

# A centrist solution to social security's problems

By

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# The objectives of social security reform

- Strengthen financial sustainability of our old age security system
- Increase labor and labor productivity, therefore real goods and services backing financial claims
  - Otherwise per capital consumption falls as share of inactive population rises
  - Saving and work incentives crucial, not incidental
- Distribute the benefits and pains equitably (in light of increased polarization of income)
- Try to build in automatic stabilizers

# Context for reform

- Our current mandatory contributions and replacement rates are among lowest in world
- We have the richest elderly but also the highest old age poverty rates within OECD
- Employer-sponsored plans cover upper half, unreliable access and participation for bottom half
- Net wages for bottom 2/3 of workers are likely to stagnate over next 3-4 decades
  - Health insurance takes increasing share of gross wage
  - Absorption of a billion Chinese and Indians into global market raises L/K ratio (gainers will be top 20%)
- Important not to increase public debt--costs us future interest payments and make us vulnerable to foreign economic and political decisions

# Key question & my answer

- Key question is: do we want to maintain scheduled benefits or scheduled taxes? Scheduled benefits will require more revenues, with or without IA's.
- My view—ratio of average pension/average wage is already modest and should be maintained
- So extra money needed and more efficient if in IA
  - diversifies income sources in old age
  - less likely to be regarded as tax
  - adds to saving, productive investment
  - if goes into trust fund, danger that it will increase treasury borrowing if invested in government bonds, political manipulation if invested in stock market
  - this is key assumption on which people will disagree
- New social security benefit comes from Part A (traditional) and Part B (IA)

# How to achieve solvency for traditional benefit (Part A):

- Link retirement age to longevity increases to hold expected # of retirement years constant
  - equivalent to cutting benefits, but sends different signal
  - increase # years averaged to 40, gradually
  - increase actuarial adjustments for early/late retirement
- Slow down benefit growth for workers above median (gradually cut 3<sup>rd</sup> factor to 10%)
- Stabilize % of total wage bill taxed at 90%
- Re-evaluate spousal and survivors' benefit
  - cap spousal benefit at 50% average benefit?
  - reduce husband's benefit to finance survivors benefit?
  - allow widows to keep own benefit+survivors benefit?
- Add minimum benefit for low earners
- This has not been scored by SSA

# Part B: Mandatory add-on contribution (about 1.5%) to IA

- With match from payroll tax targeted toward low earners for whom add-on is more binding (e.g. 1.5% with max of \$300)—no offset
- In long run: for low earners IA would provide about 30% of total ss benefit, for high earners 50%
- Financing gap covered by small estate tax or surtax on wages above taxable ceiling
- IA income allows workers to offset rise in retirement age or benefit adjustments needed to achieve solvency in traditional system

# Why this plan is better than:

- Putting more money into trust fund—smaller tax element, avoids non-transparent increase in government borrowing, diversifies income sources
- Having a larger carve-out—avoids borrowing to cover transition financing gap
- Larger benefit cuts, no new revenues—leads to overly low average pension/average wage
- Voluntary add-on—we have that now
- This plan makes social security solvent, maintains scheduled benefits, builds in work incentives, increases saving and contains built-in stabilizers
- This plan could be bi-partisan, if the parties wanted a bi-partisan solution