

REFORMING SOCIAL SECURITY

Option: 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 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:

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Argument against:

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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

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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.

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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*.

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