The Science (Not Sci-Fi) of Social Security

By Kerry Pechter *Thu, Aug 9, 2018*

The overlap of Social Security policy and behavioral finance was the subject of several papers aired at the Retirement Research Consortium's 20th annual meeting last week. Economists are trying to figure out the best way to refresh Social Security finances before reserves run out in 2034.

Millennials believe as much in space aliens as in the long-term viability of Social Security, surveys show. Economists, fortunately, tend to have more faith in the national pension program than in ETs, and some them—economists, that is—spend a lot of time looking for ways to fix it by 2034, when its reserves run dry.

The question is not whether it's possible to recharge Social Security's finances within the next 16 years, but *how* to do it. Some economists believe that if more Americans worked a couple of years longer and claimed benefits later, the system might recover solvency without politically ugly tax hikes or benefit cuts.

If no action is taken, Social Security will be able to pay only 75% of its promised benefits after 2034. To solve that problem today, the government would have to raise payroll taxes (to about 15% from 12.4%), cut benefits across-the-board by 17%, or some combination of the two. It could also generate more revenues by raising the cap on the amount of earned income—currently the first $128,400—on which the payroll is levied.

The overlap of Social Security policy and behavioral finance was the subject of several papers aired at the Retirement Research Consortium's 20th annual meeting last week. The National Bureau of Economic Research and the Centers for Retirement Research at Boston College and the University of Michigan produced the meeting at the National Press Club in Washington, D.C.

Academic proposals for improving Social Security's finances tend to be math-heavy and wonkish. But they contain the seeds of potential policy solutions. In a paper he presented at the meeting, John Laitner of the University of Michigan suggested tweaking the arcane calculation of Social Security benefits so that claiming benefits at age 63 would yield significantly more income than claiming at age 62. (In 2013, 48% of women and 42% of men claimed at age 62, according to the Center for Retirement Research at Boston College.

The lure of higher benefits, Laitner's calculations showed, could motivate Americans to work an average of 1.2 to 1.8 years longer before filing for benefits. That modest increase, he said, could provide enough new revenues from payroll taxes and federal income taxes to offset 20% to 30% of the Social Security shortfall.

Economists in other countries, including Italy and Germany, have also been working on ways to force or nudge people who are near retirement to keep working for a while. For instance, after the 2008 financial crisis, the Italian government abruptly raised the full public pension age for men to age 66 from age 65 and began gradually raising the full pension age for women from age 60 to age 66. Starting in 2021, no workers will be able to receive a full pension before age 67.

This somewhat desperate move was driven by Italy's flirtation with national bankruptcy, and it backfired, at least in the short run. According to a paper presented at the meeting by Matteo Paradisi of Harvard, delays in the retirement dates of older workers caused employers at small to mid-sized companies to lay off middle-aged workers.

Some of those laid-off workers turned to tax-financed social services, thereby offsetting some of the fiscal benefit of the higher retirement age. "One-half to two thirds of revenues generated by the reform are lost in the short-run due to the behavioral responses of firms and workers," wrote Paradisi and his co-author, Giulia Bovini of the London School of Economics and the Bank of Italy.

Other interventions can encourage people to retire earlier. A quarter-century ago, through the Pension Reform Act of 1992, Germany began paying bonuses to workers whose expected public pension benefits were depressed because, despite long work histories, their incomes had never been high. The program didn't apply to people who began contributing to the pension after 1992.

At the conference, researcher Han Ye of the University of Mannheim (Germany) shared the results of her investigation of the effects of that program. She found that, because the bonuses caused women to claim pensions and leave the workforce earlier, the program was a fiscal failure.

According to her study, an offer of 100 euros in additional monthly pension benefits induced women to claim old age pensions about 10 months earlier than before. The subsidy also raised the rate at which women claimed a pension at age 60 by 17%. "In order to raise the lifetime income of the low-income pensions by one euro, 1.3 euros have to be raised by the government, either via taxes or pension contributions,” Ye wrote.

Other research papers presented at the meeting showed:

Fears that the 2010 Affordable Care Act (ACA) would hurt the American economy by reducing the supply of workers are not justified by research data, according to a study by Helen Levy and Tom Buchmueller of the University of Michigan and Sayeh Nikpay of Vanderbilt University.

When the ACA, also known as Obamacare, went into effect in 2014, the media carried many reports that the ability to obtain health insurance outside the workplace would cause many workers to leave benefits-paying jobs. But, after analyzing trends in health insurance coverage and labor market outcomes for Americans ages 50 through 64, the researchers found “no discernible break” in the labor market participation rate in 2014, either in states that expanded their Medicaid programs or in those that did not.

Another team of researchers studied the correlation between the growing use of factory robots and on rising imports from China from 1994 to 2015 on U.S. earnings that are subject to the payroll tax, which generates Social Security program revenues.

Rising use of robotics in manufacturing was correlated with a drop of more than 3% in earnings subject to the payroll tax for Americans in the upper 60% of the income spectrum. Rising imports from China coincided with reductions in the earnings of those in the bottom half of the income spectrum by at least three percent, and reduced the earnings of lowest-earning Americans by as much as 12%.

Matthew Rutledge, Gal Wettstein and Wenliang Hou of the Center for Retirement Research at Boston College and Patrick J. Purcell of the Social Security Administration wrote the study.