Raise the Age
by Dan Jacoby

This year, due to the lingering effect of the Great Recession, it is possible that the Social Security Trust Fund (the "Fund") will pay out more money than it takes in. Once jobs come back, that will change for a few years, but then it will become a regular occurrence as the baby boom generation retires. Barring some major change in the law, the Fund will run out of money, probably in roughly 30 years.

This happened once before, in the early 1980s. The fix then consisted of three parts. The immediate part meant that the Fund borrowed about $13 billion from the U.S Treasury over two years, and paid it back later. The short-term fix consisted of huge tax increases aimed squarely at the working-class and middle-class (more about this in the next paragraph). The long-term fix was to raise the so-called "retirement age," that is, the age at which people could collect the "full" amount of their old-age benefit.

Why was the tax increase aimed at the working-class and middle-class? Because wealthy people don't pay Social Security taxes on all of their income. There is a cap on Social Security taxes, and it is tied to median income. In 1983, people paid Social Security taxes on only the first $35,700 of earned income; today we pay Social Security taxes on the first $106,800 of income. This means that a person making, say, $213,600 a year, or twice the "cap," only pays Social Security taxes for the first six months.[1] An increase in the rate at which we pay Social Security taxes, therefore, only affects the income on which we pay the taxes.

Since the Fund is in danger of running dry again, and since we cannot afford to soak the middle-class with another major tax hike or borrow (permanently) from the Treasury, we have to find another way.

One suggested method is to remove the cap, and require wealthy people to pay Social Security taxes on all of their income. Since the program was set up, however, to be separate from the usual government activities, and still maintains a separate account, it would be a lot simpler just to move the whole program into the main government account and incorporate Social Security taxes into the income tax rates. That's not likely to happen, for how would a worker know what benefit rate to expect upon retirement?

The other suggested method is to raise the retirement age again. This is a method favored, generally, by Republicans and opposed by Democrats, for reasons passing understanding by any well-informed, thoughtful person.

There have been good ideas raised by Republicans that were opposed by Democrats without any good reason. One example was the 1981 plan to index income tax rates to inflation in order to prevent "bracket creep." This was the name for what happened when a worker got a raise that only matched the inflation rate but ended up in a higher tax bracket, and as a result paid a higher tax rate. Democrats railed against this Republican idea, but failed to present a good reason for their opposition and, fortunately, lost that particular argument.

[1] http://www.ssa.gov/OACT/COLA/cbb.html

There are generally three reasons given for opposing any proposal to raise the retirement age. One is the notion that there is something magical about age 65. The second is that manual laborers will suffer, because they are less likely to live longer, and will have to work harder for a longer time as their bodies break down. The third is related; it says that poor people will suffer because they are less likely to live long enough to receive Social Security benefits.

In 1983, the age was raised from 65 to 67, but a long delay was put into the system. The actual retirement age didn't begin to rise for 20 years. Today, it is 66, and it won't begin to rise again until 2021. By 2027 the full effect of this law will be felt, and the retirement age will be 67. So much for the "magic" of 65.

The second and third arguments are essentially alike, because manual laborers are likely to earn less than people who work at desks, and are more likely to be poor. The answer to those arguments is, therefore, the same.

Benefit rates are skewed.

Because poor people are less likely to live long enough to get Social Security benefits, and because they are also likely, if they do live long enough, to get fewer checks before they die, the amount in those checks is adjusted to make up the difference.

Let's take one of those delightfully oversimplified examples of two people, both the same age and set to retire next year at 66. One went to work for a company in a low-level job at age 18 in 1962, making $8,000 in that first year, rising eventually to $35,000 this year. The other was the son of a top executive, and worked for the same company in management and executive positions all that time. The executive always made exactly three times as much as the low-level worker, with a salary that started at $24,000 and rose to the current level of $105,000.

Since the executive always earned three times that of the low-level worker, and paid Social Security taxes on every dime earned, you might expect that executive's Social Security checks next year to be three times that of the low-level worker's – and you would be wrong. In the example given above, the executive's checks will be about one and a half times that of the low-level workers, or half of what you would expect.[2]

Why is this so?

We have already stipulated that the low-level worker, being poorer, is less likely to live long enough to collect Social Security, and likely to receive fewer Social Security checks than the executive. By skewing the amount of the checks, the intent is that the average low-level worker will end up receiving one-third as much in total Social Security payments before dying as will the average executive. In this case, the executive is expected to receive about twice as many Social Security checks as the low-level worker.

[2] Source: http://www.allsup.com/personal-finance/financial-planning-calculators/social-security-benefits-estimate.aspx. Benefits calculator used the following income levels for the low-level worker, and three times these levels for the executive: in 1962, $8,000, rising $200/year through 1972, then $300/year through 1982, then $500/year through 1992, then $1,000/year through 2009, to $35,000, along with the same $35,000 for 2010 and no income after that.

Raising the retirement age would require that the amount by which the benefit rates are skewed be revisited in order to make up for any additional disparity in the number of expected benefit checks. It would also mean that poor workers will not, on average, lose anything if the retirement age is raised.

We must keep in mind through all the debate that Social Security is an insurance plan, originally devised as insurance against getting too old to work. In 1935, when the plan was created, most workers didn't expect to live to see age 65, and most workers who did live that long were in jobs that a 65 year old person just couldn't handle any more. Today, people expect to live well past 65 (or even 67), and also expect to be active and able to work. Social Security gives older people options that most of them never used to have – the option to retire, to keep working, or to change careers into something that, while less lucrative on payday, was more rewarding in other ways.

The thing about insurance plans is that there are always winners and losers. With most insurance plans, however, you win by losing – if you take out theft insurance they only pay out if what you insured is stolen. With Social Security, the losers lose both ways, by dying and by missing out on retirement benefits, while the winners win both ways, by living longer and by being paid for it.

With the skewed benefit rates, poor people on average get just as much out for every dollar they pay in as do wealthy people. There are individuals who get more and others who get less, but on the whole that demographic group is treated equally.

There is, however, one large demographic group that will, on average, win.

Women still generally earn less than men. Since they earn less, their benefit checks are smaller, but not as much smaller as their income was. Women, on the other hand, tend on average to live longer than men, and therefore receive more Social Security checks and more total benefits per dollar of taxes paid. Raising the retirement age again will most likely benefit women over men.

Properly handled, raising the retirement age will not hurt poor people on average, nor will it be a method (as some claim) for stealing from the poor and giving to the rich in a reverse Robin Hood scheme. If Democrats were actually to look at all the facts and consider them thoughtfully before they reacted, they might get on board with what may be the first good Republican idea since 1981.

One more thing – by raising the retirement age sufficiently and quickly enough, poor and middle-class Americans could actually benefit.

If we went farther than we need in order merely to keep the Fund solvent for the foreseeable future, we could actually cut Social Security taxes. Since these taxes are paid at higher overall rates by working-class and middle-class Americans, this would be the kind of tax cut that would best stimulate the economy and thereby create jobs.

Another benefit to cutting the Social Security tax rate is that it is also a tax cut for businesses that hire Americans. Employers must match the Social Security payments made by their employees; cutting the rate is a tax cut for businesses as well, and would help create even more jobs here. It's a win for just about everybody.