The Social Security actuaries have known for decades that the Social Security program faces substantial long-range deficits. But when both the Disability Insurance (DI) and Old Age and Survivors Insurance (OASI) trust funds had surpluses, policymakers failed to make program changes needed to address the long-term problem. Now, as the baby boomers retire, the surpluses are running out: the DI trust fund is expected to run short of funds to pay promised benefits in the fourth quarter of 2016, and a combined OASDI trust fund is expected to run out in 2034 (Board of Trustees 2015). Unless something is done, available revenue will cover only 79 percent of scheduled benefits in 2034, and the share falls over time.

As crisis nears, policymakers are increasingly likely to address Social Security solvency. In fact, several 2016 presidential candidates have released proposals to address this issue.

Social Security can be made solvent by increasing program revenues, decreasing program costs, or a combination of both. Different policy levers affect participants and program costs in different ways, by different amounts, and for different generations. Achieving solvency will require some individuals to lose. Who will the losers be and how much will they lose? How much will come from benefit cuts and how much from tax increases? How much will come from current beneficiaries and how much from future beneficiaries? How much can changes in earnings, labor force participation, or benefit claiming affect solvency? How would changes in immigration, fertility, or mortality affect solvency?
With Social Security reform on policymakers’ agenda, we have an opportunity to go beyond solvency and to modernize the benefit to make it work better for today’s families, improve its work incentives and ensure that it provides adequate resources for those who depend on it.

This brief is designed to help the public and policymakers understand the effects of a range of Social Security and other reforms designed to address the program’s solvency and adequacy. The brief and several accompanying blog posts will help identify who is affected by particular reforms and by how much. They will also quantify how each provision or package of provisions affects Social Security solvency and the federal budget as a whole.

Using the Urban Institute’s Dynamic Simulation of Income (DYNASIM) model, we estimate a range of policy reforms, including changing taxes (particularly the payroll tax rate and taxable maximum), and benefit provisions, including increasing the early and full and retirement ages, adjusting benefit indexing, and altering provisions for Social Security spouse and survivor benefits. The blog posts will highlight the important results, but we also provide detailed distributional tables on the DYNASIM project page.¹

Though DYNASIM can analyze many of the same policy reforms as the Social Security actuaries model,² it can also show distributional effects of policy changes that the actuaries do not produce. DYNASIM starts with a representative sample of over 100,000 people. In addition to national estimates, it can estimate the distributional impact of policy reforms for individuals and families. The model can also estimate important program interactions and the effects of behavioral changes. The Social Security actuaries and DYNASIM model use different methods, and results may differ. All long-term estimates are uncertain and require numerous assumptions. The current DYNASIM projections use the 2014 Trustees intermediate cost demographic and economic assumptions.

Below we outline the estimated impact of some commonly suggested policy reforms for improving Social Security solvency:

- Modest increases in the Social Security full retirement age (FRA) beyond the scheduled increase (currently age 67 for people born in 1960 or later) adds less than one year to solvency. Reducing benefits by increasing the full retirement age to 72 for those born after 1960 does nothing until those affected by the policy begin to retire, which does not happen until 2022 and only for early claimants born after 1960. With the exhaustion of the trust fund expected in 2034, a modest increase in the FRA does too little too late.

- A modest increase in the Social Security early retirement age (ERA) for cohorts born after 1960 (currently age 62) does little to help solvency because the program actuarially adjusts benefits, raising monthly payments for beneficiaries who claim later. Raising the ERA will likely increase labor force participation for those able to work because it prevents them from collecting benefits early, but it also increases poverty for those unable to work or claim benefits. An ERA increase reduces the number of months receiving benefits paid to those who would have claimed at an earlier age, but it increases the amount they receive each month. For individuals who would have claimed benefits after the higher ERA, an increase in the ERA does nothing.
Raising the cap on earnings improves solvency but is not enough to eliminate the funding gap. Only covered earnings up to the wage cap (currently $118,500) are subject to payroll taxes. About 6.5 percent of workers have earnings above the current wage cap. Increasing the cap from $118,000 to $150,000 over three years and then indexing the cap by wage growth plus 0.5 percentage points thereafter extends the trust fund reserve to 2035 (an additional year). The relatively modest impact on short-term reserves reflects the fact that relatively few workers (about 1 percent in 2016 rising to 3.6 percent by 2087) in any year would be affected by the increase and these workers would ultimately collect higher benefits if the higher wage base is included in their benefit formula. Increasing the cap to $180,000 over four years with the same indexing would extend the trust fund reserve to 2036 (an additional two years). Fully eliminating the cap beginning in 2016 would extend trust fund reserves through 2055 (an additional 21 years). Immediate full elimination of the wage cap affects significantly more workers than more modest increases do, and removing the phase-in brings in the revenue sooner. The early revenue gains accrue more interest over time, which helps extend trust fund assets. We assume that employers would reduce earnings by the increase in employer payroll tax to keep total compensation unchanged. An increase in the wage cap reduces federal income tax collections because of the reduced taxable earnings, but raises total government revenues. For those with high earnings, an increase in the tax cap reduces preretirement net incomes but increases postretirement net incomes.

Reducing the cost-of-living adjustment (COLA) beginning in 2016 reduces program cost for long-term recipients but extends trust fund reserves only one year. Initial benefits are indexed to wage growth, so a change in the COLA does not affect the growth rate. A reduction in COLA affects beneficiaries much more when they are old than when they are younger. Compared with current law that ties the COLA to the change in the standard consumer price index (CPI), indexing benefits by the chained-CPI—a slightly smaller price adjustment that may better reflect true price changes—beginning in 2016 would lower per capita net income by 1.4 percent for those age 62 to 69 but by more than 4 percent for those age 85 and older after 2045.

Increasing the payroll tax rate creates long-term solvency. Current payroll tax rates are 12.4 percent, paid half by workers and half by employers. A 1 percentage-point rate increase (to 13.4 percent) phased in over 10 years beginning in 2016 would extend trust fund reserves an additional 5 years. Phased in over the same timeframe, a 2 percentage-point increase (to 14.4 percent) would extend reserves an additional 18 years, and a 3 percentage-point increase (to 15.4 percent) would extend reserves through 2087, the end of our simulation. Payroll tax increases reduce workers’ net incomes without changing future benefits. As with an increase in the wage cap, we assume employers would reduce earnings by the increase in the employer payroll tax to keep total compensation unchanged. Payroll taxes have a sizable impact on solvency because they affect a lot of people and immediately boost trust fund assets that accrue interest over time.
Other than a sizable increase in the payroll tax rate, no single option discussed here can close the funding gap. A combination of reforms, some reducing benefits and some increasing revenue, will likely be adopted. Combination reforms will likely interact, so the final impact on cost and revenue cannot be obtained by simply adding the effect of each option. Our upcoming analyses of presidential candidates’ plans and other reforms will help identify the cost and benefits of specific policy options.

Notes


Reference


About the Author

Karen E. Smith is a senior fellow in the Income and Benefits Policy Center at the Urban Institute, where she is an internationally recognized expert in microsimulation. Over the past 30 years, she has developed microsimulation models for evaluating Social Security, pensions, taxation, wealth and savings, labor supply, charitable giving, health expenditure, student aid, and welfare reform. Smith has played a lead role in the development of the Social Security Administration’s Modeling Income in the Near Term microsimulation model, Urban’s Dynamic Simulation of Income microsimulation model, and the Social Security Administration’s Policy Simulation Model. Her recent work includes estimating the impact of the Great Recession on retirement well-being; analyzing income and asset accumulation patterns of the adult population; analyzing the retirement decision; evaluating the effect of disability on earnings and mortality; and using statistical matching to impute earnings, taxes, and spouse characteristics.

Smith has written extensively on demographic and economic trends, and their implications for the retirement well-being of current and future cohorts. She has contributed chapters to numerous books, including Closing the Deficit: How Much Can Later Retirement Help?: Redefining Retirement: How Will Boomers Fare?: Reshaping Retirement Security: Lessons from the Global Financial Crisis; and Social Security and the Family. She has also published articles in various scholarly journals, including the Social Security Bulletin, National Tax Journal, and Journal of Aging & Social Policy.
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