“Simpson-Bowles” reforms would reduce middle-class Social Security receipts: Urban Institute

By Editor Test *Wed, Dec 14, 2011*

Projected Social Security benefit reductions under the NCFRR recommendations are closely related to lifetime earnings, with those at the bottom of the lifetime earnings distribution largely shielded and those at the top experiencing significant reductions.

A new report from the Urban Institute claims that if the Social Security reforms recommended by the National Commission on Fiscal Responsibility and Reform a year ago were adopted, the Social Security benefits received by adults would decline relative to benefits currently scheduled.

In 2070, when all of the proposed provisions would be fully phased in, average benefits would be 14% lower for those in the middle of the earnings distribution, the Urban Institute report said.

While the proposal largely preserves scheduled benefits for those in the bottom earnings quintile, they would experience a projected 3% benefit reduction primarily because of the proposed COLA changes—despite the inclusion of several benefit enhancements for recipients with low lifetime earnings.

For those in top earnings quintile, projected benefits would fall by about a quarter. As a result, their projected first-year replacement rates from Social Security will decline markedly for future generations, along with their return from the payroll taxes they pay over their lifetimes. These declining returns could erode political support for OASDI.

The proposal generally leaves beneficiaries in the bottom four lifetime earnings quintiles with higher benefits than they would receive under a payable baseline (under which Social Security is not changed at all in the near term and beneficiaries faced across-the-board benefit reductions once the Trust Funds are exhausted).

Compared to a feasible baseline (under which action is similarly deferred until Trust Fund exhaustion, but at that point restores balance though an even division between benefit reductions and payroll tax increases), relatively fewer beneficiaries have higher benefits, but the lower two quintiles still do comparably well.

The National Commission on Fiscal Responsibility and Reform (NCFRR), led by Erskine Bowles and Alan Simpson, released a set of recommendations in December 2010 to help place the Social Security program on a sounder long-run financial footing. These recommendations included the following provisions that reduce the long-run fiscal imbalance through increased payroll tax contributions or reduced benefits:

- Increase the earnings subject to the Social Security payroll tax;
- Modify the benefit formula to slow the growth of future benefits;
- When calculating the cost-of-living adjustment (COLA), replace the current version of the consumer

price index (CPI), the CPI for urban wage earners and clerical workers, or CPI-W, with the chained consumer price index (C-CPI-U, also known as the superlative CPI);

• Index the Early Eligibility Age (EEA) and the Full Retirement Age (FRA) to life expectancy to maintain a roughly constant ratio of retirement years to work years; and

• Cover newly hired state and local workers under Old-Age, Survivors, and Disability Insurance (OASDI).

Additional provisions aim to shore up benefit adequacy and, in some cases, mitigate effects of the prior provisions. These adjustments include the following:

• A minimum benefit for full-career low-wage workers;

• A benefit enhancement for the long-lived and longtime disabled;

• A hardship exemption from increases in the EEA and FRA for individuals with low lifetime earnings and relatively long careers; and

• An option for beneficiaries subject to increases in EEA and FRA (because the hardship exemption does not apply to them) to start receiving up to one-half of the benefit for which they would be eligible at age 62.

This report presents distributional estimates of the effects of the commission's proposal on future Social Security beneficiaries. All projections rely on the Urban Institute's Dynamic Simulation of Income Model (DYNASIM), a model of the retirement resources of the U.S. population based on the 1990–1993 panels of the Survey of Income and Program Participation (SIPP).

Our distributional analysis reveals that the projected effects of NCFRR's proposal are particularly deep relative to current law scheduled for those reaching retirement age several decades from now, when reductions are phased in. In addition, projected benefit reductions are closely related to lifetime earnings, with those at the bottom of the lifetime earnings distribution largely shielded and those at the top experiencing significant reductions.