Social Security in America:

A Brief Analysis and Proposal of Alternatives

Draft 2

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Introduction:

Since the Social Security Act was signed by President Franklin Delano Roosevelt on August 14th of 1935, the Social Security program has become a staple of the American economic system. According to FDR, in making the program he "tried to frame a law which will give some measure of protection to the average citizen and his family against the loss of a job and against poverty-ridden old age" ("Historical Background and Development of Social Security"). Ultimately, through mandatory payroll tax contributions, the goal was to create a general retirement fund that would then be divided up amongst the retired population. The allocation of benefits follows a formula determined by the Social Security Administration (SSA). Workers earnings are adjusted to inflation, then the income they earned in their highest 35 years of work are averaged out and divided by 420 (the number of months in 35 years). The resulting number is then applied to the Social Security benefit formula to determine an individual's monthly benefits ("How are Social Security Benefits Allocated?"). Currently, 1 in 7 American workers, spouses, or dependents are receiving monthly social security payments and over 90% of all workers are contributing to the fund through mandatory payroll taxation ("Historical Background and Development of Social Security"). In this paper, I will analyze the viability of the Social Security program in its current format and discuss potential policy alternatives to the problems that arise as a result of this analysis

Problem Definition

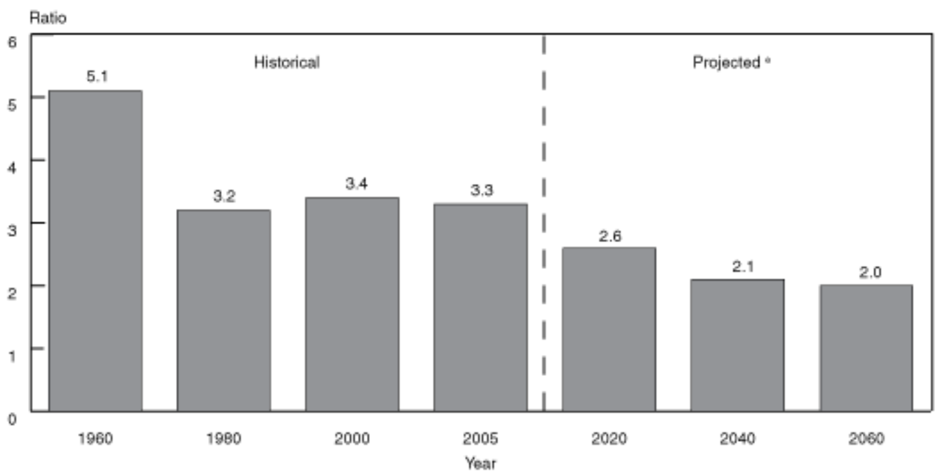
Because Social Security does affect or will affect nearly every American at some point in their lives, it is necessary to see where we might be running into problems with the policy. Since its introduction, Social Security has been expanded to include two different trust funds. The Old-age and Survivors Insurance Trust Fund (OASI) and the Disability Insurance (DI) Trust Fund with 85% of funds going to the OASI fund and 15% going to the DI fund ("United States"). According to the 2017 annual report from the Social Security and Medicare Board of Trustees, the DI fund will only be able to pay full benefits until 2028 "when tax income would only cover 93% of scheduled benefits". Furthermore, the same report suggests that the OASI fund will be insolvent by 2035 at which point it would only be able to cover 75% of scheduled benefits.

For the elderly in America, Social Security is a staple of their retirement income, and the potential loss of benefits could have catastrophic consequences for both them and their dependents. Along with pensions and personal savings, Social Security is meant to be a supplement that allows for seniors to be comfortable during retirement and serve as a protection against poverty. What we have seen in recent years, however, is that seniors have become reliant on Social Security benefits for their retirement income. According to a study published in the Social Security Bulletin, as of 2014 52% of those over 65 rely on Social security for over 50% of their retirement income and 25% rely on Social Security for over 90% of their retirement income (Dushi et al., 2017). Given these statistics, it is apparent that any decrease in Social Security benefits for the elderly could lead to widespread poverty in a population that is generally not able to support themselves through work. Therefore, it is incumbent upon policy makers to address causal factors that are leading to the potential insolvency.

The first factor that is having a dramatic impact on the viability of Social Security is the increased life expectancy that has occurred in recent decades. In 1935 when the Social Security act was established, the average life expectancy of United States' citizens was approximately 62 years old (Javier, 1999). This meant that the Social Security program did not have to keep paying benefits for a significant amount of time after retirement Currently, Americans are expected to live to an average of 79 years old with that number only expected to grow in coming years ("Life Expectancy at Birth, Total (years)", 2017). Despite the continued increase in life expectancy for Americans, there have not been any age-related adjustments to Social Security since an amendment in 1983 which changed the age to receive full benefits to 66 for the "Baby Boomer Generation" (generally understood to include people born between 1946 and 1964) and 67 for people born after 1960 (Olshansky et al., 2015, & Pollard & Scommegna, 2014).

Another factor that has proven to be problematic is that workers are leaving the workforce faster than they are entering it. The Baby Boomer Generation composes nearly 25% of the entire population of the United States (Pollard & Scommegna, 2014). For decades, the exponential increase in workers that came with the baby boomers helped to drive America to the forefront of the global economy. Now, as they range in age from 53 to 71, "Boomers" are retiring at a rate of 10,000 per day (Hobson, 2016).

In addition to an increasing number of workers leaving the workforce, the fertility rate in the United States has fallen from 3.6 children per woman in 1960 to 1.8 in 2015 ("Fertility rate, total (births per woman),", 2017). This means that the worker to beneficiary ratio has fallen from its peak of 41.9 workers per retiree in 1945 all the way to 2.9 as of 2010 (Rugy, 2012). In order for the current format of payroll taxation supporting Social Security to be sustainable, the worker-to-beneficiary ratio has to be above 3, however as the graph to the right depicts, that number is only expected to shrink in the coming decades.



Goals

The purpose of this policy brief is to examine the problems that Social Security is facing in its current state and to identify strategies to address the issues presented. Through a thorough analysis of the available data, I plan to answer the question "which alternative to the current system is most cost effective in terms of preventing the insolvency of Social Security in a way that minimizes costs to the government and taxpayers, and is politically feasible?" In order to do this analysis, I will examine a series of policy alternatives such as privatization, means-testing, and raising the maximum taxable earnings cap.

Role for Government

In 1935 when Social Security was established, it was clear that President Roosevelt and Congress believed that a government solution was the most effective way to address poverty among the elderly. This is because there is a perceived market failure in providing help for the elderly. Private business has not seen a potential for profit in this marketplace, however, the American public continues to see a need for retirement benefits for the elderly. Overall, a poll by

CBS News found that 73% of Americans think that "the benefits from Social Security are worth the cost to the taxpayer ("Social Security", 2014). The problems currently facing Social Security are a combination of both external factors outside of the government's control (i.e. decreasing birth rates) as well as a failure by the government to take action earlier on Social Security helped to expedite the process of the its insolvency. Moving forward, whether or not the government continues to provide Social Security in the same manner, they have responsibility to address the problems that they are responsible for in the program that they created.

Policy Alternatives

In recent years, politicians have proposed and debated a number of potential alternatives that could help make Social Security financially viable. Upon review of the available literature, it appears that there are three options in particular that are the most widely discussed alternatives to the current system: 1) Privatization of Social Security; 2) Means-Testing Social Security; or 3) Raising the Tax Cap on Social Security. In order to examine the potential usefulness of these alternatives, I will conduct a thorough cost-effectiveness analysis on each policy. The goal of this analysis is to arrive at a conclusion as to which alternative is most cost effective in terms of preventing the insolvency of Social Security in a way that minimizes costs to the government and taxpayers, keeps the elderly above the poverty line, and is politically feasible.

Policy Alternative #1: Partial Privatization of Social Security

Perhaps the most well-known alternative to the current Social Security system, privatization has been a popular sentiment among conservative lawmakers dating back to the 1990s, and was center-stage during George W. Bush's State of the Union Address in 2005

(Tedrow, 2006). Partial privatization of Social Security would entail massive overhaul to our current system. Essentially, it eliminates or significantly reduce the government's role in providing retirement benefits for the elderly by taking the mandatory payroll contributions that workers are already paying to the Social Security fund and putting them into a privately managed investment fund (Sauter & Altman, 2017). While Social Security benefits are already largely dependent on individual contribution, a private investment fund would make an individual's retirement benefits fully dependent on that fund and how the money they put into it is invested.

Thus far, the debate regarding Social Security privatization has largely followed party lines. Republicans see such a plan as an example of the free-market at work. Their argument is centered around the belief that private pension funds would allow for investment in stocks and bonds with higher return rates than those of the current Social Security system. Furthermore, by partially eliminating the government's role in handling retirement accounts, they are able to take the risk associated with the political process out of the equation. A study done by the right leaning think tank the Cato Institute saw a potential financial benefit for individuals through such a system. As the graph to the right shows, workers who began work in 1968 and retired in 2011 would have had a higher monthly benefits package with private stocks or bonds than with traditional Social Security (Tanner, 2012).

Table 1
Monthly Retirement Benefit: Private Investment vs. Social Security

	Monthly Benefit		
Investment Package	**Wealthy**	**Average**	**Poor**
Stocks	$4,586.00	$2,621.00	$1,287.00
50/50	$3,562.00	$2,067.00	$1,096.00
Bond	$2,539.00	$1,565.00	$896.00
Current Social Security	$2,033.00	$1,358.00	$891.00

While many Republicans see privatization as a solution to the problems that plague Social Security, many on the left are skeptical of the benefits. They claim that a privatized Social

Security System would open up workers to a whole new set of risks. A study done by the Center for American Progress tested the potential market risks that would be associated with private retirement savings. They found that while the real rate of return over the past 100 years is an impressive 6.6%, the rate of return over 35 year periods in between this time fluctuates drastically between 3-10%. This means that some of the retiree cohorts would not fair nearly as well as others. In order to cover the losses for these cohorts should the market underperform, the government would likely have to perform a bailout of these individual accounts which would be an incredibly costly venture.

In terms of feasibility, privatization is one of the more plausible options given the current make-up of the government. With Republicans controlling the Presidency, the House of Representatives, and the Senate a plan that gives control back to the people certainly has the potential to be popular. A study from the Pew Research Center found that the majority of support for privatization of Social Security comes from Millennials with 86% favoring some form of privatization (Heimlich, 2011). However, the same study found that only 58% of Baby Boomers and 52% of the Silent Generation (those born between 1925 and 1945) support privatization. Despite the popularity amongst Millennials, only 49% of Millennials voted in the last election compared to 70% of the Silent Generation and 69% of Baby Boomers (Fry, 2017). Because the Silent Generation and the Baby Boomer Generation continue to make up a significant percentage of the electorate and are less enthusiastic about privatization, politicians are likely to be fairly apprehensive to adopt any change that might not have support amongst this cohort.

Policy Alternative #2: Mean's Testing Social Security Payments

Another idea that has been presented as an alternative to the current Social Security system is to introduce some form of means-testing into the program. Means-testing already exists in a wide range of government programs such as Medicaid, TANF (Temporary Assistance for Needy Families), and SNAP (Supplemental Nutrition Assistance Program). Additionally, countries such as Australia, Denmark, and France have been means-testing Social Security successfully for years (Kitao, 2014). Means testing would essentially mean that benefits would fall with income so that the wealthy will receive incrementally less benefits the wealthier they get, while those who are less well-off will continue to receive full benefits.

As with all of the proposed alternatives, the potential benefits that would come from means testing Social Security would be entirely dependent on how the program is implemented. Proponents of means-testing Social Security argue that those at the top of the income ladder should have no real need for Social Security benefits because of their wealth and that the program should therefore be redistributive in nature. They argue that, if done correctly, means-testing has the potential to make Social security entirely self-sustainable. In a study done by Sagiri Kitao for the Review of Economic Dynamics, he found that a program that would allow benefits to fall one-to-one above a threshold level would in fact allow Social Security to be self-sustainable (Kitao, 2014). However, that program is fairly extreme and would likely be unpopular and difficult to implement.

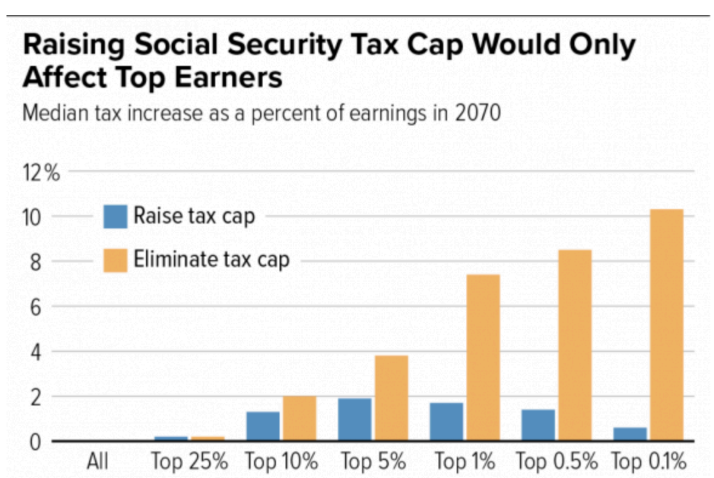
While means-testing does have the potential to be self-sustainable, it is not without its short-comings. Those who oppose means-testing claim that a means-test would actually de-incentivize work force participation from those over the age of 66. Kitao's study showed that only those "with very high productivity" will continue to work (i.e. those whose earnings put them past the benchmark for receiving benefits). This is because a system that means-tests on lifetime earnings would provide an incentive for people to leave the labor force once they meet the maximum income in order to receive benefits. Furthermore, a study done by the Center for Economic and Policy Research found that currently the majority of benefits are already going to those with lower income. Over 75% of Social Security of current benefits go to individuals with incomes less than $20,000 a year, and over 90% go to those with incomes less than $50,000 a year. (Baker & Rho, 2011). Baker and Rho also add that more reasonable approaches to means-testing such as cutting out 10% of benefits for every dollar of income over $100,000 would only save the program .58% of total benefits, and a program that cut out 20% would still only save 1.04%. Even with the small amounts saved by a more reasonable means-test, estimate show that the cost of administering such testing would increase expenses to Social Security by nearly 1.7% negating all of the proposed benefits (Baker & Rho, 2011).

A means-test for Social Security would likely be incredibly difficult to implement from a political perspective. By changing to a means-testing format of Social Security, we would essentially be changing the fundamental idea behind Social Security. As a report from the American Academy of Actuaries points out, “Past changes to the program always have been made within the universality and earned right principles of the existing system, but means testing would add a new element to the system.” (Downs et al., 2012). In addition to changing the underlying assumptions, this change would likely be very unpopular amongst the wealthy who would see little to no Social Security benefits as a result. In particular, the fewer than 400 families who are responsible for almost half of the money that was raised for political campaigns during the 2016 election would likely not be enthusiastic about giving up their hard-earned benefits (Confessor et al., 2015). Given these statistics and the massive change in ideology that would have to accompany this change, it is unlikely that a means-test would be feasible in the current political environment.

Policy Alternative #3: Raising the Maximum Taxable Earnings Cap for the Social Security Payroll Tax

In the current format of Social Security, the Social Security Administration sets a limit on the maximum amount of earnings that the Social Security payroll tax applies to. As of 2017, this limit was set at $127,200 up from $118,500 in 2016 ("Social Security Administration", 2017). Essentially what this means is that the current payroll tax rate of 7.65% would only be applicable to the first $127,200 that a worker would make. By raising this cap, the SSA could perhaps significantly increase the amount of taxable revenue that they bring in annually, however the change would not be without its risks and shortfalls. Similar to that of means-testing, the argument surround raising the tax cap is really a debate around society's notion of fairness.

For those in favor of raising the tax cap, their belief is centered on the fairly simple notion that everyone should pay the same percentage of their income for Social Security. Under this scenario, the benefits would be mostly geared towards those with incomes under the current threshold, as well as the government as it would be taking in more revenue as a result. In a study done by the Center on Budget and Policy Priorities, they point out that an increase in the cap would only affect those at the very top of the income bracket as the graph to the right shows (Romig, 2016). The fact that the



increase would only affect the wealthy would make it easier sell politically for the Democrats who generally favor higher tax rates on the wealthy.

On the other side of the argument, those who favor the cap believe that wealthy are already paying more than their share of the Social Security tax given that they receive benefits in the same way that the rest of the earners do. In an article written for the right-leaning Heritage foundation, David John suggests that raising the tax cap would only "patch the system's finances for a few years rather, rather than solving the problem for good" and that it would "impose a tremendous burden on small business (John, 2005)." John points out that raising the tax cap to $140,000 as the AARP suggests would cost families up to an additional $2,650 a year in taxes and that this change might not mean a lot to millionaires but to those on the upper-end of the income ladder, this would have a significant impact on their finances.

In terms of political feasibility, this option would certainly not be out of the realm of possibility. The tax cap has already been raised for Social Security multiple times, and the cap for Medicare was eliminated in 1994 (Romig, 2016). However, just as with means-testing Social Security, the majority of the impact for this policy change would fall on those with the most political power – the wealthy. Furthermore, the pledge that Conservative donor Grover Norquist encourages many Republicans take to not never vote for a tax increase could be problematic as more than 90% of Congressional Republicans have signed the pledge; however, this would not entail a direct increase in tax rate (Rosche, 2017). Lastly, this option appears to be relatively popular among the public, even the wealthy, with around half of millionaires approving of raising the cap (Romig, 2016).

Recommendations and Conclusion

In order to address the problems that Social Security currently faces including potential insolvency, I have conducted a thorough analysis of the potential costs and effectiveness of three alternatives to the current system: 1.) Privatization of Social Security; 2.) Means-Testing Social Security; or 3) Raising the Maximum Taxable Earnings Cap on the Social Security Payroll Tax. Upon review of my criteria of finding an alternative that will decrease the likelihood of insolvency of Social Security at the lowest cost to both the government as well as the taxpayers, keep the most seniors above the poverty line, and do so in a politically feasible way, I created the below table to illustrate the effect of each policy on the each of these criteria.

	Current State	**Alternative 1: Privatization**	**Alternative 2: Means-Testing**	**Alternative 3: Raise Taxable Earnings Cap**
Effect on Number of Seniors Below Poverty Line	N/A	Decrease *(table 1)*	Decrease	Decrease *(Romig)*
Effect on Solvency	N/A	Increase	Decrease *(Baker & Rho)*	Small Increase *(John)*
Effect on Cost to Government	N/A	Increase *(Center for American Progress)*	Increase *(Baker & Rho)*	No Impact, but increased revenue (*"Social Security Administration")*
Political Feasibility	N/A	Medium	Low	Medium

After examining each alternative and their potential effectiveness, I determined that the best option is to raise the maximum taxable earnings cap. Although this option does not entirely prevent insolvency alone, and does increase costs to some of the taxpayers, the costs are relatively concentrated, and depending on how significantly the cap is raised it has the potential to close anywhere from ¼ to ¾ of the insolvency gap (Romig, 2016). In contrast, even a reasonable means-test to Social Security would result in massive increases in costs to the government, and in order to make a significant difference in the long-term budget outlook for Social Security the means-testing would have to be extreme. Furthermore, while privatization does have the potential to all but eliminate government spending, its inherent dependency on the market means that any negative fluctuations would have to result in a costly government bailout.

To move forward with the implementation of this policy proposal, I recommend utilizing the plan proposed by the Rivlin-Domenici deficit reduction commission which would increase the cap gradually over a period of 9 years until eventually 90% of all earnings would be subject to the payroll tax ("Long Range Solvency Provisions", 2017). The progress that this policy change would make towards improving the long-term solvency should then be monitored by the Social Security and Medicare Board of Trustees. While the implementation of such a policy may face some political and logistical challenges, it is abundantly clear that change is needed to make Social Security solvent for future generations.

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