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BACKGROUNDER

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A Social Security Primer for the New Administration: Reform Needed *Now*

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Abstract

Social Security is an outdated, poorly targeted, and ineffectively budgeted federal benefit program that, absent serious reform, is heading toward financial insolvency. Social Security's main program, the Old-Age and Survivors Insurance, ran a $39 billion deficit in 2015, closing out six years of consecutive cash-flow deficits. Social Security revenues from the payroll tax and the taxation of benefits are increasingly falling short of benefit payments. Social Security's legal ability to pay full benefits in light of current cash deficits lies with its Trust Fund, which presents an accounting mechanism devoid of actual reserves. Absent reform, Social Security's Trust Fund will be depleted by 2035, at which point benefits would be automatically cut, across the board, by 23 percent. Immediately and increasingly, Social Security's cash-flow deficits are straining federal finances. Congress and the President should act to protect Social Security's most vulnerable beneficiaries from such drastic cuts, without burdening younger generations with massive tax increases or unsustainable debt. Economic growth cannot save Social Security. Lawmakers should raise the eligibility ages gradually and predictably; do a better job of targeting Social Security benefits toward those who need government assistance in retirement the most; phase in a predictable, flat benefit; and encourage more Americans to provide for more of their retirement security through private means.

Key Points

- If no action is taken to improve Social Security's solvency, benefits will be cut across the board by 23 percent in 2035. Congress can avoid indiscriminate benefit cuts, which would harm the poorest beneficiaries the most, through commonsense reforms that modernize Social Security.
- Social Security's cost-of-living adjustment is based on an outdated measure of changes in the cost of living that fails to account for how people react to changes in prices.
- Lawmakers should increase eligibility ages gradually and predictably, and index them to increases in life expectancy.
- Social Security benefits should be targeted to those who really need help. Keeping the program as it is now unfairly places an excessive tax and debt burden on working Americans and younger generations.
- The proposed Social Security Reform Act of 2016 presents a reasonable, targeted, and fiscally responsible approach to reform Social Security.

The Social Security Trustees project the Old-Age and Survivors Insurance (OASI) program to be exhausted by 2035. This means that the program is expected to have only enough revenue from payroll taxes, interest on the Trust Fund balance, and repayment of borrowed Trust Fund dollars to pay out scheduled benefits until

This paper, in its entirety, can be found at **http://report.heritage.org/bg3186**

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2035. If no action is taken to improve Social Security's finances before its Trust Fund runs dry, benefits will either be delayed or reduced across the board by 23 percent.

Already, Social Security cash-flow deficits are straining federal finances, as the program's Trust Fund merely serves as an accounting mechanism and is devoid of actual reserves. Social Security is effectively financed on a pay-as-you-go basis, with current payroll taxes and additional federal borrowing covering current benefit payments.

Beyond financing issues, Social Security's benefits are poorly targeted, paying the largest benefits to recipients who need them least. The benefit formula is so complex that most Americans have little idea of what they can expect from the program, making it difficult for them to properly plan for retirement. Several program features further encourage early retirement and reduced labor force participation among Social Security beneficiaries. These harm the economy and beneficiaries alike.

Congress and the President can modernize the outdated Social Security program and ensure financial solvency without burdening younger generations with excessive taxes or debt. Better targeting Social Security benefits to those who need federal assistance in retirement will free up resources for individuals to provide for more of their own retirement needs through private means. The Social Security Reform Act of 2016, introduced by Representative Sam Johnson (R–TX), the chair of the House Ways and Means Subcommittee on Social Security, offers viable proposals to begin the Social Security reform process.[1]

Insolvency Looming

Social Security's main program,[2] OASI, ran a $39 billion deficit in 2015, closing out six years of consecutive cash-flow deficits as the program's unfunded obligations continue to grow.[3] According to the 2016 annual Trustees' Report, the 75-year unfunded obligation of the Social Security OASI Trust Fund is $10.25 trillion, an $82 billion increase from last year's unfunded obligation of $9.43 trillion.[4] After including federal debt obligations, recorded as assets to the Social Security Trust Fund of $2.78 trillion, Social Security's total 75-year unfunded obligation exceeds $13 trillion.

Social Security may be in an even worse financial state than the Social Security Trustees reported. The Congressional Budget Office (CBO) projects the OASI program will reach insolvency in 2030, five years before the Trustees' reported insolvency date.[5]

The two agencies' projections differ because the Trustees and CBO make different demographic and economic assumptions about the future. The CBO's assumptions exacerbate the demographic challenges Social Security faces by projecting a larger elderly, retired population than the Trustees' assumptions do. The CBO projects a 1.9 fertility rate, which is slightly lower than the Trustees' projected 2.0 fertility rate. The CBO also predicts a faster decline in mortality rates than the Trustees'. The Trustees predict a 138 percent increase in the number of people 65 or older, compared to the CBO's prediction of a 156 percent increase.[6] Additionally, the Trustees' projections rely on more optimistic economic assumptions, including higher gross domestic product (GDP) growth and labor force participation rates.[7]

1. Romina Boccia, "New Social Security Reform Bill Moves in the Right Direction," The Daily Signal, December 15, 2016, http://dailysignal.com/2016/12/15/new-social-security-reform-bill-moves-in-the-right-direction/.
2. Social Security consists of two programs: Old-Age and Survivors Insurance and Disability Insurance. This *Backgrounder* discusses only OASI. For more information about the disability program, see Rachel Greszler, "Disability Insurance Fails Short-Term Solvency Test Even After Transfer from Social Security," Heritage Foundation *Backgrounder* No. 3147, October 4, 2016, http://www.heritage.org/research/reports/2016/10/disability-insurance-fails-short-term-solvency-test-even-after-transfer-from-social-security.
3. U.S. Social Security Administration, *The 2016 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, June 22, 2016, https://www.ssa.gov/oact/tr/2016/tr2016.pdf (accessed October 18, 2016).
4. Ibid.
5. Congressional Budget Office, *The 2016 Long-Term Budget Outlook*, July 2016, https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/51580-LTBO-One-Col-2.pdf (accessed October 18, 2016).
6. Congressional Budget Office, "Comparing CBO's Long-Term Projections with Those of the Social Security Trustees," September 21, 2016, https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/51988-SocialSecurityTestimony_0.pdf (accessed October 18, 2016).
7. Ibid.

Despite the Trustees' and CBO's different assumptions, both agencies agree that Social Security suffers from serious financial shortfalls. Both projections predict insolvency within the next two decades. There is no denying that Social Security is heading toward financial insolvency, and that Congress must act soon, so that reforms can be implemented gradually.

Social Security Is *Already* Adding to the Deficit

While Social Security's OASI program is considered to be solvent on paper through 2035, Social Security's cash-flow deficit is already adding to the federal budget deficit.

Since 2010, the OASI program has taken in less money from payroll tax revenues and the taxation of benefits than it pays out in benefits—generating cash-flow deficits. The 2015 cash-flow deficit was $39 billion. Over the next 10 years, OASI's cumulative cash-flow deficit will amount to more than a trillion dollars, according to the Trustees' intermediate assumptions. As long as the federal government is running deficits in excess of Social Security's cash-flow deficits, this trillion-dollar shortfall will be matched dollar for dollar by an increase in the public debt. The public debt already exceeds $14 trillion—75 percent of GDP.[8] Social Security's cash-flow deficits are adding to it every year.

Social Security's cash-flow deficits add to the public debt because in order to pay full Social Security benefits, the Treasury Department has to raise cash in excess of what it receives from the payroll tax and the taxation of benefits. Cash-flow deficits mean that the Treasury can no longer pay all Social Security benefits from the program's tax income alone. Instead, Treasury must produce additional cash from taxes or borrowing. On paper, it looks like the Social Security Trust Fund is still growing and soon its balance will simply be depleting. But since there is no actual money in the fund and with annual federal deficits in excess of Social Security's cash-flow deficit, the OASI program is already adding to the unified budget deficit.

What About the Trust Fund?

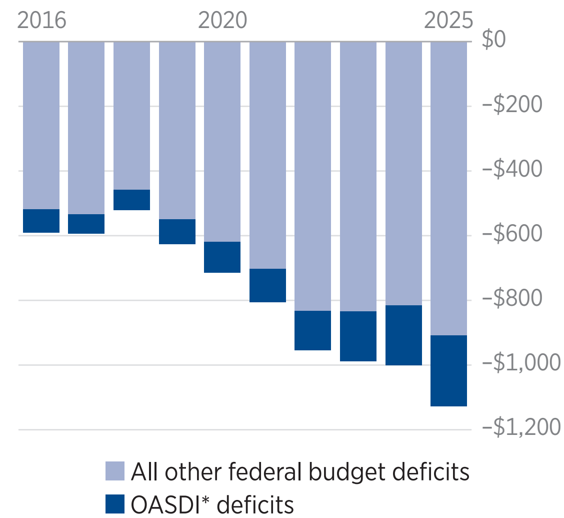
The idea behind Social Security's Trust Fund was to budget for the program's long-term expenses by pre-funding a portion of benefits and achieving actuarial balance over a specific period of 75 years. However, the technical details of how the federal government operates its trust funds mean that Trust Fund assets do not represent real savings dedicated for the programs they are supposed to fund.

Instead, when Social Security historically ran cash-flow surpluses, the federal government spent those surpluses on other federal spending; in return, the Treasury Department credited Social Security's Trust Fund with special-issue government securities. Although this $2.78 trillion in securities is not counted in the total amount of debt held by the public, it represents real debt that will

CHART 1

Social Security's Deficits

PROJECTED FEDERAL DEFICITS, IN BILLIONS OF DOLLARS



* Old Age, Survivor And Disability Insurance

SOURCE: Congressional Budget Office, "An Update to the Budget and Economic Outlook: 2016 to 2026," August 23, 2016, https://www.cbo.gov/publication/51908 (accessed January 4, 2016). Social Security Administration, *2015 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, July 22, 2015, https://www.ssa.gov/OACT/TR/2015/tr2015.pdf (accessed January 4, 2016).

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8. Congressional Budget Office, "An Update to the Budget and Economic Outlook: 2016 to 2026," August 23, 2016, https://www.cbo.gov/publication/51908 (accessed on December 19, 2016).

have to be repaid over the coming decades, unless Congress changes current law.[9]

Because Social Security surpluses were accounted for in the unified budget, they decreased the apparent size of federal deficits at that time. Every dollar of surplus payroll tax revenue dedicated to Social Security was used to offset a dollar of federal deficits. This created the illusion of more flexibility in federal finances and led to a greater willingness to increase deficits for current spending with little concern for long-term entitlement obligations. According to Jacob Reses, writing in *National Affairs*: "The budgetary gymnastics and resulting budget-solvency fictions enabled by our system of trust-fund accounting have done more than merely obscure the coming budget crisis. A closer inspection suggests that those fictions have in some measure created the crisis."[10]

Multiple economic studies confirm that Social Security surpluses have historically not been used to reduce the public debt, but rather to *increase* non–Social Security government spending.[11] Some estimates show that the increase has been dollar for dollar, meaning that Social Security's Trust Fund surpluses have contributed to more than $1 trillion in additional non–Social Security government spending.[12]

The Social Security Trust Fund represents legitimate repayments plus interest, but this distinction has no bearing on the federal budget's bottom line. Congress spent all the excess revenues when Social Security was running surpluses, and now repaying those revenues and interest on them is adding to deficits. As Chart 1 shows, shortfalls in Social Security's programs represent a considerable portion of current and future deficits. Increasingly, Trust Fund "assets" are being converted into public debt as benefit payments come due.

Congress may change current law at any time, including by eliminating the Social Security Trust Fund. Most workers perceive their Social Security benefits as an earned right, and indeed, workers do pay a significant portion of their paychecks to Social Security. However, payroll taxes to Social Security's Trust Fund do not provide any form of property right. Congress affirmed its authority to modify Social Security's taxes and benefits in the 1960 Supreme Court decision *Flemming v. Nestor*, wherein the Court held that individuals do not have a "property right" to their Social Security benefits, regardless of how many years they paid payroll taxes.[13]

Since the Trust Fund is merely an accounting mechanism with no real savings to pay Social Security benefits coming due, there would be little harm in eliminating the Trust Fund altogether. U.S. taxpayers are effectively financing Social Security benefits on a pay-as-you-go basis already, as general tax revenues cover the shortfalls between incoming Social Security revenues and outgoing benefits. The absence of this illusory Trust Fund would more likely clear the path for reasonable Social Security reforms. It would enable the nation to recognize the very real and increasing burden on younger generations from unfunded Social Security benefits. It would also reveal the folly of proposals that would create Social Security surpluses in the short run while increasing liabilities over the long run. The Trust Fund creates the on-paper savings while fueling the growth in other areas of government.

Harmful Payroll Tax Increases

The CBO analyzed how large of a payroll tax increase would be necessary, absent benefit reforms, to ensure Social Security's on-paper solvency for the next 75 years. The CBO determined that the payroll tax would have to be permanently increased imme-

9. David C. John, "Misleading the Public: How the Social Security Trust Fund Really Works," Heritage Foundation *Executive Memorandum* No. 940, September 2, 2004, http://www.heritage.org/research/reports/2004/09/misleading-the-public-how-the-social-security-trust-fund-really-works.
10. Jacob Reses, "Trust-Fund Budgeting," *National Affairs*, No. 27 (Spring 2016), http://www.nationalaffairs.com/publications/detail/trust-fund-budgeting (accessed on December 27, 2016).
11. Kent Smetters, "Is the Social Security Trust Fund Worth Anything?" National Bureau of Economic Research *Working Paper* No. W9845, July 2003, http://www.nber.org/papers/w9845 (accessed July 2, 2013).
12. John B. Shoven and Sita Nataraj, "Has the Unified Budget Undermined the Federal Government Trust Funds?" National Bureau of Economic Research *Working Paper* No. 10953, December 2004, http://www.nber.org/papers/w10953 (accessed July 2, 2013).
13. Emily M. Lanza and Thomas Nicola, "Social Security Reform: Legal Analysis of Social Security Benefit Entitlement Issues," Congressional Research Service, September 17, 2014, https://www.fas.org/sgp/crs/misc/RL32822.pdf (accessed July 13, 2014).

diately, from 12.4 percent to 17.1 percent—more than a one-third increase—to ensure the solvency of Social Security's combined Trust Funds (OASI and Disability Insurance).[14]

This substantial tax increase would do the most harm to those whom Social Security is intended to benefit in the first place. Under the 17.1 percent rate, someone earning $50,000 would pay an additional $2,350 per year in payroll taxes (half paid by his or her employer, unless the person is self-employed). This increase would put significant strain on middle-income and lower-income earners and would exacerbate the payroll tax's disincentives to work.[15] The tax increase would also disproportionately fall on younger Americans. While lifetime payroll taxes would increase by 6 percent to 9 percent for those born in the 1960s, the new rate would amount to a 27 percent lifetime increase in payroll taxes for Americans born after 2000.[16] Moreover, a payroll tax increase would leave workers with even fewer resources to spend or save in accordance with their own needs and desires.

Another proposal suggests raising or eliminating the payroll tax cap. Social Security payroll taxes apply to the first $127,200 in wage earnings in 2017. The payroll tax cap exists because Social Security was meant to provide a modest retirement benefit to workers. Since benefits are tied to earnings, the cap prevents Social Security from paying unnecessarily high benefits, and it prevents workers from paying unnecessarily high taxes.

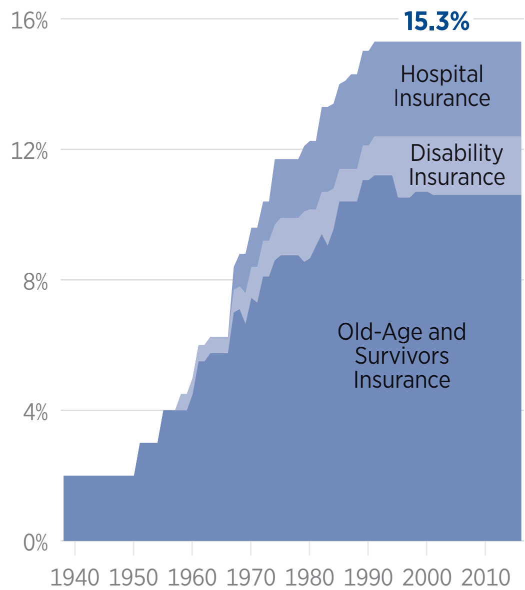
Raising, or eliminating, the payroll tax cap would not solve Social Security's financial shortfalls. It would impose economically damaging marginal tax rates on middle-income and upper-income earners, which would reduce incomes and overall economic growth while generating less revenue than projected under a static model (once accounting for behavioral changes) and enabling Congress to spend temporary surpluses in other budget areas.

Had Congress eliminated the cap in 2016, workers earning $150,000 would have experienced a 27 percent payroll tax increase, amounting to an extra $3,906 on their tax bills. A single-earner family with $250,000 income would pay $16,306 more in payroll taxes—more than doubling their current payroll tax burden.[17] This tax hike would be in addition to income taxes, which already disproportionately tax high-income earners. When combined with federal and state income taxes, some taxpayers would face marginal tax rates in excess of 70 percent.[18]

CHART 2

Payroll Taxes: Already High

PAYROLL TAX RATES



SOURCE: Social Security Administration, "Social Security and Medicare Tax Rates, 1937-2015," https://www.ssa.gov/oact/progdata/taxRates.html (accessed January 4, 2017). "Social Security Administration, Social Security Rates, 1937-2015", https://www.ssa.gov/oact/progdata/oasdiRates.html (accessed January 4, 2017)

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14. Congressional Budget Office, *The 2016 Long-Term Budget Outlook*.
15. James C. Capretta and Yuval Levin, "The GOP's Payroll Tax Opportunity," American Enterprise Institute, December 3, 2012, http://www.aei.org/article/politics-and-public-opinion/the-gops-payroll-tax-opportunity/ (accessed July 13, 2015).
16. Congressional Budget Office, "Answers to Questions from Senator Hatch About Various Options for Payroll Taxes and Social Security," July 11, 2014, https://www.cbo.gov/publication/45519 (accessed on January 6, 2017).
17. Ibid.
18. Rachel Greszler, "Raising the Social Security Payroll Tax Cap: Solving Nothing, Harming Much," Heritage Foundation *Backgrounder* No. 2923, August 1, 2014, http://www.heritage.org/research/reports/2014/08/raising-the-social-security-payroll-tax-cap-solving-nothing-harming-much.

Moreover, raising the payroll tax cap would generate surpluses in the early years of adoption, which Congress would immediately spend, thus generating largely on-paper savings without markedly improving future deficits. In the absence of federal accounting changes that prevent Trust Fund assets from being spent on other government programs, options that create temporary Social Security surpluses are likely to do more to increase non–Social Security government spending than to reduce unified budget deficits and to strengthen Social Security.

Demographic Challenges

Demographic changes directly affect Social Security's solvency. When Social Security first began, it paid out benefits to retirees who had not worked long enough to earn the benefits they received. Thus, Social Security is a pay-as-you-go system that relies on current workers' payroll taxes to fund current retirees' benefits. The number of workers to retirees is a critical ratio in financing Social Security benefits. This ratio is referred to as the worker-to-beneficiary ratio.

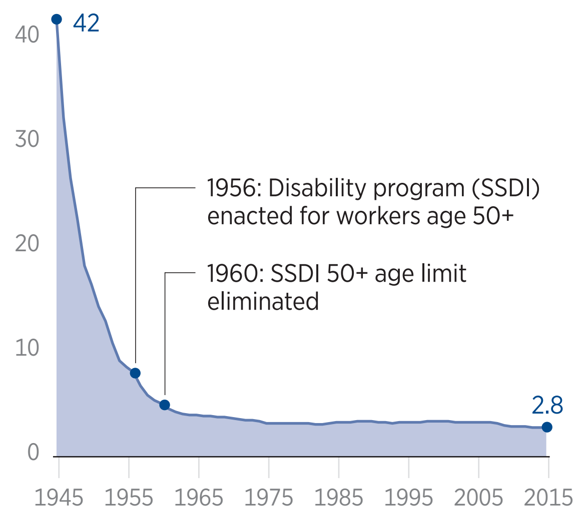
Over the past few decades, the worker-to-beneficiary ratio has dropped drastically from 42 workers for every one beneficiary in 1945, to 5.1 in 1960, to 3.4 in 2000, to 2.8 in 2015. Projections forecast that the worker-to-beneficiary ratio will continue to decline to 2.3 by 2030.[19] This ratio has been declining rapidly due to the aging and retirement of the baby boomers, and the decline in births following the baby boom.

The baby boomers, America's largest generation, totals 76 million people born between 1946 and 1964. The oldest baby boomers reached the early retirement age in 2008 and will continue to retire till 2030. To put their impact on Social Security in prospective: Every day until 2030, roughly 10,000 baby boomers will turn 65.[20] The aging of the baby boomers will transform the country's demographics. According to the CBO, the number of people 65 and older will increase by 75 percent between now and 2046, at which point the population 65 and older will make up one-fifth of the overall U.S. population.[21]

CHART 3

Social Security Recipient-to-Worker Ratio

COVERED WORKERS PER OASDI* BENEFICIARY



* Old Age, Survivor And Disability Insurance

SOURCE: Social Security Administration, *2016 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, "Table IV.B3.- Covered Workers and Beneficiaries, Calendar Years 1945–2090," https://www.ssa.gov/oact/tr/2016/lr4b3.html (accessed January 4, 2017).

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Complex Benefit Structure Few Americans Understand

The Social Security benefit structure is so complex that few Americans understand the rules and details that govern their monthly Social Security benefits. Social Security benefits are based on earnings averaged over most of a worker's lifetime, indexed to wage growth, and run through a progressive benefit formula.

Surveys have revealed that most people have very little knowledge about their Social Security benefits.

19. U.S. Social Security Administration, *The 2016 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*.
20. D'Vera Cohn and Paul Taylor, "Baby Boomers Approach 65—Glumly," Pew Research Center, December 20, 2010, http://www.pewsocialtrends.org/2010/12/20/baby-boomers-approach-65-glumly/ (accessed October 19, 2016).
21. Congressional Budget Office, "Comparing CBO's Long-Term Projections with Those of the Social Security Trustees," September 21, 2016, https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/51988-SocialSecurityTestimony_0.pdf (accessed October 18, 2016).

Less than a quarter of respondents in a Financial Literacy Center survey knew how their Social Security benefits were calculated.[22] More than a third—36 percent—of people did not know that Social Security benefits are adjusted based on "claiming age"—the age between the early retirement age of 62 and the late retirement age of 70, during which beneficiaries first apply for their benefits.[23] Americans also lack knowledge regarding spousal benefits. Fewer than half—48 percent—of people knew that they could collect benefits based on a living spouse's earnings.[24]

Social Security is supposed to be a stable and predictable source of retirement income. Instead, Americans do not know what to expect from the program, which makes it harder for them to plan for retirement.

Other program rules discourage work among older Americans. The retirement earnings test, which applies to individuals who draw Social Security benefits between the early and full retirement ages, is confusing to many people. It acts as a 50 percent tax on earnings above a certain low limit. Although future benefits are adjusted upwards to compensate for the taxed benefits, few people recognize that the tax is actuarially fair, so they work less to avoid the earning test tax.[25] Moreover, Social Security's benefit and tax structure discourages individuals from working beyond their normal retirement age because these workers have to continue to pay Social Security payroll taxes even though they rarely receive a larger base benefit as a result of their additional years of work and taxes. Finally, because Social Security taxes a portion of high earners' benefits, it discourages earnings and large-sum retirement-savings withdrawals.

Spousal and Survivor Benefits. In addition to retired worker benefits, Social Security also provides some benefits to eligible family members of the worker. Spouses who qualify for spousal benefits tend to come from either single-earner households or from situations with a large earnings differential between spouses. The spousal benefit is equal to 50 percent of the higher-earning spouse's benefit, for a total family benefit of 150 percent of the higher-earning spouse's benefit. Surviving spouses may receive 100 percent of the deceased spouse's worker benefits. Spousal and survivor benefits have been declining in importance with the increase in women's labor force participation and the increasing convergence in earnings between married spouses. The design of today's spousal benefits primarily rewards higher-income households, and provides disincentives for both spouses to work.[26]

Economic Growth and Social Security. If the U.S. experienced higher than currently projected economic growth, this would delay Social Security's date of insolvency. However, growth alone cannot achieve sustainable Social Security solvency. In the short term, higher economic growth would bring more payroll tax revenues into the Social Security program, delaying Trust Fund exhaustion, but higher wage growth would also generate higher future benefits, raising Social Security's long-run costs.[27] Benefit reforms are necessary to preserve Social Security benefits without excessive taxes or debt.

Social Security Benefit Reforms. The sooner lawmakers address Social Security's massive and growing cash-flow deficits, the lower the burden will be on current and future workers. And, the sooner lawmakers phase in benefit reforms, the more gradual those reforms can be, enabling affected individuals to plan accordingly. Several important reforms could help resolve Social Security's financial short-

22. Mathew Greenwald et al., "What Do People Know About Social Security?" Financial Literacy Center, October 2010, https://www.rand.org/content/dam/rand/pubs/working_papers/2010/RAND_WR792.pdf (accessed on December 20, 2016).

23. Ibid.

24. AARP, "The Impact of Claiming Age on Monthly Social Security Retirement Benefits: How Knowledgeable Are Future Beneficiaries?" February 2012, http://assets.aarp.org/rgcenter/general/Impact-of-Claiming-Age-On-Monthly-Social-Security-Retirement-Benefits.pdf (accessed October 19, 2016).

25. Raimond Maurer and Olivia S. Mitchell, "Older Peoples' Willingness to Delay Social Security Claiming," National Bureau of Economic Research *Working Paper* No. 22942, December 2016, http://www.nber.org/papers/w22942.pdf (accessed December 22, 2016).

26. Sita Nataraj Slavov, "Survivor and Spousal Benefits in the Social Security Retirement Program," statement before the Finance Committee, U.S. Senate, December 9, 2014, https://www.aei.org/wp-content/uploads/2014/12/12-9-14_Sita-Slavov_Senate-Finance-Committee.pdf (accessed on December 20, 2016).

27. Richard W. Johnson and Karen E. Smith, "Can Economic Growth Really Fix Social Security?" The Urban Institute, February 5, 2016, http://www.urban.org/2016-analysis/can-economic-growth-really-fix-social-security (accessed on December 20, 2016).

fall and ensure that benefits can be paid in full. Congress should:

- **Update Social Security's cost-of-living adjustment.** Social Security's cost-of-living adjustment (COLA) is based on an outdated measure of changes in the cost of living that fails to account for how people react to changes in prices. Lawmakers should index Social Security's COLA to the chained consumer price index (CPI), which acknowledges that people choose less expensive and different goods and services in response to changes in prices. This reform would eliminate about one-fifth of Social Security's long-term fiscal imbalance, and would more accurately protect the value of benefits against changes in the cost of living.[28]

- **Raise the eligibility ages.** Life expectancy increased by more than 15 years for both men and women born between 1940 and 2014. Life expectancy at age 65 also increased significantly, enabling seniors to draw benefits longer than in the past. Men who reach age 65 in 2014 live an average of six years longer than did men who reached age 65 in 1940. For women, the difference is even larger: seven years. At the same time, work in the United States has become less physically demanding, and individuals have become healthier.[29] Yet Social Security's full retirement age will gradually increase by only two years by 2027, to 67, and the early retirement age has not increased at all. Social Security's retirement age serves as an implicit guideline for actual retirement, as nearly two-thirds of eligible workers choose to receive Social Security benefits between the early and full retirement age.[30] For Social Security, this means greater financial strain, and for the economy, it means a smaller workforce, lower economic growth, less retirement security, and lower revenue. Lawmakers should gradually and predictably increase Social Security's eligibility ages, and index both to increases in life expectancy.

- **Target Social Security benefits progressively.** The OASI program can best meet its goal of protecting older Americans from poverty by providing them with the assurance of a predictable, flat benefit above the poverty line. Social Security's benefit formula should be adjusted such that more of the benefits go to working Americans of modest means. Various approaches would arrive at a flat benefit in the long run, including progressive price indexing, and bend-point and replacement-rate adjustments of the primary insurance amount calculation. Representative Sam Johnson recently introduced a formula-adjustment approach to better target benefits toward middle-wage and lower-wage workers.[31] The establishment of a minimum, anti-poverty flat benefit would result in higher benefits for some low-income workers who currently receive income below the poverty threshold.

- **Lower and phase out payroll taxes.** Social Security's size and scope should be reduced, followed by lowering the payroll taxes that finance today's system. This will allow Americans to save, spend, or invest more of their own money, and play a more active role in their retirement planning. With lower payroll taxes, more Americans will be able to accrue personal savings in their own retirement accounts—savings that will almost certainly provide higher returns than Social Security does, and which can be passed on to workers' heirs. Higher returns outside Social Security would allow many Americans to afford more generous retirements, or to save less while still receiving the same amount in retirement.

A more targeted Social Security program financed with lower taxes has the added benefit of reducing Americans' reliance on government in retirement. Phasing out payroll taxes and the Trust Fund

28. Romina Boccia and Rachel Greszler, "Social Security Benefits and the Impact of the Chained CPI," Heritage Foundation *Backgrounder* No. 2799, May 21, 2012, http://www.heritage.org/research/reports/2013/05/social-security-benefits-and-the-impact-of-the-chained-cpi\.

29. Mark Duggan and Scott A. Imberman, "Why Are the Disability Rolls Skyrocketing? The Contribution of Population Characteristics, Economic Conditions, and Program Generosity," chap. 11 in David M. Cutler and David A. Wise, eds., *Health at Older Ages: The Causes and Consequences of Declining Disability Among the Elderly* (Chicago: University of Chicago Press, 2009), pp. 337–379.

30. Rande Spiegelman, "When Should You Take Social Security?" Charles Schwab, May 17, 2016, http://www.schwab.com/public/schwab/nn/articles/When-Should-You-Take-Social-Security (accessed on December 20, 2016).

31. Boccia, "New Social Security Reform Bill Moves in the Right Direction."

entirely as part of comprehensive tax reform will stop the illusory belief that Social Security is a personal savings program, and the program would instead be financed like most other government assistance programs: with general tax revenues.

The Social Security Reform Act of 2016

The Social Security Reform Act of 2016 was introduced by Representative Johnson, the chair of the House Ways and Means Subcommittee on Social Security. Johnson's plan applies the right policy principles to achieve sustainable Social Security solvency, ensuring that the program can pay full benefits as scheduled over the 75-year projection and beyond. Most importantly, it demonstrates that no tax increase is necessary in order to accomplish these goals.

Johnson's plan would enhance the progressive features of the Social Security benefit formula, focusing benefits on American workers with lower incomes, while reducing benefits for upper-income earners who are better able to provide for their own retirement needs through savings and investment. The plan does this by (1) adjusting the benefit formula that calculates initial benefits based on lifetime earnings; (2) limiting cost-of-living adjustments to all but the lowest-income earners; (3) capping survivor and dependent benefits to the average wage index to reduce injustices in the current system; and (4) protecting lower-income workers through a new minimum benefit.

Johnson's proposal would gradually raise the full retirement age to 69, while keeping the early retirement age the same. Those able to work longer could accrue higher benefits for waiting until 72 years of age to collect benefits. Raising the official retirement age is a long-overdue change. The age should further be indexed for changes in life expectancy—something that is missing from the proposal.

The proposal makes several other adjustments, including expanding access to disabled surviving spouse beneficiaries and implementing a fairer method of calculating benefits for state and local workers subject to the windfall elimination provision under the current system.

The proposal's biggest shortfall is that it preserves the size and scope of the current Social Security program, merely tweaking it. A bolder proposal would consider reducing Social Security's payroll tax burden over time or allowing individuals to opt out of a portion of their payroll taxes (and benefits) in favor of private accounts that they own and control outside Social Security. Nevertheless, Johnson's proposal moves in the right direction. This plan presents a reasonable, targeted, and fiscally responsible approach to reform Social Security.

Social Security Needs Reform *Now*

Social Security will run up against a financial wall in less than 20 years. The largest and growing federal entitlement program is increasingly contributing to annual deficits. Absent reform, Social Security benefits will be cut across the board by 23 percent in 2035. Action should be taken soon to protect Social Security's most vulnerable beneficiaries from such drastic cuts without burdening younger generations with higher taxes or unsustainable debt. Lawmakers should immediately replace the current COLA with the more accurate chained CPI, raise eligibility ages gradually and predictably, target Social Security benefits toward those that need government assistance in retirement the most, and phase in a predictable, flat benefit, encouraging Americans to provide for more of their retirement security through private means. Despite some shortcomings, the Social Security Reform Act of 2016, introduced by Representative Johnson, presents a reasonable, targeted, and fiscally responsible approach to reform Social Security.

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