



Joint Colloquium of the IACA, PBSS and IAAHS Sections of the International Actuarial Association

Westin Copley Place Hotel, Boston, U.S.A. – 4-7 May 2008

Social Security Reform in the United States: Distributional Considerations

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Overview

- Scope of U.S. underfunding issues
- Distributional properties of U.S. Social Security (OASDI) under current law
 - Larger context of U.S. tax-transfer system, income distribution
 - Important demographic & economic patterns
- Redistribution under a (more) DC-based system
 - Details would matter **a lot**
- Political prospects
 - Intermediate steps (prefunding in non-government assets, as in Canadian case)?
 - What are the candidates saying? Bipartisan possible?

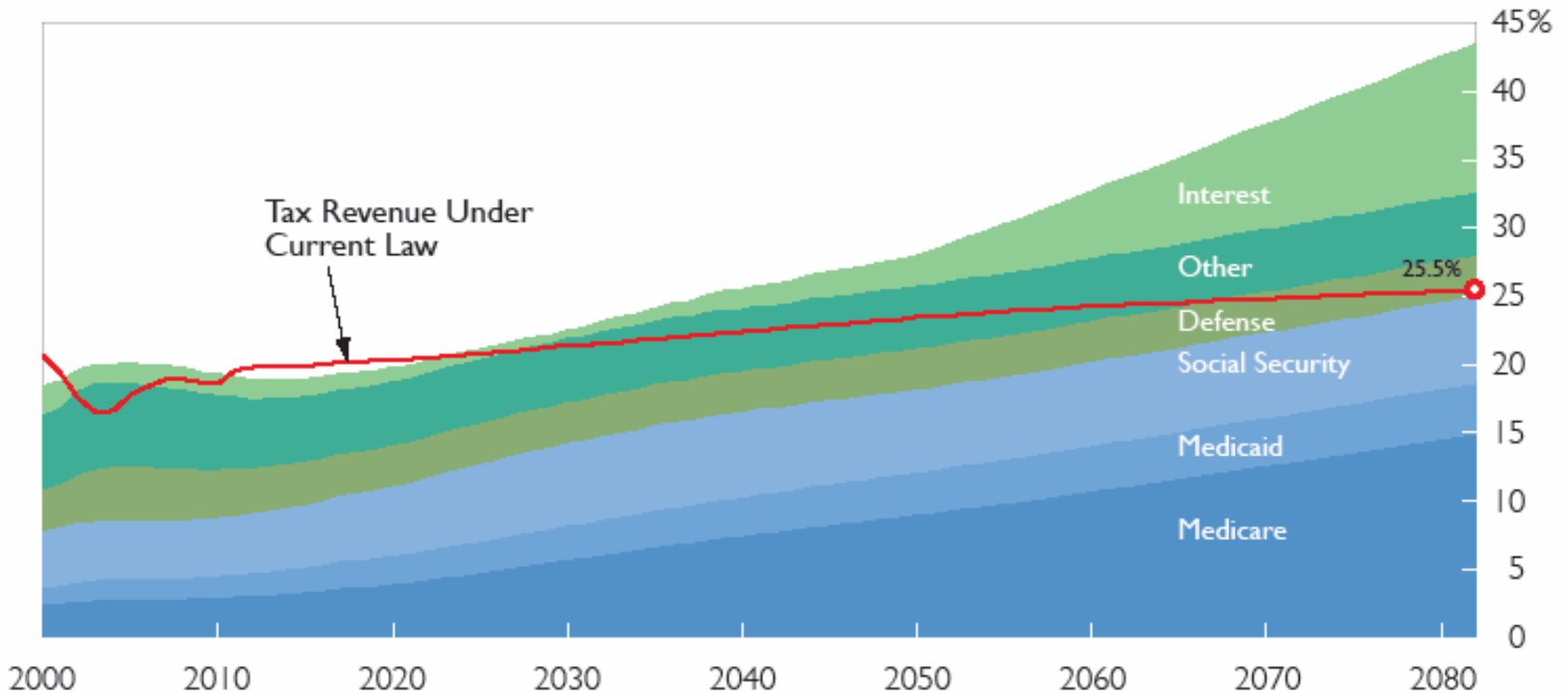
Scope of OASDI underfunding

- 75-year horizon
 - \$4.3 trillion (1.7% of payroll)
 - Relatively modest
 - Becomes bigger if we don't take action in the next few years—options for sharing the burden decline with each passing year
- Infinite horizon
 - \$13.6 trillion (3.2% of payroll, 1.1 % of GDP)
 - Emphasizes the fact that 75-year horizon is limited

But... Medicare underfunding is much, much more severe

- > 2.75 * the size of the OASDI unfunded obligation over the 75-year horizon
- Will constrain our ability to respond to:
 - Social Security
 - Other needs that we may or may not be able to anticipate (security, infrastructure, investing in children)

Federal Spending as a Percentage of GDP Under Current Law, 2000–2082



Source: Spending and Revenues from CBO Long-Term Budget Outlook, December 2007 (Extended Baseline Scenario).

Source: Taking Back our Fiscal Future (2008)

Forms of OASDI redistribution

- Within person over time
 - Much of the financial transfer
- Within families (generally from husbands to wives)
- Across generations (from children to parents/grandparents/great-grandparents)
 - “Legacy cost” – fraction of unfunded obligation that is legacy cost
- Within generations (unmarried to married, higher-income to lower-income, men to women)

Distributional properties of OASDI under current law

- Payroll tax is cross-sectionally regressive (flat rate, capped at \$102,000)
- Benefit formula is progressive
- Worker benefits relatively modest, more generous spousal and survivor benefits
 - Predicated on legal marriage, not children
- Differentials in life-course processes (mortality, fertility, marriage/divorce, employment) affect redistribution

Sample Differentials

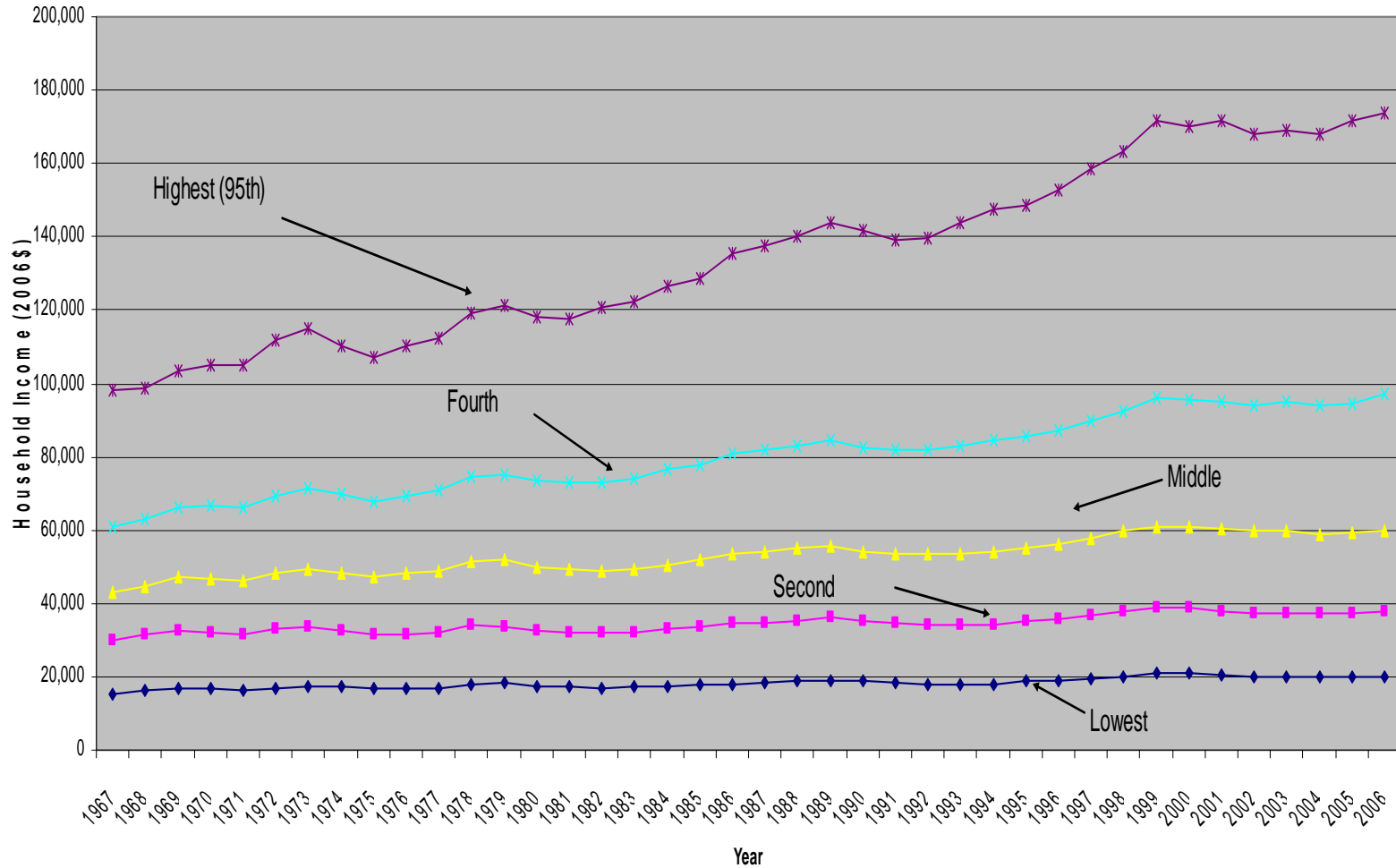
- **Mortality:**
 - Life expectancy differential between a white woman & black man at age 15 is ~ 10.5 years
 - Education, lifetime income differences
- **Marriage/Divorce:**
 - Also marked race, education, lifetime income differences
- **Disability:**
 - High school dropouts about 8 times more likely to be on DI than college grads

Distributional properties of OASDI under current law

- Evaluated over a lifetime, many of these factors are offsetting wrt lifetime income
 - Consensus: OASDI as a whole is generally progressive, but less progressive than generally perceived
 - OASI is much less progressive than DI
- Women are clearly great beneficiaries, though some women benefit much more than others (stay-at-home spouses vs. never married women)

Distributional Context

Household Income Inequality is On the Rise



Source: Census

Redistribution under a (more) DC-based system

- Applaud Kotlikoff for innovative thinking and advocacy about redistributive features under a DC system
 - Matching for low-earners
 - Earnings sharing
 - Long-term, daily annuitization
 - Sensitivity to transaction costs / remove profit motive
- Our previous analyses suggested these factors and types of adjustments were among the most critical for averting poverty, adverse distributional consequences for women under DC-heavy OASDI

Redistribution under a (more) DC-based system

- Imagine that we agree on much:
 - the language in debates about personal accounts, prefunding, and diversification overstates and oversimplifies
 - e.g., “Bad for women”
 - the current fiscal picture— and recent Congressional history—are extremely disheartening
 - Improving work incentives
- Devil is in the details

Critical details

- Annuitization
- Treatment of disability, survivors
- Recommended reading (2005):
 - National Academy of Social Insurance Report:
Unchartered Water: Paying Benefits from Individual Accounts in Federal Retirement Policy (www.nasi.org)

Political Prospects: Recent History

- President's initiatives in 2001-2004 were unsuccessful
 - Plan most strongly advocated included carve-out (DC) personal accounts (with an offset) coupled with price indexing
 - Some commission plans included longevity-indexing, other adjustments
 - Large transfers from GR for transition costs

Political Prospects: Lessons

- **Were Commission preconditions an issue?**
 - No payroll tax-side adjustments
 - No effects on current or near retirees
 - Must include personal accounts
 - No investment of Trust Fund in stock market
 - Excluded some honest brokers
 - “Overplayed” race and gender angles?

Political Prospects for 2009+?

- Could the next President be more successful?
 - McCain (and chief advisor Holtz-Eakin): most direct statements support progressive price indexing, DC accounts only as an add-on (rather than a carve-out)
 - Obama: Addresses the problem more on the tax side (increasing the taxable maximum)
 - Clinton: non-committal, focus on commission
- No President can go it alone

“Non-Partisan” Plan of Leibman, MacGuineas, Samwick

- An example of what a bipartisan plan might look like? Elements:
 - Increased retirement ages
 - Progressive benefit reductions
 - Increased taxable maximum
 - Payroll tax increase
 - Mandatory personal accounts (add-on, plus redirection of Trust Funds—possible progressive match, fully annuitized)
 - Miscellaneous updates (minimum, spousal)

Political Prospects

- Discouraging times for advocates of fiscal responsibility
 - Evidence is slim that Congress will exercise restraint
 - Incentives very poorly aligned for long-term problems
- Will it take a “crisis”?
 - Could the current liquidity squeeze precipitate more serious attention to public debt?

Policy Recommendations: Is there anything we can do short of full reform to minimize deterioration in the interim?

- “Taking back our fiscal future” recommendations
 - Explicit long-term budgeting
 - Triggers for automatic adjustments when deviations are significant

Disclosure

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