Perspectives:
Options for Reforming Social Security

Experts and policymakers in Washington are considering a broad range of proposals for reforming Social Security. This paper presents perspectives from two leading experts on some of the more frequently mentioned policy options.

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The views expressed herein are for information, debate and discussion, and do not necessarily represent official policies of AARP.
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Options for Reforming Social Security

Raise the Full Retirement Age

The age when a person becomes eligible to receive full, unreduced Social Security retirement benefits (the full retirement age), has been increasing from age 65 on a schedule set by Congress in 1983. It has reached 66 and will gradually rise 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 the monthly benefit for those claiming early would be further reduced—about 6 to 8 percent for each year that the full retirement increases.

One proposal would raise the full retirement age to 68. Starting in 2023, the age would increase by two months each year until it reached 68 in 2028. This is estimated to fill 18 percent of the funding gap. Another proposal would raise the full retirement age to 70. Starting in 2023, the age would increase by two months each year until it reached 70 in 2040. This is estimated to fill 44 percent of the funding gap.

Argument for:  
David John  
The Heritage Foundation

Argument against:  
Virginia Reno  
National Academy of Social Insurance

David John

Social Security’s full retirement age should increase for the simple reason that people are living longer. When we talk about Social Security, the number that really matters is how much longer people who have reached age 65 will live. That statistic is the best estimate of how long they will collect benefits. Facts from a number of government agencies all show the same thing. People who have reached age 65 live longer now than they did in the past, and more people live to age 65.

When Social Security was created in 1935, 65-year-old men could expect to spend about 13 years in retirement—16 percent of their lifetime. Women of the same age averaged 15 years—or 18 percent of their lifetime—in retirement. Today, a male retiree born in 1942 will live on average 17.5 years beyond age 65, and spend 19 percent to 25 percent of his life collecting Social Security benefits, depending on whether he retired at age 65 or chose early retirement. A woman born in the same year will live about 20 years beyond age 65, and will collect benefits for 21 percent to 27 percent of her life.

All Americans are living longer, although various ethnic and racial groups have slight differences. Counting both genders together, an African-American who reaches age 65 has a total life expectancy of 1.2 years less than a non-Hispanic Caucasian. However, a Hispanic worker at age 65 has a life expectancy that is 4.2 years longer than that of an
Social Security Reform Option: Raise the Full Retirement Age

African-American and 3 years longer than that of a non-Hispanic Caucasian. In all groups, women tend to live several years longer than men.

And longevity is continuing to increase. The Centers for Disease Control says that just between 2000 and 2006, life expectancy for people who have reached age 65 increased by 0.9 years. During those six years alone, it went up by a full year for both white and African-American men, 1.1 years for African-American women, and 0.7 years for white women.

Today’s Social Security has not kept pace with longevity increases that have already happened. To reflect this reality, the full benefits age should be increased still farther. Otherwise, recipients will spend an ever higher proportion of their lives in retirement.

Many who wish to work longer may have health issues or disabilities that make it impossible to delay retirement. Workers with physically demanding jobs are most likely to face these issues. They should not be penalized by higher age requirements. Instead, they should receive benefits through Social Security’s disability insurance program until they reach the new retirement ages. However, those who are healthy enough to work longer should delay when they take retirement benefits. That is only fair.

Virginia Reno

Increasing Social Security’s full retirement age (FRA) is an across-the-board benefit cut at any age you take benefits. The scheduled increase from 65 to 67 means that workers now age 52 and younger will face a permanent 13 percent cut in their monthly benefits. Cutting benefits more by further raising the age would place undue hardship on today’s young workers. Increasing the age to 68 would cut benefits by 20 percent for workers now 46 and younger; increasing the age to 70 would cut benefits by 30 percent for workers 34 and younger. This steady erosion of Social Security benefits would seriously undermine the retirement prospects of today’s young workers. Policymakers can do better. Social Security’s projected financing shortfall is manageable. In national surveys, Americans report that they value Social Security and are willing to pay for it to keep it strong.

Some people call for raising the FRA because people are living longer and thus (in their view) should work longer. But most of the gains in life expectancy over the past 30 years have gone to higher earners. A higher FRA would greatly disadvantage low-paid and minority workers, who, on average, have seen little or no gain in life expectancy. Lower-paid workers are also more likely to have physically demanding jobs, face work-limiting health problems, and experience declining demand for their skills as they grow older. As an eminent economist recently noted, raising Social Security’s retirement age is like saying that “janitors should be forced to work longer because corporate lawyers live to a ripe old age.”

Social Security already provides new incentives for people to work longer if they can. If Congress wants to encourage later retirement, it could increase public education about the advantages of waiting to start collecting benefits. People reaching age 70 in 2013 are the first to be eligible for a full 8 percent benefit increase for each year they delay taking benefits past the FRA, until age 70. In the past, the increase was just 3 percent per year. Congress could also fund the Social Security Administration to provide working Americans with personalized statements showing their projected retirement benefits (as
was done before budget cutbacks in 2011), highlighting the dramatic increases available to workers who can wait until 70 to begin claiming benefits.

Policymakers can encourage people to work longer without unfairly penalizing those who cannot. Further raising the FRA would be a stealth benefit cut that is unnecessary and unwanted. Americans of all ages say they would rather pay more for Social Security than see future benefits cut.

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**NOTE:** The estimated solvency effects in this Perspectives report are based on the intermediate assumptions in the *2011 Social Security Trustees Report.*
If, as projected, Americans continue to live longer from one generation to the next, individuals will, on average, receive Social Security benefits for a longer period of time. The trend contributes to Social Security’s funding gap, and one option to offset it is longevity indexing. Indexing would automatically modify Social Security to pay smaller monthly benefits as lifespans increase. Reducing the monthly payments could be accomplished either by increasing the age at which a person becomes eligible for full unreduced retirement benefits (full retirement age) or by changing the benefit formula. Depending on the specific proposal, this is estimated to fill 20-26 percent of the funding gap. Indexing the full retirement age for longevity is estimated to increase it by one month every two years. Each year that the full retirement age increases, there is about a 6 to 8 percent reduction in monthly benefits for any given age at which benefits are claimed.

Arguments:

**Argument for:**

David John
The Heritage Foundation

**Argument against:**

Virginia Reno
National Academy of Social Insurance

David John

In the future, Social Security’s benefits should be indexed for increases in lifespan because Americans on average are living to greater ages than they did in the past. Future Americans are expected to live even longer. While living longer is a good thing for individuals, it hurts Social Security’s finances because it means more and more people are spending longer and longer time in retirement collecting Social Security benefits. Longevity indexing can be done by increasing the full retirement age or by modifying the benefit formula, but the fairer way to do this is by indexing the retirement age.

When we discuss Social Security, it is best to only look at how much longer people will live once they reach age 65. That statistic is the best estimate of how long they will collect benefits. Facts from a number of government agencies all show the same thing. People who have reached age 65 live longer now than they did in the past, and more people live to age 65.

One way of dealing with increased lifespan is to simply increase the retirement age for full benefits. And Congress did just that in 1983. Already, the age to receive full benefits has climbed to age 66, and it is scheduled to go to 67 by about 2022. However, that only deals with the longevity increases that have already taken place. For instance, the Centers for Disease Control says that just between 2000 and 2006, life expectancy for people who have reached age 65 increased by an average of 0.9 years. During those six years alone, it went up by a full year for both white and African-American men, 1.1 years for African-American women, and 0.7 years for white women.
Social Security Reform Option: Begin Longevity Indexing

A fair way to handle future increases in longevity is to index the Social Security retirement age. Under this approach, the Social Security Administration would continue to collect data, and when longevity increases above a certain level, the age for full benefits would automatically go up. Most experts believe that longevity indexing would increase Social Security’s full benefits age by about one month every two years. Using this method starting in 2025, the retirement age would go up by about one year from 67 to 68 by about 2049.

This increase does not necessarily mean that someone would have to retire later. The alternative is a very slightly reduced benefit. Individual retirees would choose which approach to take. And they would have that information in plenty of time to make a decision.

An added advantage to indexing the retirement age is that if something happened so that Americans started to live for less time once they reached age 65, the retirement age would decrease. It is almost impossible to see this happening in reality, but it has happened in other countries. Regardless of whether longevity goes up or down, indexing the retirement age is a fair way to adjust Social Security.

Virginia Reno

Indexing Social Security benefits to longevity would mean reducing future benefits, and not just for retired workers, but possibly for everyone—including retired and disabled workers, their young children and spouses, and the children and widowed spouses of deceased workers—when average U.S. life expectancy increases even slightly. Whether done through increasing the full retirement age or by modifying the benefit formula, there are two big problems with this approach: First, overall increases in average life expectancy are unevenly shared across the population; and second, living costs do not fall as longevity rises.

Linking Social Security benefits to population-wide longevity changes would mean ignoring the wide disparities in life expectancy among subsections of the population. Most of the gains in life expectancy over the past 30 years have gone to higher earners. Men in the top half of the earnings distribution have gained an average of 6 more years of life after age 65, while lower-earning men have gained only 1.3 years. Higher-earning women have seen smaller gains, while lower-earning women have seen no gain at all. Future increases in average life expectancy are likely to follow similar patterns, with higher-income and white-collar workers gaining the most while lower-income and African-American and Native American workers generally enjoy minor gains at best. Cutting benefits across the board for all beneficiaries, based on average life-expectancy gains, would be profoundly unjust.

Moreover, using gains in life expectancy as a rationale for cutting benefits defeats the whole point of Social Security, which is to partially replace wages when earnings stop and to generate benefits sufficient to achieve—and maintain—basic economic security. What you need to make ends meet does not decline because the overall population of which you are a part happens to be living longer. Rent, groceries, medical costs, and utility bills do not become 5 percent cheaper if the U.S. population as a whole lives 5 percent longer. Social Security benefits are modest and are already being cut significantly as a result of changes enacted in 1983. Cutting them further for any reason,
let alone by tying them to average longevity, would undermine this basic insurance protection for American families.

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Social Security benefits generally keep up with inflation through a cost-of-living adjustment, or COLA. Since 1975, Social Security has based such adjustments on the Consumer Price Index (CPI), which measures changes in the prices of consumer goods and services. One option to modify Social Security would be to use an alternative price index for calculating the COLA. Options include:

- **Chained consumer price index:** By applying a different formula to the same goods and services data, 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. For example, if the current formula produced a 3.0 percent annual COLA, the chained consumer price index might yield a 2.7 percent COLA. The effect of a lower COLA would compound over time, reducing the benefit by 3 percent after 10 years and 8.5 percent after 30 years. Permanently reducing the size of the benefit adjustment every year is estimated to fill 23 percent of the gap.

- **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. In addition, the effect of a higher COLA would compound over time, increasing the benefit by 2 percent after 10 years and 6 percent after 30 years. Permanently increasing the size of the benefit adjustment every year is estimated to increase the funding gap by 16 percent.

The purpose of Social Security’s annual Cost of Living Adjustment (COLA) is to protect retirees against inflation reducing the purchasing power of their monthly benefits. Thus, the index used to set the annual COLA must provide the most accurate estimate of inflation. Unfortunately, Social Security does not use the best available inflation index. However, this problem could be easily fixed by basing the annual COLA on a better index known as the “chained CPI”.

Back in 1972, when annual automatic COLAs replaced irregular benefit increases passed by Congress (usually during election years), there was only one inflation measure available, the Consumer Price Index (CPI). It measures the inflation experienced by urban wage workers and clerical workers. This index, which was later renamed CPI-W (for worker) represents only about 32 percent of the total population.
Social Security Reform Option: Recalculate The COLA

That original index is still used to calculate Social Security COLAs although a better measure has existed since 1978. It is known as CPI-U (for urban), and measures the inflation experienced by all urban workers and most retirees. CPI-U covers almost 87 percent of the population.

Using CPI-U would be better, but both it and the current index have a serious weakness in that they fail to account for changes in the way that people buy products and services when the prices of similar items change. For instance, if the price of apples tripled while the price of oranges dropped by half, both indices assume that people would buy the same amounts of both that they would have bought before the prices changed.

Similarly, if the price of gasoline goes up, while overall food prices drop, both inflation indices assume that consumers will buy the same amount of both gas and food. In reality of course, the amounts would change, as would the amounts of many other items as consumers seek to make the best use of their limited income dollars. This more realistic type of behavior can be measured in a “chained” index, and such a measure has been available since 1999. This more accurate measure shows that in reality, inflation is about 0.3 percentage point a year less than is shown by the original measure.

Some people in Washington argue that instead the COLA should be based on a new elderly index. This is the wrong approach because people of all ages receive Social Security benefits, not just the elderly and it would increase Social Security’s financial problems.

Inflation for COLAs should be measured using the chained version of CPI-U, 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. Using this index instead of the current outdated index, would better protect seniors against seeing the value of their monthly benefits eroded by inflation. What’s more, the more accurate measure would also reduce the cost of that protection to taxpayers like their children and grandchildren.

Virginia Reno

The purpose of Social Security’s COLA is to maintain the buying power of benefits when prices rise because of inflation. While some say that switching from the present COLA to one based on a chained CPI would more accurately measure inflation on average, it would not be more accurate for older people, who differ from younger households because older people spend more out of pocket for health care costs (which rise faster than average inflation).

The present COLA already understates the inflation experienced by older people. A COLA based on the chained CPI would make things worse, cutting benefits for all current and future beneficiaries by 0.3 percentage points each year, on average. The cuts would compound over time so that the oldest beneficiaries, who are predominantly women, would experience the biggest cuts. Beneficiaries rely heavily on Social Security at advanced ages as pensions are eroded by inflation, earnings end, and assets are spent. Someone living to age 95 would see her benefits reduced by more than 9 percent because of this change. Cumulative losses over a lifetime would be substantial. For someone with a monthly benefit of $1,100 (the average for single elderly women in 2009), the lifetime loss would add up to more than $15,000 by age 90 and to nearly $20,000 by age 95.
Instead of adopting the chained CPI, policymakers should consider basing the COLA on a consumer price index that reflects the buying patterns of older people, in particular. COLAs based on a CPI for older people would go up 0.2 percentage points faster than the current COLA and 0.5 percentage points faster than a COLA based on the proposed chained index. If the purpose of the COLA is to maintain the buying power of Social Security for beneficiaries—no more, no less—an inflation measure that undercounts older people’s costs would not meet that goal; a CPI for older people would.

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Options for Reforming Social Security
Increase the Payroll Tax Cap

The Social Security payroll tax currently applies to annual earnings up to $110,100. Any wages earned above $110,100 go untaxed for Social Security. This cap generally increases every year as the national average wage increases. Today, the cap covers about 84 percent of total earnings in the nation. Raising the cap to cover a higher percent of total earnings would help close Social Security’s funding gap. How much depends on how high the cap is set and how quickly the cap would be raised to reach that level. One commonly mentioned goal would raise the cap to cover 90 percent of all earnings, which in 2012 would have meant a cap of about $215,000. This would mean any employee earning more than the current tax cap of $110,100 (as well as his or her employer) would have to pay more payroll taxes, up to about $6,500 per year for those earning $215,000 a year or more. Raising the cap to 90 percent is estimated to fill 36 percent of the funding gap.

Argument for:
Virginia Reno
National Academy of Social Insurance

Argument against:
David John
The Heritage Foundation

Virginia Reno

Lifting the cap on earnings subject to Social Security taxes to cover 90 percent would complete the job that Congress started in 1977 when it set the cap to include 90 percent of the earnings of all covered workers. Congress also provided for adjusting the cap automatically to keep pace with average wage growth so that it would continue to cover 90 percent of earnings. But because of growing inequality since then, with today’s top earners enjoying much bigger gains than everyone else, the cap now covers only about 84 percent of all earnings.

Lifting the cap to 90 percent is sensible and fair. Only 6 percent of workers earn more than the current cap of $110,100. These top 6 percent get a boost in their take-home pay when they reach the cap and stop paying into Social Security for the year. (Their employers stop paying in then, too.) For example, someone earning about $120,000 this year would hit the cap and stop paying into Social Security in late November, while someone making $2.5 million would stop paying in mid-January.

If phased in over five years, restoring the cap to include 90 percent of all earnings (or about $215,000 a year) and counting those earnings toward the worker’s future benefits would—

- Restore the intent of Congress;
- Make Social Security financing more fair by requiring top earners to pay somewhat more into Social Security; and
- Eliminate more than a third (36 percent) of Social Security’s projected financing gap over the long term.
Social Security Reform Option: Increase the Payroll Tax Cap

David John

The bad news about this idea is that it would cause a hefty tax increase that will hit middle-income taxpayers while not affecting the rich. It would especially hurt the self-employed and certain smaller business owners. And such a move only delays Social Security’s financial problems. It does not fix them.

The proposal would mean that people would pay Social Security payroll taxes on their first $215,000 of income instead of today’s $110,100 level. If accepted, this move would hit employees with up to $5,500 in new taxes each year. What is worse, the self-employed and certain small business owners would see up to an $11,000 annual tax increase.

In general, increasing taxes is a bad idea. For one thing, it reduces the amount that Americans have to spend on their own and their family’s food, housing clothes, education, and so on. Additional taxes that seem like a trivial amount to people in Washington may cause real problems to normal Americans.

Second, taking the approach that all Social Security needs is a tax increase keeps us from reviewing the program and seeing what works and what could be improved. Today’s Social Security does many things right, but its treatment of women and lower-income Americans could be improved.

Finally, tax increases tend to look like they improve Social Security’s finances more than they actually do because of the program’s complex accounting methods. Social Security’s experts say that requiring people to pay taxes on all of their earnings up to a maximum of about $215,000 would allow the program to be fully financed from its payroll tax from 2013 through 2019.

Starting in 2019, Social Security would again be forced to depend on its trust fund. Instead of running out in 2036 as it is now expected to do, the tax increase would keep the trust fund solvent until 2044. However, then everyone receiving Social Security benefits would see his or her benefits cut substantially.

This tax increase delays Social Security’s problems by only eight years while hurting middle-class Americans. It does not fix the problems.

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Options for Reforming Social Security
Eliminate the Payroll Tax Cap

The Social Security payroll tax currently applies to annual earnings up to $110,100. Any wages earned above $110,100 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. Eliminating the cap so that all earnings would be subject to Social Security’s payroll tax would help close the program’s funding gap. If your income is under $110,100, 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.

Argument for:
Virginia Reno
National Academy of Social Insurance

Argument against:
David John
The Heritage Foundation

Virginia Reno

Eliminating the cap on earnings subject to Social Security taxes would call on top earners to contribute more toward the basic economic security of the nation’s elderly and families, commensurate with top earners’ ability to pay. In a time of growing inequality between the richest Americans and everyone else, this change would reduce inequality. It would also balance Social Security’s finances for the next 75 years and, with other changes, help pay for improvements in Social Security for people who need them.

Annual earnings subject to Social Security taxes are currently capped at $110,100. Only 6 percent of workers earn more than that. These top 6 percent get a boost in their take-home pay when they reach the cap and stop paying into Social Security for the year. (Their employers stop paying in then, too.) For example, someone earning about $120,000 this year would hit the cap and stop paying into Social Security in late November, while someone making $2.5 million would stop paying in mid-January.

Since these higher earners don’t pay Social Security taxes on all of their earnings, their effective Social Security tax rates are lower—sometimes drastically lower—than the 6.2 percent rate paid by workers whose earnings fall below the cap. For instance, a worker earning $120,000—moderately above the cap—pays an effective Social Security tax rate of 5.7 percent of his or her total earnings; the employer pays a matching rate. One making $2.5 million sees the vast majority of his or her earnings exempt from Social Security, and pays only about 1/3 of 1 percent of his or her total earnings.

Ending the cap would call on top earners to pay their fair share toward keeping Social Security strong for the long term. It would—

- Equalize the Social Security tax rate, so that all workers would pay 6.2 percent on all of their earnings, just as workers making less than $110,100 already do.
Social Security Reform Option: Eliminate the Payroll Tax Cap

- Equalize the duration of Social Security taxes throughout the year, so that the top 6 percent of earners would pay into Social Security all year long, just as the other 94 percent of workers do.

This change, by itself, would wipe out virtually all (86 percent) of Social Security’s financing gap over the next 75 years. By calling on top earners to contribute to Social Security in line with their ability to pay, this change improves fairness and balances Social Security’s finances for the long term.

David John

At first blush, the idea that people should pay Social Security taxes on all of their earnings instead of just on the first $110,100 seems both fair and attractive. After all, it only applies to people with higher incomes, and it applies that same tax treatment to Social Security as now applies to Medicare. However, there is a problem. This “solution” would cause either huge Social Security checks for very high-income people or a break in the link between earnings and benefits.

The writer H. L. Mencken’s comment that “There is always a well-known solution to every human problem—neat, plausible, and wrong” especially applies here.

Today, a retiree’s benefits are based only on the income on which he or she pays Social Security payroll taxes. Because of this, in 2012 the maximum Social Security benefit that even the wealthiest American can receive is just over $30,000 a year. 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.

Average benefits could remain at roughly the current level if wealthier Americans paid taxes on their entire salaries, but their benefits remain the same as they are now. Essentially, they would be getting nothing in return for the additional taxes that they would pay. Such a move has been proposed in the past.

Other than the fact that this would be unfair, it breaks the link between earnings and benefits. So far, a retiree’s Social Security benefits have always been based on the career earnings on which he or she has paid Social Security taxes. Dropping that principle would open the door to other substantial changes in Social Security.

In general, increasing taxes is a bad idea. For one thing, it reduces the amount that Americans have to spend on their own and their family’s food, housing clothes, education, and so on.

Second, taking the approach that all Social Security needs is a tax increase keeps us from reviewing the program and seeing what works and what could be improved.
**Social Security Reform Option: Eliminate the Payroll Tax Cap**

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Options for Reforming Social Security
Reduce Benefits for Higher Earners

Social Security benefit payments are based on the portion of a worker’s earnings that was 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. This could be done by modifying Social Security’s benefit formula in a number of ways, depending on who is classified as higher earners and how much their benefits are reduced. Most options use a sliding scale to reduce benefits most for higher earners, make smaller changes for middle earners and make no benefit changes for lower earners. Options include:

✓ Reduce benefits for the highest-earning 25 percent. Gradually reducing benefits over time for the highest-earning 25 percent of individuals by a sliding scale up to a 15 percent benefit reduction for maximum earners is estimated to fill 7 percent of the funding gap.

✓ Reduce benefits for the highest-earning 50 percent. Gradually reducing benefits over time for the highest-earning 50 percent of individuals by a sliding scale up to a 28 percent benefit reduction for maximum earners is estimated to fill 31 percent of the funding gap.

Argument for:
David John
The Heritage Foundation

Argument against:
Virginia Reno
National Academy of Social Insurance

David John

Changing benefit levels for higher earners is not a radical idea. In fact, it is really just an expansion of the way that Social Security has always operated.

Today, Social Security pays a higher monthly retirement benefit compared to their average lifetime income to lower-income workers than it does to those who had much higher incomes while they were working. It does this through the formula that is used to calculate an individual’s benefits based on income history.

In the future, we face an era when Social Security has promised future retirees more in benefits than it will be able to pay once the Social Security trust fund runs out of money. It seems only fair to protect the benefits of those who have lower wages by reducing the benefits of those who have higher earnings. Everyone would still receive a benefit, but higher-earning retirees would receive less than they do now.
Social Security Reform Option: Reduce Benefits for Higher Earners

Upper-income workers tend to have better opportunities to save for retirement than those with lower incomes. They are more likely to work at a company that offers them either a traditional pension or a retirement savings plan. They are also much more likely to have extra income to put away for retirement, while lower-income workers are likely to need a higher proportion of their income for day-to-day expenses.

That does not mean that lower-income Americans are not capable of saving or do not need to save. They are and they do. Even if Social Security could afford to pay its current level of benefits indefinitely, its benefits alone are not high enough to ensure a comfortable retirement.

There are many ways to reduce benefit levels for those who have had higher incomes, but all of them achieve the same result. Some of those methods are so complex that even policy professionals with decades of experience in working with the details of Social Security have a hard time understanding them. Other methods are much simpler, but are still fairly detailed.

All of them use a sliding scale that reduces benefits most for individuals with higher incomes, make no benefit changes for people with average career incomes below a preset level, and make smaller changes for those who fall in between those two levels. That way, the higher a person’s income, the more his or her benefits are reduced. And of course, the more people whose benefits are not touched, the lower the overall savings.

Regardless of what method is used, the goal is the same. Everyone receives some level of Social Security retirement benefit. But those with higher average incomes receive less than they do now, because they have a greater chance to build other forms of retirement income.

Virginia Reno

Proposals to cut benefits for higher earners are often billed as benefit reductions for the wealthy—but they would actually cut benefits for the broad middle class. These proposals do not consider the total incomes or wealth (such as financial assets, real estate, and so forth) of the individuals whose benefits would be cut. Instead, they simply ratchet down the formula that calculates your benefit based on your lifetime earnings that were taxed for Social Security. Because taxable earnings are capped annually (at $110,100 in 2012), the formula does not distinguish between someone making $110,100 and a millionaire. Using the Social Security benefit formula to cut benefits does not target the rich; it hits middle-class workers making $110,100 or less.

People whose benefits would be cut under these proposals fall far short of making it into the much-publicized top 1 percent of household income, which begins at about $380,000 a year. Those among the top 1 percent have average incomes of about $1.5 million a year. In sharp contrast, one proposal targeting the so-called “highest-earning 25 percent” under Social Security would cut benefits for workers earning above $54,000 a year. Another proposal allegedly targeting the “highest-earning 50 percent” would start cutting benefits for workers earning as little as $37,000 a year.

The case against cutting future Social Security benefits for such middle-class workers is strong. Social Security benefits are already modest, and benefits in the future will be less adequate as the full retirement age rises from 66 today to 67. To illustrate, schoolteachers
Social Security Reform Option: Reduce Benefits for Higher Earners

or nurses now in their 40s who make about $54,000 a year and who start collecting Social Security benefits at age 62 will get benefits that replace just 29 percent of their prior earnings. That benefit of about $1,300 a month is far from overly generous. Other elements of a secure retirement—a home with a paid-off mortgage, a steady pension check, and solid savings—are much less secure than once thought. Social Security’s guaranteed benefits are more important than ever.

The recent financial crisis has strengthened Americans’ commitment to keeping Social Security strong. In a nationwide poll, large majorities of Americans across age groups and political party affiliations agree it is critical to preserve Social Security for future generations even if that means increasing working Americans’ contributions to Social Security. Social Security is affordable. Working Americans want to preserve it. Cutting benefits is unnecessary, and doing so would be a breach of trust with millions of Americans who have been paying into the program and earning their modest benefits.

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NOTE: The estimated solvency effects in this Perspectives report are based on the intermediate assumptions in the 2011 Social Security Trustees Report.
Social Security provides benefits to retired workers and their families; to the spouses and dependents of workers who have died; and to workers who have become disabled and their families. Those benefits are too low for certain groups, according to some who argue that as part of any effort to strengthen Social Security, lawmakers should consider increasing benefits for more-vulnerable recipients. Some proposals to improve benefits include the following:

- A new minimum benefit that is guaranteed to keep low-paid workers with long careers above the poverty level
- Earnings credits for people who are not in the paid workforce because they are caring for a child or other family member
- Increased benefits for a surviving spouse

Each of these proposals would require other adjustments to benefits or revenue. Proposals to improve benefits for caregivers and low-wage workers have been estimated to increase the funding gap by 5 to 13 percent. There are no available estimates for proposals to improve benefits for surviving spouses.

Perspectives on improving benefits:

Virginia Reno  
National Academy of Social Insurance

David John  
The Heritage Foundation

Virginia Reno

Social Security has all the features of an ideal pension plan: It is fully portable from job to job, it is secure, it pays benefits as long as you live, and it keeps up with the cost of living. But the adequacy of Social Security benefits could be—and should be—improved.

Benefits are modest—just $1,230 per month for the average retiree. Yet Social Security is the main source of income for most older people. Two in three beneficiaries over age 65 rely on it for more than half their incomes. Looking ahead, Social Security’s guaranteed benefits are likely to be more important than ever for tomorrow’s retirees. The case for improving benefits is strong.

The good news is that we afford to preserve and improve Social Security. The benefits that now go to 55 million Americans account for 5 percent of the entire economy. That share will increase as boomers retire, but will level off at about 6 percent. That is affordable. In survey after survey, across party lines and age groups, Americans say they would rather pay more than see benefits cut; majorities also support benefit improvements. Here are some possibilities. Each shows how much more an average
worker making $45,000 a year might pay, with matching funds from his or her employer, to cover the cost of the improvement.

- **Help those most in need** by updating Social Security’s special minimum benefit so that someone who works at low wages and pays into Social Security for 30 years can retire at 62 and not be poor (cost: 82 cents a week).

- **Give working parents credit for care giving** by letting them count up to eight years out of the workforce while caring for young children toward benefits that will keep them out of poverty in retirement (cost: $1.21 a week).

- **Improve economic opportunity for children of workers who die or become disabled** by continuing the child’s benefit until age 22 if he or she is in college or vocational school. Congress ended these student benefits in 1981. Later research found that they enabled many students from low-income families to complete their education and increase their lifelong earning power (cost: 30 cents a week).

- **Improve survivor benefits** for dual-earner couples and **help the oldest old** by raising benefits 5 percent at age 85 to help meet living costs (including out-of-pocket health care costs) as other resources are eroded by inflation or spent down at advanced ages (cost: 43 cents a week).

- **Raise benefits by $60 a month for all beneficiaries** to better help them make ends meet. This would provide the largest percentage increase to those with the lowest benefits (cost: $3.25 a week).

We could make some improvements soon, others later. There are many ways to improve the adequacy of Social Security benefits, if we wish to do so.

**David John**

For certain people, Social Security’s current benefit structure is unfair and unrealistic. For instance, a very low-wage worker can pay Social Security taxes for 35 years and end up with a benefit that is below the poverty limit. We claim to value people who interrupt their careers to raise children or care for a very ill family member, but the result is lower Social Security benefits and less security in retirement. And benefits for the surviving spouse of a couple can be extremely low.

All of these situations can—and should—be improved, but only as part of a complete overhaul of the entire Social Security system. Otherwise, the added cost will exhaust the Social Security trust fund even earlier than the program’s nonpartisan experts currently expect. If that happens, then current law says that everyone who is receiving benefits will have their benefits reduced by about 25 percent. This includes the lowest-income retiree whose entire income comes from Social Security and is just barely scraping by as well as the millionaire who really doesn’t even notice his or her Social Security benefits.

The most recent Social Security trustees’ report says that as it is now, the trust fund will be gone in 2033. The report called on Congress to act quickly to save the system for all of us. Most discussions about fixing Social Security focus only on fairly unpleasant actions such as raising taxes, cutting benefits, or raising retirement ages, but they could also include benefit increases for certain groups who are not being treated fairly. The program’s benefit structure has not been reviewed for almost 30 years, and much of it dates back much farther than that. Modernization is long overdue.
Social Security Reform Option: Improve Benefits

For instance, it would be simple and fairly inexpensive to guarantee that everyone who has worked a full career and paid Social Security taxes for at least 35 years gets a benefit that is at least poverty level or slightly above. Similarly, benefits for widows or widowers could be set to increase their retirement security.

An equally important improvement would be to give people who interrupt their careers to care for a child or ill family member credit toward their Social Security benefits. This credit should be limited to a set number of years, and structured to reduce the number of years they need to work and pay the needed taxes for full benefits from the current 35 to a shorter period.

These are all excellent goals, but they must be part of a package that restores Social Security’s financial health so that it can provide greater retirement security for all. Otherwise, these benefit increases will only make across-the-board benefit cuts for everyone—including the very people who would be helped by benefit improvements—come even sooner than 2033.

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NOTE: The estimated solvency effects in this Perspectives report are based on the intermediate assumptions in the 2011 Social Security Trustees Report.
Employers and employees each currently pay a 6.2 percent tax to Social Security on earnings up to $110,100. Self-employed workers pay both the employer and employee share, for a total of 12.4 percent. One option to help close the Social Security funding gap would raise the payroll tax rate for all workers and employers. For instance, on a $50,000 annual salary, increasing the payroll tax rate to 6.45 percent would increase both the annual employee and employer contribution by $125 each. Changing it to 7.2 percent would increase the annual employee and employer contribution by $500 each. The rate increase could occur gradually or all at once. Increasing the payroll tax rate from 6.2 percent to 6.45 percent immediately is estimated to fill 22 percent of the funding gap. Increasing the payroll tax rate gradually over 20 years on employers and employees from 6.2 percent to 7.2 percent is estimated to fill 64 percent of the funding gap.

**Options for Reforming Social Security**

**Increase the Payroll Tax Rate**

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| **Virginia Reno**  
National Academy of Social Insurance | **David John**  
The Heritage Foundation |

**Virginia Reno**

Workers pay for Social Security’s insurance protection through premiums (also called payroll taxes) that are deducted from their pay, and their employers pay a matching amount. Social Security does not need additional income now, but almost certainly will within the next 25 years. Policymakers should act soon to schedule an increase in the payroll tax rate to take effect in the future when more money will be needed. This fiscally responsible action would help balance Social Security’s long-term finances and assure young workers that they can count on getting the benefits they are paying for. This kind of responsible stewardship is a long-standing feature of Social Security.

Policymakers could act now to schedule a gradual rate increase starting five years from now, when the economy is expected to be stronger. A gradual increase of 1/20th of 1 percent each year for 20 years, from 2017 through 2036, would eliminate nearly two-thirds of the program’s projected 75-year shortfall. For an average worker, the additional payment would amount to about 50 cents more a week each year—"barely the cost of a pack of chewing gum,” as one advocate of this policy has noted. If Congress combines this gradual rate increase with lifting the cap on earnings, we can afford to improve benefits for particularly needy and deserving individuals and balance Social Security’s finances for 75 years and beyond.

Americans say they don’t mind paying for Social Security, and they would rather pay more than see benefits cut. Across both party lines and age groups, large majorities of
Americans agree that it is important to preserve Social Security even if that means increasing working Americans’ contributions to the program. In a recent NASI poll, those agreeing with this statement included 87 percent of Democrats, 75 percent of independents, and 67 percent of Republicans; and 79 percent of younger workers (age 18–34), 71 percent of the middle group (age 35–49), and 76 percent of workers age 50–64.

Scheduling a gradual increase in Social Security premiums—to match the increase in future benefits as baby boomers retire—simply makes good sense. Together with lifting the cap on earnings subject to Social Security taxes, this change would—

- Soundly finance Social Security’s promised benefits for the next 75 years;
- Pay for some improvements to benefit adequacy; and
- Assure young workers that they can count on Social Security just as their parents and grandparents have done.

David John

Increasing Social Security’s payroll tax rate is a bad idea. It would increase taxes for everyone, no matter what their income. Higher payroll taxes would cause increased unemployment. The number of jobs lost would depend on how high the payroll tax level gets and when. Economists have known for decades that if the cost of employees gets too great, employers have an incentive to replace them with machines or to move to a lower-tax location. Unfortunately, this does not hit all employees equally. Employers are most likely to replace younger workers and those with lower skill levels.

Even seemingly small increases in the percentage of wages that both the employer and employee must pay to Social Security would have an effect. Increasing payroll tax rates a tiny amount could cost jobs in companies that only earn a few cents for each dollar of sales and firms that are already losing money. In a highly competitive international economy, every dollar counts.

What is worse is the added uncertainty that such a move would cause. Payroll tax rates have remained the same since 1990. Once they start to change, employers will fear that additional increases will follow and factor this worry into their hiring decisions.

The amount of the increase needed to fix Social Security depends on when the increase is made. An increase now would just produce more surpluses for Congress to spend just as it spent the surpluses from 1983 through 2009. Most experts agree that if payroll taxes are increased when Social Security needs them to close its deficits, payroll tax rates would have to go up by a total of 50 percent in order to solve all of Social Security’s financial problems. That would mean that instead of the employer and employee each paying an amount equal to 6.2 percent of income to Social Security, they would have to pay about 9 percent of income each. And both would still have to pay state, federal, and sometimes local income taxes also. What is worse, the self-employed and certain small business owners who pay both the employer and employee share would see their Social Security payroll taxes climb from 12.4 percent of income to about 18 percent of income.

In general, increasing taxes is a bad idea. For one thing, it reduces the amount that Americans have to spend on their own and their family’s food, housing clothes, education, and so on. This is especially true in today’s economy, where so many people
Social Security Reform Option: Increase the Payroll Tax Rate

live from paycheck to paycheck. What seems like a trivial amount to people in Washington may cause real problems to normal Americans.

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Options for Reforming Social Security
Tax All Salary Reduction Plans

Virginia Reno

Congress should complete a reform it launched in 1983 by treating workers’ contributions to all employer-provided salary reduction plans as earnings that are subject to Social Security taxation and that count toward workers’ future benefits. In 1983, Congress followed the advice of an expert commission, led by Alan Greenspan, which recommended that workers’ contributions to 401(k) plans should be covered by Social Security. Otherwise, as 401(k) plans became more common, workers would lose some of their earned Social Security protection (including a portion of life and disability insurance and credits toward retirement benefits) and the Social Security trust funds would lose revenues needed to pay future benefits. The same argument applies today to other types of salary reduction plans.

Salary reduction plans allow workers to exclude from taxable income their out-of-pocket spending for health care, dependent care, or qualified commuting costs for parking, van pooling, or transit fares. Such plans were either nonexistent or rare in 1983 but have since become common. Treating all employee contributions to such plans as covered earnings for Social Security purposes (while maintaining their income-tax exemption) would—

- Provide consistent treatment between 401(k)s and other salary reduction plans;
- Reflect the intent of Congress;
- Fill 10 percent of the projected gap in Social Security’s finances; and
- Ensure that all of workers’ earnings count toward their future Social Security benefits.

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 do not, however, pay these payroll taxes on their contributions to some other types of benefit plans at work, like Flexible Spending Accounts. Collecting payroll taxes on contributions to all such benefit plans would increase the Social Security program’s funding, as well as increase the earnings used to calculate the Social Security benefits of workers who have those benefit plans. If you contributed $2,000 to a Flexible Spending Account, you and your employer would pay the 6.2 percent payroll tax (or $124 each) on that money. Taxing these salary reduction plans for Social Security the same way we tax contributions to 401(k) plans is estimated to fill 10 percent of the funding gap.
Social Security Reform Option: Tax All Salary Reduction Plans

David John

This would be a case of robbing Peter to pay Paul. Changing the tax treatment of salary reduction plans is a bad idea that would increase the cost of health care and other employee benefits, while also discouraging employers from offering the plans in the first place.

Salary reduction plans, which are also called cafeteria plans or flexible spending accounts, are designed to provide a tax subsidy that partly offsets the cost of health insurance and other employee benefits. They include the accounts that millions of Americans now use to pay for glasses, eye exams, medication, and a host of other needs. They can also help to pay for transportation expenses, life insurance, child care, and a number of similar services.

Because of these accounts, many employers are able to provide better health care insurance coverage than they could otherwise afford. This is especially true of smaller employers that cannot completely absorb the rising cost of their health care policies. Depending on the specifics of the plan, employees may pay a proportion of their basic health insurance premiums, or the full cost of insurance covering items such as dental, optical, or other health care needs. The plans also allow employees to tailor benefit packages to meet their own special needs and interests.

Under the current structure, both employees and employers receive a tax benefit for offering salary reduction plans. Employees benefit because the amount that they contribute is deducted from their taxable income. They are exempt from paying state and federal income taxes and federal payroll taxes on that amount. Employers benefit because they do not have to pay the matching payroll taxes or federal unemployment taxes on amounts deducted from the employees.

Supporters of eliminating the payroll tax exemption correctly point out that employee contributions would still be exempt from federal and state income taxes. However, their costs would still go up by more than 6 percent, an amount that could be significant to people who must count every cent in tough economic times.

What is worse, though, is that such a move would eliminate the incentive that employers have to offer these salary reduction plans. Those tax savings help to offset the employer’s cost of operating the plans. The result would almost certainly be fewer employers that are willing to offer this type of benefit. Individual workers would either have to buy the coverage themselves or to do without.

Eliminating the payroll tax exemption from cafeteria and flexible spending plans might marginally improve Social Security’s finances. However, if it comes at the cost of reduced family health care coverage, that cost may be too high.

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About 25 percent of state and local government employees are not covered by Social Security. Rather, these workers are covered by retirement plans provided by state or local governments that have chosen not to participate in the Social Security program. Under one proposed change, Social Security would cover all newly hired state and local government workers. Those workers and their employers would each pay their share of Social Security payroll taxes, and the workers would receive Social Security benefits. Current state and local government workers would not be affected. This proposal is estimated to fill about 8 percent of Social Security’s funding gap.

**Argument for:**

**Virginia Reno**  
National Academy of Social Insurance

A social insurance system works best if it covers everyone. Today, Social Security covers almost all workers. The main exception is the 25 percent of state and local government employees who are covered by other pensions and whose employers have chosen not to provide Social Security coverage. Congress last extended Social Security coverage in 1983 when it brought all newly hired federal workers under Social Security. Now, 25 years later, the large majority of federal workers are covered. By including newly hired state and local workers in Social Security, the state systems can gradually phase in a new pension plan that supplements Social Security.

Many have called for extending Social Security to state and local workers who are not now covered. That way, workers who move between jobs that do and do not currently provide Social Security coverage would gain seamless insurance coverage throughout their working lives, and would not have to contend with complex rules for coordinating benefit amounts across programs when they retire or become disabled.

Understandably, some states with large numbers of employees not covered by Social Security are reluctant to have those workers covered by Social Security. These states would have to begin paying Social Security taxes (in their role as employers), and they would need time to modify their pension systems to fit with Social Security. Extending Social Security coverage only to newly hired workers offers state and local governments a manageable way to make the transition.
Social Security Reform Option: Cover All Newly Hired State and Local Government Workers

The rationale for extending Social Security coverage is to improve the fairness and predictability of the entire system—Social Security plus the supplemental public pensions. All workers would be able to count on Social Security, which is fully portable between jobs and provides a foundation of inflation-protected retirement benefits, life insurance, and disability protection—an umbrella broader than most state and local plans provide. And state and local government employers and employees could count on the fact that their employer-provided benefits will be on top of Social Security’s basic foundation of income security. This change would bring in new revenue in the near term as newly covered workers and their employers pay into Social Security, and it would later provide benefits to those workers.

David John

Requiring all newly hired state and local government workers to join Social Security is a short-term fix that eventually makes Social Security’s financial problems worse. In addition, it may cause even greater problems for state and local government employees’ pension plans. Many of those non-Social Security pension plans already lack the money to pay all of the benefits they have promised, and may need bailouts to pay their full promised benefits.

Back when Social Security was created in 1935, no government employees were allowed to be part of the system. Since 1984, newly hired federal government employees have been part of the program. State and local government employees were first allowed to be covered in 1950, and today a bit more than seven out of ten state and local government employees have joined Social Security. However, that leaves more than 6.5 million state and local government workers outside of Social Security.

Coverage varies, but all 50 states have some government workers who are not in Social Security. Many of these uncovered workers are in small local retirement plans that cover police or firefighters. Nationwide, seven out of ten firefighters are not covered by Social Security. The International Association of Fire Fighters opposes mandatory Social Security coverage because their current plans offer better benefits and reflect the special circumstances of their work. Other uncovered workers are in big state employee plans. In California, Colorado, Louisiana, Massachusetts, Nevada, Ohio, and Texas, more than half of all state and local government workers are not in Social Security.

Requiring all newly hired state and local government employees to be part of Social Security would help close that program’s financial problem for now. That money would come from increased payroll tax collections. However, eventually those workers would start to collect benefits, and at that point the savings would disappear and be replaced by higher costs. The Social Security Administration says that if all newly hired state and local government workers were added to Social Security in 2012, the program would start to bring in additional money almost immediately. However, by 2065, Social Security would be paying out more to retiring state and local government workers than it receives in additional revenue from them.

A more immediate problem is the effect on underfunded state and local employees’ pension funds. Many of these plans have already promised to pay more benefits than they can afford to pay.
Social Security Reform Option: Cover All Newly Hired State and Local Government Workers

Adding newly hired state and local government workers to Social Security would do nothing to reduce the cost of those programs since the benefits of current workers would not be affected. However, it could increase the plans’ underfunding when those newly hired workers contribute less than they would now. If that happens, Americans in some states would see the temporary improvement in Social Security’s finances offset by higher state and local taxes.

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Options for Reforming Social Security

Increase Number of Years Used to Calculate Initial Benefits

Social Security retirement benefits are based on a worker’s average earnings history. Average earnings are computed from a worker’s highest 35 years of annual indexed earnings that were subject to Social Security payroll taxes. If a worker has fewer than 35 years of earnings, each year needed to reach 35 is assigned zero earnings. One option to help close the Social Security funding gap would increase the number of years of earnings used to calculate Social Security retirement benefits from 35 to 38 or even 40. Because that method would typically include more years of lower earnings, the average earnings would decrease and benefits would be lower. Increasing the number of computation years to 38 is estimated to fill 13 percent of the solvency gap.

Argument for:

David John
The Heritage Foundation

Argument against:

Virginia Reno
National Academy of Social Insurance

David John

Social Security calculates monthly retirement benefits using only the highest 35 years of earnings during an individual’s work history. The rest of them are discarded. This produces a skewed picture of an individual’s full employment history, and inaccurate Social Security benefits. A more accurate method would be to expand the required work history from today’s 35 years to either 38 years or even 40 years.

Under the current method, an individual who goes to work full time at age 21 has worked and paid Social Security taxes for 45 years by the time that he or she reaches Social Security’s current full benefit age of 66. Going to work at age 18 adds three years for a 48-year work history. Meanwhile, people could wait until age 30 before going to work and still receive full credit toward their eventual retirement benefits, allowing them to pay fewer years of Social Security payroll taxes than someone who works longer, but get the same benefits.

Increasing the number of years used to calculate an individual’s Social Security benefit would provide an added incentive for him or her to go into the workforce sooner and to keep working. It would also enable the Social Security Administration to use a more complete picture of an individual’s working life when it calculates benefits.

In fairness, for many workers a change to counting 38 years of earnings would include some lower earning years that today’s 35-year work history ignores. That would slightly reduce benefit levels. Moving to a required 40-year work history would reduce them slightly more. On the other hand, people who continue to work beyond their full benefit age would still receive higher benefits than those who retire earlier and could thereby make up that difference in most cases.
Neither change would result in a major change in most individuals’ benefits, but adding everyone’s small benefit reductions together would help to strengthen Social Security and make its scarce resources last longer. The improvement to the program’s finances would not be enough by itself to completely fix Social Security. It would need to be combined with other changes to do that.

Increasing the number of years an individual must work to qualify for full Social Security benefits recognizes that people are living and working longer on average than they did in the past. The change would encourage younger people to start working sooner than they might otherwise, and the small benefit changes would help to preserve Social Security for everyone.

Virginia Reno

This proposal is a bad idea because it would reduce benefits the most for people who need them the most: women and lower-income, less-educated, and minority retirees. It would reduce benefits not only for retired workers, but also for their dependents and survivors.

The cuts would occur because many retirees do not have a full 35 years of earnings, much less 38 or 40 years. The largest reductions would affect people with gaps in their covered work histories, typically women. Women are more likely than men to drop out of the workforce to raise children or care for other family members. The average monthly benefit for retired women ($1,073) is 78 percent of the average benefit for men ($1,383); this proposal would increase that gender gap.

This change would have little or no impact on benefits of people who have worked steadily for 38 or 40 years—but far fewer people than might be expected have such work records. Because of periods of unemployment, incomplete work records, or temporary illness or disability, most workers have gaps in their work histories. The Social Security Administration estimates that about 75 percent of all those receiving retired-worker benefits would experience a benefit cut if the computation period were increased to 40 years.

Social Security benefits are modest and already being cut as a result of changes enacted in 1983. Cutting them further is unnecessary, as large majorities of Americans report that they would rather pay more for Social Security than see future benefits cut further.

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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 their other income—investment, pension, savings—the person receives in addition to Social Security benefits (although a portion of Social Security benefits is taxable if the total income exceeds a certain threshold). One option to help close Social Security's funding gap is to “means test.” Means testing would reduce benefits for higher-income recipients and could even eliminate benefits altogether for the highest-income households.

Unlike the reform 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.

One version of means testing is estimated to fill about 11 percent of the funding gap.

**Argument for:**

David John  
The Heritage Foundation

**Argument against:**

Virginia Reno  
The National Academy of Social Insurance

**David John**

In an era of scarce resources, Social Security cannot afford to continue to pay benefits to every eligible retiree regardless of what other retirement income they have. One approach to preserving the program would be to provide monthly benefits only to retirees who have less than a certain amount of non-Social Security annual income. Those with more income would be guaranteed that if their circumstances change, they would start to receive their benefits. Social Security would continue to be insurance against retirement poverty for everyone, but would focus its benefit payments on those who really need them.

Back on November 14, 1934, in an address to the committee that was developing Social Security, President Franklin D. Roosevelt noted that “It takes so very much money to provide even a moderate pension for everybody, that when the funds are raised by taxation only, a ‘means test’ must necessarily be made a condition of the grant of pensions.” In short, he said that taxpayer-paid retirement benefits should only go to those who really need them or the overall cost would be too high. FDR appears to have subsequently changed his mind, but he had the right idea the first time.

For example, under one plan individual retirees with more than $55,000 of non-Social Security retirement income would see their monthly benefits reduced. For every $1,000
of income they have over $55,000, their Social Security benefits would be reduced by about 1.8 percent. So if they had non-Social Security retirement income equal to $65,000, their benefits would be reduced by 18 percent. If they had retirement income over $110,000, they would receive no Social Security benefits. Again, the decision would be based only on their non-Social Security income.

Couples would see the means test start to reduce benefits if they had non-Social Security income equal to $110,000, and they would receive no benefits if their income was over $165,000. In the case of both individuals and couples, the decision would be based on their annual tax return. If something happened in the future so that their income dropped, Social Security would restart their benefits. In an emergency, they could start to receive benefits very quickly.

This plan would reduce benefits for about 4½ percent of retirees and eliminate benefits for another 4½ percent. The other 91 percent would not be affected at all.

There are many other ways to apply a means test, but all of them preserve scarce benefit dollars by paying them to those who really need the income. And all taxpayers, no matter what their income level, receive the guarantee that Social Security will be there for them if they need it. That gives everyone something of value for their Social Security payroll taxes.

**Virginia Reno**

Means testing Social Security would fundamentally change it from social insurance (a universal system of benefits earned by all who have paid in) to welfare (a system requiring you to prove you are needy in order to qualify for benefits). As social insurance, Social Security provides a foundation of retirement security, family life insurance, and disability income protection for virtually all American workers. Benefits are an earned right based on earnings from which premiums are deducted, as payroll taxes. Social Security uses an earnings replacement concept, recognizing that there is a relationship between your standard of living while working and the benefit you need in order to achieve income security in retirement. The benefit formula already replaces a higher portion of past earnings for low earners than for higher earners.

Means testing would violate many of the key principles that have made Social Security so effective and popular for 77 years. For example:

- *A means test is a penalty on thrift.* It creates a huge disincentive for people to save, buy other insurance, or work part-time in retirement; or for employers to provide pensions to their workers. With a means test, anything else you have reduces your benefit amount.

- *A means test undermines the principle that benefits are an earned right.* It destroys the link between premiums paid from wages and the benefits that are designed to replace part of those wages.

- *A means test would be far more intrusive and expensive to administer than Social Security is today.* Applicants for benefits would have to undergo investigations of their income and asset holdings, possibly including the income and assets of others in their households. Investigations would have to be updated frequently as income and wealth change, and benefit levels would have to be adjusted accordingly.
Most important, means testing would likely cut benefits for the broad middle class, because only a very small share of benefits goes to wealthy people. Only 2 percent of benefits are paid to people with more than $100,000 in other income. One plan, which features means testing and other Social Security benefit cuts, illustrates the problem. This plan would shrink total Social Security benefits paid by 45 percent over 25 years. To cut spending so much—especially when the baby boomers will be in their 70s and 80s and counting heavily on Social Security—would mean deep cuts for middle-class retirees, such as nurses, teachers, firefighters, office workers, and small-business owners.

Means testing Social Security would undermine much of its core strength, turning it into an unpopular welfare program while sharply reducing the adequacy of Social Security benefits for middle-class baby boomers and younger American workers.

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NOTE: The estimated solvency effects in this Perspectives report are based on the intermediate assumptions in the 2011 Social Security Trustees Report.