Social Security’s Political Problems

By Kerry Pechter *Thu, May 12, 2022*

As evidenced by the Committee for a Responsible Federal Budget's objections to a recent Social Security bill, even the moderates in Washington can't agree on reforms.

Social Security’s problems have always been more political than economic. We can expect Washington to make inconsistent stabs at refinancing the program, depending on the politics of the moment.

Today, even the moderates can’t get in synch.

Having praised Rep. John B. Larson’s 2019 “**Social Security 2100 Act**,” which raised payroll taxes on the wealthy, the non-partisan Committee for a Responsible Federal Budget (CRFB) has panned the bill’s **latest iteration**, which doesn’t.

“The previous version of Social Security 2100…would generate enough new revenue to restore solvency and expand benefits,” the committee said last week. “The legislation would subject earnings over $400,000 to the payroll tax while also gradually raising the payroll tax rate from 12.4% to 14.8%. In addition to closing the program’s financial shortfall, the funds would finance a stronger minimum benefit, larger cost-of-living adjustments, and reduced taxation of benefits.”

Larson (D-CT) replaced that bill last October, however, with a new bill (H.R. 5723, or “Social Security 2100, A Sacred Trust”). It disappoints the CRFB.

“The new legislation removes nearly half of the solvency-improving revenue from the original bill, while dramatically expanding new spending—but making that spending temporary to cover up the costs… The new legislation removes adjustments to the payroll tax rate—which were responsible for closing two-thirds of the solvency gap — while adding eight new benefit expansions that would further increase benefits for disabled workers, spouses, young adults, and the very old.”

In revising the bill, Rep. Larson may have wanted to replace deal-killing tax hikes with sweeteners in order to gain more support for its passage from the left and right. But the revision appears to have offended the middle, as represented by the CFRB.

Meanwhile, we get closer to Social Security's 2034 political reckoning, whose outcome may hinge on the results of the 2028 presidential election. Which is to say, very soon.

Most of the news about Social Security tends to be characterized either by sensationalist cliff-hanging for its own sake or reductive name-calling ("Ponzi scheme") by those who would replace our pay-as-you-go national pension with a defined contribution system.

Social Security's actual economic situation is not so dire. Even facing demographic headwinds (rising life expectancies and falling fertility rates), 75% of all promised benefits can continue to be paid after 2034, regardless of whether the program crosses into technical "insolvency."

Social Security doesn't face failure. It faces the question: Do we value it enough, as the most efficient way to manage the longevity risk of the tens of millions of American elderly, to pay a bit more for it—so that we can get what we've already been promised?

Social Security is not a giant burden to the US economy. Every year, $1 trillion that would have gone into the bank accounts of workers goes into the bank accounts of retirees. They spend it into the economy. Workers receive incremental credits toward a guaranteed life-contingent pension.

The banking system—the economy—enjoys the same amount of reserves either way, and can lend just as much to businesses. High-income managers, professionals and business owners continue to contribute the maximum to their 401(k) accounts.

Critics of Social Security say it should be pre-funded. It has been. Starting in the late 1980s, pre-Boomers and Boomers paid trillions of dollars more in Social Security taxes than flowed out as benefits. The trust fund—still more than $2 trillion—reflects the pre-funding.

It is said that Social Security is a bum deal for high earners, because it replaces relatively less of their pre-retirement income than of low earners' pre-retirement income. But high earners receive much larger benefits than low income earners. And because they are healthier, on average, they tend to collect longer.

A dual-income professional couple who waited to claim the maximum benefit at age 70 would receive as much as $4,200 a month each in 2022 from Social Security. That benefit is protected from market risk, inflation risk, sequence risk, and longevity risk. A comparably safe single premium immediate retail annuity would cost a man about $700,000 and a woman about $750,000, according to immediateannuities.com.

Those who recommend that we replace Social Security with a national defined contribution (DC) retirement system underestimate the difficult of switching from social insurance to investment-driven retirement savings, judging by other countries’ experience.

National DC typically calls for large mandatory contributions from employers, a centrally managed pension fund with illiquid individual accounts, a means-tested minimum benefit for those who’ve never worked, a “smoothing” mechanism so that market volatility doesn’t create winners and losers, and often a requirement for at least partial annuitization. You can’t just throw a lever and divert half of the payroll tax to target-date funds.

The politics of designing and implementing such a system in the US would be even more difficult and time-consuming than fixing Social Security, which needs only a few fiscal tweaks. It would take many years to pilot a new DC system through our contentious, erratic, lobbied and game-able legislative process.

We don’t have many years.