

POLICY *focus*

RECIPES FOR RATIONAL GOVERNMENT

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Time to Modernize Social Security

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Introduction

Social Security is our country's largest, most expensive federal program. It was created in 1935 by President Franklin D. **Roosevelt** to protect "against poverty-ridden old age." Social Security was meant to take a small share of workers' wages to pay those who have reached retirement age.

Today, Social Security requires one out of every eight dollars earned by the average worker and still falls short of its mission, as about 10 percent of Americans over age 65 still live in poverty. These high payroll taxes make it difficult for workers to save for retirement or other needs. Worse, Social Security's costs already outstrip payroll taxes, and costs will continue to climb, creating additional burdens on taxpayers and the federal budget. If nothing is done, by 2034, payroll taxes will only cover about three-quarters of promised benefits, resulting in a significant loss of income for all Social Security beneficiaries.

In January 2018, IWF published a policy focus written by **Kristin Shapiro** outlining how Social Security could be modernized to provide earned family leave for new parents, enabling people to decide when they need benefit support most and without increasing overall costs. This would be an important step in making Social Security more responsive to people's needs.

However, policymakers also need to reform Social Security to make it financially sustainable, encourage work and savings, offer more flexibility, and ensure that it fulfills its mission of preventing poverty in old age.

Why You Should Care

Many seniors depend on Social Security for financial security, and Social Security's payroll tax is the largest tax the average American pays. It's important that we have a Social Security system that works as efficiently and effectively as possible.

- **Protecting Seniors:** Under current law, if no changes are made to Social Security, all Social Security benefits will be reduced by about 25 percent in 2034. For seniors who depend on Social Security to get by, this would be devastating.
- **Protecting Taxpayers:** Taxpayers already pay a lot to keep Social Security going, but it isn't enough. Social Security will require more taxpayer dollars each year, which could mean tax increases for young workers and means the federal government will have less money to spend on other priorities, from the environment to national security.
- **Sensible Solutions Exist:** Policymakers have the opportunity to create a better, fairer retirement system that ensures that Social Security keeps its core promise without overburdening taxpayers.

Social Security is too important to allow political expediency to prevent needed actions. Policymakers have the opportunity—and the responsibility—to create a legacy of a better economy and greater retirement security by modernizing Social Security.

More Information

The Root Causes of Social Security's Financial Problems

Often there is great disagreement about what factors underlie a public policy problem. With Social Security at least, that's not the case: it's clear why Social Security faces financial trouble.

Social Security is financed as a pay-as-you-go system, which means that taxes collected are immediately used to pay beneficiaries. With sound retirement plans, including savings vehicles used by individuals, assets contributed today are held in an account and invested so that those assets are there, and have accrued interest, to be used during retirement. Sadly, that's not the case with Social Security. Benefits to today's retirees must come from today's workers. Future retirees' retirement benefits must be funded by future taxpayers.

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When Social Security first began paying out regular monthly benefits in 1940 it collected **two percent** of each worker's paycheck. There were about **159 workers per each retiree**. By 1960, there were about five workers paying for each one person collecting retirement benefits. Today, due to changes in demographics—lower birth rates and longer life expectancy—there are fewer than three workers per retiree. A 12.4 percent payroll tax is levied on workers' earnings up

to a maximum income of \$128,000 in 2018, for a maximum tax payment of just under \$16,000 per year. Social Security is the largest tax most workers' pay, and it still isn't enough to meet obligations.

Social Security's benefits have also become more generous in real terms overtime. While Social Security benefits are earned, in that people have paid into the system to become eligible to receive benefits, the value of promised benefits far exceeds the payments that have been promised (but that cannot be paid for) under current law.

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A Sensible Approach to Reducing Social Security's Unfunded Liabilities

Attempts to address Social Security's unfunded liabilities are often derailed by charges that current seniors' benefits will be cut. Yet essentially every serious Social Security reform plan in recent decades—regardless of whether offered by Republicans or Democrats—has protected benefits for those already at or near retirement. Everyone agrees that it would be unfair to make changes for those who lack the capacity to adapt to the new system. Seniors made plans based on the assumption that government would meet its promised obligations. Most cannot realistically increase their income, and reduced benefits could result in real hardship. Benefit reductions for existing retirement beneficiaries are essentially off the table.

However, there are several sensible ways to change benefits for those still decades from retirement, who have time to adapt to, and could benefit from, a modernized Social Security system.

Adjusting the Retirement Age

Social Security's normal retirement age **gradually increased** from 65 to 67 between the birth years 1938 and 1960. That reform was passed in **1983**, giving affected parties twenty years to prepare for extra months of work.

Policymakers should explore similar adjustments in the retirement age to reflect increases in longevity and encourage more people to extend their working lives. Encouraging people to work longer not only leads to greater financial security and reduced government dependency, but also increases seniors' engagement, which can lead to better health and happiness.

More Accurate Cost of Living Calculations

Today's benefit payments are higher in real terms than they were years ago, in part because Social Security uses a consumer price index (CPI) that overstates inflation, leading to larger benefits in real terms. Social Security experts, such as former Social Security public trustee, Charles Blahous, **argue** that it's misleading to call proposed changes to CPI “reform” since

they are more accurately understood as technical corrections to a flaw in the current system. Making this important correction, however, would be a fair first step to improving Social Security's financial picture and should be relatively easy.

Refocusing Social Security Toward Helping Those Who Need It Most

Social Security was designed to be an earned benefit, so that the benefits one receives from Social Security are related to what one has contributed to the system. This makes sense as a matter of fairness.

However, given Social Security's enormous long-term financial imbalance, which must either result in benefit cuts or significant increases in taxes or public debt, and that benefits promised but not paid for under current law are more generous than would be supported by the payments made into the system, it makes sense that those most able to shoulder benefit reductions do so. Again, reductions in the benefit levels of future retirees ought to be phased in so that no one in or near retirement is impacted and those affected have ample time to plan.

“ Given Social Security's enormous long-term financial imbalance, which must either result in benefit cuts or significant increases in taxes or public debt, ... it makes sense that those most able to shoulder benefit reductions do so. ”

For example, AEI's Andrew Biggs **makes the case** to transition Social Security to a flat benefit plan in which, rather than using a progressive formula to calculate an individual workers' benefit, everyone would receive the same base benefit that provides enough income so that all seniors live above the poverty threshold. This would mean a reduction in promised benefits for future, upper- and middle-income seniors, but would at least prevent them from also being hit with more exorbitant tax rates to support a perpetually unsound and overburdened retirement system.

Encouraging Retirement Savings

As policymakers scale back future Social Security benefits to sustainable levels, it's important to encourage people to do more to save for their retirement and to take advantage of the benefits of saving and investing over the long-term.

Congress should seek to make it easier for companies to offer 401ks and automatically enroll their employees at a higher level of savings, or create similar savings vehicles to help all workers better prepare for retirement.

Creating Flexibility to Better Support Workers

While some seniors face financial hardship despite Social Security, **seniors are actually the wealthiest age cohort**. Moreover, those who face poverty in old age tend to have had inconsistent work histories, leaving them ineligible or eligible for very modest Social Security benefits, and without the additional savings and assets that might have accrued during a lifetime of consistent work.

Seen through this lens, the proposal to give workers access to earned parental leave benefits through Social Security make sense not only as the least disruptive policy to help younger parents who lack paid parental leave and face financial hardship, but to encourage consistent work, which is the key to long-term retirement security. Women with access to paid parental leave are **more likely** to return to work than those who don't, and have higher future earnings, all of which results in better financial security, as well as less long-term government dependency and increased tax payments broadly.

Policymakers looking to modernize Social Security should consider how to incorporate this kind of flexibility into the system, so that workers can better tailor their benefits to when they need it most, while also encouraging a recognition of the trade-offs that come with choosing different benefit options.

Additionally, while **Shapiro's initial proposal** for Social Security parental leave required workers to effectively pay back their leave benefits by delaying retirement benefit eligibility, policymakers could also consider giving workers other repayment options. For example, new parents who took leave could opt to pay a slightly higher payroll taxes after resuming work for as long as it took to pay back those benefit costs.

Steps in the Right Direction

Closing Social Security's roughly \$10 trillion unfunded liability gap is hard. Reforming a nearly century-old pension system, designed for a time and population that no longer exists, so that it works for the modern age is also hard.

However, policymakers should recognize that embracing even modest reforms that reduce future liabilities and encourage savings and work would leave a legacy of a fundamentally healthier economy and better, more financially secure American society. In other words, even small steps in the right direction would be huge.

Rep. Sam Johnson's Plan to Permanently Save Social Security

Rep. Sam Johnson of Texas offered legislation to enact many of these much-needed Social Security reform ideas, including correct CPI calculations; increasing the retirement age; making the overall benefit system more progressive, to increase the minimum Social Security payment, while lowering benefits received by high-income seniors (including spousal benefits); and removing disincentives for seniors to work and save.

The Social Security Administration found that this legislative package would set Social Security on a fully sustainable course.

While some object to this approach, which relies entirely on curbing the benefits to future retirees so that they can be financed with existing Social Security assets and payroll taxes, rather than raising taxes on workers, this criticism overlooks that anyone defending the status quo is supporting much more abrupt and draconian benefit cuts that would harm low-income seniors most.

What You Can Do

Get Informed

Learn more about modernizing Social Security at:

- [Independent Women's Forum](#)
- [American Enterprise Institute](#)
- [Mercatus](#)

Talk to Your Friends

Help your friends and family understand these important issues. Tell them about what's going on and encourage them to join you in getting involved.

Become a Leader in the Community

Get a group together each month to talk about a political/policy issue (it will be fun!). Write a letter to the editor. Show up at local government meetings and make your opinions known. Go to rallies. Better yet, organize rallies! A few motivated people can change the world.

Remain Engaged Politically

Too many good citizens see election time as the only time they need to pay attention to politics. We need everyone to pay attention and hold elected officials accountable. Let your Representatives know your opinions. After all, they are supposed to work for you!

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ABOUT INDEPENDENT WOMEN'S FORUM

Independent Women's Forum (IWF) is dedicated to building support for free markets, limited government, and individual responsibility.

IWF, a non-partisan, 501(c)(3) research and educational institution, seeks to combat the too-common presumption that women want and benefit from big government, and build awareness of the ways that women are better served by greater economic freedom. By aggressively seeking earned media, providing easy-to-read, timely publications and commentary, and reaching out to the public, we seek to cultivate support for these important principles and encourage women to join us in working to return the country to limited, Constitutional government.

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like you!**

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