Saving Social Security

Lenox Club

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Outline

- What is Social Security?
- Why is Social Security in Trouble?
- Principles for Saving Social Security.
- One Example of a Bipartisan Solution.

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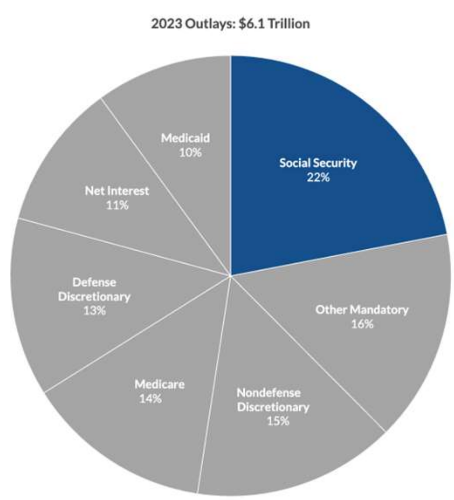
What is Social Security?

- Social Security is a federal social insurance program that provides financial support to workers and their families.
- Different benefits:
  - **Retirement Benefits**: Social Security provides monthly payments to qualified retirees based on their lifetime earnings.
  - **Disability Benefits:** It provides financial support to individuals who are unable to work due to a disability.
  - **Survivor Benefits:** Social Security offers benefits to the families of deceased workers, including spouses and children.

Soc Sec is The Single Largest Gov't Program



Source: Office of Management and Budget • Get the data • Embed • Download image
Note: Outlays for Social Security include non-retirement benefits.

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Source: https://www.pgpf.org/article/9-facts-about-social-security-and-the-need-to-strengthen-it/

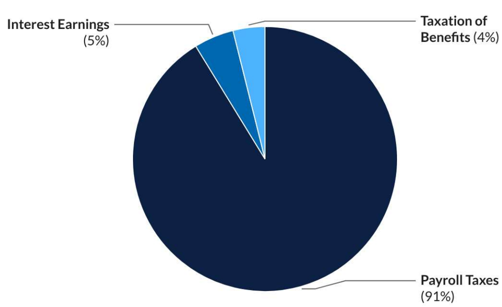
The Mechanics of Social Security

- **"pay-as-you-go" system**
  - Revenues come from: Payroll taxes on workers and employers, and income taxes on some social security benefits.
  - Revenues pay the benefits of the currently retired, or otherwise eligible.
- **Payroll taxes amount to 12.4% of earnings.**
  - Workers pay 6.2% of earnings as payroll taxes.
  - Employers also pay 6.2% of worker's earnings.
- ***Earnings Cap.* Not all earnings are subject to payroll taxes.**
  - In 2026, only the first $184,500 of earnings are taxed.
  - Earnings above that level are not taxed.
- **Income taxes on SS Benefits:**
  - For lowest income, benefits are not taxable
  - As income rises, a fraction of benefits become taxable up to 85% at about $50,000 of AGI (not indexed).

Sources of SS Revenue

Most OASDI income comes from payroll taxes

Total OASDI Income in 2024: $1,418 Billion



Source: Social Security Administration

Note: General Fund Credits account for 0.01% of total OASDI income and, therefore, are not shown above.

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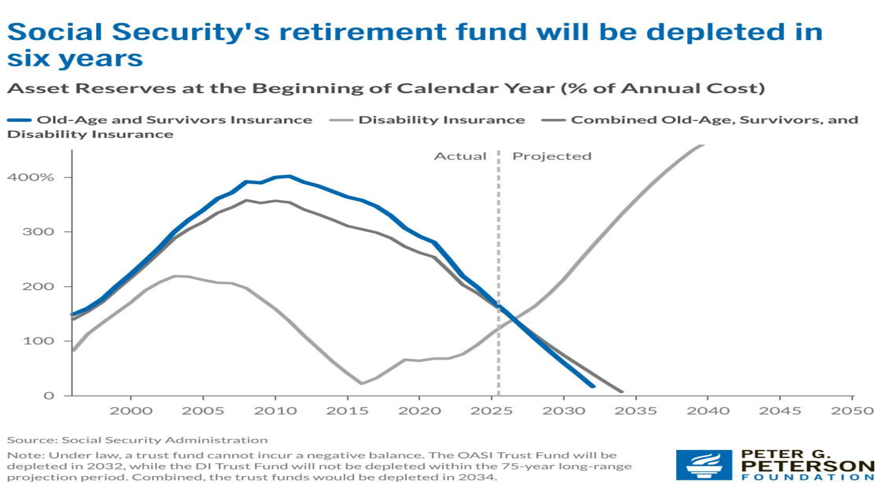
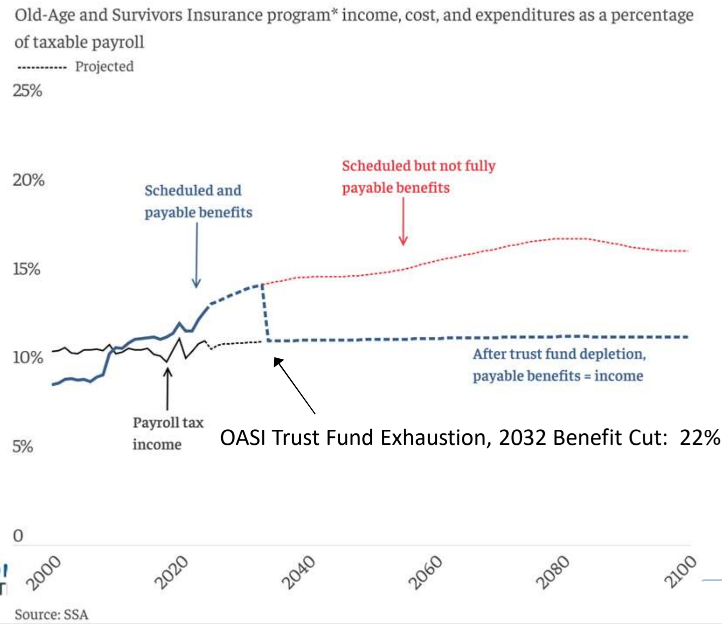
What if SS Tax Revenues Don't Match Benefits?

- **The Trust Fund**
  - If revenues exceed benefits, the trust fund is credited with **non**marketable government securities by the amount of the surplus.
  - If benefits exceed revenues, the trust fund redeems **non**marketable securities by the amount of the deficit.
  - Really just one branch of government trading Ious with another.
  - **The existence of the trust fund has no economic significance: The amount the government must borrow depends on total federal spending (including Social Security) less total tax revenue (including Social Security taxes).**
- **But the existence, or lack thereof, has enormous political significance: Under current law, If the Trust fund is exhausted, Social Security benefits are limited to Social Security income.**

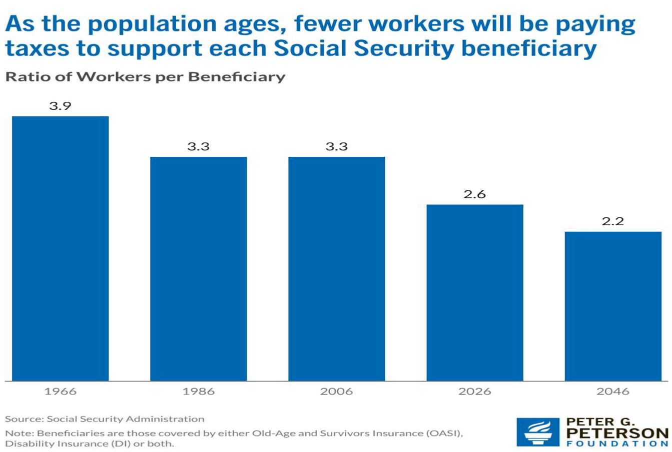
The Problem: Trust Funds are Running Out



What Happens When The Trust Fund Runs Out?



Main Problem Due to Aging Population



1. Baby Boomers are retiring.
2. Increasing Life Expectancy.
3. Baby Bust: By 2030, births = deaths.
4. Net immigration Way down

Additional Problem: Growing wage inequality means more income is not subject to the payroll tax.

Source: https://www.pgpf.org/article/how-does-social-security-work/

A Closer Look at Retirement Benefits?

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Benefits are Based on Your Primary Insurance Amount (PIA)

PIA which depends on:

- **Your work history.**
  - Your average highest income over 35 years, where earlier years are indexed to wage inflation.
  - Except that income for any year is "capped," currently at $184,500
- **Income Cap plays two roles:**
  1. Remember earnings above the cap are not taxed.
  2. But, earnings above the cap do not affect individuals' average SS earnings.
- **PIA determines Retirement Benefit of a single retiree at Full Retirement age, 67**

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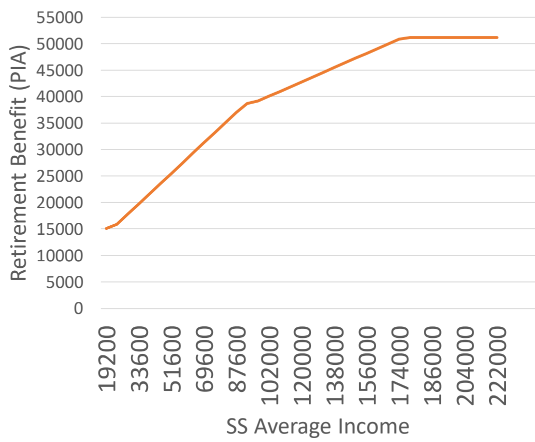
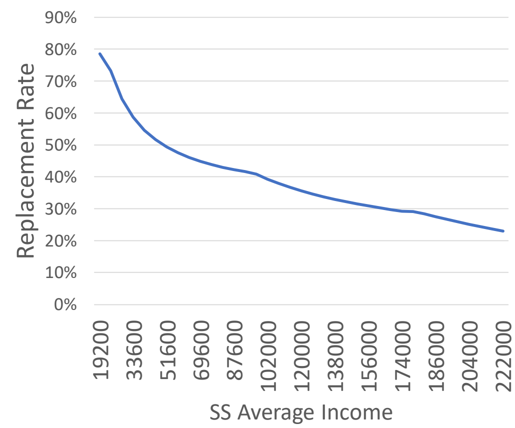
Benefit Formula is Highly Progressive





For every dollar average income exceeds $93K, benefits increase by 15 cents

Benefit Adjustments to PIA

- **Age when claiming**
  - Early: 70% at 62 to 100% bat 67.
  - Delayed: 108% at 68 to 124% at 70.
  - Fractions designed to be (roughly, on average) actuarially fair.
- **Marital Status:**
  - Nonworking spouse adds 50% of PIA at full retirement age.
  - Working spouse claims off own earnings record if it is greater.
- **Benefits go up each year based on CPI inflation.**

Solving the Social Security problem is simple

More revenues and/or
Reduced benefits

- **Why hasn't this happened?**
  Politics!

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Personal Opinion: Disingenuous & Unhelpful

Scott Bessent, Treasury Secretary at his confirmation hearings:

"These entitlements are massive. I think the next four years isn't the time to deal with them, that we've got to deal with the discretionary portion of the budget…then the next step is for a future administration to have the confidence to be able to deal with entitlements."

Total Federal Spending last fiscal year $7 trillion: 60% Mandatory (mostly Social Security and Medicare); 27% was discretionary, and 14% was interest on the debt.

One Big Beautiful Bill and Immigration Policies are a substantial reason Social Security Finances got worse in 2025.

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https://www.foxbusiness.com/politics/treasury-secretary-nominee-scott-bessents-3-3-3-plan-what-know

So, Let’s Consider Some Options

But the appropriate choices depend on the goals of the program!

Not mutually exclusive goals of Social Security:

1. **Partial earnings replacement via forced savings.**
2. **Social Insurance: protect workers against risks that are hard to insure privately.**
3. **Poverty Prevention among the elderly.**

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1. SS as One Leg of the Three-Legged Stool

Why Forced Savings?

1. **Private Pensions**
   - But, only 50-55 percent of private-sector workers are covered mostly by Defined Contribution Plans.
2. **Private Savings**
   - But, roughly 50 percent of workers aged 55-64 have little or no private savings (does not include housing wealth).

The weaknesses of these 2 legs is worse the poorer the household. Also, both these legs are subject to investment and inflation risk.

(From 1970-2025 the S&P 500 fell by 20% or more 7 times).

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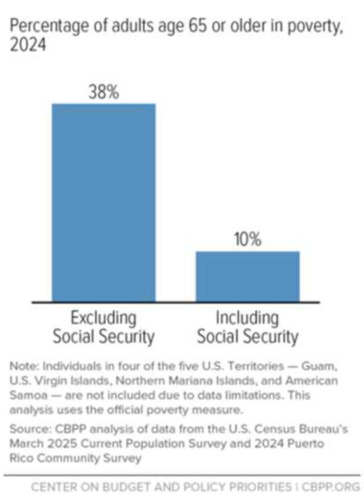
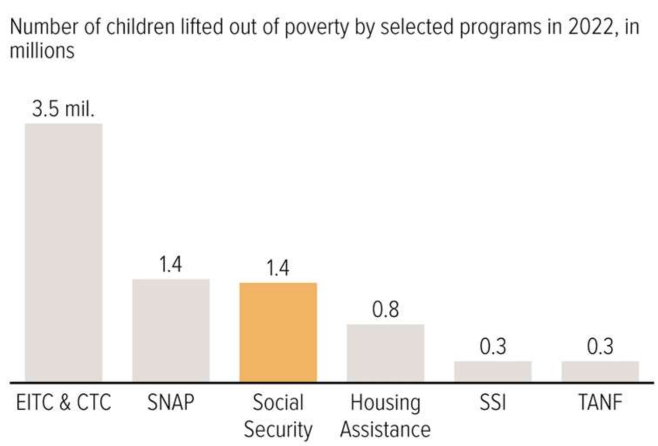
2. SS Insures Against Significant Risks

1. Protects against becoming disabled.
2. Protects survivors, widow(er)s and children.
3. Protects against outliving resources because it acts like a lifetime annuity with the important added bonus that benefits are indexed to inflation

3. Soc Sec Significantly Reduces Poverty





Implications of 3 Different Goals

If there were only one goal (which there is not), what would be the implications for saving Social Security?

1. Forced Savings: Maintain a link between taxed earnings and benefits.
2. Social Insurance: Survivor and disability benefits are central. Progressivity in benefits is appropriate because low earners face greater risk.
3. Poverty Prevention: Payroll tax links to benefits is a historical artifact. Means-tested benefits. (Conflicts with 1.)

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Brookings Principles for a Solution

Principles:

1. Bipartisan which means benefit cuts and tax increases.
2. Solvency (increase revenues and lower benefits by 4.42 % of taxable payrolls. Eliminate the "GAP")
3. No benefit reduction for current recipients (?).
4. No general fund financing (Pay benefits from SS taxes).
5. Universal participation.

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https://www.brookings.edu/articles/fixing-social-security-blueprint-for-a-bipartisan-solution/

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My Interpretation of Brookings Principles

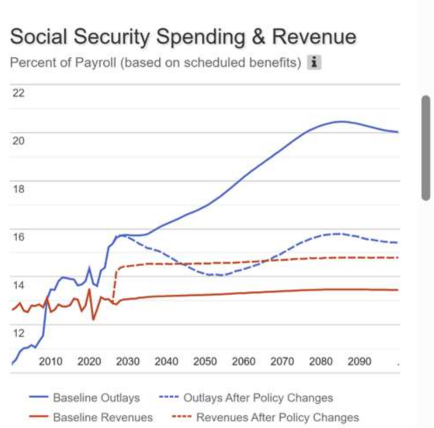
- **Social Security is a special program, not just poverty prevention.**
  - "…link between wages and benefits has been a central principle… and a foundation of its political support."
- **Bipartisan: I would go further: Don't try to fix the inequities of the federal tax system with social security reform**
  - Preserve the traditional view that Social Security is a different type of government program.
  - SS reform is tough enough and the problem is urgent.

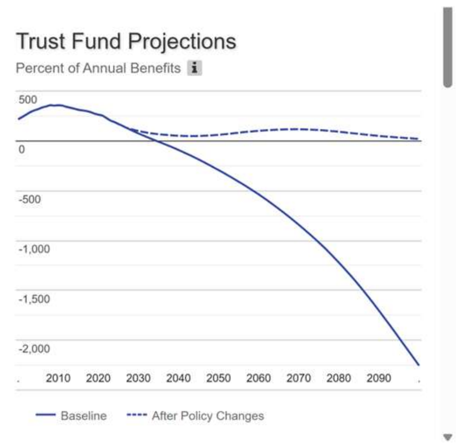
Example: Roughly Based on Brookings

1. **Slow the benefit growth of high earners (38%, of gap removed)**
2. **Index COLA to "Chained" CPI (16%)**
3. **Phase out nonworking spouse benefit (4%)**
4. **Expand Widow(er)s Benefit to 75% of combined benefit (-3%)**
5. **Calculate PIA on a 40-year average rather than 35 (15%)**
6. **Raise earnings cap to $330,500 in 2026 to cover 90% of wages (23%)**
7. **Raise the payroll tax to 12.6% (5%)**
8. **Tax all SS Benefits for Retirees making more than $100,000. (3%)**

Bipartisan because it involves benefit reductions (70%) and tax increases (31%)

Results





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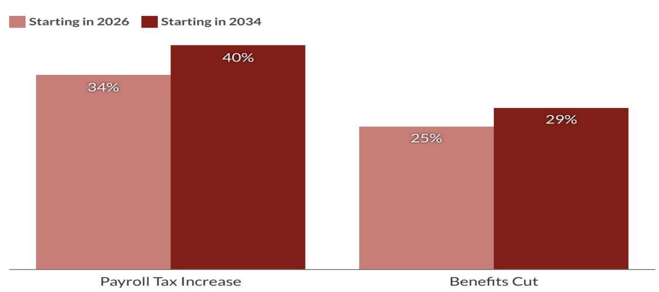
The Sooner We Act the Better

We cannot afford to let the “best” be the enemy of the “good.”

Waiting to reform Social Security will increase the magnitude of change needed

Policy Change to Prevent Depletion of OASDI Trust Funds (% Change)



Source: Social Security Administration

Notes: The Social Security Administration projects the impact of insolvency to the combined OASDI fund. Increases in the payroll tax rate would be equal to a 4.25 percentage point increase if reform started in 2026 and a 4.90 percentage point increase if reform started in 2034. Data for benefit cuts reflect the combined OASDI fund and assume cuts are made to current and new beneficiaries. According to the 2026 Trustees Report, projected benefit cuts for the OASI fund only would be 22% across the board two years prior in 2032.

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Should Current Retirees Share the Burden?

- **Current retirees have less flexibility to adjust income and spending.**
- **That may argue for a smaller relative burden, but not zero.**
- **Also, higher income retirees have more flexibility in adjusting spending.**
- **My opinion, for intergenerational fairness and for social solidarity, the more affluent of our generation should bear some burden**

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Summary

- **Social Security is an important part of the social safety net.**
- **The OASI Trust Fund is likely to be exhausted in 2032.**
- **Why are the funds being depleted?**
  - An aging population and slower growth in the labor force.
- **What happens when the funds are depleted?**
  - Benefits may have to be reduced by 22%, but the system will continue
- **Solutions abound. The problem is political will.**
  - The needed changes will be unpopular, but they are manageable. The longer we wait the bigger the problem.
- **There is hope: both the Senate and House are considering different bills to form a commission to make proposals.**

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Let's Hear from You!

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Slides available

https://www.needecon.org/delivered_presentations.php

Additional Material

https://sites.google.com/view/macro-current-issues/social-security

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