V. Social Security

Social Security is the foundation of economic security for millions of Americans. More than 50 million Americans – living in about one in four households – receive Social Security benefits, with about 70 percent going to retired workers and families, and the rest going to disabled workers and survivors of deceased workers. Social Security is far more than just a retirement program – it is the keystone of the American social safety net, and it must be protected.

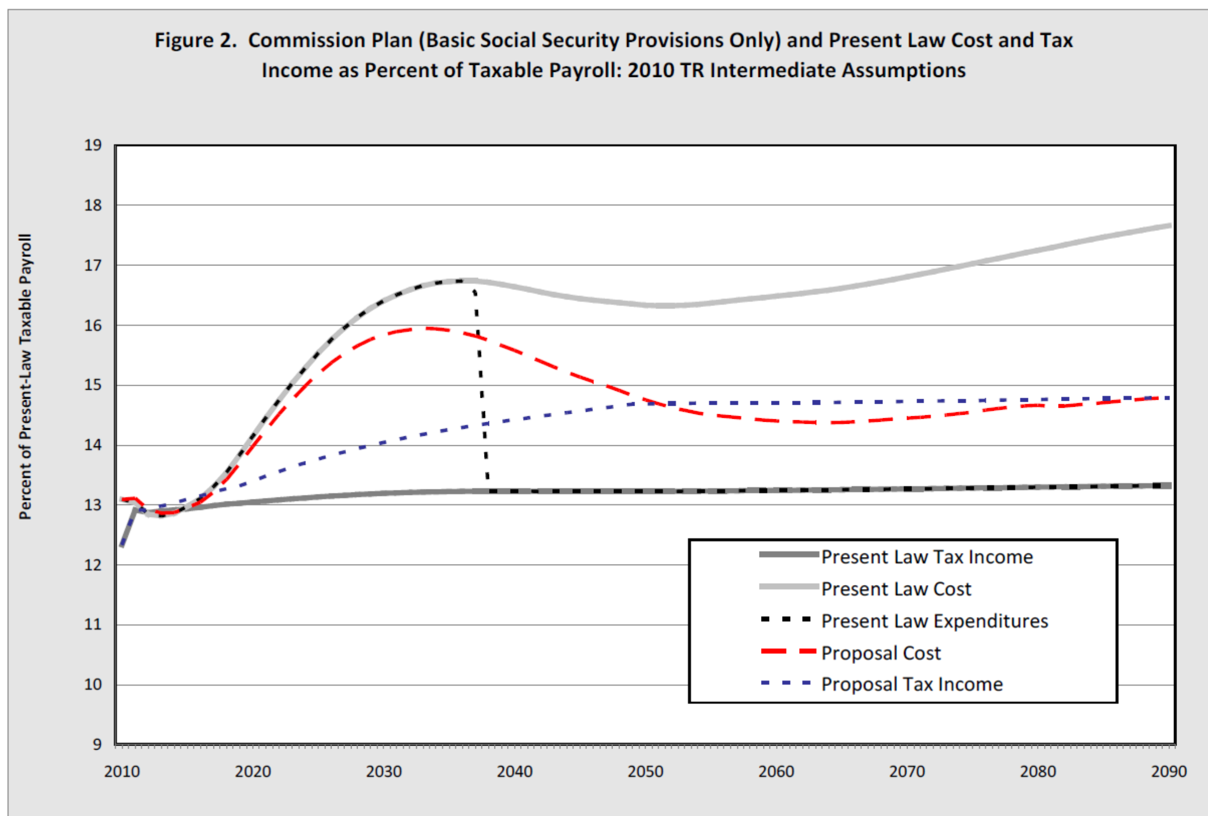
Three quarters of a century after its creation, we must renew the promise of Social Security for the century ahead. When Franklin Roosevelt signed Social Security into law, average life expectancy was 64 and the earliest retirement age in Social Security was 65. Today, Americans on average live 14 years longer, retire three years earlier, and spend 20 years in retirement. In 1950, there were 16 workers per beneficiary; in 1960, there were 5 workers per beneficiary. Today, the ratio is 3:1 – and by 2025, there will be just 2.3 workers "paying in" per beneficiary.

Unless we act, these immense demographic changes will bring the Social Security program to its knees. Without action, the benefits currently pledged under Social Security are a promise we cannot keep. Today, the program is spending more on beneficiaries than it is collecting in revenue. Although the system's revenues and expenditures are expected to return to balance temporarily in 2012, it will begin running deficits again in 2015 if interest from the trust fund is excluded and in 2025 including interest payments. After that point, the system's trust fund will be drawn down until it is fully exhausted in 2037.

Unfortunately, the default plan in Washington is to do nothing. The do-nothing plan would lead to an immediate 22 percent across-the-board benefit cut for all current and future beneficiaries in 2037. Over the next 75 years, the program faces a shortfall equal to 1.92 percent of taxable payroll. Seventy-five years from now, that gap will increase to 4.12 percent of payroll.

The Commission proposes a balanced plan that eliminates the 75-year Social Security shortfall and puts the program on a sustainable path thereafter. To save Social Security for the long haul, all of us must do our part. The most fortunate will have to contribute the most, by taking lower benefits than scheduled and paying more in payroll taxes. Middle-income earners who are able to work will need to do so a little longer. At the same time, Social Security must do more to reduce poverty among the very poor and very old who need help the most.

Figure 10: Commission Social Security Plan and Present Law as Percent of Taxable Payroll



RECOMMENDATION 5.1: MAKE RETIREMENT BENEFIT FORMULA MORE PROGRESSIVE. Modify the current three-bracket formula to a more progressive four-bracket formula, with changes phased in slowly. Change the current bend point factors of 90%|32%|15% to 90%|30%|10%|5% by 2050, with the new bend point added at median lifetime income.

In order to control costs, the Commission proposes gradually moving to a more progressive benefit formula that slows future benefit growth, particularly for higher earners. Currently, initial benefits are calculated using a progressive three-bracket formula that offers individuals 90 percent of their first $9,000 of (wage-indexed) average lifetime income, 32 percent of their next $55,000, and 15 percent of their remaining income, up to the taxable maximum. The Commission recommends gradually transitioning to a four-bracket formula by breaking the middle bracket in two at the median income level ($38,000 in 2010, $63,000 in 2050), and then gradually changing the replacement rates from 90 percent, 32 percent, and 15 percent to 90 percent, 30 percent, 10 percent, and 5 percent.

Figure 11: Social Security Bend Points

Bend Point Locations in 2010	Current Law	Proposal	Projected Bend Point Locations in 2050 (in 2010 Dollars)
$0 to $9,000	90%	90%	$0 to $15,000
$9,000 to $38,000	32%	30%	$15,000 to $63,000
$38,000 to $64,000		10%	$63,000 to $102,000
$64,000 to $107,000	15%	5%	$102,000 to $173,000
>$107,000	n/a		$173,000 to tax max

Note: All numbers are FC staff estimated and rounded to the nearest $1000.

This benefit formula change will be phased in very slowly, beginning in 2017 and not fully phasing in until 2050. Because all bend point factors will continue to be *wage-indexed*, future beneficiaries will continue to have inflation-adjusted benefits larger than those received by equivalent beneficiaries today.

RECOMMENDATION 5.2: REDUCE POVERTY BY PROVIDING AN ENHANCED MINIMUM BENEFIT FOR LOW-WAGE WORKERS. Create a new special minimum benefit that provides full career workers with a benefit no less than 125 percent of the poverty line in 2017 and indexed to wages thereafter.

Social Security reform must ensure that the program can continue to meet its basic mission: to prevent people who can no longer work from falling into poverty. The Commission recommends creating a new special minimum benefit which provides full-career (30-year) minimum wage workers with a benefit equivalent to 125 percent of the poverty line in 2017 and wage-indexed thereafter. The minimum benefit would phase down proportionally for workers with less than 30 but more than 10 years of earnings.

RECOMMENDATION 5.3: ENHANCE BENEFITS FOR THE VERY OLD AND THE LONG-TIME DISABLED. Add a new "20-year benefit bump up" to protect those Social Security recipients who have potentially outlived their personal retirement resources.

The oldest old population – those over age 85 – is projected to expand rapidly over the coming decades: from 5.8 million this year to 19 million in 2050. To better insure against the risk of outliving one's own retirement resources, the Commission proposes a new "20-year benefit bump-up" that offers a benefit enhancement, equal to 5 percent of the average benefit, 20 years after eligibility. The enhancement is phased in over five years (1 percent per year). Eligibility is defined by the earliest eligibility age (EEA) for retirees and the determination of disability for disabled workers.

RECOMMENDATION 5.4: GRADUALLY INCREASE EARLY AND FULL RETIREMENT AGES, BASED ON INCREASES IN LIFE EXPECTANCY. After the Normal Retirement Age (NRA) reaches 67 in 2027 under current law, index both the NRA and Early Eligibility Age (EEA) to increases in life expectancy, effectively increasing the NRA to 68 by about 2050 and 69 by about 2075, and the EEA to 63 and 64 in lock step.

To account for increasing life expectancy, the Commission recommends indexing the retirement age to gains in longevity. The effect of this is roughly equivalent to adjusting the retirement ages by one month every two years after the NRA reaches age 67 under current law. At this pace, the NRA would reach 68 in about 2050, and 69 in about 2075; the Early Eligibility Age (EEA) would increase to 63 and 64 in step.

This approach would also maintain a constant ratio of years in retirement to years in adulthood; as life expectancy grows by one year, individuals will still be able to spend an additional 4 months in retirement, as compared to today.

RECOMMENDATION 5.5: GIVE RETIREES MORE FLEXIBILITY IN CLAIMING BENEFITS AND CREATE A HARDSHIP EXEMPTION FOR THOSE WHO CANNOT WORK BEYOND 62. Allow Social Security beneficiaries to collect half of their benefits as early as age 62, and the other half at a later age. Also, direct the Social Security Administration to design a

hardship exemption for those who cannot work past 62 but who do not qualify for disability benefits.

As workers approach retirement, they are faced with varying needs, and different retirement patterns make sense for different workers and their families. In recognition of these diverse experiences, the Commission's proposal introduces significant new flexibilities and protections in addition to an indexed retirement age.

First, the Commission proposes allowing beneficiaries to collect up to half of their benefits as early as age 62, with applicable actuarial reduction, and the other half at a later age (therefore incurring a smaller actuarial reduction). This increased flexibility should provide for a smoother transition for those interested in phased retirement, or for households where one member has retired and another continues to work.

Second, we propose a hardship exemption for those who may not qualify for disability benefits, but are physically unable to work beyond the current EEA. A recent RAND analysis reported that 19 percent of early retirees claimed a work-limiting health condition that would have limited their ability to continue in the paid labor force. To protect this population, the Commission proposal sets aside adequate resources to fund a hardship exemption for up to 20 percent of retirees. This exemption would allow beneficiaries to continue to claim benefits at age 62 as the EEA and NRA increase, and hold them harmless from additional actuarial reduction resulting from increased NRA. The Commission is charging the Social Security Administration with designing a policy over the next ten years that best targets the population for whom an increased EEA poses a real hardship, and considering relevant factors such as the physical demands of labor and lifetime earnings in developing eligibility criteria.

At the same time, the Commission recommends eliminating a provision that allows retirees who claim benefits early to withdraw a benefit application and return benefits received – even years after claiming – without paying interest or inflation, before reapplying for benefits at a later age and with a smaller actuarial reduction. This loophole is in effect an interest-free loan for wealthier retirees able to take advantage of it.

RECOMMENDATION 5.6: GRADUALLY INCREASE THE TAXABLE MAXIMUM TO COVER 90 PERCENT OF WAGES BY 2050.

As recently as the early 1980s, the Social Security payroll tax covered 90 percent of wages (in other words, 9 of every 10 dollars in wages were subject to the payroll tax). Since then, however, the taxable maximum wage cap (currently $106,800) has not grown as fast as wages above the cap; as a result, less than 86 percent of wages were subject to the payroll tax in 2009, and less than 83 percent will be subject to the tax by 2020. The Commission proposes to gradually increase the taxable maximum so that it covers 90 percent of wages by 2050. This recommendation would result in a taxable maximum of about $190,000 in 2020, versus approximately $168,000 in current law. The proposal will also de-link increases in the taxable maximum from increases in the Cost of Living Adjustment (COLA), allowing the taxable maximum to increase even in zero-COLA years.

RECOMMENDATION 5.7: ADOPT IMPROVED MEASURE OF CPI. Use the chained CPI, a more accurate measure of inflation, to calculate the Cost of Living Adjustment for Social Security beneficiaries.

As with the rest of the mandatory budget and the tax code, we recommend relying on the "chained CPI" to calculate the Cost of Living Adjustment (COLA) in Social Security, rather than the standard CPI. The Bureau of Labor Statistics has stated that the chained CPI is designed to more closely approximate a cost-of-living index than the standard CPI, and experts on both sides of the aisle have supported this technical improvement to the index.

RECOMMENDATION 5.8: COVER NEWLY HIRED STATE AND LOCAL WORKERS AFTER 2020. After 2020, mandate that all newly hired state and local workers be covered under Social Security, and require state and local pension plans to share data with Social Security.

Under current law, more than 90 percent of all workers are covered by Social Security, but a small share of states and localities exclude their employees from Social Security and instead maintain separate retirement systems. As states face a double hardship of prolonged fiscal challenges and an aging workforce, relying entirely on this pension model has become riskier for both government sponsors and for program participants, and a potential future bailout risk for the federal government. To mitigate this risk and to plan for an orderly transition to comprehensive Social Security coverage, the Commission proposes to mandate coverage for all state and local workers newly hired after 2020.

Full coverage will simplify retirement planning and benefit coordination for workers who spend part of their career working in state and local governments, and will ensure that all workers, regardless of employer, will retire with a secure and predictable benefit check. To improve the coordination of benefits for existing part-career state and local workers, the Commission also recommends requiring state and local pension plans to share data with Social Security.

RECOMMENDATION 5.9: DIRECT SSA TO BETTER INFORM FUTURE BENEFICIARIES ON RETIREMENT OPTIONS. Direct the Social Security Administration to improve information on retirement choices, better inform future beneficiaries on the financial implications of early retirement, and promote greater retirement savings.

Working longer and saving more has significant positive implications for both individuals and society as a whole. Yet the mixed signals sent to individuals often lead them to make less informed, and potentially precarious, choices. To help correct this, we propose directing SSA to provide better information to the public on the full implications of various retirement decisions, with an eye toward encouraging delayed retirement and enhanced levels of retirement savings. We encourage SSA to consider behavioral economics approaches (such as structured choice and others based in sound science) when providing this information.

Note that the Commission does not make specific recommendations to reform the Social Security Disability Insurance (DI) program or the Supplemental Security Insurance (SSI) program beyond program integrity investments discussed in recommendation 6.4. The Commission recommends a comprehensive redesign of the DI program to modernize both the program objectives and the eligibility criteria to better provide adequate and appropriate support to the disabled community without putting in place barriers to work and full community participation. This redesign is a critical next step, but is beyond the scope of this Commission.

RECOMMENDATION 5.10: BEGIN A BROAD DIALOGUE ON THE IMPORTANCE OF PERSONAL RETIREMENT SAVINGS.

Individuals need more financial assets and less debt, especially for retirement. Social Security forms the first tier of support for retirement but was never intended to be the sole source of retirement income. Retirement security solutions need to recognize and incorporate the challenges for self-reliant Americans who take responsibility for their families through a lifetime of work. Business owners and employees have historically negotiated over retirement benefits, and government employers face revenue challenges. Many private and public pension plans face serious underfunding of their long-term obligations.
A serious bipartisan conversation needs to take place regarding incentives to generate personal retirement savings that supplement Social Security and addresses the gap between what Americans need for retirement and what they currently have. Employers and employees can both play a role in strengthening the personal retirement savings of Americans. An ideal system should be open to all, portable, prevent leakage from high fees and early withdrawals and allow for pooled investments that can spread risk. It should encourage Americans to build wealth through savings and investment that will generate a return sufficient to allay fears that retirees will outlive their savings, and should permit Americans to have the option to transmit the remainder of their accumulated savings to their heirs. Americans need a fiscally responsible personal retirement savings system that is advanced funded, supplements the pay-as-you-go Social Security system, and accumulates funds for investments in business and infrastructure to help sustain a healthy economic growth rate.

Figure 12: Social Security Reform Provisions

	75 Year	75th Year
Gradually phase in progressive changes to benefit formula, modifying PIA factors to 90%|30%|10%|5% by 2050	45%	51%
Offer minimum benefit of 125% of poverty for an individual with 25 years of work; index minimum benefit level to wage growth	-8%	-6%
Index normal retirement age (NRA) and earliest eligibility age to longevity so that they grow about 1 month every two years. Also direct SSA to create "hardship exemption"	18%	30%
Provide benefit enhancement equal to 5% of the average benefits (spread out over 5 years) for individuals who have been eligible for benefits for 20 years	-8%	-6%
Gradually increase taxable maximum to cover 90% of earnings by 2050	35%	22%
Apply refined cost of living measure (chained-CPI) to COLA	26%	17%
Cover newly hired state and local workers after 2020	8%	0%
Add increased flexibility in retirement claiming options by allowing retirees to collect half of their benefits at a time, including by allowing them to collect the first half at age 62	-	-
SHARE OF EXISTING SHORTFALL CLOSED:	**112%**	**102%**

The plan proposed by the Commission is designed to restore actuarial balance as a stand-alone proposal. However, the tax reform process recommended by the Commission may separately result in additional payroll tax revenues into the Social Security system as a result of base broadening measures which would likely cause employers to shift some portion of non-wage compensation into wages (with resulting indirect increase in payroll tax revenues). As noted in the tax reform section, the Commission recommends that the precise details of tax reform be developed under a fast track procedure over the next two years. The impact of this reform on trust fund revenues will depend on the decisions Congress makes in the process. If Congress considers the Commission's Social Security recommendations in conjunction with or subsequent to tax reform legislation that results in additional trust fund revenue, this additional revenue will provide flexibility to moderate the changes in benefits or taxation recommended by the Commission.

Figure 13: Social Security Distributional Analysis

2050 Distribution (Including Illustrative Hardship Benefit)

	Average Annual Benefit			Mean Change in Benefits	
	Scheduled	Payable	Plan	Payable	Scheduled
Bottom Quintile	$9,732	$7,656	$10,284	31.9%	3.8%
2nd Quintile	$14,268	$11,208	$14,340	27.3%	0.0%
Middle Quintile	$18,000	$14,148	$16,488	16.2%	-8.7%
4th Quintile	$22,140	$17,400	$18,840	8.4%	-14.8%
Top Quintile	$27,480	$21,600	$22,416	3.4%	-18.7%

2070 Distribution (Including Illustrative Hardship Benefit)

	Average Annual Benefit			Mean Change in Benefits	
	Scheduled	Payable	Plan	Payable	Scheduled
Bottom Quintile	$12,300	$9,432	$12,708	33.8%	2.6%
2nd Quintile	$17,880	$13,716	$17,664	27.5%	-2.2%
Middle Quintile	$22,308	$17,100	$19,512	14.5%	-12.2%
4th Quintile	$27,612	$21,180	$21,336	4.2%	-20.1%
Top Quintile	$34,092	$26,148	$24,624	-3.8%	-26.2%

2050 Distribution (Excluding Hardship Benefit)

	Average Annual Benefit			Mean Change in Benefits	
	Scheduled	Payable	Plan	Payable	Scheduled
Bottom Quintile	$9,732	$7,656	$10,164	30.2%	2.4%
2nd Quintile	$14,268	$11,208	$13,872	23.2%	-3.2%
Middle Quintile	$18,000	$14,148	$16,344	14.0%	-10.4%
4th Quintile	$22,140	$17,400	$18,804	7.6%	-15.4%
Top Quintile	$27,480	$21,600	$22,416	3.1%	-19.0%

2070 Distribution (Excluding Hardship Benefit)

	Average Annual Benefit			Mean Change in Benefits	
	Scheduled	Payable	Plan	Payable	Scheduled
Bottom Quintile	$12,300	$9,432	$12,480	31.1%	0.5%
2nd Quintile	$17,880	$13,716	$16,884	21.8%	-6.6%
Middle Quintile	$22,308	$17,100	$19,236	11.5%	-14.5%
4th Quintile	$27,612	$21,180	$21,300	3.3%	-20.8%
Top Quintile	$34,092	$26,148	$24,624	-4.3%	-26.6%