ISSUE BRIEF

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Three Social Security Fixes to Solve the Real Fiscal Crisis

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A solution to the fiscal cliff should include changes to Social Security. Demands that Social Security should be taken off the table, such as those made by Senator Dick Durbin (D–IL)[1] and several others, are both misguided and wrong.

Although Social Security has a trust fund that will last for just over 20 years, it is already running massive cash-flow deficits that will last for at least the next 75 years. Repaying its trust fund bonds will take increasing amounts of general revenue taxes that will either squeeze other spending out or cause even higher deficits. And after the bonds run out, the program faces automatic 25 percent benefit cuts for every recipient.

As a solution is found to the fiscal cliff, policymakers should include the first steps toward fixing Social Security.

This paper, in its entirety, can be found at
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Social Security's Grim Financial Picture. According to the Social Security Administration, Social Security has been running deficits since 2010 and owes $11.3 trillion[2] more in benefits over the next 75 years than it will receive in payroll taxes. In order to pay all of its promised benefits, Social Security will require massive annual injections of funding in addition to what the program receives from payroll taxes.

Social Security's trust fund gives it the legal authority to receive general tax money to pay its benefits until about 2032. However, general revenue funds used to pay Social Security benefits would not be available to pay for anything else. That is why Social Security is part of the spending debate. And after 2032, Social Security benefits would be cut by about 25 percent.

There are three simple changes, two of which have wide bipartisan support, that should be included in any settlement.

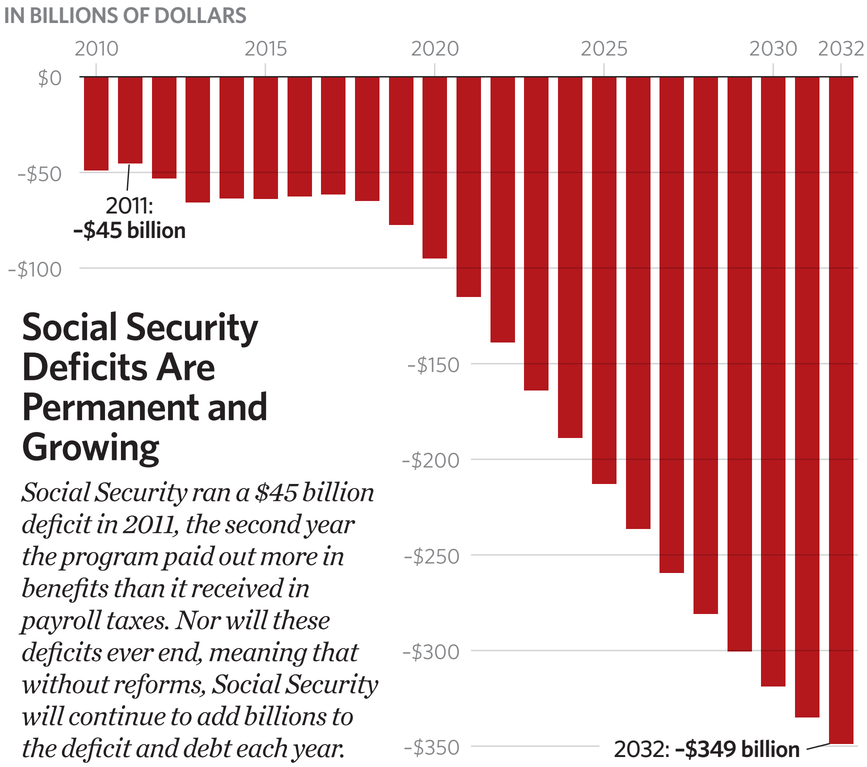
1. Fix the Annual Inflation Adjustment. Social Security's annual cost-of-living adjustment (COLA) protects retirees against inflation reducing the purchasing power of their monthly benefits. Thus, the index used to set the annual COLA should provide the most accurate estimate of inflation. However, Social Security does not use the best available inflation index.

The current index fails 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 gasoline goes up, while overall food prices drop, today's inflation index assumes 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, which has been available since 1999 and measures inflation for about 87 percent of the workforce. This more accurate measure shows that inflation is actually about 0.3 percentage points per year less than is shown by the index that Social Security uses.

Using this index instead of the current outdated index would better reflect the actual increases in inflation that affect seniors. It would result in real savings to Social Security, especially over time, while still protecting the value of seniors' monthly benefits from being eroded

CHART 1



Social Security Deficits Are Permanent and Growing

Social Security ran a $45 billion deficit in 2011, the second year the program paid out more in benefits than it received in payroll taxes. Nor will these deficits ever end, meaning that without reforms, Social Security will continue to add billions to the deficit and debt each year.

Note: Figures for 2012 and after are estimates in 2012 dollars.

Source: Social Security Administration (OASI and DI Trust Fund Data and 2012 trustees report).

IB 3807 heritage.org

by inflation. This more accurate measure would also reduce the cost of that protection to taxpayers.

Both the problem and its simple solution have been understood for decades. The improved index can be implemented quickly and without complication.

2. Increase the Full Retirement Age. On average, Americans are living longer than in the past. Some of this improvement is due to conquering childhood diseases and other causes of early death. For this reason, when discussing Social Security, the number that really matters is how much longer people who have reached age 65 will live. That statistic is a better estimate of how long they will collect benefits.

Facts from a number of government agencies all show that more people reach age 65, and once they do, they live longer now than they did in the past.[3] For example, 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.[4]

Yet today's Social Security—even after the coming increase in the full retirement age to 67—has not kept pace with longevity increases that have already happened. To reflect this reality, the full benefits age should be increased still further to age 68 or beyond and then indexed to future changes in longevity.[5] A gradual implementation should cause little or no disruption to the retirement plans of current workers while providing significant long-term savings.

3. Focus Benefits on Those Who Most Need Them. Changing benefit levels for higher earners is not a radical idea. One of Social Security's original purposes was to protect seniors from poverty and

1. Ryan Grim, "Dick Durbin: Social Security Should Be off the Fiscal Cliff Table [UPDATE]," The Huffington Post, November 27, 2012, http://www.huffingtonpost.com/2012/11/27/dick-durbin-social-security-fiscal-cliff_n_2199224.html (accessed December 18, 2012).
2. Congress would have to invest $11.3 trillion today in order to have enough money to pay all of Social Security's promised benefits through 2086. This money would be *in addition* to what Social Security receives during those years from its payroll taxes.
3. Various ethnic and racial groups have slight differences in longevity. 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 African American and three years longer than that of a non-Hispanic Caucasian. For all groups, women tend to live several years longer than men.
4. During those six years, longevity at age 65 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.
5. For a full discussion of changing the retirement age, including a discussion of how those who are physically unable to continue to work would be able to receive disability benefits, see David C. John, "Time to Raise Social Security's Retirement Age," Heritage Foundation *Backgrounder* No. 2492, November 22, 2010, http://www.heritage.org/research/reports/2010/11/time-to-raise-social-securitys-retirement-age.

economic hardship. Changing benefit structure would be a step toward returning to that goal.

Today, Social Security's benefit formula pays a higher monthly retirement benefit to lower-income workers compared to their average lifetime income than it does to those who had higher incomes. But the simple fact is that the money is not there to pay full benefits even as they are income adjusted today. To do so would require ever increasing taxes on younger generations.

Social Security could further focus benefits on lower-income workers by paying still lower benefits to those with high levels of non–Social Security retirement income. An even further step would be to completely eliminate benefits for those with the highest amounts of non–Social Security income.

One way to accomplish this goal is found in The Heritage Foundation's plan *Saving the American Dream*.[6] The Heritage plan makes Social Security an insurance program that would protect every American against retirement poverty. It focuses exclusively on a retiree's non–Social Security retirement income and both reduces benefits for those with incomes above a certain level and eliminates them for retirees with still higher incomes. As a true insurance plan, if a retiree's circumstances changed and his or her retirement income dropped, Social Security would quickly re-start the person's benefits.

Upper-income workers are more likely to work at companies that offer them either traditional pensions or retirement savings plans. They are also much more likely to have extra income to put away for retirement.

This change would strengthen the Social Security program's finances markedly while avoiding the large and continuous tax increases on younger generations who need to build their own savings. It would also pave the way for other substantive reforms to Social Security and retirement savings.

Improving Social Security to Meet Tomorrow's Needs. It is time to focus on the real cause of America's fiscal problems. These three improvements would help make Social Security more affordable, reduce today's cash-flow deficits, and start the process of heading off 2033's automatic 25 percent benefit cuts. However, these reforms are just a start. Actually fixing the program will require still more reforms.

Once the immediate fiscal cliff debate ends, the nation should ask how Social Security can be structured to better meet Americans' needs in the decades to come. That discussion should lead to more fundamental reforms, among which should be ensuring that every American is protected from retirement poverty. Making the changes proposed above as part of the current budget debate is a good way to start that conversation.

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6. Stuart M. Butler, Alison Acosta Fraser, and William W. Beach, eds., *Saving the American Dream: The Heritage Plan to Fix the Debt, Cut Spending, and Restore Prosperity*, The Heritage Foundation, 2011, pp. 5–7, http://savingthedream.org/about-the-plan/plan-details/.