Evaluating Proposed Changes to Social Security
(Social Security 2100 Act)

A major worry for the retired and those about to retire is that Social Security benefits will have to be cut in future years. Under current funding arrangements the Social Security Administration will only be able to pay 79% of scheduled benefits in the year 2034. A new proposal before the House intends to address this issue.

You can read the full analysis of the proposal by the Social Security Administration's chief actuary here. The actuary's main finding is that the new legislation would assure that the Social Security trust fund would be solvent for at least the remainder of this century.

The act does this without cutting benefits or changing the retirement age. In fact, it increases benefits: An across-the-board benefit increase of about 2%, a better cost-of-living adjustment, and an increase in the minimum benefit. To pay for those increased benefits and to address the actuarial deficit, the act would increase the Social Security payroll tax from its current 6.2% to 7.4% in increments over the next 24 years, for both employee and employer, and begin levying the Social Security payroll tax on earnings above $400,000. (Currently that tax isn't levied on income above $132,900, which means that, if this act became law, income between $132,900 and $400,000 would be untaxed.)[1]

On the benefit side of the ledger, the enactment of this new legislation would immediately increase Social Security benefits by 2%. And if current benefits would otherwise be below the new higher minimum, there'd be an even bigger increase. Furthermore, retirees would benefit from a more liberal cost of living adjustment in future years. Under current law, the annual cost-of-living adjustment (COLA) applied to Social Security benefits is calculated using the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W). The proposed law would use the Consumer Price Index for the Elderly (CPI-E) increase rather than the CPI-W increase. This would increase the effective COLA by 0.2 percentage points per year on average.

On the cost side, the act would increase the Social Security tax rate by 1.2 percentage points, for both workers as well as their employer. That increase will take place over 24 years, meaning that the increase in any given year (for both workers and their employer) will be 0.05 of a percentage point.

The tax increase will be larger for incomes of more than $400,000. To illustrate the increase in your effective tax rate in that event, assume that you have $500,000 of income. Under current law you would pay 6.2% of the first $132,900, or $8,239.80, for an effective tax rate of 1.6% on your entire income. If this proposal became law, your tax would go to $14,439.80—for an effective tax rate of 2.9%.

Absent changes to current law either future benefits will have to be cut or taxes increased. We can also agree that, the longer we wait, the harder it will be to make necessary changes.

There are, of course, competing proposals for altering social security:

[1] https://www.marketwatch.com/story/this-social-security-proposal-could-be-something-to-get-excited-about-2019-02-26

Raise the Full Retirement Age

The age when a person becomes eligible to receive full Social Security retirement benefits has risen to 67 for those born in 1960 and later. Raising the full retirement age further is one option to help close Social Security's funding gap. The earliest age for claiming reduced benefits could remain at age 62, but one proposal would raise the full retirement age to 68.

Pro: People on average are living longer, and the full benefits age should be increased. Otherwise, recipients will spend an ever-greater amount of their lives living in retirement, which we simply cannot afford.

Con: Low-earning workers have seen little or no gains in longevity. Raising the full retirement age for everyone simply because well-off Americans are living longer is a stealth benefit cut that is unnecessary and unjust. We can afford to improve and pay for Social Security without benefit cuts.

Recalculate the COLA

Since 1975, Social Security has based such adjustments on the consumer price index, which measures changes in the prices of consumer goods and services. Options to use an alternative price index for calculating the COLA include: Chained consumer price index: This index aims to account for ways consumers change their buying habits when prices change. Experts predict that the annual COLA would be on average 0.3 percentage points lower under this new formula. Elderly index: This method aims to reflect specific spending patterns of older Americans, in particular the greater amounts they spend on health care costs. Experts predict that the annual COLA would be on average 0.2 percentage points higher under this formula. For example, if the current formula would produce a 3.0 percent annual COLA, the elderly price index might yield a 3.2 percent COLA.

Pro: (chained consumer price index): The index used for the COLA must provide the most accurate estimate of inflation. The best index is the chained consumer price index, which both measures the inflation experienced by a larger part of the population than the current index and better represents the way that real people react to price changes in different types of goods and services.

Pro: (elderly index): The current COLA doesn't keep up with the inflation that seniors face because they spend more than other Americans for out-of-pocket health care costs and those costs rise faster than average inflation. The chained consumer price index would make matters worse by reducing the COLA. A more accurate Social Security COLA would compensate for the higher inflation that seniors actually experience by using an elderly index.

Eliminate the Payroll Tax Cap

The Social Security payroll tax currently applies to annual earnings up to $132,900. Any wages earned above $132,900 go untaxed for Social Security. This cap generally increases every year with increases in the national average wage. Today, the cap covers about 84 percent of total earnings.If your income is under $132,900, you would see no change. If you make above that amount, you (as well as your employer) would pay the 6.2

percent payroll tax on your remaining wages. If all earnings were immediately subject to the Social Security tax, the new revenue is estimated to fill 86 percent of the funding gap.

Pro: Eliminating the tax cap would make Social Security's financing more fair. Only 6 percent of workers earn more than the current cap of $110,100. They would pay on all their earnings throughout the year just as everyone else does, and would get a modest increase in benefits. This change alone would just about eliminate Social Security's long-term financing gap.

Con: At first blush, the idea that people should pay Social Security taxes on all of their earnings seems both fair and attractive. However, this "solution" would cause huge Social Security checks for very high-income people. If millionaires pay Social Security taxes on all of their salary income, the maximum annual benefit payment could reach over $150,000 a year. This development would not bankrupt the program, but it would change its nature. Social Security was not intended to provide such large benefits.

<u>Reduce Benefits for Higher Earners</u>

Social Security benefit payments are based on the portion of a worker's earnings subject to Social Security payroll taxes. While higher lifetime earners receive higher payments than lower lifetime earners, their benefits replace a smaller share of their past earnings than do the benefits provided to lower earners. One option to help close Social Security's funding gap would be to reduce benefits for higher lifetime earners.

Pro: In coming years, when Social Security won't have enough payroll tax money to pay full benefits to everyone, it seems only fair to pay full benefits to lower-wage workers and lower benefits to those who had higher earnings. Wealthier retirees have other ways, such as pensions and savings, to fund their retirements. They don't need full benefits. Everyone would still receive a benefit, but higher-earning retirees would receive less than they do now.

Con: These proposals would actually cut benefits for middle-class workers making as little as $35,000 a year. They are not "high earners." Benefits are already modest. Retirees' health care costs are rising while other retirement resources—home equity, pensions, lifetime savings—are at risk or unavailable for too many Americans. Most seniors get most of their income from Social Security.

<u>Tax All Salary Reduction Plans</u>

Employees now pay Social Security and Medicare payroll taxes on their contributions to tax-preferred employer-sponsored retirement accounts, such as 401(k) plans. They don't, however, pay these payroll taxes on their contributions to some other types of benefit plans at work, like Flexible Spending Accounts.

Pro: Congress should complete a reform it launched in 1983 when it treated workers' contributions to 401(k) salary reduction plans as earnings that are taxed and counted toward Social Security benefits. Extending the same treatment to other such plans would be consistent, it would ensure workers that all of their earnings will count toward their future Social Security benefits, and it would reduce the Social Security funding gap.

Con: This would be a case of robbing Peter to pay Paul. Changing the tax treatment of salary reduction plans would increase the cost of health care and other employee benefits because the tax savings help to offset the employer's cost of operating the plans. The result would be fewer employers that are willing to offer these types of benefits. Individual workers would either have to buy these benefits themselves or to do without.

Begin Means-Testing Social Security Benefits

Social Security benefits have always been provided to anyone who has paid into the system and who meets the work and age requirements. That's regardless of other income—investment, pension, savings—the person receives in addition to Social Security benefits. Means testing would reduce benefits for higher income recipients and could even eliminate benefits altogether for the highest-income households. Unlike the option to reduce benefits for higher earners, which uses a measure of career average earnings to reduce benefits, means testing would reduce benefits based on the full range of current income. Who would be affected and by how much depends on how the income thresholds are defined.

Pro: In an era of scarce resources, Social Security can't continue to pay benefits to all retirees regardless of what other retirement income they have. Instead, the program should provide monthly benefits only to retirees who have less than a certain amount of non-Social Security annual income. Social Security would continue to be insurance against retirement poverty for everyone, but would focus its benefit payments on those who really need them.

Con: Means testing would change Social Security from an earned right to welfare. It would penalize you if you saved or earned a pension because that income would reduce your Social Security. And it would cost more to administer. The government would have to routinely check your income and assets in order to adjust your benefit. Means testing would be a huge breach of faith with working Americans who earned their benefits by paying in over the years.[2]

References

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If you'd like to see how many bills have been introduced to "reform" Social Security look at:

The Social Security actuary's report at https://www.ssa.gov/OACT/solvency/index.html

[2]The Future of Social Security:12 Proposals You Should Know About, AARP, https://www.aarp.org/content/dam/aarp/work-and-retirement/social-security/2012-06/The-Future-Of-Social-Security.pdf