EXECUTIVE SUMMARY

# Reforming Social Security for the Long Haul

by Mark Duggan

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## The Challenge

The US Social Security system, a key part of America's social safety net, is facing an immediate funding problem. Today, one in five Americans receives a check from Social Security, which supports elderly Americans, surviving family members, and disabled workers. However, the country's aging population and high levels of income inequality are causing substantial funding pressures: annual spending already exceeds payments into the system, and by 2033 actuaries forecast Social Security will exhaust its savings. Without any reforms, beneficiaries will then see around a one-quarter cut in payments, creating economic hardship among Americans who rely on this assistance. Mark Duggan examines the forces driving the financial crisis and puts forward a six-part plan to restore Social Security's solvency.

## Background

**Social Security is the country's largest single spending program.** Formally termed the Old Age, Survivors, and Disability Insurance (OASDI) program, it is also the most important source of income for elderly Americans. The payments to which individuals are entitled are determined by their earnings history, but spending on today's retirees is funded primarily by payroll taxes from current workers and their employers.

**The Social Security trust fund is projected to hit zero in 2033.** In 2022, the OASDI program already paid out $22 billion more in benefits than it took in revenue, after years of building savings through funding surpluses. This deficit is projected to steadily increase to almost $380 billion in 2032. Social Security's actuaries predict that the program will exhaust its entire savings fund in 2033. When that happens, absent changes in legislation, Social Security will need to uniformly cut payments by about one-quarter.

**America's demographic challenges are a driving force behind this financial imbalance**. First, Americans are living longer, which means they are receiving benefits for a longer time. In addition, US birth rates have fallen over time, which has led to fewer younger workers paying into the system to fund today's benefit payments. The ratio of workers per beneficiary has already fallen from 3.3 in 2007 to 2.8 in 2022. Additionally, slow wage growth (leading to slower tax-revenue growth) and rising earnings inequality (leading to a greater share of earnings being above the program's taxable maximum) have contributed to the program's financial challenges.

**The Social Security System faced similar, but less imminent, funding issues in the 1970s and 1980s.** In 1983, policymakers worked in a bipartisan way to put the program on secure financial footing by raising the payroll tax on wages and gradually increasing the age at which workers can claim their full benefits. These changes enabled the system to move from persistent annual deficits between 1975 and 1981 to build up a trust fund more than three times as large as annual spending in 2008.

## Policy Recommendations

To improve Social Security's weak financial outlook and prevent massive benefit cuts in the future, Duggan outlines six policy changes that will put the program back on a sustainable path and avoid imposing economic hardship on America's older population:

1. Modestly increase the Social Security payroll tax from 12.4 percent to 13.4 percent, a change that is much smaller than the 1.8 percent increase phased in between 1983 and 1990.
2. Increase the Social Security wage base so that 90 percent of earnings will be subject to Social Security's payroll tax (as was true in 1983). The share of total workers' earnings subject to the Social Security payroll tax has fallen from 90.0 percent in 1983 to 81.4 percent in 2021. Increasing Social Security's taxable earnings maximum by 2.5 percent more than average annual earnings growth each year for about 25 years would result in 90.0 percent of earnings once again being subject to this payroll tax.
3. Implement a small tax rate of 3 percent on all earnings above that year's taxable maximum.
4. Increase the age at which workers can claim full retirement benefits from 67 to 68 but leave unchanged benefits for those who claim their retired-worker benefits in the two years from age 62 to 64.
5. Adjust the 90-32-15 Social Security benefit formula to reduce the growth rate of benefits for high-income earners by freezing the formula's second "bend point." Social Security's formula to translate a worker's career earnings into their monthly retirement benefit is already progressive in that it converts a larger share of lower-income workers' earnings into benefits. This change would make it more progressive.
6. Allow the OASDI trust fund to borrow from the US Treasury to cover shortfalls, as other trust funds—like those for state unemployment insurance programs—are allowed to do. Duggan suggests that future annual OASDI surpluses be used to repay this debt.

## Conclusion

Any plan to restore America's fiscal outlook must address imbalances facing Social Security, imbalances largely stemming from an aging population and a smaller-than-forecasted tax base of earnings. Politicians have in the past come together to enact necessary reforms, and such action is needed once again to avert painful benefit cuts. Changes to increase the program's revenue while reigning in spending growth will strengthen this program that has become a bedrock of America's social safety net.

## ABOUT THE AUTHOR

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Mark Duggan is the Trione Director of the Stanford Institute for Economic Policy Research (SIEPR) and the Wayne and Jodi Cooperman Professor of Economics at Stanford. His research focuses on the health care sector and the effects of government expenditure programs such as Medicare, Medicaid, and Social Security. His research has been published in leading academic outlets including the American Economic Review, the Journal of Political Economy, and the Quarterly Journal of Economics and has been featured in many media outlets including The Economist, The New York Times, and The Wall Street Journal. Duggan was the 2010 recipient of the ASHEcon Medal (awarded once every two years to the leading health economist in the MA under age 40) and his research has been funded by National Science Foundation, the National Institutes of Health, the Alfred P. Sloan Foundation, the Robert Wood Johnson Foundation, and the Social Security Administration. He has testified about his research to committees in both the US Senate and US House of Representatives and he served from 2009 to 2010 as the senior economist for Healthcare Policy at the White House Council of Economic Advisers. He teaches "Econ 1" at Stanford and advises dozens of undergraduate and graduate students.

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