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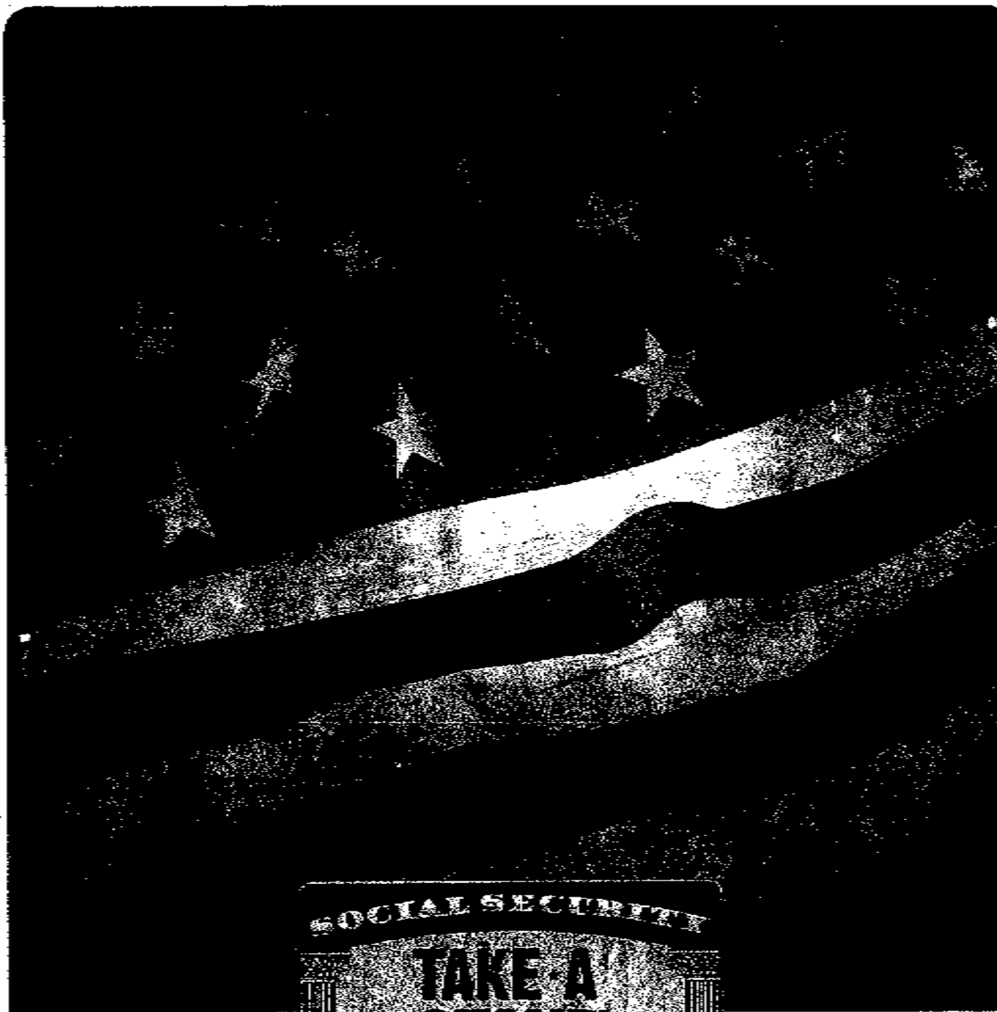

Updating Social Security for the 21st Century:

12 Proposals You Should Know About

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Real Possibilities

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Updating Social Security for the 21st Century:

12 Proposals You Should Know About

Pros and cons of options presidential candidates and policy experts are talking about

You've paid into Social Security, and you deserve to know what changes are being proposed by presidential candidates and policy experts and how each might affect you, your kids and generations to come.

The world has changed a lot since the Social Security Act was signed into law in 1935. Social Security needs to be updated for the 21st century so we can keep the promise we've made to future generations.

According to the Social Security Trustees, benefits will be cut by nearly 25 percent after 2034 if no action is taken.

Here are summaries of 12 options being talked about on the campaign trail and in Washington. The calculations in the options are based on the 2015 Social Security Trustees' report. Each summary is accompanied by two opinions that AARP commissioned from experts whose views typically represent different sides of the issues.

The experts:

- *Romina Boccia, the Heritage Foundation*
- *Virginia Reno, formerly with the National Academy of Social Insurance*

❶ Raise the Full Retirement Age

The age when a person becomes eligible to receive full Social Security retirement benefits (the full retirement age) has been increasing from age 65 on a schedule set by Congress in 1983. It has reached 66 and will gradually rise to 67 for those born in 1960 and later. Raising the full retirement age further is one option to help close Social Security's funding gap. Each year that the full retirement age increases there is about a 6 to 8 percent reduction in monthly benefits for any given age at which benefits are claimed. The earliest age for claiming reduced benefits could remain at 62, or the earliest age for claiming could be increased along with the full retirement age.

One proposal would raise the full retirement age to 68. Starting in 2023, the age would increase by two months each year until it reached 68 in 2028. Estimates say this would fill 16 percent of the funding gap.

Another proposal would gradually raise both the full retirement age and the early eligibility age. Starting in 2023, the full retirement age would begin to increase from 67 until it reached 70 in 2069. The earliest eligibility age would increase from 62 until it reached 65 under the same schedule as the full retirement age. This would fill an estimated 26 percent of the funding gap.

PRO: *Americans are living longer than ever before, which means they are also drawing Social Security benefits for longer than ever before. Increasing Social Security's full retirement age slightly and on a known schedule to reflect Americans' longer life spans is a fair and commonsense approach to improving the program's finances. When Social Security started in 1935, 65-year-old men expected to spend about 13 years in retirement, compared with about 18 years today. Women in 1935 averaged 15 years in retirement and today spend about 20 years drawing benefits. (Romina Boccia, Heritage Foundation)*

CON: *Raising the full retirement age is a benefit cut no matter what age you begin taking benefits. The increase from 65 to 67 already in law cuts benefits by 13 percent. Low-earning workers have seen little or no gains in longevity. Raising the full retirement age for everyone simply because well-off Americans are living longer is a stealth benefit cut that is unnecessary and unjust. We can afford to improve and pay for Social Security without benefit cuts. (Virginia Reno, formerly with the National Academy of Social Insurance)*

❷ Begin Longevity Indexing

If, as projected, Americans continue to live longer from one generation to the next, individuals will, on average, receive Social Security benefits for a longer time. The trend contributes to Social Security's funding gap, and one option to offset it is longevity indexing. Indexing would automatically modify Social Security to pay smaller monthly benefits as life spans increase. Reducing the monthly payments could be accomplished either by increasing the age at which a person becomes eligible for full, unreduced retirement benefits (full retirement age) or by changing the benefit formula. Depending on the specific proposal, this would fill an estimated 18 to 19 percent of the funding gap. Indexing the full retirement age for longevity is estimated to increase it by one month every two years. Each year that the full retirement age increases there is about a 6 to 8 percent reduction in monthly benefits for any given age at which benefits are claimed.

PRO: *Tying the Social Security retirement age to longer life spans is a fair and commonsense way to reflect the fact that Americans are expected to live longer. Assuming life span continues to increase as it has in the past, this method would increase Social Security's full benefits age by about one month every two years; if it started in 2023, the retirement age would increase from 67 to 68 by about 2047. These small increases in the retirement age would improve Social Security's finances over the long term and provide ample time for Americans to better plan for retirement. (Romina Boccia, Heritage Foundation)*

CON: *To index benefits for longevity would unfairly cut benefits for almost everyone. Low-earning workers and other disadvantaged groups have seen little or no gains in longevity. Cutting benefits for everyone just because well-off Americans are living longer would be profoundly unjust. Moreover, this change would violate the purpose of Social Security, which is to ensure basic economic security. Rent, utilities, groceries and medical care don't cost less just because some people are living longer. (Virginia Reno, formerly with the National Academy of Social Insurance)*

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❸ Recalculate the COLA

Social Security benefits generally keep up with inflation through a cost-of-living adjustment, or COLA. Since 1975, Social Security has based such adjustments on the consumer price index, which measures changes in the prices of consumer goods and services. One option to modify Social Security would be to use an alternative price index for calculating the COLA. Options include:

- Chained consumer price index: By applying a different formula to the same goods and services data, this index aims to account for ways consumers change their buying habits when prices change. Experts predict that the annual COLA would be on average 0.3 percentage points lower under this formula. For example, if the current formula produced a 3 percent annual COLA, the chained consumer price index might yield a 2.7 percent COLA. The effect of a lower COLA would compound over time, reducing the benefit by 3 percent after 10 years and 8.5 percent after 30 years. Permanently reducing the size of the benefit adjustment every year would fill an estimated 21 percent of the gap.
- Elderly index: This method aims to reflect specific spending patterns of older Americans, in particular the greater amounts they spend on health care. Experts predict that the annual COLA would be on average 0.2 percentage points higher under this formula. For example, if the current formula would produce a 3 percent annual COLA, the elderly price index might yield a 3.2 percent COLA. In addition, the effect of a higher COLA would compound over time, increasing the benefit by 2 percent after 10 years and 6 percent after 30 years. Permanently increasing the size of the benefit adjustment every year would increase the funding gap by about 14 percent.

PRO: *(chained consumer price index): Social Security should use the most accurate price index for the COLA to best protect benefits from being eroded by inflation. The chained consumer price index measures the inflation experienced by a larger part of the population than the current index and better represents the way that actual people react to price changes in different types of goods and services. (Romina Boccia, Heritage Foundation)*

PRO: *(elderly index): The current COLA doesn't keep up with the inflation that seniors face because they spend more than other Americans for out-of-pocket health care costs and those costs rise faster than average inflation. The chained consumer price index would make matters worse by reducing the COLA. A more accurate Social Security COLA would compensate for the higher inflation that seniors actually experience by using an elderly index. (Virginia Reno, formerly with the National Academy of Social Insurance)*

❹ Increase the Payroll Tax Cap

The Social Security payroll tax currently applies to annual earnings up to $118,500. Any wages earned above $118,500 go untaxed for Social Security. This cap generally increases every year as the national average wage increases. Today, the cap covers about 83 percent of total earnings in the nation. Raising the cap to cover a higher percentage of total earnings would help close Social Security's funding gap. How much depends on how high the cap is set and how quickly the cap would be raised to reach that level. One commonly mentioned goal would raise the cap to cover 90 percent of earnings, which in 2016 would mean a cap of about $274,200. This would mean any employee earning more than the current tax cap of $118,500 (as well as his or her employer) would have to pay more payroll taxes, up to about $9,650 per year for those earning $274,200 a year or more. Raising the cap to 90 percent would fill an estimated 29 percent of the funding gap.

PRO: *Lifting the cap to cover 90 percent of all earnings is sensible and fair. Only 6 percent of workers earn more than the current cap of $118,500. It is fair for top earners to pay more into Social Security, and they would get a bit more in benefits. This change reflects the intent of Congress in 1977, when it set the cap to include 90 percent of earnings. Congress also provided for automatic adjustments for average wage growth so that the cap would continue to cover 90 percent. But with today's top earners enjoying much bigger gains than everyone else, the cap now covers only about 83 percent of earnings. This proposal, together with other changes, could keep Social Security strong and pay for benefit improvements. (Virginia Reno, formerly with the National Academy of Social Insurance)*

CON: *This proposal would increase taxes on some middle-class Americans without fully fixing Social Security's financial problems. It reduces the amount that working Americans have to spend on their families' food, housing, clothes, education, etc. The tax increase would also discourage some Americans from working more and thereby hurt our economy. The self-employed and certain smaller business owners would be hit particularly hard. (Romina Boccia, Heritage Foundation)*

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❺ Eliminate the Payroll Tax Cap

The Social Security payroll tax currently applies to annual earnings up to $118,500. Any wages earned above $118,500 go untaxed for Social Security. This cap generally increases every year with increases in the national average wage. Today, the cap covers about 83 percent of total earnings. Eliminating the cap so that all earnings would be subject to Social Security's payroll tax would help close the program's funding gap. If your income is under $118,500, you would see no change. If you make above that amount, you (as well as your employer) would pay the 6.2 percent payroll tax on your remaining wages. If all earnings were immediately subject to the Social Security tax, the new revenue would fill an estimated 71 percent of the funding gap.

PRO: *Eliminating the tax cap would make Social Security's financing more fair. Only 6 percent of workers earn more than the current cap of $118,500. They would pay on all their earnings throughout the year just as everyone else does, and would get a modest increase in benefits. This change alone would eliminate most of Social Security's long-term financing gap. Combining this with other changes could wipe out the gap and pay for needed benefit improvements. (Virginia Reno, formerly with the National Academy of Social Insurance)*

CON: *This proposal may sound like an easy and attractive solution, but it would make all Americans worse off by hurting the economy. High-earning workers, including the self-employed and certain business owners, would face very high marginal tax rates, discouraging them from working more, hiring additional workers or expanding their businesses. Eliminating the tax cap immediately would cause Social Security surpluses in the early years after this change. Those surpluses would encourage higher spending by Congress on other programs through further borrowing from Social Security. (Romina Boccia, Heritage Foundation)*

❻ Reduce Benefits for Higher Earners

Social Security benefit payments are based on the portion of a worker's earnings that was subject to Social Security payroll taxes. While higher lifetime earners receive higher payments than lower lifetime earners, their benefits replace a smaller share of their past earnings than do the benefits provided to lower earners. One option to help close Social Security's funding gap would be to reduce benefits for higher lifetime earners. This could be done by modifying Social Security's benefit formula in a number of ways, depending on who is classified as higher earners and how much their benefits are reduced. Most options use a sliding scale to reduce the benefits most for higher earners, make smaller changes for middle earners and make no benefit changes for lower earners.

Options include:

- Reduce benefits for the highest-earning 25 percent. Gradually reducing benefits over time for roughly the highest-earning 25 percent of individuals by a sliding scale up to an 8 percent benefit reduction for maximum earners would close an estimated 3 percent of the funding gap.
- Reduce benefits for the highest-earning 50 percent. Gradually reducing benefits over time for the highest-earning 50 percent of individuals by a sliding scale up to a 31 percent benefit reduction for maximum earners would fill an estimated 33 percent of the funding gap.

PRO: *Social Security has promised more benefits than it can afford to pay in the future. To continue to meet Social Security's original intent of protecting against poverty in old age, we should protect the benefits of lower-wage workers by reducing the benefits of those who have higher earnings. Reducing benefits for higher earners by changing Social Security's benefit formula would expand on its current design. Everyone would continue to receive benefits, but higher earners would receive less than they do today. (Romina Boccia, Heritage Foundation)*

CON: *These proposals would actually cut benefits for middle-class workers making as little as $40,000 a year. They are not "high earners." Benefits are already modest. Retirees' health care costs are rising while other retirement resources — home equity, pensions, lifetime savings — are at risk or unavailable for too many Americans. Most seniors get most of their income from Social Security. Cuts are not the answer. We can afford to preserve Social Security's promised benefits. (Virginia Reno, formerly with the National Academy of Social Insurance)*

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❼ Increase the Payroll Tax Rate

Employees and employers each currently pay a 6.2 percent tax to Social Security on earnings up to $118,500. Self-employed workers pay both the employer and employee shares for a total of 12.4 percent. One option to help close the Social Security funding gap would raise the payroll tax rate for all workers and employers. For instance, on a $50,000 annual salary, increasing the payroll tax to 6.5 percent would increase the annual employee and employer contributions by $150 each. Changing it to 7.2 percent would increase the annual employee and employer contributions by $500 each. The rate increase could occur gradually or all at once. Increasing the payroll tax rate from 6.2 percent to 6.5 percent from 2018 to 2023 would fill an estimated 20 percent of the funding gap. Increasing the payroll tax rate gradually over 20 years on employers and employees from 6.2 percent to 7.2 percent would fill an estimated 53 percent of the funding gap.

PRO: *Gradually increasing the Social Security tax rate from 6.2 to 7.2 percent over 20 years makes good sense. Most Americans say they would rather pay more than see Social Security cut. This change — just 50 cents more a week for an average earner — would close just over half of the financing gap. Together with eliminating the earnings cap, it could pay for much-needed improvements and keep Social Security strong for the long term. (Virginia Reno, formerly with the National Academy of Social Insurance)*

CON: *Increasing Social Security's payroll tax rate is a bad idea that would increase every worker's taxes, regardless of income. On the employer side, the payroll tax increases would result in higher labor costs, which would discourage hiring and encourage employers to move overseas or automate more production processes. This would especially hurt younger and low-wage workers, who would have fewer job opportunities available in a highly competitive global economy. Older workers could also face fewer opportunities and be pushed to retire earlier than they would otherwise choose. (Romina Boccia, Heritage Foundation)*

❽ Apply Payroll Tax to All Salary Reduction Plans

Employees now pay Social Security and Medicare payroll taxes on their contributions to tax-preferred employer-sponsored retirement accounts, such as 401(k) plans. They don't, however, pay these payroll taxes on their contributions to some other types of benefit plans at work, like flexible spending accounts. Collecting payroll taxes on contributions to all such benefit plans would increase the Social Security program's funds, as well as increase the earnings used to calculate the Social Security benefits of workers who have those benefit plans. If you contributed $2,000 to a flexible spending account, you and your employer would pay the 6.2 percent payroll tax (or $124 each) on that money. Taxing these salary reduction plans for Social Security the same way we tax contributions to 401(k) plans would close an estimated 10 percent of the funding gap.

PRO: *Congress should complete a reform it launched in 1983 when it treated workers' contributions to 401(k) salary reduction plans as earnings that are taxed and counted toward Social Security benefits. Extending the same treatment to other such plans would be consistent, it would ensure workers that all of their earnings will count toward their future Social Security benefits, and it would reduce the Social Security funding gap. (Virginia Reno, formerly with the National Academy of Social Insurance)*

CON: *Changing the tax treatment of salary reduction plans would increase the cost of health care and other employee benefits because the tax savings help to offset the employer's cost of operating the plans. The result would be fewer employers offering these types of benefits to workers, and higher total tax bills for millions of workers covered by these plans. (Romina Boccia, Heritage Foundation)*

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9 Cover All Newly Hired State and Local Government Workers

About one-quarter of state and local government employees are not covered by Social Security. Rather, these workers are covered by retirement plans provided by state or local governments that have chosen not to participate in the Social Security program. Under one proposed change, Social Security would cover all newly hired state and local government workers. Those workers and their employers would each pay their share of Social Security payroll taxes, and the workers would receive Social Security benefits. Current state and local government workers would not be affected. This proposal would fill an estimated 6 percent of Social Security's funding gap.

PRO: *Social Security works best for everyone when it covers everyone. Workers gain seamless, portable life and disability insurance as well as basic retirement income protection. Any employer-provided pensions are then added to Social Security. Extending coverage to newly hired workers, as was done with federal employees in 1983 legislation, would ease the transition for the workers and jurisdictions that would be affected. (Virginia Reno, formerly with the National Academy of Social Insurance)*

CON: *Making newly hired workers join Social Security would increase revenue now, but eventually the program would have to pay these workers benefits. That would make Social Security's financial problems even worse. In addition, certain already underfunded state and local government employee pension plans would see reduced contributions and almost certainly would need state-level tax hikes to pay promised benefits. (Romina Boccia, Heritage Foundation)*

10 Improve Benefits

Social Security provides benefits to retired workers and their families; to the spouses and dependents of workers who have died; and to workers who have become disabled and their families. Those benefits are too low for certain groups, according to some who argue that as part of any effort to strengthen Social Security, lawmakers should consider increasing benefits for more-vulnerable recipients. Some of the proposals to improve benefits are:

- Increased benefits for a surviving spouse
- Earnings credits for people who are not in the paid workforce because they are caring for a child or other family member
- A new minimum benefit that's guaranteed to keep low-paid workers with long careers above the poverty level

Each of these proposals would require other adjustments to benefits or revenue. Proposals to improve benefits for surviving spouses, caregivers and low-wage workers have been estimated to increase the funding gap by up to 10 percent.

PRO: *Social Security has features of an ideal pension plan: It is portable from job to job, keeps up with inflation and lasts as long as you live. Most seniors rely on it for most of their income. Yet benefits are modest — $1,230 a month, on average. We can afford to improve it. We could ensure that people who pay in at least 30 years will not be poor in retirement, give working parents credit for caregiving and improve benefits for survivors. We could also help any child of workers who die or become disabled by continuing benefits until age 22 if the child is in college or vocational school. (Virginia Reno, formerly with the National Academy of Social Insurance)*

CON: *Social Security benefits are too low for certain groups, and they should be improved as part of fundamental Social Security reform that reduces benefits for higher earners, increases the retirement age, and makes other changes to improve Social Security finances overall. Otherwise, the added costs would only increase Social Security deficits and exhaust the trust fund faster, accelerating potential large benefit cuts for everyone, including the most vulnerable populations. (Romina Boccia, Heritage Foundation)*

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⓫ Increase Number of Years Used to Calculate Initial Benefits

Social Security retirement benefits are based on a worker's average earnings history. Average earnings are computed from a worker's highest 35 years of annual indexed earnings that were subject to Social Security payroll taxes. If a worker has fewer than 35 years of earnings, each year needed to reach 35 is assigned zero earnings. One option to help close the Social Security funding gap would increase the number of years of earnings used to calculate Social Security benefits from 35 to 38 or even 40. Because that method would typically include more years of lower earnings, the average earnings would decrease and benefits would be lower. Increasing the number of computation years to 38 is estimated to fill 11 percent of the solvency gap.

PRO: *Increasing the number of years an individual must work to qualify for full Social Security benefits recognizes that most people are living and working longer than they did in the past. Today's method produces a skewed picture of an individual's full employment history and inaccurate Social Security benefits. Adding more years would encourage people to stay in the workforce longer, and the resulting small benefit changes would help to preserve Social Security for everyone. (Romina Boccia, Heritage Foundation)*

CON: *This proposal would reduce benefits the most for people who need them most: women and lower-income, less-educated and minority retirees. It would reduce benefits not only for retired workers, but also for their dependents and survivors. Social Security benefits are modest and are already being cut as the retirement age goes up. We can afford to preserve, improve and pay for the Social Security benefits that today's workers are earning with their Social Security taxes. (Virginia Reno, formerly with the National Academy of Social Insurance)*

⓬ Begin Means-Testing Social Security Benefits

Social Security benefits have always been provided to anyone who has paid into the system and who meets the work and age requirements. That's regardless of other income — investment, pension, savings — the person receives in addition to Social Security benefits (although a portion of Social Security benefits is taxable if the total income exceeds a certain threshold). One option to help close Social Security's funding gap is to "means test." Means testing would reduce benefits for higher-income recipients and could even eliminate benefits altogether for the highest-income households. Unlike the option to reduce benefits for higher earners, which uses a measure of career average earnings to reduce benefits, means testing would reduce benefits based on the full range of current income. Who would be affected and by how much depends on how the income thresholds are defined.

One version of means testing would fill about 10 percent of the funding gap.

PRO: *In an era when Social Security's benefit costs are increasingly outpacing its revenue inflows, Social Security can't continue to pay benefits to all retirees regardless of what other retirement income they have. Instead, the program should provide benefits only to retirees who have less than a certain amount of non–Social Security annual income. Social Security would continue to be insurance against retirement poverty for everyone but would focus its benefit payments on those who really need them. (Romina Boccia, Heritage Foundation)*

CON: *Means testing would change Social Security from an earned right to welfare. It would penalize you if you saved or earned a pension, because that income would reduce your Social Security. And it would cost more to administer. The government would have to routinely check your income and assets in order to adjust your benefit. Means testing would be a huge breach of faith with working Americans who earned their benefits by paying in over the years. (Virginia Reno, formerly with the National Academy of Social Insurance)*

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