ALTERNATIVES TO STRENGTHEN SOCIAL SECURITY

Statement before the
Committee on Ways and Means
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C. Eugene Steuerle

C. Eugene Steuerle is a senior fellow at the Urban Institute, codirector of the Tax Policy Center, and a columnist for *Tax Notes Magazine*. Any opinions expressed herein are solely the author's and should not be attributed to any of the organizations with which he is associated.

SOCIAL SECURITY REFORM

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to testify on alternatives to strengthen Social Security. I must confess my frustration at how narrowly the Social Security debate has usually been focused. It's as if the public is being asked to choose a dog from the pound by looking only at its tail—or at best its hind legs—but not the whole dog. Since Social Security was first enacted, vast changes have occurred in the economy, life expectancy, health care, the physical demands of jobs, the labor force participation of women, the percentage of women who are left on their own to both raise children and work, the age at which one can be considered old, the consumption levels of the elderly relative to the non-elderly, and poverty levels of children relative to the old—to mention only some factors. Yet we often debate Social Security as if the type of system we want in 2080 should be determined by perceptions and measures of needs of a society in 1930, or 150 years earlier.

The Social Security debate could and should be part of a larger one in which we engage our fellow citizens in choosing the best direction for society as a whole as better things happen to us in the way of longer lives and new health care goods and services. How can we really take best advantage of these new opportunities? How can we spread the gains from this increased level of well-being and wealth to create a stronger nation with opportunity for all? And how should we share the costs?

Instead, the debate is upside down. Due to the ways we have designed our programs and our budgets, every year we spend greater shares of our national income in areas where needs have declined, and then claim we don't have enough left over for areas—such as education, public safety, children, and anti-terrorism—where real needs remain and have often grown. I sometimes imagine sitting in the Ways and Means Committee room when someone from the National Institutes of Health comes in claiming to have found a cure, though expensive, for cancer. The members of committee, trapped in the logic of our current budget, find that instead of celebrating this advance, they commiserate among themselves about the increased cost for Social Security.

As a member of the baby boom generation, I remember youthful conversations among my cohort, regardless of political persuasion, that centered on what type of government we could help create to best serve society. As now scheduled, our legacy is to bequeath a government whose almost sole purpose is to finance our own consumption in retirement. Not only haven't we come close to paying for the government transfers we are scheduled to receive, but we plan to pay for them by dwindling almost to oblivion the rest of government that would serve our children and grandchildren.

With the exception of the World War II period, programs for the elderly have been absorbing ever-higher shares of national income and of the budget for almost seven decades. Define "lifetime benefits" as the value, at age 65, of Social Security and Medicare benefits as if they were sitting in a 401(k) account that would earn interest but be drawn upon over retirement. In today's dollars, lifetime benefits for an average-

income couple have risen from about $195,000 in 1960 to $710,000 today ($439,000 in Social Security and $271,000 in Medicare) to over $1 million for a couple retiring in about 25 years (over $1/2 million in both Social Security and Medicare—see figure 1). We cannot provide a very large portion of the population $1/2 to $1 million packages of benefits and simultaneously encourage them to drop out of the workforce for the last third of their adult lives without affecting dramatically the services that can be provided through the budget to our children and to working families.

The impact on the budget is especially large beginning around 2008 because it is then that so many start moving from the working-age population into the retired population. Assume merely that Social Security, Medicare, and Medicaid continue on automatic pilot, that interest on the debt is paid, and that as a percent of GDP existing levels of revenues are allowed to rise only moderately and defense expenditures decline only modestly. Then by about 2015 no revenues are left for anything else—not for justice or transportation or education, not for wage subsidies or education or environmental clean-up or community development, not for the IRS or national parks—not even to turn on the lights in the Capitol. The pressure on the budget is not awaiting some magical date like 2018 or beyond. Social Security and Medicare are already spending much more than the Social Security tax for Social Security and Medicare, and even this accounting does not include all the other programs for the retired and elderly in the budget. The pressure on programs for children and working families is being felt right now, and the fight over the fiscal 2006 budget makes this glaringly apparent.

Social Security is only part of this problem, but it is an important part for four reasons:

(1) It sets the standard for how long we should work and who covers the costs associated with our longer lives and the new medical care we receive;

(2) There are many inequities and inefficiencies in Social Security that are independent of its size;

(3) By default (in absence of new legislation), Social Security is designed to absorb ever-larger shares of our national income, thereby squeezing out other programs, particularly discretionary expenditures, that are not treated equally in the budget process.

(4) A number of related employee benefit reforms would likely increase private saving, enhance the well-being of low- and average-income workers in retirement, and improve the solvency of Social Security.

MAJOR ISSUE ONE: LABOR FORCE PARTICIPATION

The facts are simple. Social Security's current dilemma centers almost entirely on labor force issues—the drop in scheduled workers per retiree. Although more saving would be nice, whether in trust funds or accounts, we are not going to save our way out of this problem. Consider some of the consequences of the current system.

The system has morphed into a middle-age retirement system.

- Close to one-third of the adult population is scheduled to be on Social Security within about 25 years. Including adults on other transfer programs, we are approaching the day when the majority of the adult population will depend upon transfers from others for a significant share of its support.

- People already retire on average for close to one-third of their adult lives.

- The average Social Security annuity for a man retiring at 62 lasts 17 years, for a woman 20 years, and for the longer living of a couple at least 25 years. The numbers are even higher for those with above-average lifetime earnings.

- When Social Security was young—for instance, in 1940 and 1950—the average worker retired at about age 68. To retire for an equivalent number of years on Social Security, a person would retire at age 74 today and age 78 in another 60 years (figure 2).

Almost every year a smaller share of Social Security benefits goes to the most vulnerable.

- By constantly increasing benefits to middle-age retirees, at least as defined by life expectancy, smaller and smaller shares of Social Security benefits are being devoted to the elderly (figure 3). If progressivity is defined by how well the vulnerable are served, the system is becoming less progressive every year.

The economy gets hit several ways, not just in terms of costs.

- Among the most important, but ignored, sides of the Social Security budget equation is the decline in growth of the labor force, national income, and revenues (figure 4).

- When a person retires from the labor force at late middle age, national income declines. But the decline is borne mainly by other workers, not by the retiree. For instance, when a $50,000-a-year worker retires a year earlier, national income declines by approximately $50,000, but most of those costs are shifted onto other workers as the retiree starts receiving about $23,500 in Social Security and Medicare benefits (much more in the future) and pays about $18,300 less in taxes (figure 5).

- Saving declines because people retire in what used to be their peak saving years. For instance, when a person retires for 20 years versus 15, he both saves for 5 years less and spends down his or society's saving for 5 years more.

Believe it or not, there is tremendous opportunity in all of this. People in their late 50s, 60s, and 70s have now become the largest underutilized pool of human resources in the economy. They represent for the first half of the 21st century what women did to the labor force for the last half of the 20th century. I believe the labor demand is there, and it is mainly our institutions, public and private, that are blocking us from making full use of these valuable and talented people.

What are some of the reforms that can address these problems?

Increase the early and normal retirement ages. We should do this even if there were no long-term imbalance and even if all the saving were devoted back to Social Security. Increasing the retirement age would allow us to devote greater resources to the truly old, since it has no effect on benefits at later ages. Relative to other benefit cuts, it would provide higher annual benefits, since a delay of even one year in retiring can often increase annual income by 8 to 10 percent for many individuals. At any given tax rate, it provides for a higher lifetime benefit since it results in increased revenues from working longer. It also provides relief for Medicare through higher Medicare taxes, and for the rest of the budget through higher income tax revenues.

For all these reasons, an increase in the retirement ages (including the early retirement age, else it is just an across-the-board benefit cut) causes the least hardship of almost any benefit cut.

I recognize that some people are concerned about groups with shorter than expected life expectancies. But attempting to address their needs by granting many of us who are healthy a 20th and 21st and 22nd year of transfer support and tens, if not hundreds, of thousands of dollars in extra benefits for retiring early is a very bad form of trickle-down policy. As discussed below, an increase in the retirement age can be combined with other provisions that help, rather than hurt, groups with shorter life expectancies.

Backload benefits more. Whatever the level of lifetime benefit that is settled upon in a final reform package, actuarial adjustments can provide more benefits later and fewer earlier. These adjustments can take various forms: adjust benefits upward at the point that Social Security predicts that average life expectancy has fallen below, say, 12 years (about age 74 in 2005) and downward in earlier ages; provide a lower up-front benefit in exchange for post-retirement wage indexing. This type of adjustment has all the right effects. It progressively moves benefits to later ages when people have less ability to work, lower income, and less help from a spouse to deal with impairments. It puts labor force incentives where they are most effective—in late middle age, including the 60s, when most people report being in fair, good, or excellent health.

Provide a well-designed minimum benefit. A minimum benefit can be designed to help most lower-income households and to reduce poverty rates (using a poverty standard that is adjusted for living standards or wage-indexed) among the elderly. With such a minimum benefit in place, any of the age-of-retirement adjustments can actually increase, rather than decrease, the relative share of benefits for those groups with lower

life expectancies, since their life expectancies are correlated with lower lifetime earnings. In fact, with a good minimum benefit, we can increase the income of low-income people and reduce poverty rates, even relative to current law.

MAJOR ISSUE TWO: SIGNIFICANT INEQUITIES AND INEFFICIENCIES IN THE EXISTING SYSTEM

Social Security consistently violates notions of equal justice by taxing more or paying less to those who are equally situated. Many of these inequities also have extremely perverse anti-work and inefficiency aspects. I have approached many analysts and advocates across the ideological spectrum, and none so far has disagreed that these problems ought to be addressed. Their one excuse for failing to tackle these problems is political: that to restore equal justice affects some current winners whose winnings might be reduced.

The major cause of many of these problems is provisions that initially were meant to help some of those who might be vulnerable, but in fact did so in a poorly targeted way. These provisions are equivalent to going to a poor area of the city and dropping money off a roof. In particular, the Social Security spousal and survivor benefit—unlike that in private pensions or even public pensions in most countries around the world—provides "free" transfers whose generosity increases the richer the person one marries. This benefit is free in the sense that no additional contribution is required; in the private pension system, standards of fairness argue for determining spousal and survivor benefits actuarially through higher contributions or a lower initial worker benefit. Nor was the "free" benefit designed around any measure of need. Listed below are some of the problems that result:

Single heads of household face especially egregious discrimination (the anti-welfare reform effect).

Who doesn't get the "free" spousal or survivor benefit? The answer, of course, is those without spouses (from marriages with ten years duration or longer). Here are some of the consequences:

- When a mother is abandoned by her spouse, Social Security reduces her expected Social Security benefits without any change in the worker benefit owed to the father or to the spousal benefits he can pass onto to a new wife.
- Fewer benefits are paid to many single heads of household who work more, pay more taxes, and raise more children than to many spouses who don't work, don't pay taxes, and don't raise children. For instance, a single head of household who works for $20,000 a year for 40 years and raises her children will get lifetime benefits of about $95,000 while paying taxes of $50,000, whereas a nonworking spouse who doesn't raise children but happens to marry someone making $100,000 a year will get about $250,000 in lifetime benefits and pay $0 in taxes.

- Low-income minority and less-educated women are among the groups most likely to need additional help—the original purpose of the spousal and survivor benefit—and the least likely to receive it.

Two-earner households often receive substantially fewer benefits than one-earner households (the anti–working woman effect).

The design of spousal and survivor benefits also discriminates against two-earner families, with women more likely than men to get no additional benefits for their additional contributions.

- A couple with each spouse earning $15,000 annually will get lifetime benefits of about $177,000, whereas a couple with one spouse earning $30,000 but paying no more in tax will get about $273,000—close to $100,000 more.

- If a single earner in a family increases his average earnings subject to tax, higher benefits are provided to the household. But if a spouse also works, the additional taxes she pays often do not increase the household's Social Security benefits. Many of these penalties tend to hit female labor force participants more than males, and couples who share child-rearing responsibilities more than those where one spouse takes on most of this effort. For example, a one-earner couple with annual earnings of about $30,000 can expect a total lifetime benefit of around $273,000, whereas a couple with the $30,000 split $25,500/$4,500 will get lifetime benefits of about $243,000—little different than the amount if one spouse earned $25,500 and the other earned nothing.

Benefits for the divorced are highly variable and often unrelated to need or contributions (the divorce roulette wheel effect).

- For the same contributions, someone who marries several times can multiply benefits relative to someone who marries only once. In the extreme, a worker can generate additional benefits for every spouse of 10 years or more—with no reduction in his or her own benefits. For example, if a high-wage male worker has three former spouses, all from marriages that lasted 10 years or longer, the spousal and survivor benefits payable on his earning record would be $710,000. Spousal and survivor benefits would be only $237,000 if he had only one spouse. In both cases, he is not required to share any portion of his own benefit.

- Someone who divorces after 10 years, less one day, of marriage gets nothing from the shared responsibility of the marriage, even if she is left taking care of the children. She will receive hundreds of thousands of dollars less in benefits than someone equal in all other respects who happens to divorce after ten years and one day.

- People who remarry are often subject to marriage penalties—if their new spouses have lower lifetime earnings than their former spouses (the marriage penalty effect). A woman divorced from a high-wage man after more than 10 years of marriage would receive about $237,000 in spousal and survivor benefits. However, if she remarries and her new husband is a low earner, her benefits would fall to about $101,000—a steep penalty for remarrying.

- A divorced person is often better off if her former spouse dies (the Agatha Christie effect). Upon death of a former spouse, the divorced person can start receiving the much larger survivor benefit; before death, only the smaller spousal benefit is provided. For example, a divorced woman whose high-wage spouse has died before she reaches normal retirement age would receive $373,000 in benefits. However, if both she and her husband live into retirement and then she dies at average life expectancy but her husband outlives her, she can only expect $186,000, as she will never receive his more generous survivor benefits.

People who marry significantly younger spouses will find that their contributions are much more likely to generate a higher package of benefits for the household than are the contributions of people who marry others of a similar age (the trophy wife and husband effect).

Again, Social Security spousal and survivor benefits are not actuarially adjusted for age. If a person marries someone a lot younger, he will be more likely to generate additional survivor benefits for which he has paid nothing extra.

People who have children later in life are much more likely to receive additional benefits, no matter how rich they are (the Hollywood effect).

With longer lives, higher divorce rates, and births at later ages, it is becoming more common for older people, especially men, to still have children in the home when they start receiving retirement benefits. Under current law, they often become eligible for children's benefits at the same time, regardless of need.

People with long work histories face discrimination in the system (the anti-worker effect).

Someone who works 45 years at $35,000 a year gets substantially fewer benefits than someone who works 35 years at $45,000 a year—for a single male, $165,000 in lifetime benefits versus about $200,000. The system counts only 35 years of work, a rather perverse way of trying to achieve progressivity.

Of course, there are ways to reform this system while still protecting the vulnerable.

Determine family benefits for middle- and upper-income individuals in an actuarially neutral manner. Actuarial neutrality would apply private pension standards to middle- and upper-income households in making sure that benefits were shared equitably. Different forms of benefit sharing or earnings sharing could be tried. While transitioning to this type of system, cap existing types of family benefits that are not paid for out of additional contributions. Similarly, extend toward divorced persons the types of equity rules that apply in the private pensions system.

Provide a minimum benefit that extends to spouses and divorced persons as well as workers. For the same level of expenditure, higher minimum benefits for lower-earning workers—as well as for spouses who have generated low worker benefits on their own records—would provide additional protections for the vulnerable. One should first require the actuarial adjustment, then figure out where additional levels of protection can best be granted. This would reduce the amount of transfers that are going free—without any additional contribution—to higher-income households. For those concerned with low-income women, whether single or survivors, it would improve their status overall.

Count all years of work history. No one would think to deny some people their employer's 401(k) contributions because they worked more than 35 years. There is no legitimate reason in Social Security that all years of work should not be counted. Redistribution can always be made to low-earning workers through the benefit formula or a minimum benefit. This change would have an additional work incentive effect as well; under current law, many years of work result only in a pure additional tax, with no additional benefit generated.

MAJOR ISSUE THREE: CHANGING THE DEFAULT

Under current policy, spending of the federal government grows automatically, by default, faster than tax revenues as the population ages and health costs soar. These defaults are threatening the economy with large, unsustainable deficits. More important, they deny to each generation the opportunity to orient government toward meeting current needs and its own preferences for services. Only by changing the budget's auto-pilot programming can we gain the flexibility needed to continually improve government policies and services.

Rudolph L. Penner (also a senior fellow at the Urban Institute and a former director of the Congressional Budget Office) believes there is no way to get the budget in order without addressing the issue of these defaults. They apply to a number of programs of government, but the largest are linked to Social Security and Medicare. As currently structured, these programs are designed to rise forever in cost faster than national income and revenues—an impossible scenario. In Social Security, the problem is caused by the combination of a constant retirement age as our health and life expectancy improve and wage indexing for annual benefits.

Regardless of what Social Security reform is undertaken, some rule should be adopted that would put the program back into balance over the long term should, for

instance, the trustees report for three consecutive years that the program is likely to be in long-run deficit. This trigger should force the system's automatic features to move back toward budgetary balance.

With the trigger pulled, two of many options at that point strike me as particularly simple and easy to implement. First, the early and normal retirement ages could be automatically increased two months faster per year than under current law for everyone younger than, say, 57 in the year the trigger is pulled. Second, in those years, the benefit formula could be indexed to the lower of price or wage growth in a way that allows average real benefits to increase but more slowly than wages.[1] This approach could be supplemented by a new special minimum benefit indexed to wage growth. Other approaches to this option can also be devised to reduce the growth rate of benefits more for high earners than for low earners.[2]

Of these two options, I prefer increasing the retirement ages, since that allows more revenues for the system and, consequently, for the same tax rate, a greater level of lifetime benefit to be generated. Other benefit reductions, as noted, hit the oldest beneficiaries with their greater needs as well as everyone else. For similar reasons, among the "progressive price indexing" options, I prefer creating a wage-indexed minimum benefit, since that is more likely to protect the more vulnerable, including survivors, than is a form of progressive price indexing that continues to spend larger shares of revenue on increasing benefits for those with well-above-median income. But, regardless, the system must be redesigned so that, when on automatic pilot, the default option is one that leads to a responsible and sustainable budget.

There is, of course, no reason to believe that these types of automatic changes will alone lead to a socially optimum Social Security system. For instance, they do not deal with the discrimination I noted above against single heads of households. The point of changing the defaults is, rather, to migrate from a system in which the Congress has little choice but to enact painful benefit cuts to one in which Congress has the opportunity to provide more generous benefits from time to time—that is, to play tax Santa Claus rather than Scrooge sometimes, as politics requires.

By creating a system in which the budget automatically becomes ever more responsive and responsible to future taxpayers and beneficiaries, the door is also open to spending more now on programs for people who aren't elderly—especially children—and on public investments. Or Congress might use the freed-up resources to make Social Security benefits more generous to those with low average lifetime earnings or to provide more cash to lower-income elderly to help pay for medical payments. And, of course, Congress can always choose to raise taxes to provide a higher benefit growth rate in each

[1] Technically, the so-called bend points in the benefit formula could be indexed to the lower of wage or price growth. This approach to price indexing differs from some recent proposals that ratchet down future benefits derived from the current benefit formula by the difference between the rate of growth of wages and prices.
[2] The term "progressive price indexing" has sometimes been applied to this effort, but there are many ways it can be implemented.

year, though remaining responsible means making each year's decision to increase benefit levels independent of the next year's.

MAJOR ISSUE FOUR: RELATED PRIVATE RETIREMENT AND EMPLOYEE BENEFIT REFORMS

We can only consume what we produce. That production comes from labor and capital. I have indicated that I consider the primary economic problem for Social Security is to take advantage of the vast pool of human talent and capital that we are wasting. There are a variety of ways to fix our private employment systems to enhance their ability to hire older workers and to induce greater saving.

> ***Most middle-class retirees—not just the poor—depend primarily upon government in their retirement.***

Over two-thirds of those approaching retirement have less in accumulated wealth in all forms—retirement plans, housing, and saving accounts—than the value of their Social Security and Medicare benefits (figure 6).

> ***The personal account debate reflects a search for something between a mandated Social Security system that for the most part is pay-as-you-go and discourages saving by individuals, and a private pension system that is not mandated, but generates little in retirement saving for most citizens.***

I had hoped that the personal account debate would evolve toward figuring out how to address the difficult problem of promoting saving effectively. Our private pension system is not doing an adequate job of promoting saving, nor is our Social Security system. Some hybrid system may well be needed on this score.

> ***The Social Security tax base has been eroding for some time and in ways that are causing other problems—such as the government actually paying tax benefits in ways that increase the number of uninsured.***

The earnings base for the Social Security tax has been eroding over time for two reasons: first, the earnings distribution has become more unequal; and, second, smaller percentages of compensation are being paid in the form of cash, rather than tax-deferred, compensation. In the latter case, the primary problem has been the growth in the percent of compensation paid in the form of health benefits. To make matters worse, the tax subsidy for employer-provided health insurance is expected to cost an additional $100 billion annually (in both income tax and Social Security tax revenues) within a few years. And that additional expense will likely increase, rather than decrease, the number of persons who lack health insurance. As designed, the subsidy encourages excessive growth in the cost of medical care, thus leading more employees to drop insurance.

It is hard for government to force people to save or to control the dynamics of the bargains between labor and management. However, some prudential steps can be taken.

Reduce the tax gaming. Taxpayers now borrow and take interest deductions, while deferring tax on interest and other capital income in their retirement accounts. In effect, they get tax breaks for making deposits, not for saving. Such interest deductions should be restricted when the interest and other capital income is not being subjected to tax.

Provide an additional incentive for plans that do a better job at providing a portable benefit for all workers. Here is one example. Many types of contributions to 401(k) and other plans do not benefit from the FICA exclusion accorded many defined benefit plans. Making use of this FICA tax is an alternative way of financing increased deposits to retirement accounts—although it, too, should be paid for. I suggest that some additional incentive be made available to all plans where all workers in the firm are guaranteed that they will walk away at least with 6 percent of pay compounded over time by some reasonable interest rate. I would apply such a rule to employer and employee contributions and to any type of plan, whether defined benefit or defined contribution. Other pension tax benefits might be gradually reduced for plans that did not provide such a portable benefit. Adopting this type of rule could also allow for a simplification of pension discrimination rules.

Make clearer in the law that employers can use opt-out, not just opt-in, methods of encouraging participation—without threat of lawsuit. Evidence seems fairly strong that the former method—where employees are included in a plan unless they formally choose to be excluded—results in much higher participation rates. In addition, default options can allow the employee contribution rate to rise when pay rises.

Focus retirement plan incentives more on lower-wage workers. This might be done, for instance, through an increase in the savers credit. However, that credit should be reformed so the monies are more likely to make their way into retirement accounts (currently the credit is just a tax reduction that can easily be spent). The credit should also be made available for employer, as well as employee, contributions.

Provide safe harbors for employers hiring or retaining older workers. Our current pension and retirement plan rules are designed for a world in which people had much lower life expectancies and labor force demands could more easily be met by all the baby boomers and women entering the workforce. That period is swiftly passing. Still, employers today are often fearful of retaining or hiring older workers because of threats of lawsuits under ERISA, the tax law, and age discrimination laws. Even when employers feel they are clearly acting within all these laws, the threat of lawsuit deters them from acting. Congress should provide safe harbors for the types of employee benefits that firms can provide when hiring or retaining older workers.

Restore or at least prevent further erosion of the Social Security earnings base. The president and some others have offered to consider restoring the Social Security wage base to compensate for some of the former effects. But long-term

projections of Social Security's solvency are also affected significantly by income and Social Security tax incentives to receive more and more compensation in nontaxable forms. A cap on employer-provided health insurance would go a long way not just to improve Social Security's solvency (allowing for higher benefits for the same Social Security tax rate), but also to help the health insurance market and help prevent the erosion of private health insurance coverage. One should also consider extending the Social Security tax to other preferred forms of employee benefits in an administrable way.

Note that the combination suggested here—a higher wage base to compensate for the more uneven distribution of earnings, a cap on tax subsidies for health insurance to promote a more efficient market and greater health insurance coverage, and reduction in other inefficiencies caused preferences for other employee benefits—may represent a classic conservative–liberal compromise that has many side benefits to restoring solvency to Social Security.

CONCLUSION

Social Security reform is possible, but focus needs to extend far beyond the narrow confines of the current debate. Many reforms are consistent with legitimate principles accepted by individuals of all political persuasions. We can and should fix a system that favors middle-age retirement in ways that reduce shares of resources for the truly elderly; that discriminates against single heads of households, working couples, and many others; and that by default automatically reduces the share of revenues available for programs for children and working families. We should also consider changes in the tax and related laws affecting employee compensation to restore solvency, increase private saving, make it easier for employers to hire older workers, and in other ways complement Social Security reform.

Summary of Recommendations

- **Increase the early and normal retirement ages** so that at any given tax rate, the system provides fewer subsidies for middle-age retirement and increased revenues, higher annual benefits in retirement, higher lifetime benefits, and a greater portion of resources to those who are truly old.

- **Backload benefits more** to older ages, such as the last 12 years of life expectancy, so as to progressively increase benefits in later ages when they are needed more and to increase labor force incentives for individuals still in late-middle age, as defined by life expectancy.

- **Provide a well-designed minimum benefit** to help low-income households and groups with less education and lower life expectancies, while simultaneously reducing poverty rates (relative to living standards or wages) among the elderly.

- **Determine family benefits for middle- and upper-income individuals in an actuarially neutral manner** by applying private pension standards, making sure that benefits are shared equitably, and reducing or removing significant discrimination against single heads of household, many abandoned spouses, two-earner couples, many divorced persons, those who marry others close to their own age, some who pay significant marriage penalties for remarrying, and those who bear children earlier in life.

- **Provide a minimum benefit that extends to spouses and divorced persons as well as workers** to provide additional protections for groups that are particularly vulnerable, and as an alternative to free and poorly targeted transfers to higher-income households.

- **Count all years of work history**, providing an additional work incentive and removing the discrimination against those who work longer.

- **Ensure responsible budgetary policy by changing the default rules** to guarantee the system automatically moves toward balance—say, through adjustments in the retirement ages or the rate of growth of benefits for higher-income households—whenever the Social Security trustees repeatedly report a likely long-run deficit.

- **Reduce the tax gaming** used with retirement plans when taxpayers simultaneously report interest deductions while deferring or excluding interest and other retirement plan income from taxation.

- **Provide additional incentive for plans that do a better job at providing a portable benefit for all workers**, such as using the FICA tax exclusion to finance increased deposits to retirement accounts and guaranteeing all workers in a qualified plan a minimum level of portable benefits.

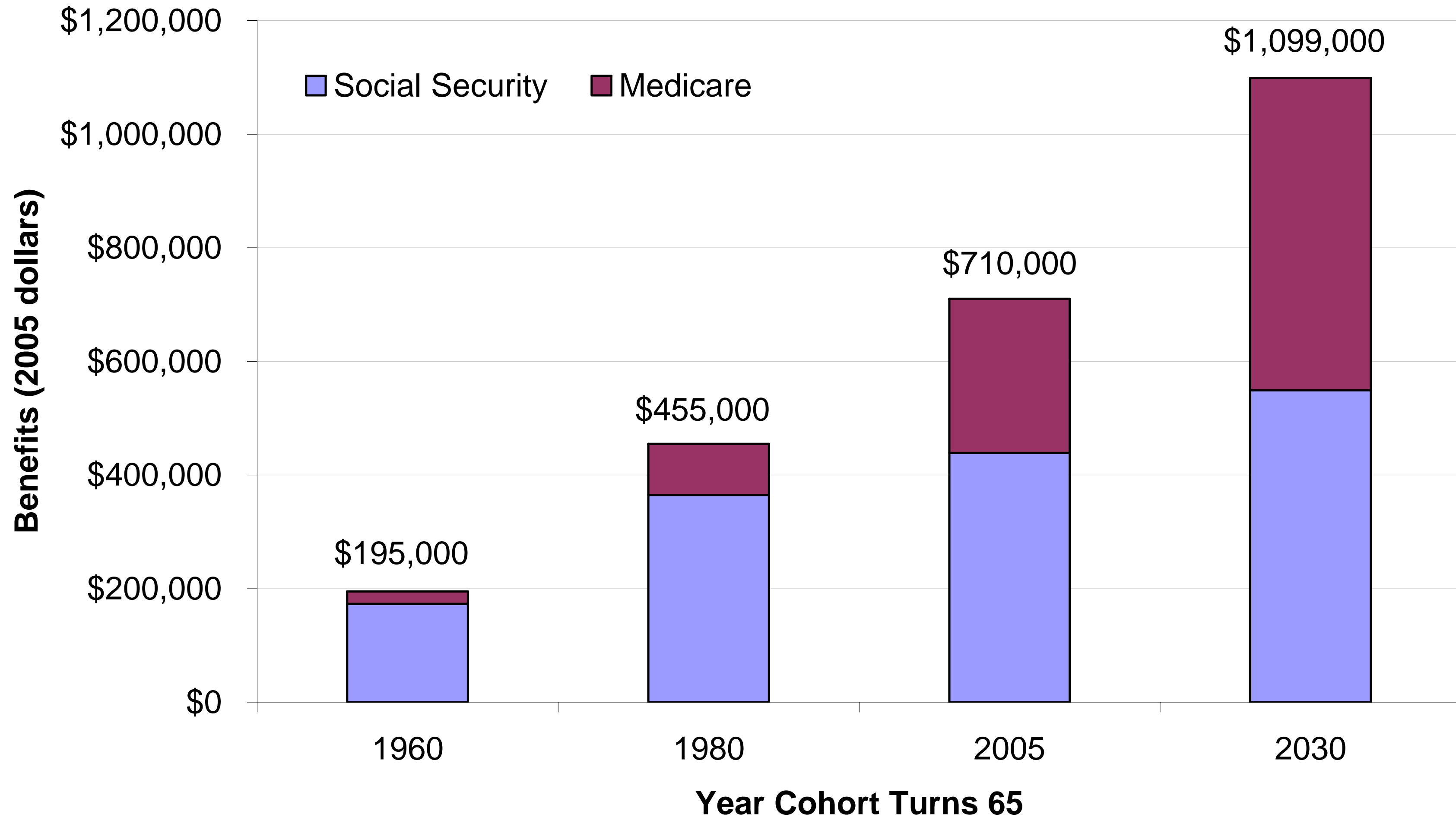
- **Make clearer in the law that employers can use opt-out, not just opt-in, methods of encouraging retirement plan participation—**without threat of lawsuit.

- **Focus retirement plan incentives more on lower-wage workers**, for instance, through an increase in a modified savers credit, which should be adjusted so that it is available for employer, as well as employee, contributions and so that the credit is deposited in retirement accounts.

- **Provide safe harbors from lawsuits** for designated types of retirement and other benefit plans offered by employers who hire or retain older workers**.**

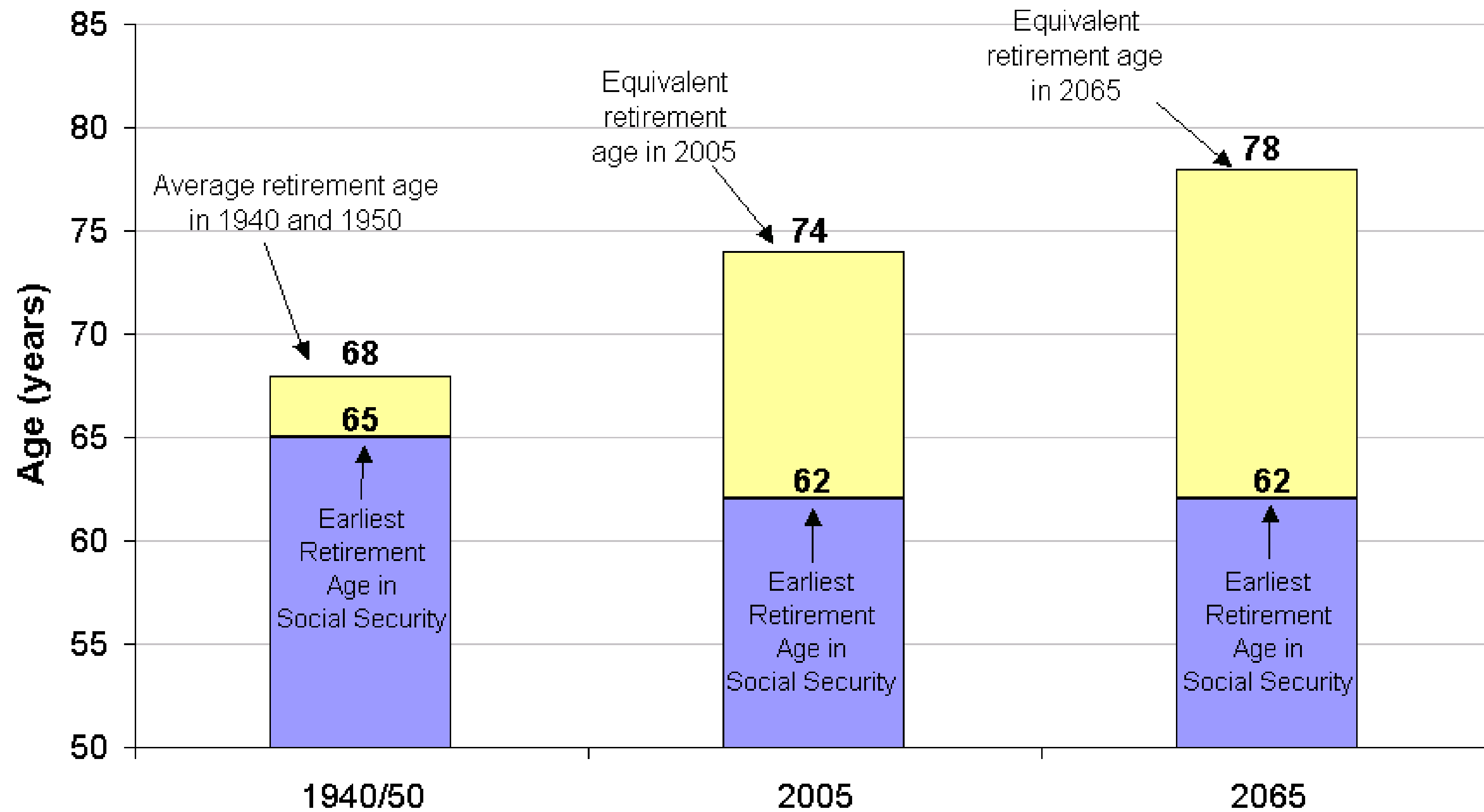
- **Restore the earnings base for Social Security** by increasing the portion of cash wages subject to Social Security tax, capping the tax-free levels of health insurance that can be provided, and dealing with tax preferences for other employee benefits.

Figure 1



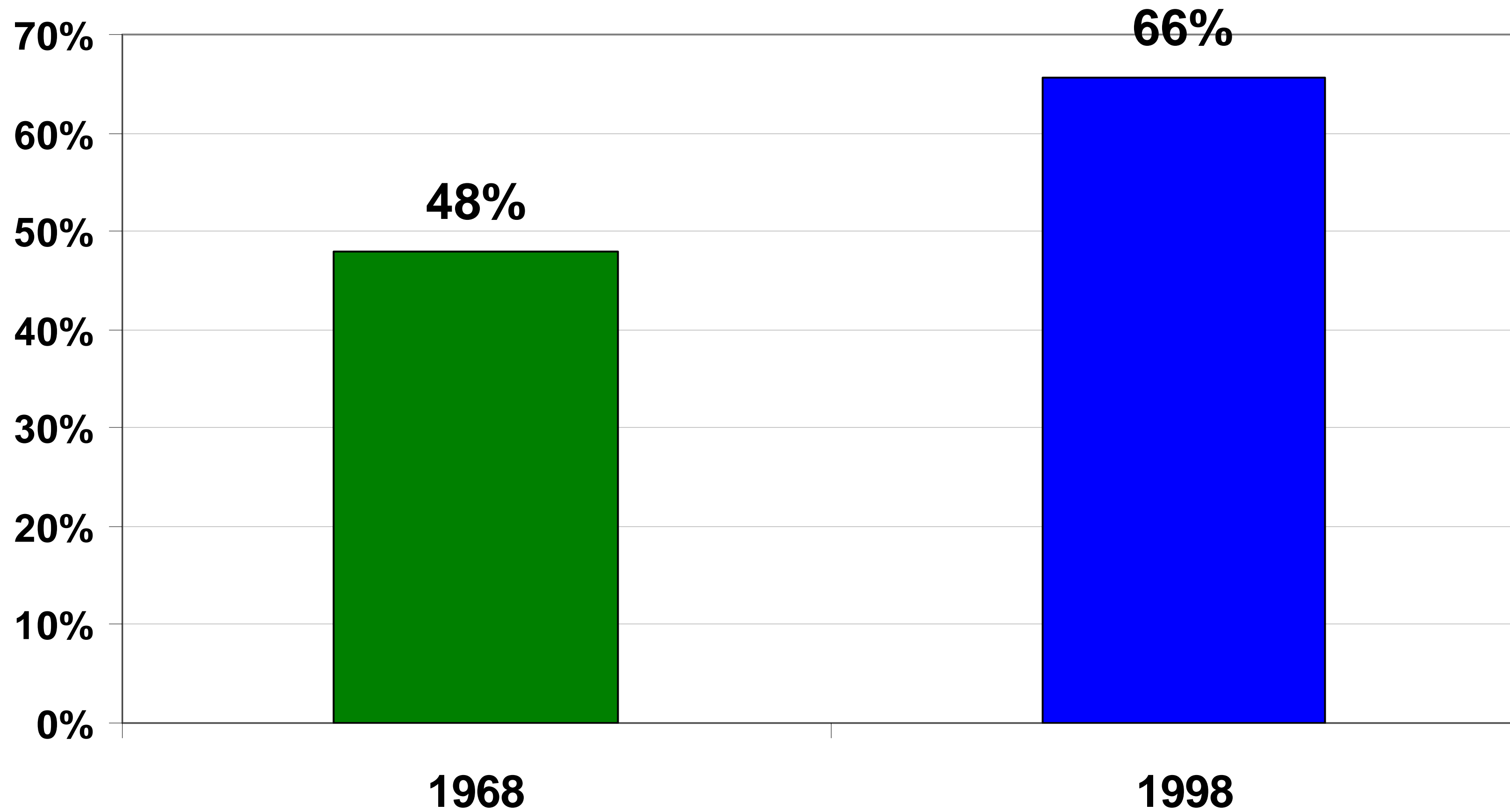
* Expected rather than realized benefits. Notes: The "high" and "average" wage profiles are those hypothetical profiles routinely employed by the Social Security Administration in its analyses. Lifetime amounts, rounded to the nearest thousand, are discounted to present value at age 65 using a 2 percent real interest rate and adjusted for mortality. Projections based on intermediate assumptions of the 2005 OASDI and HI/SMI Trustees Reports. Includes Medicare Part D. Source: Adam Carasso and C. Eugene Steuerle , The Urban Institute, 2005.

Figure 2



Source: The Urban Institute, 2005. Based on data from the Social Security Administration, Birth Cohort Tables, 2005.

Figure 3



Source: C. Eugene Steuerle and Adam Carasso, The Urban Institute, 2002. Based on data from the Social Security Administration's 2001 Annual Statistical Supplement, Table 5A.1.

Figure 4

Labor Force Projections

Annual Growth Rate (% over Period)		
2000-10	2010-20	2020-30
1.08	0.38	0.38

Note: Projections assume no change in patterns of retirement by age and sex.

Source: C. Eugene Steuerle and Adam Carasso, The Urban Institute, 2002. Based on data from the US Bureaus of Census and Labor Statistics.

Figure 5

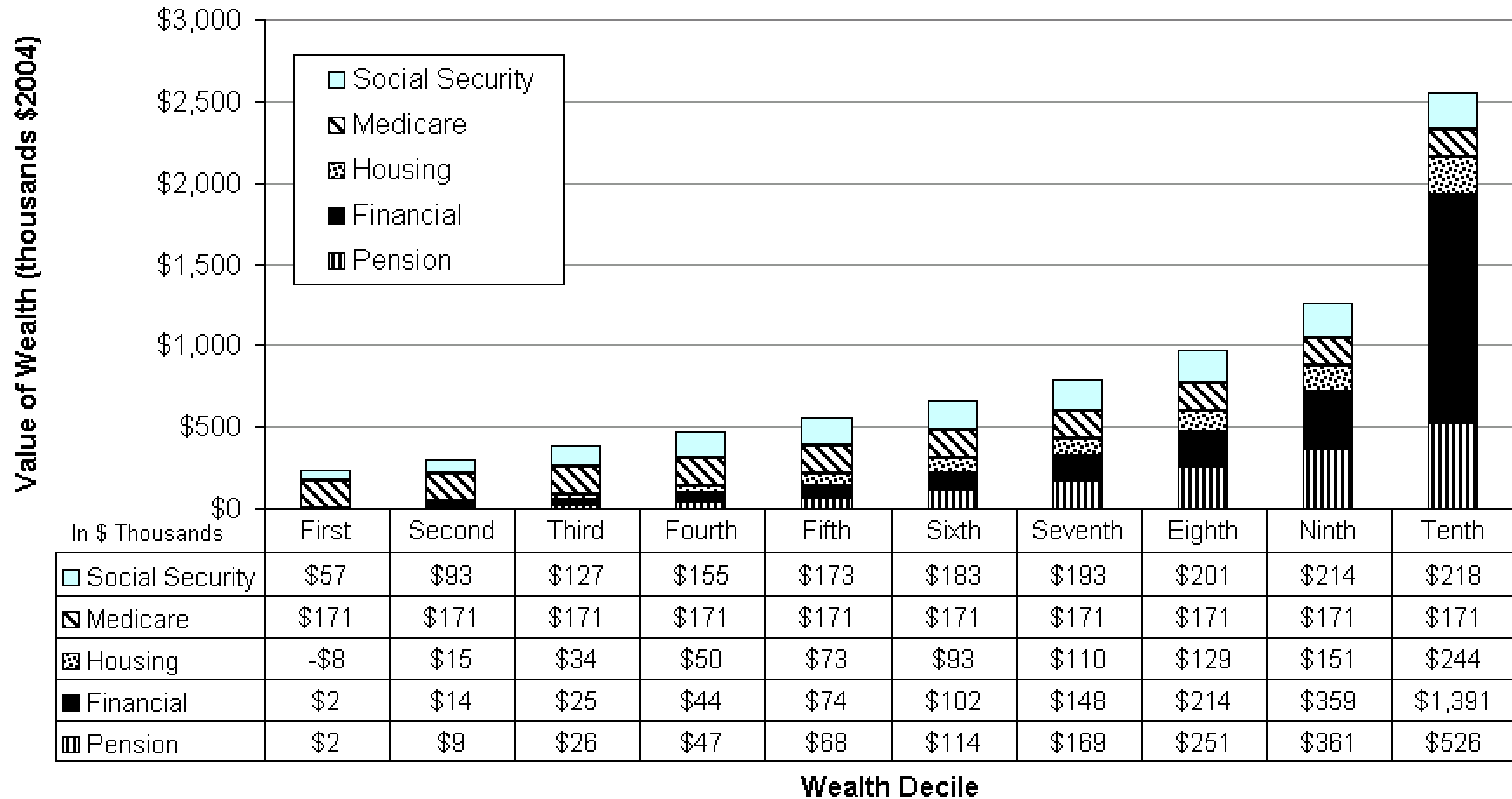
For a worker who earns $50,000…

Increases in Resources Transferred from Others	
Social Security Benefits	$18,500
Medicare Benefits	$5,000
Total 1	$23,500
Decrease in Resources Transferred to Others	
Social Security Taxes	-$7,700
Federal Income Taxes	-$6,600
Other Taxes (Including State and Local)	-$4,000
Total 2	-$18,300
Net Change in Transfers Received (Total 1 - Total 2)	**$41,800**
Addendum: Additional decline in retiree's after-tax earnings otherwise available to meet current and future needs	$31,700

Source: C. Eugene Steuerle and Adam Carasso, The Urban Institute, 2002.

Figure 6

Mean Value and Composition of Household Wealth, Ages 51-61, by Wealth Decile



In $ Thousands	First	Second	Third	Fourth	Fifth	Sixth	Seventh	Eighth	Ninth	Tenth
Social Security	$57	$93	$127	$155	$173	$183	$193	$201	$214	$218
Medicare	$171	$171	$171	$171	$171	$171	$171	$171	$171	$171
Housing	-$8	$15	$34	$50	$73	$93	$110	$129	$151	$244
Financial	$2	$14	$25	$44	$74	$102	$148	$214	$359	$1,391
Pension	$2	$9	$26	$47	$68	$114	$169	$251	$361	$526

Note**:** Private pension, Social Security, other financial, and housing wealth data come from Moore and Mitchell (2000), based on a sample of households from the Health and Retirement Survey in which at least one member was age 51-61 in 1992. Medicare wealth is from Steuerle and Carasso (2004).
Source: Moore, James F., and Olivia S. Mitchell. 2000. "Projected Retirement Wealth and Savings Adequacy." In *Forecasting Retirement Needs and Retirement Wealth*, edited by O.S. Mitchell, P.B. Hammond, and A.M. Rappaport. Philadelphia: Univ. of Pennsylvania Press; C. Eugene Steuerle and Adam Carasso. 2004. "The USA Today Lifetime Social Security and Medicare Benefits Calculator: Assumptions and Methods." Washington, DC: The Urban Institute.