REFORMING SOCIAL SECURITY

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IT'S TIME TO TOUCH THE THIRD RAIL OF POLITICS

Old-Age, Survivors, and Disability Insurance (OASDI)—more commonly known as Social Security—is approaching its 85th year, and in its long history, it has undergone a series of changes which have redefined it in our current society: Social Security is a pay-as-you-go social insurance program that millions rely on. As of 2018, **benefits were provided to 63 million people** including 47 million retired workers, 6 million survivors of deceased workers, and 10 million disabled workers (Board of Trustees, 2019, p. 2). The total cost of those benefits was **$1 trillion**. That is indeed a massive figure, but benefits have been growing faster than the rate of inflation since the implementation of automatic wage indexation in 1972 (Béland, 2007, p. 28). This is just one of many problems facing Social Security, but put together with dwindling trust fund reserves, demographic change, increasing longevity, and financially insecure future generations of retirees, the program is on the cusp of an incredible test. How it will fare depends on how quickly policymakers respond.

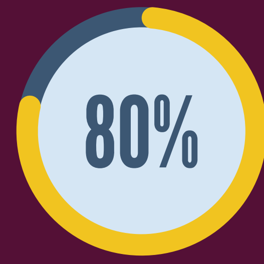
MORE THAN JUST RETIREES RELY ON SOCIAL SECURITY

3 out of 5 people aged 65 and older receive most of their income from Social Security (Romig, 2019, p. 2).

However, Social Security is especially important for women and people of color which will become increasingly important when Millennials—the most diverse generation—begin retiring. Without Social Security, **22.1 million more Americans today would be poor** including 6.7 million adults under age 65 and 1.1 million children (Romig, 2019, p. 2).

THE TRUST FUNDS

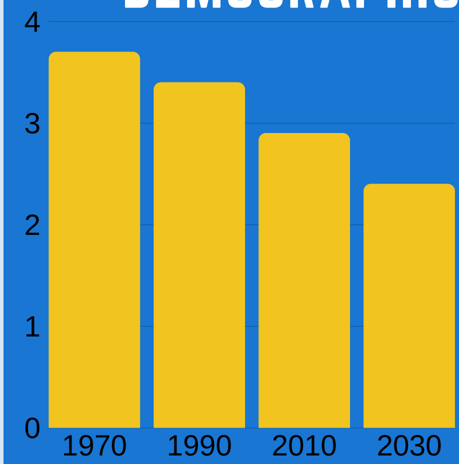
Starting in 2020, the program's total cost is projected to be more than its total income, forcing the use of the OASI and DI Trust Fund reserves. **The reserves are projected to be depleted in 2035** (Board of Trustees, p. 22).



of scheduled benefits are projected to be paid after 2035

(Board of Trustees, p. 22)

DEMOGRAPHIC CHANGE



The retirement of Baby boomers will increase the number of OASDI beneficiaries faster than the number of workers increases because of lower birth-rate generations replacing them at working ages.

COVERED WORKERS PER BENEFICIARY

(Board of Trustees, 2019, p. 60)

MILLENNIALS

Median student loan debt for Millennials was $18,000 in 2017 versus $13,000 for Generation X in 2004

(Kurz, Li & Vine, 2018, p. 13)

Generational income inequality is higher

(Kurz, Li & Vine, 2018, p. 11)

Two thirds of Millennials lack any retirement savings

(Brown, 2018, p. 13)

Average real net worth of Millennials in 2016 was 20% less than Baby boomer households in 1989

(Kurz, Li & Vine, 2018, p. 15)

The Millennial generation will retire after the trust fund reserves are depleted, yet they are financially worse off than the generations before them (Kurz, Li & Vine, 2018, pp. 11-14). The kicker is: **Millennials save at the same rate as Generation X** (Brown, 2018, p. 2).

ADVANCE FUNDING IS THE SOLUTION

Advance funding promotes economic growth, helps insulate the effects of demographic shifts, and **promotes inter-generational equity** (Arnold, 1998, p. 220).

There is **bipartisan support** for advance funding (Blahous, 2010, p. 48).

Advance funding substantially **increases the welfare of those born in the long run** by increasing the capital stock (Nishiyama & Smetters, 2007, p. 1682).

The current pay-as-you-go system simply is not resistant to the changes happening, and because of that, it is projected to impose net losses upon younger generations (Blahous, 2010, p. 51). **Why should future generations of retirees receive less than they were promised?** Two potential forms of advance funding are presented below.

1. Partial Privatization

Full privatization is unlikely because Social Security is path dependent with broad public support as a social insurance program (Béland, 2007, p. 22). However, partial privatization **allows workers to control how a portion of their own contributions are invested.**

- A transition to any privatized system is extremely expensive in the short term because it must satisfy existing obligations while allowing workers to direct their own contributions into personal accounts, but it does have **long-term benefits** (Arnold, 1998, p. 222).
- There are additional administrative costs associated with maintaining millions of individual accounts (Arnold, 1998, p. 233).
- The current system provides risk sharing through its progressive benefit formula, and this loss would decrease economic efficiency (Nishiyama & Smetters, 2007, p. 1700).

Learning from Sweden

A Partially Privatized System

Swedish participants are given the opportunity to choose their portfolios out of 700 options: in 2001, **68% of participants made an active choice, but that declined to just 10%** in 2005 (Sundén, 2006, p. 143). This emphasizes the importance of designing a default option especially in the US where financial literacy differs significantly based on gender, race/ethnicity, and education (Lusardi & Mitchell, 2011, pp. 513-516).

2. Enlarge the Fund

Transfer the existing OASI and DI funds into a single, independently controlled fund invested more aggressively in private equities instead of only US Treasury securities. Additionally, immediately increase the payroll tax by 0.8% to **create a permanent fund and increase national savings** (Diamond, 1997, p. 9).

- While there is the cost of the tax increase, this is **much smaller than the transition cost faced by privatization** and **smaller than the loss of benefits incurred from doing nothing** (Arnold, 1998, p. 227).
- Investments of this magnitude could give the government excess power in the corporate arena; however, Canada represents how this can be addressed (Arnold, 1998, p. 232)
- Investing in equities is riskier; however, most private, state, and local pension funds are invested in the stock market (Arnold, 1998, p. 232).

Learning from Canada

The Canadian Pension Plan (CPP) is part of Canada's Social Security system that is partially invested in private equities; in order to address concerns of excessive government power, the **CPP Investment Board** was created. It is an independent board which no government official can sit on (Béland, 2006, pp. 575-576). It has a **singular goal of generating the highest returns possible without undue risks** for plan members (Béland, 2006, p. 575). This model could be implemented in the US to confront the main reservations of opponents.

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