

HOW SOCIAL SECURITY CAN COSTLESSLY OFFSET DECLINES IN PRIVATE PENSION PROTECTION

Here's a well-kept secret: the Social Security Administration today offers one of the best investment options anywhere. This great deal allows individuals to add to the Social Security annuities that they already qualify for at age 62. Since the classic pension plans that used to provide workers with private annuity payments until death are fast disappearing, this option gets more valuable by the day.

This add-on, like the basic Social Security annuity, is as insured as an investment can get, doesn't fluctuate with the stock market or economic downturns, and rises in value along with inflation. The rate of return is decent too.

So where's the rub? This option is buried in Social Security's overlapping and confusing provisions. That's why so few people who could really use this extra protection end up understanding, much less buying, it.

My suggested reform: daylight this hidden concoction of provisions and convert it into an open, understandable, and far more flexible option. Doing so would favor saving and reward work while better preparing elderly people for their very high likelihood of living to age 80 and beyond. And it needn't cost anything.

How? As part of a broader Social Security reform of the retirement age. Instead of confusing notions of early retirement at 62 and normal retirement at 66, surrounded by formal "earnings tests" and "delayed retirement credits," adopt a simpler annuity option. (Stay tuned for some definitions of terms, but keep in mind that the very fact that most people misunderstand how all these provisions interact proves the need for reform.)

Under my plan, the Social Security Administration would simply tell people their benefit at a specific retirement age (either an earliest age or a "normal" age). Then it would show a simple set of penalties or bonuses for withdrawing money or depositing it with Social Security. It could fit on a postcard.

Although not essential, I would sweeten the deal for people who not only delay benefits but also work longer and pay extra taxes. With this additional option, the penalties would be higher and the bonuses greater for workers than nonworkers. For instance, the employee portion of Social Security tax could be credited as buying a higher annuity. These extra bonuses could be financed by making the up-front benefit available at the earliest retirement age a bit lower for higher-income beneficiaries who stop working as soon as possible. This combined strategy backloads benefits more to later years when people are older and frailer, and it encourages work—an approach I have advocated, as does Jed Graham in his recent book, *A Well-Tailored Safety Net*.

The simple, easily understood bonuses would basically be annuities with higher payouts than standard Social Security benefits. They could be purchased whether a worker quit work or not. As people can today, many would purchase these fortified annuities by forgoing all their Social Security checks for a while. But, unlike today, they could also specify how much of their Social Security check they would forgo or send a separate check to Social Security.

How would the poor fare under this new approach? To protect them, let's increase minimum benefits under Social Security so most lower-income households end up with higher lifetime Social Security benefits—regardless of what other reforms may be undertaken. Say, for example, we accept the additional option of lowering the up-front benefit for those who totally stop work as soon as possible in their 60s by 10 percent but bump up a minimum benefit to \$900. Then someone who used to get more than \$1,000 could get less in those early years but has a great option for beefing up the annuity in later years. Someone formerly getting \$1,000 or less would not lose out at all, even in early years of

retirement.

Helpful employers (or 401(k) account managers, financial planners, or banks) could help workers take advantage of this great annuity option. As one example, they could easily map out a range of schedules for drawing down private assets or taking partial Social Security checks for a couple of years in exchange for better old-age protection—higher annual, inflation-adjusted payments—in later years.

Setting up a similar payout trade off today is sometimes possible if you're not easily discouraged, but you wouldn't get much credit for additional taxes. In fact, you can even send back Social Security money received in the past to boost future benefits. (Who knew?)

Too bad most people believe that if they hit age 62 in 2010, the "earnings test" they face is a "tax" up to the age 66 that reduces benefits by 50 cents for every extra dollar they earn between \$14,160 and \$37,680. But that's what they think, and they calculate this "tax," add it to their other tax burdens, and quickly decide that they're better off retiring. Yet, that's not really right. In truth, if they forgo some benefits now, they have just bought an additional annuity, and their future annual Social Security benefits go up permanently by roughly \$67 for every \$1,000 in Social Security benefits they temporarily forgo for one year.

Today, those age 66 to 70 have different options than when they were younger than 66. This only adds to the confusion. They no longer *must* purchase the annuity (face the earnings test) if they work, but they are free to take a delayed retirement credit—this time, \$80 in every future year of retirement for each \$1,000 of Social Security benefit forgone for one year. But they often don't realize that they don't need to start benefits at retirement. By living off other assets awhile, even a month or more, they can convert some of their riskier assets into a higher Social Security annuity asset.

Just to further complicate things, Social Security administrators often tell people to "get your money while the getting is good" when, in fact, it's risky to draw down benefits too soon when one member of a typical couple is likely to live for 25 or 30 years after age 62.

The type of reform I'm proposing could never be timelier. Had more older individuals taken advantage of this simplified option before the stock market crashed, they'd be a lot more secure today. Similarly, folks retiring today with many of their assets tied up in either risky or very low return investments could sleep better if they take this option.

Why wait? Let's redesign and simplify the Social Security super-structure surrounding retirement ages, related earnings tests, and delayed retirement credits. Let's help more retirees build up additional annuity protection in old age, make more transparent the advantages of delaying benefits, reward better those who work longer and pay more taxes, and create simpler and more flexible options for depositing different sums of money to purchase larger annuities in Social Security.

The Government We Deserve is a periodic column on public policy by Eugene Steuerle, an Institute fellow and the Richard B. Fisher Chair at the nonpartisan Urban Institute. Steuerle is also a former deputy assistant secretary of the Treasury. The opinions are those of the author and do not necessarily reflect those of the Urban Institute, its trustees, or its sponsors.

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