



Fixing Social Security

Summary of Findings and Recommendations



Social Security reform is currently high on the national agenda. The future of this venerable program is the subject of much debate in Congress and across the country. CED examined this issue in the 1997 policy statement, *Fixing Social Security*, which presented findings of the challenges posed to Social Security by an aging population and issued recommendations for strengthening and modernizing the program. CED's proposal is just as relevant today as when it was first developed.

FINDINGS

Social Security is one of the most successful social programs in U.S. history. But in order to continue to fulfill its vital purpose in providing retirement security to retirees and survivors, reforms must be enacted to sustain the long-term stability of the program in the face of demographic and fiscal concerns, and to make it more appealing to a new generation of workers who are skeptical of its relevance to them.

As the baby-boom generation retires, beginning within this decade, Social Security will disburse more in benefits to recipients than it will collect through payroll tax revenues from current workers. Absent systemic reform, a sizeable and inequitable tax increase on future workers or a deep and disruptive reduction of benefits will be required to prevent depletion of the Social Security Trust Fund by 2052 (the year the Congressional Budget Office projects the Trust Fund will be exhausted). It is imperative that reform be initiated now to ameliorate the effects of restructuring the system and to provide sufficient time for workers to make appropriate adjustments in their retirement planning. The cost of restoring fiscal balance rises substantially

each year that action is postponed. Furthermore, reform of the major entitlement programs (Social Security, Medicare, and Medicaid) is critical to addressing the long-term federal budget deficit, which threatens economic growth and stability. Social Security reform must complement efforts to rationalize the federal budget, not contribute to an already dire fiscal situation through unwarranted borrowing to finance politically expedient, but economically flawed strategies.

Reform of Social Security must balance preserving the income redistribution elements of the program with improving the rate of return on contributions. This is indispensable so that Social Security will maintain its safety-net function for low-income workers and their families who require a minimum retirement income, and so that it will also be supported by younger workers who are wary that Social Security will be of any service to them when they need it. Such an approach will also promote intergenerational equity in the program.

RECOMMENDATIONS

CED proposes creating a two-tier system that would both restore the fiscal solvency of Social Security, and convince young contributors who perceive a low and diminishing return on their contributions that Social Security will provide a meaningful benefit to them. The first tier would return the current basic system to long-term fiscal solvency through relatively modest adjustments. The second tier would "add-on" a new system of individually controlled personal retirement accounts to increase the rate of return for younger workers.

First Tier – Restore the basic system to long-term fiscal solvency

Reasonably moderate changes, undertaken now and phased in gradually, will restore long-term fiscal solvency to the basic Social Security system without placing an acute burden on future retirees. Retaining the basic system and its core safety net must be paramount goals in Social Security reform.

The first priority in buttressing the basic system should be to reduce the growth of the initial benefit, the primary insurance amount (PIA). CED recommends gradually reducing replacement rates for the two-higher wage brackets. This would shrink the growth of future benefits for middle- and upper-income participants without reducing monthly benefits for low-income individuals. In addition, **the number of years of employment included in the calculation of the PIA should be raised from 35 to 40.** This change will also reduce the growth of benefits by included years of low-wage or no employment in the calculation of benefits. These modifications alone will contribute substantially to improving Social Security’s financial outlook. The fact that Americans are living much longer than they did when Social Security was first created must also be addressed. In order to adapt to the large increase in life expectancies, **CED recommends gradually raising the normal retirement age to 70 and indexing future increases in the retirement age to changes in average life expectancy.**

Another key adjustment is to require that **Social Security benefits in excess of the contributions made by the worker should be subject to the income tax.**

CED also recommends that **benefits for non-working spouses be steadily reduced to 33 percent of the working partner’s PIA,** which will improve equity in benefits between working and non-working spouses. Finally, **all new state and local employees should be required to participate in the Social Security system,** and current employees should be permitted to join on a voluntary basis. Expanding coverage of the program will also widen the burden of redistribution. Making these adjustments will more than restore the basic Social Security system to permanent fiscal balance.

Second Tier – “Add-on” personal retirement accounts

CED recommends that, in addition to the basic program, a system of personal retirement accounts (PRAs) be created through requiring payroll contributions from workers and their employers. Personal accounts would be funded by a mandatory contribution of 3 percent of payroll, divided equally between employers and employees. Accounts would be held and controlled by the individual, and invested in a limited number of broad-based funds.

CED believes that adding personal accounts to the basic system is necessary to maintain the significance of the program to younger workers who are less risk-averse and more comfortable with investing in the stock market. At the same time, we recognize that personal accounts themselves cannot restore solvency to Social Security.

CED rejected a “carve-out” approach to personal accounts because it would deplete the resources needed to maintain Social Security’s foundation for retirement security, and thus would undermine the fundamental character of the program. Furthermore, the transition costs of a carve-out program would significantly degrade the already bleak federal budget picture. CED’s approach would boost the national savings rate, while a carve-out approach would not.

CED also rejected government ownership and control of assets invested in private financial instruments because such a policy would present the opportunity for government interference in private investment decisions; potentially undermine the independence of businesses

with a government stake in them; and take retirement investment decisions out of the hands of individuals.

Policymakers must realize that there is no painless alternative to preserving Social Security. But if responsible reform is initiated now, we can uphold the essential character of the program while also updating it to ensure its continued importance against the tide of demographic and economic forces.

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