumably, be more clearly visible? As the Comptroller General explained to a Committee of Congress nine years ago, two powerful reasons not to wait are 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.\(^9\)

Assuming that solvency requires downward adjustment of the program’s benefit formulae and higher taxes in some combination, the greater the delay in implementation, the more that burden will be concentrated on younger workers and future cohorts of beneficiaries, with those who fall in both categories taking a double hit. Of course, the intergenerational equity point applies, with equal force, to Medicare, the national debt and U.S. trade imbalance, exploitation of natural resources, and a myriad other issues. It is simply more evident with Social Security because of the way the program is structured.

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 the Bushes, both senior and junior, 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 over $2.2 trillion. (During 2007 $110 billion, 14% of program revenue, came from interest payments on that debt.\textsuperscript{11}) 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 testimony before the Senate Special Committee on Aging in February 2005: “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.\textsuperscript{12}

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. That argument rests at bottom on claims about psychology and politics, not law.

D. What happens if Congress does nothing?

The Social Security Act itself appropriates the funds for Social Security benefits. There is no need for the Social Security Administration to secure an appropriation each year for benefits. (On the other hand, the program’s administrative costs, although funded from the same source, the trust funds established by 42 U.S.C. §401, are subject to annual Congressional approval.) Concerns about an imbalance between program revenue and benefit commitments are dealt with primarily through procedural devices designed to alert Congress to the problem. The most important of these is the annual report by the program trustees called for by 41 U.S.C. §401(c). Section 401 also authorizes inter-fund borrowing as a short-term solution (\textit{e.g.}, the Disability Insurance trust fund can borrow from the Old-Age and Survivors Insurance fund or vice versa). \textit{See} 42 U.S.C. §401(l).

In addition, the mechanism in 42 U.S.C. §415 for annual cost-of-living benefit increases shifts from price to wage indexing, if lower, when the "fund ratio" drops too low. \textit{See} 42 U.S.C. §415(i).

There is nothing in the Act that provides for scaling back benefits so that they match revenues. The assumption is that before that would become necessary Congress, having been forewarned by the trustees and the chief actuary, will have made appropriate adjustments (as it has in the past). Should Congress do nothing and the trust funds experience cash flow embarrassment, the Social Security Administration would have no legal authority to pay benefits beyond the sums flowing in. In the absence of further Congressional direction through amendment to the Act, what the agency would be authorized to do in shaping benefit outflow to inadequate revenue is an open question.\textsuperscript{13}
E. The far greater challenges posed by Medicare (and Medicaid)

The 2008 Trustees Report on Medicare summarized its future as follows:

Medicare expenditures represented 3.2 percent of GDP in 2007. Costs increase to about 7.0 percent of GDP by 2035 under the intermediate assumptions and to 10.8 percent of GDP by the end of the 75-year period.\(^{14}\)

The report adds: “[I]t is important to note that, after 2007, Medicare expenditures are understated because of unrealistic substantial reductions in physician payments scheduled under current law.”\(^ {15}\) A later passage puts these GDP figures in perspective: “For comparison, over the last 50 years total Federal income tax receipts have averaged 11 percent of GDP.”\(^ {16}\)

Comparable rojections of Social Security show it rising from its current level (between 4 and 5% GDP) to 6% or so seventy-five years out, roughly half the projected Medicare figure.\(^ {17}\) 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.”

F. Framework for analysis and comparison

A book by Diamond and Orszag, published in 2004,\(^ {18}\) 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 substantial 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.”\(^ {19}\) 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.\(^ {20}\)

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.

G. Social Security and gender

As we have seen in this course, notwithstanding its formal gender neutrality, 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.

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.)

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. 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 senior women in December 2004 (averaging across all benefit types) was 74.5% that paid senior men. 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 2006, the average retired worker benefit for women was 76.8% that for men. 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. (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 as age increases.

Figure 2

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<th>Marital Status: 2000</th>
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<td>(Percent distribution. Data based on sample. For information on confidentiality protection, sampling error, nonsampling error, and definitions, see <a href="http://www.census.gov/prod/2000pubs/s4/4.pdf">www.census.gov/prod/2000pubs/s4/4.pdf</a>)</td>
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<td><strong>Total population, 15 and older</strong></td>
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Source: U.S. Census Bureau, Census 2000 special tabulation.

Because of their greater longevity and the typical age gap between spouses women are far more likely than men to fall in the widowed category. Nearly 4 out of 5 women 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 who do.
Implications of these demographic realities for Social Security revision

Due to increased labor force participation the percentage of women above Social Security’s age of eligibility receiving retired worker benefits has grown steadily. 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.
Women who have never been married or whose marriage or marriages ended in divorce before lasting 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 only retired worker benefits 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.

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.

H. 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 physical or mental impairments. 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 2006, over eight in ten were retired workers, spouses of retired workers, or surviving spouses. Over six in ten new benefits awarded whites that year fell in those categories; the comparable figure for blacks was only about four in ten. Death and disability strike young black workers disproportionately with the result that more than forty percent of the Social Security benefits awarded blacks in 2005 were based on disability. Nearly one in ten went to children of deceased workers. 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.

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. During the height of the 2005 press for action on the President Bush’s reform plan, “White House official and Republican strategists” the New York Times reported, began “a push to persuade African-Americans and Hispanics that Social Security, long thought to be of benefit to them, is a bad deal.” In the context of a campaign for a personal account “carve out” this was 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.

I. 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. 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-four 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 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 a major 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 ($102,000 for 2008) 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

A core element of all plans put forward by the Bush Administration was the inclusion of voluntary personal accounts. (This was a requirement the President laid on his 2001 commission.) For a worker electing to establish such an account there would be a Social Security offset (sometimes referred to as a “carve out”), i.e. the worker 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.)

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 variously 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 numerous critical issues of detail.37
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 does voluntary mean? 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? President Bush’s proposal appeared 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 have ramped 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 in 2005 consisted of 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 would have to understand all of this well enough to decide whether to participate or leave the full amount of their contributions within Social Security. The percentage rate underlying the 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 fairly 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 proposal the White House was pursuing used 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 would receive higher total benefits if and only if the personal account realized a better net return than assumed in the clawback shadow account. One recent study concluded that a significant fraction of personal accounts would not be likely to achieve sufficient returns to offset the corresponding Social benefit reductions if premised on a 3% above inflation interest figure.38

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 had in mind is the Thrift Savings Plan (TSP) available to Federal employees and members of the military.39 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 during the recent “personal account” debate are a series of “ownership” questions.

A. Spousal rights

We looked closely at spouse benefits in the course. What rights would a non-contributing spouse have in a worker’s personal account? If the recommendations of the President’s Commission of 2001 were followed, spousal rights would 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 stated: “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.” It went 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.”

B. Pre-retirement access

President Bush explicitly embraced his Commission’s recommendation on this point. A White House Document entitled “Strengthening Social Security for the 21st Century” (February 2005) stated: “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 potential complexity of this seemingly straightforward principle.) Should the worker die before retirement, however, the worker’s heirs would have immediate access.

C. Payout options

The 2001 Commission Report also recommended limits on the form in which the account balance could be withdrawn upon retirement, preventing the holder, in most cases, from taking everything out as a lump sum. 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 resulting from workers making payments into personal accounts (clawback) would have occurred far in the future. The oldest workers permitted to contribute under the President’s proposal would have been 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 have come until years later as younger workers hit retirement age. Meanwhile, every dollar going into a private account would be a dollar not available to cover program outflows. This lag between the revenue and
benefit impact of personal accounts 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. Throughout last year’s political debate, the implications of substituting a personal retirement account for a portion of “traditional” Social Security remained unclear in general. Particularly unsettling was the seeming inattention to what this might mean for young covered workers who experience an accident or injury preventing future employment (DI) or who die 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. Approximately one out of four individuals who receive Social Security payments are someone other than the worker on whose earnings those payments are based. (23.08%) And those payments total nearly one-fourth of the annual distribution of benefits by the program. (22.61%).

Vague assurances that the changes proposed for the program’s old-age benefits would not affect these other elements were ultimately unpersuasive because of how integrally Social Security’s different benefits are linked. 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 revision of 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 whenever the cash flow reversal year turns out to be) or the exhaustion of the program’s nominal reserves around the century’s midpoint. 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. During the period he was actively pursuing of Social Security revision, President Bush ruled out a prospective tax rate increase (though apparently not the raising or removing the cap on earnings subject to the tax). From the start, the Administration’s emphasis was on the benefit side.
A. Reducing future benefit payments

1. Price indexing replacing earnings indexing

President Bush never got to the point of tabling a specific solvency plan, the Model 2 scheme presented by his 2001 commission, which most closely resembled his personal account proposal, provides an example of the kind of the program adjustments that might have been bundled with it. In that model the principal source of prospective benefit reduction was a shift in the PIA formula. For the current earnings indexing, it would substituted 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 explained 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.”

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.”

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 ratios that are 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 power, is not a benefit cut.

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

One member of the 2001 Commission, Robert Pozen, achieved visibility in March of 2005 with a plan he 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.

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

Other forms of future benefit reduction receiving attention during recent Social Security policy debates include: a) continuing the upward adjustment of full retirement age
beyond age 67 and/or speeding up the increase to 67, and b) automatically decreasing the 
PIA as life expectancies increase (longevity indexing). Additional options 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 Orszag\textsuperscript{50} includes 
tax rate increases, which as noted above President Bush categorically ruled out. Many 
have urged bringing those state and local government employees who still remain outside 
Social Security under the program. Other options including raising or removing the cap 
on the range of earnings subject to the Social Security tax (with or without including 
those earnings in the benefit formula) and increasing the amount of Social Security 
benefits subject to the income tax.

Finally, there are general revenues (perhaps, drawn from a restored and reinvigorated 
estate tax). 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:

\begin{quote}
In order to maintain the ability to pay benefits throughout the 75-yer period, additional 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.\textsuperscript{51}
\end{quote}

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.\textsuperscript{52}

IV. Other Program Changes Likely to Be Bundled

A. Surviving spouse benefits

Two of the three plans put forward by the President’s 2001 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. No further details were furnished.\textsuperscript{53} We discussed such a plan 
under Topic 4. As we observed 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.
Important as the spouse benefit structure is for women, using it as the principal instrument for addressing issues of gender equality and benefit adequacy for older women has serious and growing problems. The equity issues are huge. In addition, because of declining marriage rates and the prevalence of divorce following fewer than ten years of marriage, it is likely that in successive cohorts of senior women, fewer and fewer will be eligible for these secondary benefits. Because these trends are particularly pronounced among black women, any enhancement of widows’ benefits will result in greater racial disparity.

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.

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. Whenever hard choices about the program were thrust 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. 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. In 2005 negative public sentiment about “privatizing Social Security” led the Administration to insist that the President be understood as proposing “personal accounts” and opponents with equal persistence to characterize the President Bush’s plan as one of “private accounts” or “privatization.” The President failed to build public or political acceptance of the terms or concepts within which his preferred package of changes could 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 bipartisan support could be built.

One basis for my preference of “longevity indexing” over further adjustment of the “full retirement age” is a belief the terminology relates more clearly to a coherent rationale for ongoing benefit formula revision. Similarly, shifting to a different and “more accurate”
measure of the impact of price inflation on beneficiaries is, in my view, more saleable than simply subtracting a percentage point from the current formula. So long as the debate remains stuck at the level of whether or not there is a “crisis” and whether or not “privatization” is a good idea, there is, I fear, little hope of responsible legislative action.


8 The 2008 report, like those before, notes:

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


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

13 In a "Policy Brief" entitled "The Distributional Consequences of a 'No-Action' Scenario: Updated Results" Social Security Administration's Office of Retirement Policy works from the premise that since the trust funds are projected to be exhausted in 1941 "All beneficiaries would have their scheduled benefits cut by 27 percent in 2042." However, the first footnote concedes that "a proportionate cut ... is only one possible option for allocating benefit reduction among beneficiaries." See http://www.ssa.gov/policy/docs/policybriefs/pb2005-01.pdf.
14 2008 Medicare Report, supra note 7, II.D, at 8.
15 Id.
16 Id. III.A, at 34.
17 See Lavery, supra note 4, at 4.
18 Diamond & Orszag, supra note 6.
19 Id. at 84.
20 Id. at 88.
23 In December 2006, the number of male Social Security recipients per 100 female recipients was 86.7 for the age range 65-74, 70.1 for the age range 75-84, and 44.8 for the range 85 and above. See Social Security Administration, Annual Statistical Supplement, 2007, Table 5.A10.
24 $878.50 for women 60 or older compared to $1,178.10 for men 60 or older. Id.
25 $904.60 for women compared to $1,177.50 for men. Id.
27 Yvonne Gist & Lisa Hertzel, We the People: Aging in the United States 2 (Census Bureau 2004).
28 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).
29 Smith, supra note 21, at 3 (Census Bureau 2003).
31 See Annual Statistical Supplement, supra note 23, Table 5.A15.
32 See id. Table 5.A1.
34 See Diamond & Orszag, supra note 6, at 174-75.
36 Diamond & Orszag, supra note 6, 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.

For more information about the TSP go to http://www.tsp.gov/.

President’s Commission to Strengthen Social Security, supra note 1, at 53.

Id. at 54.

See id. at 50.

See id. at 51.

See Annual Statistical Supplement, supra note 23, Table 4.A5, Table 4.A6, Table 5.A1.


President’s Commission to Strengthen Social Security, supra note 1, at 109, n. 42.

Id. at 109.

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).


Diamond & Orszag, supra note 6.

President’s Commission to Strengthen Social Security, supra note 1, at 110.

See Goss memo, supra note 49, at 7 and Table 1a.

See President’s Commission to Strengthen Social Security, supra note 1, at 97.


President’s Commission to Strengthen Social Security, supra note 1, at 14.
