**Budget Model**

# PWBM Budget Contest: A Flat Benefit for Social Security

**Summary:** As part of PWBM's "Democratizing the Budget Contest," Andrew Biggs, Ph.D. proposed a package of Social Security reforms centered around gradually transitioning the program to a flat benefit for new retirees. PWBM projects that this proposal would reduce the program's conventional 75-year imbalance by 2.44 percent of taxable payroll, leaving a remaining imbalance of 0.8 percent of current law taxable payroll. The proposal would decrease GDP by 0.6 percent in 2030 while increasing GDP by 0.6 percent in 2050.

**Key Points**

- The proposed reforms would, after a transition period, establish a flat Social Security benefit equal to the individual over-65 poverty threshold and available to all retirees regardless of work history.

- We project that this proposal would reduce Social Security's conventional 75-year imbalance by 2.44 percent of current law taxable payroll, leaving an imbalance of 0.8 percent.

- The proposal breaks the linkage between payroll taxes paid and Social Security benefits received while reducing total spending. As a result, the proposal tends to discourage work while encouraging private saving. We project that GDP would decrease by 0.6 percent in 2030 due a reduction in labor supply but increase by 0.6 percent in 2050 due to increases in investments from a higher savings rate.

**Introduction**

This brief analyzes one of three winning proposals from the PWBM Democratizing the Budget Contest. This proposal, by Andrew Biggs, Ph.D. of the American Enterprise Institute seeks to remedy the projected imbalance of the Social Security Trust Fund while lowering elderly poverty rates and incentivizing delayed retirement. We model four main provisions of this proposal, summarized in Table 1 and below.

## Table 1. Proposed Reforms to Taxes and Benefits

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| **Benefit Provisions** | **Current Policy** | **Proposal** |
|---|---|---|
| Cost of Living Adjustment (COLA) | Yearly COLA based on the Consumer Price Index - Urban Wage Earners and Clerical Workers (CPI-W) | For Social Security beneficiaries born in 1959 or before, the yearly COLA would be based on:<br>• The CPI-Elderly (CPI-E) for retirees with PIAs below $1022,<br>• The CPI-W for retirees with PIAs between $1022-1750,<br>• Chained CPI for retirees with PIAs above $1750.<br>These thresholds ($1022 and $1750) would be indexed to the CPI-W. |
| Universal Flat Minimum Benefit | Workers aged 62 or over with at least 10 years of employment (40 Quarters of Coverage) are eligible for earning-related benefits, with a "special minimum benefit" of $886.40 in 2019. This minimum is indexed to the CPI-W. | All individuals aged 62 or over would be eligible for a flat dollar benefit equal to the single, over-age-65 federal poverty threshold published by the U.S. Census Bureau ($1022 per month for 2019). This provision would be applied to individuals born in 1960 or later. The minimum benefit amount would be adjusted each year according to average wage growth. |
| Reduce PIA Replacement Rates | 35-year Average Indexed Monthly Earnings (AIME) are replaced by 90% up to $996, 32% up to $6200 and 15% above $6200 | Over 25 years, beginning in 2022, replacement rates are gradually reduced to 90%, 4%, and 0%. |
| **Tax Provisions** | | |
| Payroll Taxes on Wage Earnings | 12.4% Social Security payroll taxes are applied to earnings up to the taxable maximum ($142,800 in 2021). | Social Security taxes would be waived for individuals age 62 or older. |
| **Other Provisions** | | |

| Benefit Provisions | Current Policy | Proposal |
|---|---|---|
| Private Savings | | Individuals would be required to save 3% of their wage income in an employer sponsored plan, if available. Individuals without access to an employer sponsored plan would be required to save 3% of after tax wage income in a government-provided retirement plan. |

**Changes to Benefits for Current Retirees**

The proposal does not *directly* change benefits for anyone receiving Social Security benefits in 2021, i.e., those who first claim before the policy comes into effect. Instead, it uses differential Cost of Living Adjustments (COLA) to gradually reduce benefits for higher-income individuals while increasing benefits for lower-income individuals. Retirees with benefits below the U.S. Census Bureau poverty threshold for an individual aged 65 or older would have their benefits adjusted each year using the U.S. Bureau of Labor Statistic's CPI-E measure, which generally grows faster than the currently used CPI-W measurement. Those individuals with a monthly benefit above $1750 would receive yearly adjustments using the chain-weighted CPI, which generally grows more slowly than the CPI-W.

**Changes to Benefits for New Retirees**

The proposal has two effects on the benefits for new retirees who first claim Social Security benefits after the policy takes effect in 2022. First, the proposal immediately establishes a flat *minimum* benefit for all new retirees. This minimum benefit would be available regardless of work experience and set at the poverty threshold for an individual aged 65 or older.[1]

Second, Primary Insurance Amount (PIA) replacement rates would be lowered gradually, decreasing new retirees' benefit amounts until *all* beneficiaries are receiving the same flat minimum benefit amount, i.e., the paid benefit is not just a minimum but the same for all households. This change would phase in over 25 years, lowering PIA replacement rates from 0.9, 0.32, and 0.15 to 0.9, 0.04, and 0, respectively.[2]

The new minimum would lead to a short-term increase in total benefits paid. Those with very low-wage earnings histories (25 percent of AWI) would see a 17 percent increase in benefits under the new minimum. However, once the reduction in replacement rates is fully phased in after 25 years, the proposal would reduce Social Security benefits as all new retirees receive the flat minimum. A hypothetical "middle-income" retiree with a 44-year age-adjusted earnings history equal to the Average Wage Index (AWI) would see a 46 percent decrease in their monthly benefit. An individual with a higher-wage work history above the taxable maximum would see a 67 percent decrease in their monthly benefit, while someone with a lower-wage work history (45 percent of the AWI) would see an 11 percent decrease in their OASDI benefit.

**Changes to Taxes**

The proposal only makes one change to taxation: eliminating Social Security payroll taxes for those aged 62 and older. This change attempts to incentivize individuals to delay exiting the labor force and thus to continue

paying federal income and Medicare taxes.

**Other Provisions**

The proposal additionally includes two provisions to boost private retirement savings, for which we only provide a conventional estimate. First, employees with access to an employer-sponsored retirement plan would be auto-enrolled at a minimum contribution rate of three percent of employee wages. This provision would reduce revenue initially as individuals receive a deduction for these contributions. In the future, these savings would be taxed, mitigating some of the revenue loss. Second, the federal government would establish a defined contribution retirement plan and private-sector employees without access to an employer-sponsored retirement plan would be auto-enrolled in this new federal retirement plan at a minimum contribution rate of three percent (treated akin to a Roth IRA for tax purpose). This provision would not have a budget consequence due to the Roth treatment.[3] Additionally, in the event of future long-run Social Security surpluses, the proposal suggests allowing the OASDI Trust Fund to temporarily borrow against those future surpluses.

**Budget Effects**

Two provisions in the Biggs proposal would have direct budgetary effects, estimated on a conventional basis in Table 2. First, elimination of the Social Security payroll tax for workers 62 years of age or older directly lowers tax revenue and would cost about $1,211 billion from 2022-2030. Second, the minimum contribution rate for employer-sponsored retirement plan reduces revenue by about $48 billion from 2022-2030.[4]

## Table 2. Conventional Revenue Estimates, Fiscal Years 2021 - 2030

*Billions of Dollars, Change from Current-Law Baseline*

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| Provision | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 |
|---|---|---|---|---|---|---|---|---|---|---|
| Eliminate Payroll Tax for 62+ | 0 | -107.55 | -123.12 | -126.92 | -131.73 | -135.13 | -138.5 | -144.13 | -149.39 | -154.66 |
| Forced 3% Savings | 0 | -5.6 | -5.5 | -5.4 | -5.4 | -5.4 | -5.4 | -5.3 | -5.2 | -5.1 |
| **Total** | **0** | **-113.2** | **-128.6** | **-132.3** | **-137.1** | **-140.5** | **-143.9** | **-149.4** | **-154.6** | **-159.8** |

**Effects on Social Security's Finances**

Overall, the Biggs proposal would worsen Social Security's short-term deficits but improve its long-term finances. The minimum benefit for new retirees and elimination of payroll taxes for older workers both take effect immediately, increasing costs and decreasing revenues, respectively. Over time, as the flat benefit takes effect for all beneficiaries, costs would decrease.

These trends can be seen in Figure 1, which reports annual estimates of Social Security's non-interest balance ratio on a conventional basis, not including macroeconomic feedback effects. The non-interest balance ratio represents the difference between annual costs and non-interest incomes, divided by annual taxable payroll under current law. Under current policy, Social Security's annual non-interest income balance will continue to decrease steadily over time, while under the proposed reforms it would turn positive beginning in 2059.

## Figure 1. Social Security's Annual Non-Interest Income Balance as a Share of Current-Policy Taxable Payroll, Static Estimates

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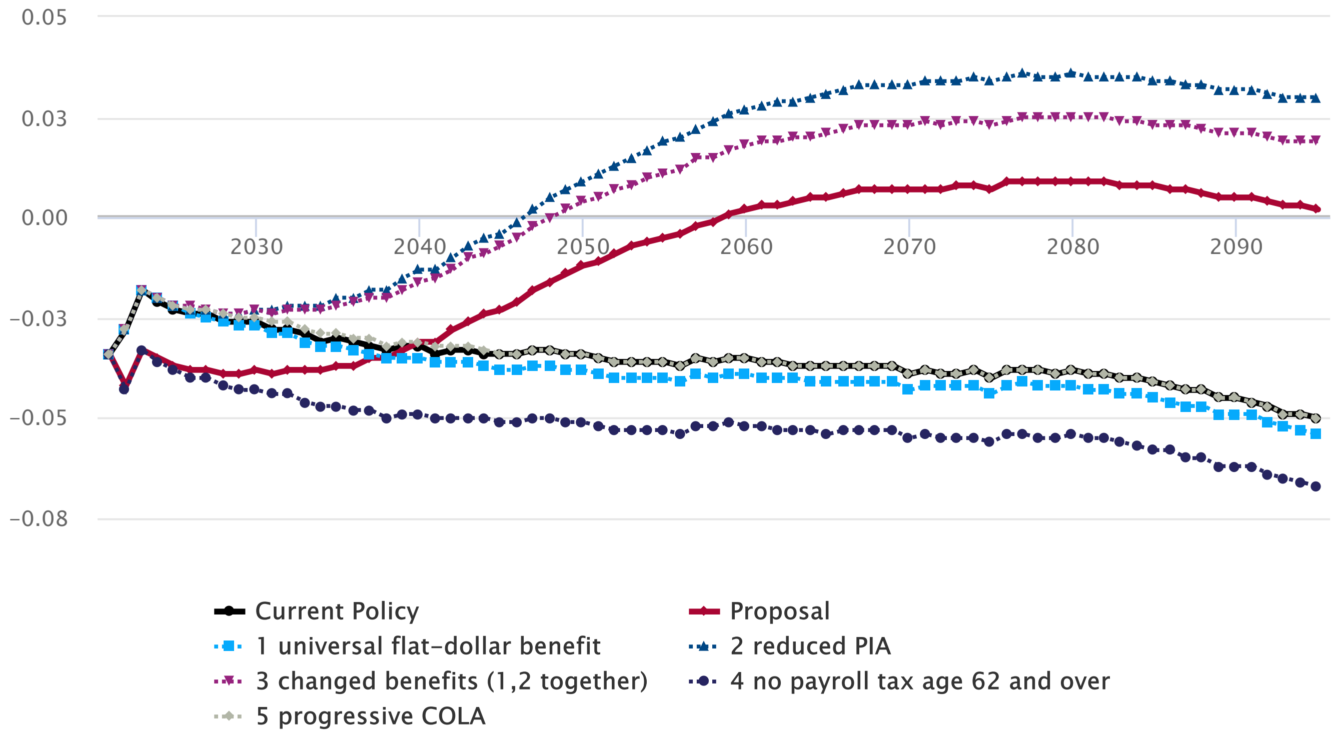


Table 3 summarizes the effects of each individual provision of the Biggs proposal on Social Security's finances in terms of the OASDI Trust Fund depletion date and the program's 75-year (2021-2095) actuarial balance. This ratio indicates the program's fiscal shortfall as a fraction of all future payrolls.

## Table 3. Estimated OASDI Financial Effects, Relative to Current Policy

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| | | Static 75-year (2021-2095) Actuarial Balance (as a percentage of taxable payroll) | Change in Static 75-year Actuarial Balance | Year of Depletion for OASDI Trust Fund |
|---|---|---|---|---|
| **0** | **Current Policy** | **-3.24** | | **2033** |
| *1* | *Universal Flat-Dollar Benefit* | *-3.53* | *-0.29* | *2033* |
| *2* | *Reduced PIA Factors* | *1.38* | *4.62* | *2035* |
| ***3*** | ***Changes to Benefits (1 and 2 together)*** | ***0.74*** | ***3.98*** | ***2035*** |
| *4* | *Payroll Tax Change* | *-4.86* | *-1.62* | *2029* |
| *5* | *Progressive COLA* | *-3.19* | *0.05* | *2034* |
| **6** | **Full Proposal (3, 4, and 5 together)** | **-0.80** | **2.43** | **2029** |

The proposal's reforms, taken together would reduce the long-run shortfall in Social Security's finances, increasing the program's 75-year balance ratio from -3.24 percent of current law taxable payroll to -0.80 percent. The increase in the balance ratio is mostly due to the reduction in benefits ("Reduced PIA Factors"), which, considered alone, would increase the long-run balance ratio by 4.62 percentage points. The proposal would, however, bring the OASDI Trust Fund's depletion date forward from 2033 under current policy to 2029, at which point only 75 percent of scheduled benefits would be payable.

### Macroeconomic Effects

Table 4 shows the projected macroeconomic effects of the proposal as a whole.

## Table 4. Effects on Key Macroeconomic Variables

*Percent Change from Baseline*

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| | Output | Capital Stock | Hourly Wage | Hours Worked | Government Debt |
|---|---|---|---|---|---|
| 2030 | -0.6 | 0.4 | 2.2 | -2.8 | 7.8 |
| 2040 | -0.3 | 2 | 2.9 | -3.1 | 10 |
| 2050 | 0.6 | 4.6 | 4 | -3.3 | 7.5 |

Under current policy, the payroll taxes do not distort decisions about work as much as other taxes on labor. The reason is that payroll taxes paid are linked to expected future benefits. As explained in our previous work, this effect is captured in dynamic lifecycle models such as the PWBM Dynamic OLG.

The new flat minimum benefit immediately severs the link between payroll taxes paid and benefits received. This change makes the Social Security payroll tax fully distorting and thus discourages work, dominating the relatively small increase in labor that results from exempting workers over the age of 62 from Social Security payroll taxes. Total hours worked in the economy decreases by 2.8 percent in 2030, 3.1 percent in 2040, and 3.3 percent in 2050.

The Biggs proposal also increases government debt. This calculation includes *implicit* debt, which the proposal adds to by increasing Social Security's short- and medium-term deficits. Total government debt increases by 7.8 percent in 2030 and by 10 percent in 2040. By 2050, however, as Social Security's finances improve under the proposal, total government debt goes back down to 7.5 percent above baseline.

While increased government debt crowds out capital formation, the new flat benefit increases savings, as households generally would like to have more income in retirement than just the flat benefit. On net, the latter effect dominates—the capital stock is 0.4 percent larger in 2030, 2 percent larger in 2040, and 4.6 percent larger in 2050.

In the short- and medium-run, the reduction in work outweighs the increase in capital. As a result, GDP would be 0.6 smaller in 2030 and 0.3 percent smaller in 2040. By 2050, however, GDP would be 0.6 percent *larger* under the proposed reforms, as the increase in capital begins to dominate the decrease in work.

*This analysis was conducted by Sophie Shin and Jon Huntley. Prepared for the website by Mariko Paulson.*

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1. The proposal does not affect the actuarial adjustments for early and late claiming of benefits. I.e., individuals retiring at their Full Retirement Age would receive the minimum benefit, while those claiming earlier/later would receive a smaller/larger monthly benefit. ↩
2. The new PIA factors (0.9, 0.04, 0.0) are calculated so that the flat benefit would be higher than PIA-based benefits for all retirees in 25 years. ↩
3. An important consequence of this forced savings is the burden it puts on individuals who would not have saved this income in absence of the provision. We do not consider those welfare effects in this analysis. ↩
4. In addition, benefit side provisions would reduce revenues ($10 billion from 2022-2030) from taxes on Social Security benefits. ↩