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POLICYNOTE

RETIREMENT REFORMS ARE NECESSARY—SO IS STRENGTHENING SOCIAL SECURITY

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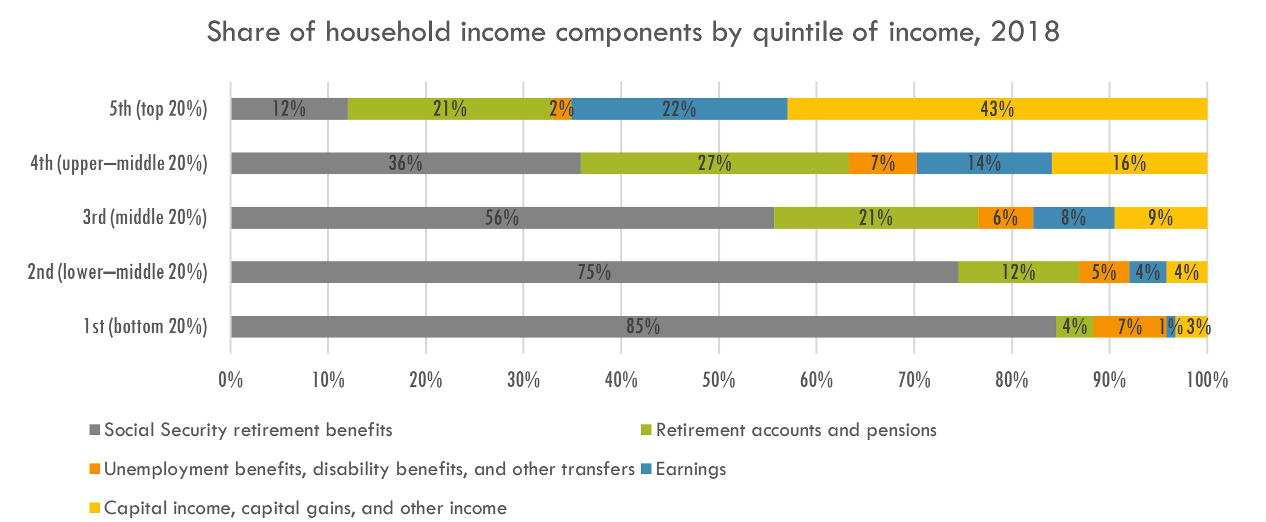
Elevator Pitch: Social Security is the most essential and well-functioning part of the U.S. retirement system. Any reforms to federal retirement policy—while necessary and long overdue—must be built on the foundation of a protected and strengthened Social Security system. More than 60 percent of adults 65 and older receive most of their income from Social Security and all recipients benefit from the annuitized income the system provides. Despite calls to cut benefits and misleading claims about its finances, Social Security should be bolstered and expanded.

Throughout 2022, proposals for reforming the U.S. retirement system gathered strength among lawmakers on both sides of the aisle. While this is a welcome turn of events in the face of a retirement savings crisis that demands congressional action, legislators must not lose sight of the fact that any proposed reforms will be built on top of Social Security, which serves as the bedrock of the U.S. retirement system.

Outside of Social Security, the U.S. retirement system is a patchwork of do-it-yourself programs and narrowly targeted policies that leaves millions of workers without stable and secure ways to save for retirement. Most savers depend on workplace plans to accumulate retirement wealth. Yet employers are not obligated to sponsor or contribute to their employees' retirement plans, leading to unacceptably low rates of retirement coverage—one-third of workers aged 55-64 lack access to workplace retirement savings.[1] Among those who do have 401(k)s and Individual Retirement Accounts, savings are vulnerable to

Figure 1: Social Security is the main source of retirement income for most American households



Source: SCEPA calculations using the RAND Health and Retirement Study data (HRS) 2018 wave.
Note: HRS Household weights. Sample includes all households with at least one spouse of age 65 or older.

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leakages when workers lose their jobs or suffer other adverse shocks.[2]

Only Social Security provides the near-universal, well-protected, and annuitized retirement income that savers rely on to enjoy a relatively secure retirement. Yet more could be done to protect and strengthen Social Security to meet the future retirement needs of people working today. This policy note outlines the crucial role Social Security plays in the U.S. economy and explores prospects for its future.

Social Security combats poverty and inequality

Social Security is the most successful anti-poverty program in the U.S. The system lifts roughly 23 million people out of poverty every year.[3] More than 60 percent of adults 65 and older receive most of their income from Social Security, and the poorest one-fifth of elders receive 85 percent of their income from the program (Figure 1).

Although retirement-age adults face high levels of income and wealth inequality, Social Security sharply reduces these disparities.[4] Examining employer-sponsored retirement plan wealth, we see that the top-earning fifth of older workers has about four times the wealth of the middle group; but when we include future Social Security earnings, that ratio shrinks to three-to-one.

While Social Security is structured progressively to deliver higher returns to lower earners, the poor and middle-class are not the only groups who gain. The program is not simply a savings vehicle but a form of insurance that provides annuitized income for older adults. This benefits even those who are fortunate enough to build up significant private savings.[5] Since Social Security is a universal social insurance policy, it avoids the inefficiencies and adverse selection effects that arise from the private provision of annuities, thus benefiting all classes of Americans.[6]

Social Security stabilizes the economy

Social Security's benefits extend beyond the individual to the broader economy. Social Security checks feed back into local economies; it is estimated that every $1 in Social Security benefits generates $2 in economic output.[7] This is especially important for rural counties, which have an older population and have witnessed slowing economic growth in recent decades.[8]

Another under-appreciated aspect of the Social Security system is that it reliably delivers income to households both in boom times and in recessions. Business cycles are exacerbated by the fact that when workers cut back their spending, this reduces the incomes of other households—a negative feedback loop that pushes economies into recession. Yet in counties where a high share of household income derives from Social Security, earnings and employment are more insulated from economic downturns.[9] In other words, steady Social Security payments help cushion local economies against economic instability.

The stabilizing effect of Social Security contrasts sharply with the 401(k) system of private, do-it-yourself savings, which magnifies business cycle fluctuations.[10]

Funding Social Security

As is well-known, Social Security's finances require timely action from Congress. The aging of the U.S. population and worse-than-expected widening of inequality have created an imbalance between the Social Security system's incoming contributions and the benefits it must pay out.[11] This shortfall means that, absent congressional action, the Social Security Old-Age and Survivors Insurance Trust Fund is expected to be depleted by 2035, after which beneficiaries will receive only about 75 percent of their scheduled benefits—an unacceptable outcome.[12]

Unfortunately, sensationalistic headlines about Social Security "insolvency" often do more to confuse and distract than to inform, and can lead many recipients to the financially harmful decision of claiming benefits early.[13]

The funding challenge is real, but solutions that help protect and even expand Social Security benefits are straightforward. Actuarial projections by the Social Security Administration show that a rise in payroll contributions amounting to 3.24%, split between employers and workers, would keep the combined Social Security trust funds solvent for 75 years. Even an increase of this size would leave the U.S. with Social Security contribution rates lower than many advanced economies.[14]

Further revenues could be raised by lifting or eliminating the cap on maximum taxable earnings, which is currently $147,000. This means that every dollar earned by individuals making more than this amount in a year contributes nothing to the Social Security system. Roughly 17 percent of wages earned in the U.S. are above the cap threshold; this is up from only 10 percent in the early 1980s, the share that Congress originally envisioned.[15]

The impediments to shoring up Social Security's finances are not technical but political. Public opinion polling finds strong and bipartisan support for a policy package that combines payroll contribution increases and lifting the taxable earnings cap.[16]

It is not uncommon to see proposals to privatize Social Security or to invest its assets in riskier and higher-yielding assets. Yet these proposals mistake the fundamental nature of Social Security, casting it as an individualized savings and investment vehicle rather than a broad social insurance program intended to stabilize society. Privatization represents a societal transfer of risk to the individual, undoing the very qualities of the program that motivated its creation and that make it the successful anti-poverty and insurance program it is today.

Expanding Social Security

Until around 2016, lawmakers frequently proposed packages of Social Security benefit cuts, including proposals to raise the Social Security retirement age, a form of benefit cut. In recent years, however, proposals to expand Social Security have outnumbered the austerity alternative.[17]

Why expand Social Security? Despite its progressive formula, many elders still live in poverty. According to the most recent Census Bureau figures, about 10 percent or 6 million adults 65 and older live at or below the poverty line.[18] The rate of elder poverty in the U.S. is 75 percent higher than in the rest of the OECD.[19] For the average worker, Social Security replaces only 40 percent of pre-retirement income.[20]

Although tools exist within Social Security to further alleviate elder poverty, these tools have grown obsolete. So-called special minimum benefits were intended to assist the lowest-earning beneficiaries, but virtually no one receives these anymore due to the way the special minimum benefit was indexed.[21] Raising and reindexing benefit levels and changing eligibility guidelines are two policy levers that exist within the current framework to deliver poverty-reducing minimum benefits to low-income seniors.[22]

Some commonly cited arguments against expanding Social Security or in favor of cutting benefits rely on flawed assumptions. The notion that seniors must simply work longer overlooks the fact that many older workers *already* claim benefits even while they continue to work to supplement low wages.[23] While longevity has increased in recent decades, so have inequalities in who gets healthy years of retirement. Benefit cuts in the form of an increased retirement age would exacerbate these inequalities.

Policy Recommendations

Increase the special minimum benefit and expand eligibility

The current funding formula for special minimum benefits is obsolete. The minimum benefit level should be set to ensure an income floor above the poverty level for an individual. Increasing benefit levels will expand eligibility to a broader population of workers who have low earnings over the course of their careers and whose regular retirement benefits are insufficient to keep them out of poverty.

Fund Social Security by increasing contributions and lifting the taxable earnings cap

Lawmakers can ensure that Social Security benefits are fully funded for the next 75 years through a combination of increased payroll tax contributions and by raising the taxable earnings cap. It is essential to implement these reforms soon—if Congress waits until the Social Security Trust Fund is depleted in 2035, the amount of payroll taxes needed to balance the books rises from 3.24 percent to 4.07 percent. Congress should not seek to balance Social Security's finances by cutting benefits, including cuts through a higher full retirement age.

Provide an option for catch-up contributions

Lawmakers should consider implementing a new feature within Social Security called catch-up contributions. This program would allow workers to contribute an additional 3.1 percent of salary, starting at age 50, in return for enhanced benefits. The program would modestly reduce elder poverty and diminish the Social Security shortfall in the near-term, and would be roughly actuarially neutral over 75 years.

Create universal retirement accounts

Social Security significantly reduces retirement wealth inequality and helps lift seniors out of poverty, but it does not replace enough pre-retirement income to suffice on its own. Congress should ensure that all workers have access to retirement plans and fix the current structure of retirement tax incentives that mainly benefits the wealthy, by providing workers with an accessible and affordable way to save for their retirement and supplement their Social Security benefits.[24]

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