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Building It Up, Not Tearing It Down

A Progressive Approach to Strengthening Social Security

Christian E. Weller December 2010

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Fast facts about Social Security

Our Social Security modernization proposal

This report lays out in detail the main reasons why a comprehensive overhaul of Social Security will preserve the system's fiscal strength and update its progressive goals for a new century. A progressive solution should focus on three goals:

- Protect the basic income guarantees that Social Security now offers
- Modernize benefits in line with demographic and economic changes to improve retirement income security for those who need it the most
- Make Social Security financially viable for the next 75 years

More specifically, our proposal will:

- Protect Social Security's insurance value
- Balance revenue increases and benefit changes in a progressive way
- Protect the principle of intergenerational commitment to the common good
- Modernize benefits to better meet the needs of the most vulnerable
- Strengthen Social Security's insurance protections for women
- Update the program in line with economic insights
- Achieve fiscal balance for the next 75 years.

Our comprehensive Social Security reform plan will ensure a modernized, fiscally sustainable program that can serve today's American working families as it has for past generations by continuing to provide a basic income guarantee to all working Americans. But achieving these goals will require changes to benefits, taxes, and other features of Social Security. We detail the reforms necessary to achieve these goals as well in this paper, but briefly our proposals will:

- Create a minimum benefit level so that no American lives in poverty upon retirement
- Raise benefits by 5 percent for Americans 85 years and older
- Improve survivorship benefits so that surviving spouses do not face large benefit cuts
- Strengthen divorce benefits so that divorcees are eligible for more benefits
- Create a caregiving credit so that workers can temporarily care for ailing family members
- Expand spousal benefits to married same-sex couples
- Gradually phase in progressive changes to benefit formula
- Eliminate the cap on the employer share of the payroll tax to increase contributions
- Treat cafeteria benefit plans like 401(k) plans for purposes of calculating the employer share of the Social Security payroll tax
- Use a more accurate inflation measure to achieve savings in the system
- Allow Social Security to invest some trust fund assets in the stock market to boost returns

Together, these reforms will protect the fundamental insurance function of Social Security, modernize benefits in line with demographic and economic changes over time, and sustain Social Security's finances for the next 75 years. In the pages that follow, we will detail these reforms alongside the reasons why we need to embark on this modernization today. By acting now, we will have a more sustainable Social Security system that will improve the economic security of future generations of beneficiaries.

The need to modernize Social Security now

There is a real need today to modernize Social Security to account for changes in employment patterns, differences in life expectancies by income, and social changes such as the growth in single households, greater acceptance of same-sex marriages, and increasing divorce rates. What's more, there are new economic insights that can make the system more efficient. Here are the trends modernization would account for in Social Security

Trend: Persistent old-age poverty	Proposal: New minimum benefit
Trend: Jump in poverty for oldest old	Proposal: Bump up benefit at age 85
Trend: Greater female labor force participation	Proposal: Improved survivorship benefits
Trend: Rise in divorce rates	Proposal: Easier eligibility for divorce benefits
Trend: More caregiving needs	Proposal: New caregiving benefits
Trend: More same-sex marriages	Proposal: Benefit extension
Trend: Increased inequality in life expectancy	Proposal: Phase in of progressive benefit changes
Trend: Shifting income away from workers	Proposal: Eliminate cap on employers
Trend: Shrinking tax base	Proposal: Treat cafeteria benefit plans like 401(k)s
Trend: Better price measures	Proposal: New inflation index
Trend: Better financial management	Proposal: Diversify trust fund portfolio

The conservative alternative: Privatization

Our comprehensive Social Security reform plan would, if enacted, put Social Security on a path to fiscal sustainability, modernized benefits, and an updated program structure. The conservative alternative—privatization—would achieve exactly the opposite for the program. Specifically, privatization would:

- Make the expected long-term financing shortfall for Social Security much worse by incurring trillions of dollars of new debt to pay for privatization
- Seriously weaken the insurance protections that Social Security offers by cutting benefits by as much as 50 percent to pay for privatization
- Expose future retirees to the vagaries of the financial market for their basic retirement income, creating a potentially massive problem for individuals since they may retire in the middle of a bear market, when they have a lot less money in their retirement accounts than expected

The bottom line is that privatizing Social Security means workers would lose insurance protection on their Social Security benefits because the entire system would receive less income and because individuals would be exposed to more financial risks. This would leave most Americans in retirement today or nearing retirement in serious jeopardy of their so-called "golden years" becoming anything but golden. And future generations of Americans entering retirement would be counting on a Social Security system hobbled by debt and unable to protect their private accounts from the whip-saw nature of private financial markets.

Contents

Introduction and summary

Social Security is arguably the greatest progressive achievement of the last century, embodying the values of shared responsibility and economic security for everyone, not just a select few. When President Franklin D. Roosevelt formed the Committee on Economic Security—the basis for Social Security—he said he wanted a program that would "provide at once security against several of the great disturbing factors in life—especially those which relate to unemployment and old age." Those values continue to be the foundation of Social Security today. The program represents a shared responsibility to one another and from one generation to another. It underpins the retirement income of 36 million Americans, provides basic survivor benefits for another 6 million widows or widowers, and delivers critical disability insurance to another 10 million working families.[1]

Social Security protects almost all Americans who work or have worked for pay and their families. Currently, 156 million Americans are paying into Social Security in 2010 and 205 million people in 2009 had paid enough into Social Security or were dependent on somebody who had paid enough into Social Security to qualify for retirement and survivorship benefits.[2] Most of these current workers and their dependents will count on Social Security as their income insurance for decades to come.

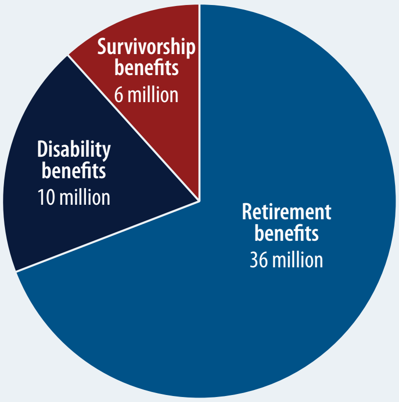
Social Security, in short, is our bedrock for basic income insurance for all Americans.

Yet the program and its founding progressive values face two significant challenges: one short term and the other longer term. The immediate challenge is defending Social Security from decades-long conservative charges that the program is too costly. What Republican Presidential Candidate Alf Landon said about Social Security in 1936—that it would encourage wasteful spending and deliver children nothing but "roll after roll of neatly executed IOU's" from their fathers' safe deposit boxes—isn't very different from what conservatives of the present day continue to predict. They always see disaster just over the horizon, and propose diminishing and now privatizing Social Security.

Social Security: fundamental facts in today's society and economy

Few modern public or private endeavors boast as successful a track record as Social Security. It provides a basic income guarantee to millions of families when their primary source of income disappears because of the retirement, disability, or death of the main bread winner. The nation's premier retirement, disability, and life insurance program for working families was created in 1935 and served 53 million people in 2009.[3]

Social Security's three branches serve 53 million people



Retired workers made up the largest group of Social Security beneficiaries. Thirty-six million Americans received checks in 2009.[4] Those checks provided the majority of income for 63.9 percent of families 65 years old and older in 2008, the last year for which complete data are available.[5] An additional 10 million beneficiaries received disability benefits, and 6 million got benefits from the survivorship program in 2008, the last year data on those programs were available. A total of 4.1 million children received Social Security benefits from Social Security's three parts—retirement, disability, and survivorship insurance—in 2008.[6]

Almost everybody is somehow insured by Social Security. Close to 90 percent of Americans either earned enough over the years to qualify for retirement or survivorship benefits or who at one time or another were dependent on somebody who did.[7] Social Security provides some means of income to ensure that families can at least cover the basics in retirement, when a worker becomes disabled, or when the primary bread winner dies.

The average retirement benefit in 2008 was $1,105 per month, the average disability benefit amounted to $914, and the average survivorship benefit totaled $981 per month for each individual recipient.[8] Those workers who earn average or even high wages during their careers can expect to pay for basics with Social Security, but it won't afford them a lavish lifestyle.

In fact, Social Security's current benefits are not a universal guarantee against old-age poverty. Just under ten percent (9.7 percent) of families 65 years old and older lived in poverty in 2007. This was less than the poverty rate of 12.4 percent for the entire population, but it meant that 3.6 million people over 65 years of age were poor.[9]

Progressives should reach out to all sides of the political spectrum, but we cannot pretend to give "even handed" treatment to arguments that have been wrong for 75 years. Social Security today faces a conservative onslaught seeking to undermine and dismantle the program. Congressman Paul Ryan (R-WI), who will certainly enjoy an elevated position in the new 112th Congress that convenes in January next year with its Republican majority, released a budget roadmap that privatized Social Security similar to President Bush's unsuccessful privatization plan in 2005. This conservative plan, if enacted, would dismantle Social Security's founding progressive principles and replace it with an "on-your-own" philosophy that guts benefits for middle-class families, explodes the national debt even further, and is not supported by the majority of Americans.

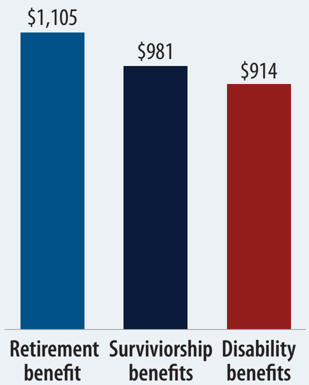
There is a clear need for this kind of basic income insurance, as the Great Recession amply demonstrates. A financial market crisis and housing crisis can destroy a lot of savings in the blink of an eye. American families saw their personal wealth fall by a whopping $19.3 trillion (in 2010 dollars) from June 2007, the last peak of personal wealth, to March 2009, its latest bottom.[10] The bursting housing and stock market bubbles dashed a lot of dreams of a secure retirement, even for many of those who had done the right thing and saved for retirement by paying down the mortgage on their home and by putting money into their personal retirement savings accounts.

And working longer is not always an option. Many older workers today would like to work longer, but they simply cannot find a job, just like everybody else. The share of people over the age of 65 who are employed reached its highest level, more than 16 percent, since 1970, yet more older workers are looking for a job and cannot find one than at any time since 1948. The unemployment rate for people 65 years old and older was above previous record high unemployment rates throughout the second half of 2009 and into early 2010.[11]

Then there is Social Security coverage for premature death and disability, which are much less predictable and much harder to prepare for. An accident or illness can easily derail a once-productive career or leave a family without its primary source of income. Social Security estimates that one-quarter of those 20 years old today will become disabled, and about 1-in-8 will die before reaching the full retirement age of 67.[12] No amount of planning and saving will adequately prepare America's families for these eventualities.

There is thus a clear need for a basic income insurance for all Americans when the primary source of household income disappears due to retirement, disability, or death. Social Security has successfully and efficiently provided this insurance for the past 75 years. Our comprehensive plan presented in this paper details how this can be achieved effectively, pragmatically, and progressively—protecting all Americans for generations to come.

Average monthly benefits in 2009



Progressives must stand up to these attacks on Social Security but also tackle the long-term challenge of modernizing Social Security so that it can offer the best insurance benefits to those who need them the most. This means updates to address demographic and economic changes that have occurred over the past few decades as well as Social Security's long-term financial challenges so that we can provide these modernized benefits for generations to come. In 2037, all of those participating in the program will suddenly receive benefits one-quarter below what they were promised—if nothing changes. This would be an unprecedented break in the generational agreement in place since the 1930s to support everybody's retirement and those struck by disability or the death of a primary breadwinner. (See Box)

These challenges—both the conservative assault on Social Security and the need for modernization—cry out for progressive changes to Social Security to ensure the program's long-term viability without jeopardizing the values on which it was built. Social Security is in no immediate danger of financial insolvency—the long-term financial challenge is being used by conservatives simply as an excuse to destroy the program. But Social Security does need to change in order to strengthen the program for the rest of this century.

Our nation must rise to meet these twin challenges today. Conservative plans to dismantle Social Security represent a clear and present danger, but another lesser danger is to reject any calls for updating the program. Progressive governance requires us to modernize this program to provide a strong and fiscally sustainable Social Security system to meet the economic challenges of our age. This is not the political fad of the moment, but an economic imperative for each and every generation of Americans.

In this paper, the Center for American Progress proposes a Social Security system worthy of meeting America's challenges in the 21st century. Our approach to social insurance rewards work with secure retirement, attacks poverty, and responds in meaningful ways to the fundamental changes in how families work and live today. And our recommendations meet Social Security's financial needs for the next 75 years. Specifically, our proposal will:

- Protect the basic income guarantees in the program
- Modernize benefits to improve economic security for those who need it most
- Strengthen the system's financial viability without placing the burden on the backs of working Americans and their families and without drastic changes for all Americans, such as raising the retirement age

Our proposals to modernize Social Security are generally supported by the majority of Americans. What most Americans don't want is to dismantle Social Security through privatization and drastic across-the-board cuts alongside an increase in the retirement age.

Indeed, in the finest tradition of progressivism, we propose to modernize and strengthen Social Security just as we have done since its enactment. Disability benefits were added in 1954, automatic cost-of-living adjustments were introduced in 1972, and federal employees became part of Social Security for the first time with a new law in 1983.[13] All these changes improved Social Security benefits for a larger share of our workforce.

We should act with a similar goal in mind today. Social Security is an unqualified success, but for it to remain so we must update it to reflect the needs of our 21st century workforce, not the workforce of the past century. There is a real need today to modernize the program to account for changes in employment patterns, including higher employment among those with caregiving responsibilities, differences in life expectancies by income, and social changes such as the growth in single households, greater acceptance of same-sex marriages, and increasing divorce rates. What's more, there are new economic insights that can make the system more efficient.

Instead of simply parrying away any attacks on this bedrock program, progressives must forcefully articulate a straightforward and progressive plan to modernize it. We should strengthen the program by making it more inclusive on the one hand and by addressing the long-term fiscal challenges on the other hand.

The American people embrace Social Security's progressive values. Our proposal builds on those values. But the longer we wait the more difficult it will be to fix the long-term financial deficit faced by Social Security and to modernize the system to meet the needs of our changing society and economy without extending the retirement age.

Indeed, the sooner we modernize the program the better. The reason: Updating Social Security sooner rather than later will ensure its role as basic income insurance for tens of millions of Americans throughout this century and enable policymakers to modernize the program to match social and economic changes since the advent of the program in the 1930s.

Modernizing in the near term will allow policymakers to phase in these changes so that knee-jerk, across-the board cuts that eventually would be necessary if changes do not occur. Unavoidable adjustments to Social Security can then be designed so that those who rely on Social Security's retirement, disability, and life insurance are helped, not hurt, by the reforms—today and well into the future.

Social Security's benefits and its revenues will grow apart over the long run if updates are not undertaken soon. Social Security has built up two trust funds and invested them in government bonds since 1983, which will allow it to cover the forecasted shortfalls through 2037.[14] After that, social security taxes would still allow the program to pay on average 76 percent to 80 percent of its promised benefits with its expected tax revenue.[15] This level of future benefits would be higher in inflation-adjusted terms than the benefits that current Social Security beneficiaries can expect. The initial benefit for new retirees who retire at age 65 after a lifetime of medium earnings in 2038 will be equal to 111.2 percent of the initial benefits in 2010—even if there is an across-the-board benefit cut to scale future benefits to the expected future cash flow from payroll taxes.[16]

Doing nothing, however, means that all retirees will receive fully scheduled benefits until 2037 and all retirees thereafter will get only three-quarters of the scheduled benefits. And those who retire after 2037 will arbitrarily get a lot less per dollar paid into the system than those who will be retired before 2037. There is no justification for the arbitrary drop-off in retirement benefits in 2037. Such an abrupt change in retirement income from one year to the next also makes it hard for current workers and future retirees to adequately plan for their future, while a gradual reform will increase planning certainty.

This is why the federal government should modernize Social Security now so that updates can be introduced gradually to strengthen Social Security's basic income guarantee and achieve fiscal balance for the next 75 years. This would be fair to current and future generations of Americans and therefore in line with the Social Security's mandate as an intergenerational insurance program. Updating the program now means the costs of adjustment will be spread out over several generations, offering the maximum protection to everybody.

This report lays out in detail the main reasons why a comprehensive overhaul of Social Security will preserve the system's fiscal strength and update its progressive goals for a new century. Briefly, though, our proposal will:

- **Protect Social Security's insurance value.** The program's basic safety net protects those who need it and have paid into the system, which can only be achieved by maintaining the existing social insurance character of Social Security.

- **Balance revenue increases and benefit changes in a progressive way.** Revenue increases under our plan will cover a little more than half of the expected shortfall, while benefit changes will cover the rest. We also pay for additional benefit improvements that are necessary to modernize Social Security.

- **Protect the principle of generational equity.** Gradually introducing tax-and-benefit changes will ensure the burden of the necessary adjustments to Social Security is equitably shared across generations.

- **Modernize benefits to better meet the needs of the most vulnerable.** Those who rely on Social Security the most will see clear improvements in their expected benefits.

- **Strengthen Social Security's insurance protections for women.** Women make up half of the labor force, but many women still lack basic economic security throughout their lives. We emphasize a range of common-sense updates to Social Security that would strengthen economic security for women.

- **Update the program in line with economic insights.** New ways of measuring inflation more accurately and gauging investment risks will make it easier to deliver reliable benefits over time.

- **Achieve fiscal balance for the next 75 years.** Our proposal is a responsible balance between benefit updates and tax changes, enabling the program to return to fiscal balance without impeding efforts to put the rest of the federal budget in more fiscally responsible territory.

Our comprehensive Social Security plan will ensure a modernized, fiscally sustainable program that can serve today's American working families as it has for past generations by continuing to provide a basic income guarantee to all working Americans. But achieving these goals will require changes to benefits, taxes, and other features of Social Security. We detail the reforms necessary to achieve these goals as well in this paper, but briefly our proposals will:

- **Create a minimum benefit level.** This improved benefit level will allow a full-time career worker to receive benefits that will exceed at least the poverty line, which is necessary to make sure workers who have paid into the system for decades are able to live at least at the poverty line in retirement.

- **Raise benefits for the oldest of the old.** America's seniors exhaust their savings, pay ever larger shares of their benefits for health insurance, and rely heavily on Social Security to meet their consumption needs after the age of 85, which is why their benefits would increase by a fixed dollar amount equal to an average benefit of 5 percent.

- **Improve survivorship benefits.** Surviving spouses will receive at least 75 percent of a couple's combined benefit, thus limiting the benefit reduction that a widow or widower can experience upon the death of a spouse, especially dual-earner couples who now face larger benefit cuts upon death of one spouse.

- **Strengthen divorce benefits.** Phase in benefits for divorced spouses over time, ending the current system in which divorced spouses currently must be married for a minimum of 10 years before a divorced spouse becomes eligible for divorcee benefits.

- **Introduce family caregiving benefits.** Workers with caregiving responsibilities can access Social Security benefits temporarily during their career years so they can take care of an infant or newly adopted child, family members who are elderly, or seriously ill, or recover from a serious illness.

- **Expand spousal benefits to married same-sex couples.** All legally married couples regardless of their sexual orientation should be entitled to the same insurance benefits under Social Security

- **Gradually phase in progressive changes to benefit the formula.** The benefit amount for the bottom 67 percent of income earners will not change under this proposal. The initial benefit amount for the top one-third of income earners will grow more slowly than is currently the case. These changes in the benefit formula will be gradually phased.

- **Eliminate the cap on the employer share of the payroll tax.** Earnings are currently subject to Social Security payroll taxes only if they fall below a certain cap, currently $106,800, yet over time the share of total earnings above the cap has risen while the share of taxpayers with earnings above the cap has fallen. Eliminating the cap on the employer portion of the payroll cap counters the growing earnings inequality in our country among retirees and future retirees.

- **Treat cafeteria benefit plans like 401(k) plans to calculate the employer share of the payroll tax.** The contributions to flexible spending plans or cafeteria plans will be treated like contributions to 401(k) plans, which are already subject to Social Security taxation. Under our proposal, only the employer share of the payroll tax will apply to the relevant contributions to cafeteria plans.

- **Use a more accurate inflation measure.** Social Security benefits will be tied to a more consistent and more accurate measure of inflation over time, better reflecting the price changes that people actually experience.

- **Allow Social Security to invest some trust fund assets in the stock market.** This will allow the trust funds to improve its risk-return profile and thus extend the life expectancy of the trust funds.

Together, these updates will protect the fundamental insurance function of Social Security, modernize benefits in line with demographic and economic changes over time, and sustain Social Security's finances for the next 75 years. In the pages that follow, we will detail these changes alongside the reasons why we need to embark on this modernization today. By acting now, we will have a more sustainable Social Security system that will improve the economic security of future generations of beneficiaries.

No need to raise the retirement age

Raising the retirement age is often offered up as a way to achieve "actuarial balance" in the Social Security system, the rationale being that delaying the age at which people can collect their full retirement benefits makes sense because people now live longer. But that's not an accurate picture of all retiring Americans, which is why we have deliberately chosen not to increase the retirement age in our proposal to modernize Social Security.

There are two reasons for this. First, there is a great deal of variation in how long people can expect to live. In particular, lower-income workers don't live as long as higher-income workers, and minorities not as long as whites, as I detailed in a 2005 report for the Center for American Progress, "Raising the Retirement Age for Social Security: Implications for Low Wage, Minority, and Female Workers." The life expectancy for wealthy men, for instance, once they reach age 65, rose by six years between 1997 and the end of 2006, but the increase rose only 1.3 years among men with lower incomes once they reached 65 over the same period.

Indeed, Hillary Waldron of the Social Security Administration discovered that low-income men registered only about one-fifth of the gain in life expectancy at age 65 compared to higher-income men over this period, according to her 2007 working paper titled "Trends in Mortality Differentials and Life Expectancy for Male Social Security-covered Workers by Average Relative Earnings." Raising the retirement age would likely hurt those who rely the most on Social Security.

Second, the American public strongly opposes raising the retirement age. (See page 49 about public attitudes toward Social Security.) What's more, the retirement age is already scheduled to reach 67 years of age in 2025. Beginning that year, Americans will have to wait until they are 67 before they can collect full retirement benefits. They can still retire early at age 62, as they can today, but their retirement benefits will be permanently reduced if they do, and the reduction will be larger than for previous generations.

As we demonstrate in the main pages of this report, there are other ways to strengthen the Social Security system without raising the retirement age, which would be inequitable and deeply unpopular.

Social Security's basic and universal benefits

Social Security replaces part of a family's income when the primary bread winner retires, becomes disabled, or dies. The nation's premier retirement, disability, and life insurance program for working families was created in 1935 and served 50.9 million people in 2008, the last year for which complete data are available. (see Table 1) It is a near universal system, with 88 percent of all Americans fully insured under Social Security in 2009. Close to 90 percent of Americans have either earned enough or were dependents to somebody who had earned enough to qualify for retirement or survivorship benefits.

The distribution of Social Security benefits highlights the importance of all three basic Social Security benefits: retirement, survivorship, and disability benefits. Retired workers made up the largest group of Social Security beneficiaries with 32.3 million in 2008, 7.4 million beneficiaries received disability benefits, and 6.5 million got benefits from the survivorship program. A total of 4.1 million children received Social Security benefits from the three income guarantee components of Social Security in 2008. (see Table 1 on page 11)

Social Security benefits ensure a basic standard of living for people with average or even high earnings, but they do not allow for a life of luxury. The average monthly retirement benefit in 2008 was $1,105.[17] The typical disability and survivorship benefits are lower with $1,063 and $981, respectively.[18]

Social Security benefits offer some protection, but no guarantee against poverty in old age. The poverty rate in 2008 for those over the age of 65 is 9.7 percent, which compares favorably (but sadly, too) with 19.0 percent for children and 11.7 percent for those between the ages of 18 years and 64 years.[19] Social Security clearly helps to substantially lower poverty in old age below where it otherwise would be because it offers disproportionately higher benefits to lower-income earners than to higher-income earners. Yet social security does not offer enough of a basic income floor to guarantee that retirees won't experience poverty in their old age, even after a full career.

TABLE 1

Social Security benefits by the numbers

Number and average monthly benefit, by type of benefit, December 2008

Type of benefit	Number (in millions)	Average monthly benefit
Total Social Security	**50.9**	**$1,054**
Retirement benefits	**35.2**	**$1,105**
Retired workers	32.3	$1,152
Spouses of retired workers	2.4	$569
Children of retired workers	0.5	$568
Survivor benefits	**6.5**	**$981**
Children of deceased workers	1.9	$745
Widowed mothers and fathers	0.2	$835
Nondisabled widow(er)s	4.2	$1,112
Disabled widow(er)s	0.2	$684
Disabled workers	**7.4**	**$1,063**
Spouses of disabled workers	**0.2**	**$289**
Children of disabled workers	**1.7**	**$318**

Source: Social Security Administration, "Annual Statistical Supplement 2009" (2010).

Social Security checks are a reliable source of income that constitutes the most important source of income for families 65 years old and above. In 2008, the bottom 20 percent of families in this age group based on income received on average 83.2 percent of their income from Social Security.[20] The program's benefits provided the majority of income for 49.1 percent of all families 65 years old and older.[21] Indeed, only the top 20 percent of families in this age group based on income collected less from Social Security than from other earnings. Even 43.6 percent of families in the fourth quintile in this age group still relied on Social Security as their single largest source of income for families.[22]

Clearly, Social Security benefits offer consistent protection of retirees' basic benefits against the erosion of their purchasing power from inflation. The initial benefit that a new group of retirees can expect to collect grows each year with the wages in the economy overall because the benefits are now indexed to wages at retirement. Retirees then see those initial benefits increase each year with inflation. Social Security benefits thus afford each new group of retirees a higher standard of living than prior retirees since wages rise faster than prices. And Social Security benefits are insulated from the eroding effects of inflation.

The importance of these two benefit indexes became clear most recently when the U.S. economy experienced its most severe recession since the Great Depression. During the Great Recession of 2007-2009, Social Security benefits held steady while other sources of retirement income security eroded swiftly and sharply. Personal wealth was decimated as the housing market and financial markets took a nosedive. Families' total wealth was $14.8 trillion less (in 2010 dollars) in March 2010 than it had been in June 2007, when the wealth decline started even prior to the onset of the Great Recession in December 2007.[23]

What's more, because of the recession workers nearing retirement and retirees still in the workforce can no longer rely on continued employment opportunities as much as they had in the past to cover any shortfalls in future retirement income. Employment opportunities disappeared for all kinds of workers—blue-, pink-, and white-collar employees—including in particular those 65 years old and older. The unemployment rate for this age group in 2009 rose to 6.4 percent, the highest level since the Bureau of Labor Statistics collected these data in 1948.[24]

This reduced opportunity to work longer clashes with a growing need to find new sources of retirement income. What's more, traditional pension plans known as defined-benefit plans (because they pay out a defined income upon retirement) are less and less common in today's economy. Only 20 percent of private-sector workers were covered by a traditional defined-benefit pension in 2009, compared to 39 percent in 1975.[25] Conversely, the share of private-sector workers with so called defined-contribution retirement savings plans, in which workers and sometimes their employers invest in defined assets in financial markets and then rely on those returns upon retirement, rose during this time. But the combined share of private-sector workers with any type of retirement plan at work dropped to less than half (43.6 percent) in 2008 from a high of 50.3 percent in 2000.[26]

The upshot: Social Security benefits are growing in importance as other sources of income for older families come under attack due to the consequences of the Great Recession combined with the shift in other forms of pension retirement plans away from defined benefits at retirement to more volatile defined-contribution plans. These changes are occurring just as other changes in our society and our economy point to the need to update Social Security swiftly. To this we now turn.

The need for Social Security modernization

A number of important changes have taken place over the past three decades since the last major reform of the Social Security program. It's time to recognize those changes through a comprehensive update to Social Security. Congress and the Obama administration should address these demographic and economic changes as well as take into account new economic insights into how to manage Social Security benefits and the Social Security Trust Fund to ensure that Social Security can deliver its basic income guarantee in the most efficient manner over the course of the 21st century.

Let's first address the need to strengthen Social Security benefits for those who need them the most. There are a number of reasons why this needs to happen, specifically because of the:

- Growing economic vulnerability of our workers
- Rising poverty among the oldest of our seniors
- More women in the our workforce
- More caregiving needs among our workforce
- More divorced couples in our society
- Rising income inequality in our economy

Let's look more closely at each of these changes in our society and economy.

Growing vulnerability

Public policy, of course, encourages families to save for retirement outside of Social Security, through various individual retirement accounts and through homeownership. These forms of private saving, however, can be very risky as massive wealth losses during the Great Recession showed. Americans who did the right thing, saving for retirement in their 401(k) defined-benefit plans and Individual Retirement Accounts and paying off their mortgages now find that much of their savings can evaporate in a matter of months. There are few possibilities for older households to recover those losses, and the sharply lower savings will thus mean less money for health care, housing, utilities, and food, among other things.

Working longer is often not really a viable to option when savings and thus retirement income decline due to drops in financial and housing markets. House prices and stock prices, for instance, tend to drop at the same time as the economy slumps and the labor market shrinks. That means older workers, who are looking for a job to compensate for the fall in the value of their private retirement savings, will typically discover finding a job to be very difficult. The unemployment rate for workers 65 and older soared to 7.3 percent in the first three months of 2010, the highest level since the Bureau of Labor Statistics collected these data, going back to 1948.[27]

And it's not just markets that can throw households a curve ball. There is a substantial chance of disability or death before reaching retirement age. Social Security reports that a 20-year-old worker today has a one-in-four chance of becoming disabled before reaching their normal retirement age of 67, and a one-in-eight chance of dying before reaching retirement oftentimes leaving widows or widowers to enter retirement without the benefit of their spouses' social security checks. [28]

Social Security serves as a back stop when households do not have sufficient personal savings. The severity of market crashes and the substantial probability of career-ending disabilities or premature death are the fundamental reason why Social Security offers basic income insurance in the event of retirement, disability, and death. Social Security's basic insurance function is essential since the possibility of things going awfully wrong won't disappear. Indeed, in some cases these benefits need to be strengthened.

Then there are low-income earners who throughout their lives miss opportunities to climb into the middle class and who all too frequently live in poverty once they retire—despite having contributed to the Social Security system throughout their careers. This group includes workers employed full-time at low-paying or minimum-wage jobs their entire career, those who exit and reenter the workforce multiple times, and those who were employed but haven't worked for many years at a job covered by Social Security.

Social Security is intended to serve as basic protection against all of life's unexpected outcomes, including poor career earnings. The Supplemental Social Security Income program currently provides monthly benefits for workers over 65 with assets and income below specific levels, but many recipients still live below the poverty threshold in retirement.[29]

Rising poverty among the oldest of our seniors

Poverty rates rise with age. The poverty rate was 5.2 percent in 2008 for men between the ages of 65 and 69, 6.5 percent for men between the ages of 70 and 74, 8.7 percent among men between the ages of 75 and 79, and 7.4 percent for men 80 and older. Among women, the respective poverty rates were 9.5 percent, 12.1 percent, 12.3 percent, and 13.9 percent in 2008.[30]

There are several reasons for the fact that poverty increases with age. First, older retirees are less likely than younger ones to work to supplement their Social Security benefits. Second, even if beneficiaries are lucky enough to have additional retirement earnings that stretch well into old age as well as Social Security, the value of those outside pensions will erode over time. This will happen because many defined-benefit pensions are not fully indexed to inflation, and all defined-contribution pensions are drawn down over time and have no inflation protection.

Greater female labor force participation

Few women worked outside the home when Social Security was created in the mid-1930s. The vast majority of women typically still worked; they just weren't paid for their work. Social Security deserves a lot of credit for attempting to rectify this by granting a spousal benefit equal to one half of the primary earner's benefit if the spouse's benefit was less than one half of the primary earner's benefit.

In other words, a spouse, historically more likely the wife, who does a lot of unpaid housework does not earn enough money to qualify for her own Social Security benefits. Instead, she will receive 50 percent of her husband's Social Security benefit upon his retirement. The couple then receives 150 percent of the primary earner's benefit. Once one of the retired spouses dies, the surviving spouse will receive 100 percent of the benefit—a reduction of one-third of the couple's total Social Security benefit.

But this scenario became more rare over time as more women entered the labor market. Formal labor market opportunities substantially improved for women over the past 60 years, and beginning in the 1970s economic pressures on families often required that both spouses work.[31] Now, both spouses will receive their own Social Security check. And upon death of one spouse, that spouse's Social Security benefits stop.

This creates a dilemma. Two families may have paid the same Social Security taxes over their lifetime, but under different circumstances. One may be a couple with each earning $50,000 annually, while the other is a single-earner couple with a $100,000 annual wage or salary income. Both couples will receive retirement benefits based on $100,000 annual earnings. But, in the first case, the survivorship benefit after the death of one spouse is half of the total family benefit, while in the second case it is two-thirds.

In short, the relative family income cut can be larger as a result of a spouse's death depending on the earning history of each spouse. Unfortunately, the chance of larger income cuts because of this anachronism in the Social Security program are on the rise as more wives have entered the labor force over the past few decades.

More caregiving needs

Women's increased participation in the workforce also increases pressures on family caregiving needs. Americans experienced a shift over the past 60 years in how they work and how they provide care for our families. Not that long ago, most families had a stay-at-home parent—usually a mother—but today, that is rarely the case. The vast majority of children today grow up in a home where there are either two working parents or a single, working parent. Yet our nation's workplaces and labor policies haven't kept pace. The United States is the only developed nation that does not provide paid leave for the birth of a child or to care for a seriously ill family member.[32]

Workers need paid time off from work to care for one another in a nation where most families now have no one at home to provide care. Social Security requires workers to pay taxes to provide family income security when they retire, becomes disabled, or die. Yet Social Security does not provide for any cash income when workers who are contributing to Social Security need time off to care for their family members or recover from a serious illness.

The risk of family and medical issues turning into livelihood-threatening events is much higher today than it was in 1935 when Social Security was established and when most women were working in the home and thus able to be a primary caregiver. A modernized Social Security system must take this into account by offering temporary Social Security benefits to caregivers who need to stay home to take care of loved ones.

Increasing divorce rates

Divorce is more widespread today across the country. The U.S. Census Bureau's 2008 American Community Survey shows a declining percentage of Americans who are married—52 percent of males ages 15 and older and 48 percent of females ages 15 and older were married in that year. This trend has persisted for decades. The proportion of those currently married is lower than it has been in at least half a century.

Comparing family groups by type and selected characteristics, Census data also shows that never-married and divorced people of both genders account for a larger part of the population in 2003 than they did in 1970. Indeed, 13 percent of women 15 years and older were divorced or separated in 2003 compared to 6 percent in 1970.[33]

Theses trends have direct implications for Social Security benefits. Spouses qualify for spousal benefits only if their marriage lasted at least 10 years, but the average marriage lasts eight years.[34] This can contribute to increased old-age poverty among women, who, up to this point, tend to be more likely than men to leave the labor force during marriage.

Divorced and widowed elderly women experience the second-highest rates of poverty, just under never-married elderly men and women, while married couples had far lower rates of poverty compared to all other marital statuses.[35] Researchers at the Urban Institute predict that by age 67, divorced women are more likely than women of other marital statuses to be among the lowest 40 percent in income.[36]

Greater legal recognition of same-sex marriages

An important recent social change in recent years is the increased ability of same-sex couples to get married. A total of six states currently offer the possibility of same-sex marriages, and another nine states recognize the marriage of same-sex couples. Massachusetts recognized same-sex marriages in 2004, Connecticut in 2008, Iowa, Vermont, and New Hampshire in 2009, and the District of Columbia in 2010.[37] There were an estimated 100,000 same-sex marriages in 2008.[38]

Some of the same states that offer the possibility of same-sex marriages and a number of other states offer a range of legal arrangements for same-sex couples. Vermont instituted legally recognized civil unions in 2000, New Jersey in 2006, and New Hampshire in 2007. Maine provided for domestic partnerships in 2004, California in 2005, Oregon and Washington in 2007, Maryland in 2008, and Nevada and Wisconsin in 2009. Moreover, Maryland established a legal framework for designated same-sex beneficiaries in 2008 and Colorado in 2009. Finally, Hawaii has offered legal protections for reciprocal beneficiaries since 1997.[39] These legal changes only serve to highlight the growing trends toward a wider social acceptance of the equality of same-sex couples.

Yet same-sex married couples do not qualify for the same basic insurance protections that heterosexual, married couples enjoy under Social Security. Married same-sex couples cannot access four different Social Security benefits: spousal retirement benefits, spousal disability benefits, survivorship benefits, and death benefits.

Equalizing Social Security benefits for same-sex married couples is especially critical for female same-sex couples. Female same-sex couples have fewer private-sector retirement savings than their male and different-sex counterparts. Only 50 percent of female same-sex couples had at least one member eligible for an employer-sponsored retirement plan compared to 56 percent for different-sex married couples and 79 percent for male same-sex couples. The participation rates also vary. Only 46 percent of female same-sex couples had at least one partner participating in an employer-sponsored retirement plan, compared to 52 percent for different-sex couples and 69 percent for male same-sex couples.[40]

As a result, female same-sex couples rely more heavily on Social Security benefits than their male and different-sex counterparts. Social Security comprised 36 percent of a female same-sex couple's total income, when both members where at least 65 years old. The comparable share for married different-sex couples was 33 percent and 31 percent for male same-sex couples.[41]

Rising income inequality

The pernicious growth in income inequality in our country carries implications for both the distribution of Social Security benefits as retirees grow in number and revenue generation as younger generations pay into the system expecting to be supported by still younger generations of working Americans. Unpacking the consequences rising income inequality within generations and across generations reveals some startling facts.

First of all, the life expectancy of higher-income earners is rising faster than the life expectancy of lower-income earners. Americans today can expect to live longer than in the past, but longevity is more pronounced among higher-income earners than among lower-income ones. The result: Higher-income earners experience a larger boost in their lifetime retirement benefits than lower-income earners.

This ever-widening chasm in the distribution of income is one of the primary causes of a growing gap in the life expectancy of American families. A male in the top half of all income earners who turned 60 in 1972 could expect to live 1.2 years longer than one in the bottom half. By 2001, the gap had grown to 5.8 years, according to a working paper by Hilary Waldron of the Social Security Administration.[42]

Higher-income earners have, due to their greater life expectancy, seen substantially larger lifetime benefit increases under Social Security than lower-income workers since benefits are paid out as guaranteed lifetime streams of income. This has gradually weakened Social Security's insurance character over time, and is one of the main motivations for modernizing Social Security's benefit structure.[43] A lower-income American over the age of 64 who had income above the bottom 20 percent of income earners but below the top 60 percent, for example, relied on Social Security for 96.6 percent of his income to support himself and his wife. In contrast, a wealthy American in the top 20 percent of the income distribution received only 88.9 percent of his retirement income from Social Security, yet the wealthy American will collect that Social Security check for about six years longer.[44]

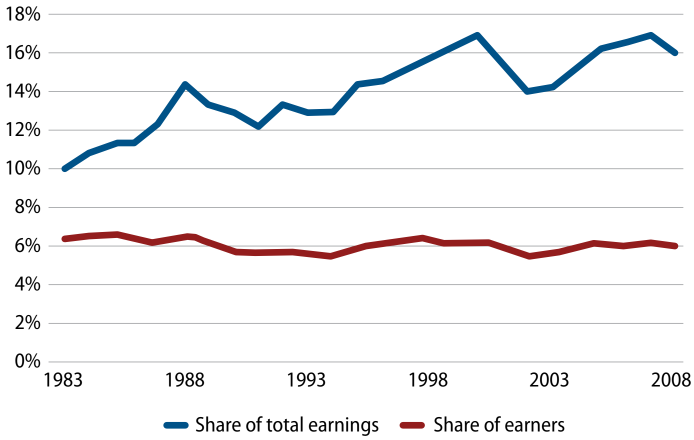
Rising income inequality also affects Social Security's revenues. The tax base for Social Security payroll taxes has been shrinking as a share of gross domestic product for two reasons. First, the share of nonwage income, such as interest, dividend payments, and capital gains climbed steadily over the past three decades. The share of total wage income out of total national income fell to 51.4 percent in 2009, the last year for which complete data are available, from 54.6 percent in 1983.[45] This may not sound like a significant shift, but in an economy with $12.2 trillion in national income in 2009 the difference amounts to $399 billion, a significant decline by any measure.

Rising income inequality over the past three decades also means more wealthy Americans boast more non-Social Security income because more income is concentrated among fewer tax payers at the top end of the income scale. What's more, some of this wage income is exempt from Social Security taxation since it is above the cap put on earnings for the purposes of calculating Social Security payroll

FIGURE 1

Higher incomes, less contributions

Percent of earnings and earners with earnings above payroll tax cap, 1983 to 2006



Source: All figures are percent. Social Security Administration, 2010a, Annual Statistical Supplement 2009, Washington, DC: SSA. The share of earners for 2008 is held constant from 2007.

taxes (no such cap exists for Medicare payroll taxes). The cutoff for paying Social Security payroll taxes in 2010 was $106,800.

From a national perspective, such income inequality weighs heavily on Social Security. The share of wage income below the cap stood at 84.1 percent in 2008, meaning that 15.9 percent of wage income was above the cap in 2008, the last year for which complete data are available, up from 10 percent in 1983.[46] Yet the share of wage earners with wage and salaries above the cap fell to 6.1 percent from 6.3 percent over the same period. [47] This demonstrates that fewer Americans boast far higher incomes today than three decades ago and are paying less and less into the Social Security trust fund. (see Figure 1)

Accounting for modern economic insights

Beyond the need to modernize Social Security to reflect the changing economic and demographic makeup of our nation, other parts of Social Security should be upgraded to take advantage of new insights in modern economics. These insights include better ways to calculate price changes in the economy over time as well as new understandings about the importance of diversifying Social Security's investment portfolio to improve on its returns over time.

Diversifying investments for Social Security is important for the Social Security trust funds is important because it will put the system's two trust funds in the black for one additional year. Similarly, changing the system's calculation of inflation to a superior inflation measure is estimated to put the trust funds in the black for an additional three years.[48] We'll now examine each of these proposed updates in turn.

Diversify Social Security's investment portfolio

The rationale for changes in the trust fund allocation stems from insights into who is better situated to bear financial market risks. The financial market crisis of 2008-09 showed that individuals are poorly situated to handle large swings in financial markets. Many individuals who are now considering their retirement options cannot wait several years, or perhaps even a decade or more, until asset prices recover. Others who cannot work because of their health cannot invest at all toward their retirement. For most Americans, there are scant opportunities to stretch individual careers and life spans to optimally spread long-term financial market risks to match their retirement-income needs.

This is why conservative proposals to privatize social security entirely or in part by requiring individuals to choose their retirement investment options for social security on their own is such a bad idea. We compare the privatization option to our own in a later section of this paper, but for now imagine if, say, one third

TABLE 2

The benefits of diversification for government trust funds

Asset allocation of National Rail Road Investment Trust, 2008

Asset class	Target allocation
U.S. equity	26 percent
Non-U.S. equity	22 percent
Private equity	10 percent
Global equity	**58 percent**
U.S. fixed income/convertibles	17 percent
Non-U.S. fixed income/convertibles	10 percent
Global fixed income	**27 percent**
Real estate	10 percent
Commodities	5 percent
Global real assets	**15 percent**
Opportunistic	0 percent
Total fund	100 percent

Source: National Rail Road Investment Trust, "Annual Management Report for Fiscal Year 2008" (2009).

of retirees' Social Security income had been slashed due to the sharp financial market downturn over the past two years. The resulting pain and poverty would have been devastating.

The federal government, in contrast, has in effect an infinite time horizon, which means it can spread the risks that arise from large, long-term market swings over generations in order to be able to pay out consistent benefits over time.[49] The government, in short, can take financial market risks where individuals cannot, thereby improving returns on investment while maintaining steady benefits. This is especially pertinent in the case of Social Security because the program specifically manages the assets of its trust funds to help pay for individual benefits.

Social Security, then, could take advantage of its long-term investment horizon and diversify its assets across a broader range of asset classes, specifically to include corporate securities, taking advantage of a potentially higher rate of return. This could translate into a greater longevity of the trust funds and lower the so-called actuarial costs—the estimated costs of Social Security's financial shortfalls over the next 75 years.

There is some precedent for investing federal trust funds in securities other than government bonds. The National Rail Road Investment Trust, which is a federal retirement program that runs parallel to Social Security for some workers in transportation industries, has invested in private-market securities such as corporate bonds and stocks since 2002. NRRIT invested the vast majority of its $26.7 billion in assets in private securities, including, for instance, 22 percent in overseas stocks by the end of the fiscal year 2008 ending on September 30.[50] (see Table 2)

Use a more accurate price measure for benefit calculations

Comprehensive Social Security reform will require an update of the price measure used to calculate annual benefit changes. The currently used inflation measure has long been considered inadequate by economists, largely because it is inconsistent over time. The Consumer Price Index for Clerical Workers, which is currently used to calculate changes in Social Security benefits for people who already receive benefits each year, is inconsistent over time because it relies on changes in consumption that may not accurately reflect changes in people's behavior.

Other, more accurate sets of data are readily available. Most published data on consumers, such as the annual income data from the Department of Labor's Bureau of Labor Statistics and the triennial wealth data from the Federal Reserve, instead use an inflation measure that is consistent and more accurate over time, the so-called chained Consumer Price Index for Urban Consumers. This measure more accurately reflects the inflation that consumers are actually experiencing because it follows actual consumption patterns more closely than the Consumer Price Index for Clerical Workers.

Turning to these two important economic insights about asset diversification and price changes over time will modernize the way the Social Security trust funds invest and pay out benefits and help shore up the system's financial position between now and 2037. That's when Social Security will have to lower benefits by 21 percent to 24 percent if nothing is done to fix it. Before we detail how to fix the system, though, we need to grasp the demographic reasons why it would be useful to tackle updating Social Security now rather than later.

The current state of Social Security financing

Social Security's primary source of revenue is payroll taxes. Employers and employees are each required to pay 6.2 percent of earnings to Social Security. Earnings that are subject to the payroll tax are capped, meaning that some wage earnings are not subject to the payroll tax and are not counted for the purpose of Social Security benefits. The cap on earnings subject to the payroll tax currently increases annually in line with the overall average wage of workers calculated by the Social Security Administration. The cap was set at $106,800 in 2010.

Payroll taxes will likely exceed benefit payments from 2012 through 2014, as they have done since the last comprehensive Social Security reform in 1983, based on the Social Security trustees' intermediate assumptions. The cash surplus is invested in government bonds that are held in Social Security's two trust funds—one for the retirement and survivorship parts of the program and one for the disability insurance part of Social Security. Both trust funds receive and invest the cash surpluses from their respective parts of Social Security. They are expected to use the assets in the trust funds to pay benefits when tax revenues fall short of annual benefit payments.

Despite the current surplus, Social Security will likely encounter a financial shortfall in the coming decades. The latest Trustees Report estimated that Social Security in 2015 will encounter a pure cash shortfall, at which point benefit payments will exceed payroll tax revenues for the first time since 1983.[51] Social Security has been preparing for this eventuality for decades, generating cash surpluses every year since 1983. These surpluses have been invested in secure government bonds that are held in Social Security's trust funds. The trust funds amounted to $2.4 trillion, or 358 percent of annual benefit payments, in 2008, the last year for which data are available.[52] The interest and principal from the bonds in the trust funds will help to cover the continuous cash shortfall after 2015 through 2037, according to the latest Trustees Report.[53]

But beginning in 2038 and continuing to 2083, returns on these government bonds will only cover between 76 percent and 79 percent of its promised benefits—if nothing changes.[54] The remaining 21 percent to 24 percent is what Congress and the Obama administration need to focus on today.

Indeed, it is important to note that Social Security's costs will become comparatively stable once the baby boom generation born between 1946 and 1964 is no longer drawing upon Social Security. This means dealing with the anticipated shortfall beginning in 2037 would put Social Security on solid ground for most of the 21st century. The data on Social Security's finances thus show that progressive modernization of Social Security is manageable. We can build up Social Security's crucial insurance benefits for generations to come and avoid tearing down the program through privatization and drastic benefit cuts for all Americans.

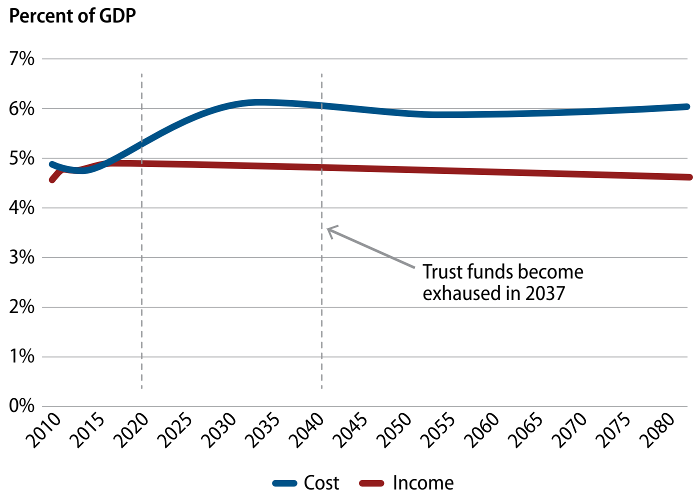
Figure 2 shows the income and cost rate of Social Security relative to U.S. gross domestic product, the sum total of all products and services generated by our economy. The figure shows acceleration in the cost rate from 2013 to 2035 as the baby boom generation enters and stays in retirement. But the cost increases stop before the trust funds are exhausted in 2037. This was Congress's intent in 1983 when it started to build up the investments in the two trust funds—to cover the expected costs of the baby boomer retirement. The expected shortfalls will likely appear after the baby boom generation is gone—the youngest baby boomers, born in 1964, will be 73 years old in 2037. The costs actually decline again in the subsequent years, albeit at a very slow rate and stay at 5.9 percent to 6.0 percent for the next 50 years.

The data also show an almost continuous decline in tax revenue for Social Security over time. Payroll taxes amount to the equivalent of 5 percent of GDP in 2009 and are expected to fall to 4.6 percent in 2085. (see Figure 2) This income decline reflects the assumption by the Social Security actuaries that nonwage compensation, such as health care, other benefits, and bonuses, will make up an ever greater part of employees' pay, thereby eroding the tax base for Social Security.

FIGURE 2

The Baby Boom bulge

Income and cost of Social Security as a share of GPD, 2009 to 2085 amid the retirement of baby boomers



Notes: All figures are percent of GDP. All figures are projections based on the Social Security Trustees' intermediate assumption. Source: Social Security Administration, "2010 Trustees Report" (2010).

The data lead to three important conclusions that inform our policy proposals. First, there is clearly no cost explosion associated with an aging population beyond the baby boom—which is mostly paid for and which in turn means that Social Security's costs stop growing after the baby boom generation is gone. Second, Social Security's costs nonetheless will be higher in the future than in the present. Third, Social Security's tax base is expected to decline over the course of this century. These conclusions should help define the fiscal goals of Social Security reform.

Goals for Social Security modernization

The ultimate goal of updating Social Security must be to bolster the current program so that it can provide strong benefits that offer basic income security for American workers in the years and decades to come. Achieving this goal will require policymakers to modernize Social Security's benefit-and-tax structure and to make Social Security's finances sustainable for the next 75 years. This also implies that updates will have to avoid privatization and drastic benefit cuts for millions of Americans.

The most recent Social Security Trustees Report estimates that Social Security would need an additional $5.4 trillion, which together with interest earned on these assets will cover the forecasted actuarial deficit. This is equivalent to saying that Social Security would need an additional 1.92 percent of payroll each year for the next 75 years to cover the forecasted actuarial deficit.[55] But simply lifting the payroll tax without addressing other problems in Social Security's benefit design would be a mistake.

Social Security, after all, is showing its age not just in the fiscal arena. Social Security as structured today does not necessarily offer the greatest possible economic security to those who need it the most. This can be accomplished by modernizing Social Security's benefits and taxes in line with recent economic and demographic trends, and modern economic insights. Updating Social Security now is clearly the better alternative to doing nothing—and then cutting benefits across the board when the system encounters the expected financial shortfall after 2037.

First of all, updating the system now would preserve the generational commitments of shared responsibility to Social Security's long-term stability—commitments to the common good that are a foundation of our civil society—by facing up to financial challenges sooner rather than later. The alternative of doing nothing means one generation of Americans—those who will retire in 2038 and beyond—will be arbitrarily chosen to bear the full brunt of the necessary reductions in their benefits of about 21 percent to 24 percent relative to the scheduled benefits, while all previous retirees will get to enjoy the full scheduled benefits.[56] Starting reform sooner rather than later will allow the burden of adjustment to be spread over future generations.

Secondly, an overhaul of Social Security's benefit structure is long overdue anyway in light of the long-standing economic and demographic trends that we discussed in the previous section of this report and will examine in detail in the next section. These economic and demographic changes have led to some unintended consequences, whereby vulnerable groups of Americans do not receive the full protections that Social Security could and should offer. Strengthening Social Security's basic insurance protections for those who need them the most would improve Social Security's cash flow in the near-term and put Social Security on the path to actuarial balance for the next 75 years. This will strengthen the program and its insurance functions for the foreseeable future.

Detailed discussion of proposals

Our comprehensive Social Security proposals will sustain the system's finances for the next 75 years, address recent economic and demographic trends to make the system more progressive, and upgrade the system's structure based on modern economic insights. In the pages that follow, we will examine each of our individual proposals in detail, briefly present the current rules and structures, and then lay out our proposed changes. We will then discuss the likely results before presenting estimates of the likely effect on Social Security's long-term financial outlook. All of these elements are summarized in Table 3 on page 30.

Before we begin, though, two points deserve further clarification. First, most of our proposals appear with start dates of 2010. This is obviously unrealistic. But we chose these dates so that we can rely on the publicly available estimates of the financial consequences of Social Security changes from the Social Security Administration. The financial effect of our proposals should change little, if the start date is moved by a one or two years. Second, we report the financial costs of our proposals as shares of taxable payroll for the next 75 years. This is a commonly used metric since it relates the financial needs of Social Security to its long-term revenue source.

Modernizing the system to address recent economic and demographic trends

Create poverty level benefit

Social Security provides a special yet inadequate supplemental minimum benefit in place since 1972.[57] It is inadequate because workers earning the minimum wage or near to it over the course of their working lives can fall into old-age poverty—even though they have contributed to Social Security throughout their careers. Social Security is intended to provide more benefits to workers with the greatest financial need, yet many retirees still receive meager benefits despite working and paying into the system for more than the minimum number of years.

TABLE 3

A progressive approach to updating Social Security

A summary of our proposals and their consequences

Proposal	Economic/demographic rationale	Primary impact	Change in deficit as a percent of taxable payroll	Years after passage of phase in
Create antipoverty level benefit	Substantial old-age poverty	Reduce old-age poverty	+0.13	1
Increase benefits by a fixed dollar amount at age 85	Poverty rises with age among beneficiaries	Reduce poverty among our oldest seniors	+0.09	1
Improve survivorship benefits	Higher female labor-force participation can adversely affect married couples' lifetime benefits	Improve benefit fairness for dual-earner couples	+0.06	1
Streamline divorce benefits	Increased divorce rates have left many people without adequate benefit security	Raise economic security for divorced people	+0.06	1-9
Gradually phase in progressive changes to benefit formula	Longevity has increased fastest for higher-income earners	Rebalance the distribution of lifetime retirement benefits	-0.24	6
Add caregiving benefit	Working families have growing caregiving responsibilities	More flexibility for working families to fulfill their caregiving responsibilities	+0.10	6
Ensure Social Security equality for same-sex married couples	Growing legal recognition of same-sex marriages	Offer married same-sex couples the same protections as other married couples	0.00	6
Eliminate cap on employer share of payroll tax	There is an increasing shift of national economic resources from workers to companies	Increase revenue for Social Security	-1.16	6
Treat cafeteria benefit plans like 401(k) plans to calculate employer payroll tax	Social Security's tax base is shrinking	Broaden Social Security's tax base	-0.11	1
Invest 25 percent of the trust funds in broad equity markets index	The government is best situated to handle financial market risks	Improve the risk-return profile of Social Security's two trust funds	-0.45	1-10
Improve the inflation measure for calculating annual cost-of-living adjustments	Current inflation measures are inconsistent over time	Put benefit changes in line with actual price changes	-0.49	1
Total		Fiscal sustainability, modernized benefits, updated structure	-2.00	

Notes: See text for description of proposals. "+" shows a widening and "-" a narrowing deficit.

Conservative and progressive policymakers and economists alike agree that Congress must strengthen the minimum Social Security benefit.[58] Nobel laureate Peter Diamond, a professor at the Massachusetts Institute of Technology, and Peter Orzag, former director of the White House's Office of Budget and Management in the Obama administration, rightly argue that the Social Security Administration should increase benefits for very low lifetime earners.[59] So, too, did President Bush's Commission to Strengthen Social Security back in 2001.

To grasp the complexities of providing retirement income requires some technical background on how Social Security benefits are calculated. The discussion uses some numbers that are shown in Table 4 on page 34 based on two hypothetical workers, one a high-income earner and the other a lower-income earner. The high-income worker earned $100,000 in 2009 and the lower-income worker earned $40,000. The earnings of these two workers in the preceding years grew at the average historical growth rate of wages. Both workers put 40 years into their careers, from 1970 to 2009.

Here's how Social Security would handle the calculation of their retirement benefits. The current formula for Social Security benefits is tied to the average rate of wage growth over the worker's career. The initial benefit that new retirees receive grows each year with average wages in the country. Calculating these benefit levels, however, is complex.

The first ingredient in Social Security benefit calculation is the average indexed monthly earnings amount. The AIME calculation follows several steps that are summarized in Table 4. First, the two workers would list all of their so-called benefit-relevant earnings over their 40-year earnings, which means all their earnings upon which they paid Social Security payroll taxes. The lower-income workers' benefit-relevant earnings would match his actual earnings, but not so with the higher-income worker, whose maximum taxable earnings would include earnings not subject to Social Security taxes because of the cap on Social Security payroll taxes.

Secondly, the benefit-relevant earnings are then multiplied by the so-called index factor. This multiplication makes sure that each year the initial benefit amount of new retirees matches new wage levels each year. Third, the highest 35 years of earnings are included and the lowest five years of indexed earnings are deleted.

(Our two hypothetical workers would both see their highest 35 years of earnings calculated into this index factor, but if a new retiree has less than 35 years of earnings, then the missing years are set equal to zero. Social Security defines a year as four quarters with a minimum dollar amount of earnings. If a worker earns the minimum amount for the entire year in just one quarter, then the worker's earnings record will be credited with four quarters of earnings.)

In the case of our two hypothetical workers, the examples in Table 4 show the lowest five years of earnings were 1970, 1971, 1972, 1973, and 1975 for the high-income earner and 1970, 1972, 1973, 1974, and 1975 for the lower-income earner.

With these years excluded, the amounts of the highest 35 years of indexed earnings for these two workers are added up and then divided by 420 (the number of months in 35 years). This amount is equal to $7,878 for the high-income earner and $3,310 for the lower-income earner.

Each new beneficiary's benefit is then adjusted based on the so-called primary insurance amount. The PIA is calculated based on the average indexed monthly earnings for each worker to arrive at the amount of Social Security benefits that a retiree will receive. The AIME is split into three parts at two points, the so-called bend points. The first part—the dollar amount below the first bend point of the AIME—is multiplied by 0.9. The second chunk, above the first bend point and below the second bend point, is multiplied by 0.32; and the third chunk, above the second bend point, by 0.15. These multipliers are constant over time, which means that they increase with wage growth since the AIME is also tied to average U.S. annual wage growth worker's career.

For our two hypothetical workers who retired in 2009, the first bend point in their first year's Social Security calculation occurs at $761, and the second bend point at $4,586. The bend points change each year. The PIA is the sum of its three parts.

For our high-income earner, then this means the total amount of $7,878 is split into three chunks of money:

$761+($4,586-$761)+($7,878-$4,586)=$761+$3,825+$3292=$7,878

For the lower-income earner, there are only two chunks of money, since the AIME falls between the first and second bend point:

$761+($3,310-$761)=$761+$2549=$3,310

The resulting amounts are shown in Table 4, but the main takeaway for both our higher-income and lower-income worker (and for all new retirees) is that their Social Security benefit calculations each year are based on their initial benefits, which then increase all the more because each year the PIA is also adjusted for inflation once beneficiaries start receiving benefits.

The upshot: Each new generation of retirees can expect to see benefits that deliver a slightly higher standard of living, even after accounting for prices, than earlier retirees since wages rise faster than inflation. For our two retirees (and for all retirees) their standard of living is then maintained throughout retirement due to automatic annual cost-of-living adjustments. But for our two retirees, the amount of benefits each year means that the higher-income earner will collect higher benefits each year relative to our lower-income worker because the benefit levels reflect the earnings over one's career.

For any Americans who have worked in low-wage jobs for an entire career, this means they will receive a very low benefit that will be below the poverty line. The calculation above, after all, shows that one's Social Security benefit is a percentage of one's average earnings over an American's entire career. This is why Congress needs to help the lowest lifetime earners by increasing the special minimum Social Security benefit and making some key changes, starting in 2010.[60]

To do so, Congress first should change Social Security's definition of an earnings year so that it is defined as a year in which four-quarters of coverage are earned, not as a definition tied to a minimum dollar amount each year as is currently the case. This change will prevent people who work for short periods of time at high earnings in a given year from qualifying for Social Security benefits and thus target the special minimum benefit to lower-wage earners. In our proposal, the PIA for the special minimum benefit would initially be set so that 30 years of coverage—paying into Social Security—at the minimum wage are equal to 125 percent of the monthly poverty level, or about $1,128 in 2009.

In addition, the initial PIA per year of coverage under our proposal will be indexed by wage growth for successive groups of retirees. The new special-minimum benefit will thus keep up with the wage-indexed benefit formula. This change means that the special minimum benefit maintains its insurance value relative to the average Social Security benefit over time. This newly created poverty benefit will target low lifetime earners and not those who have worked for a short time for higher wages.

This proposed change should lead to a substantial reduction in old-age poverty. Workers who worked for an extended period of time at very low wages will receive a higher benefit than is the case under the current system. Peter Orszag and Peter Diamond's estimate for a proposal similar to this one show that about 3 percent of men and 6 percent of women would have seen increased benefits if this benefit had been in effect beginning in the early 2000s, and estimated that 10 percent of low lifetime earners would have been helped by their proposal.[61]

TABLE 4

Calculating Social Security benefits

A hypothetical example of a higher income earner and a lower income earner who both retire in 2009

Year	Maximum taxable earnings	High-income worker's earnings	Benefit relevant earnings of the higher income earner	Lower-income worker's earnings	Benefit relevant earnings of the lower-income worker	Index Factor	Highest 35 years of indexed earnings (high earner)	Highest 35 years of indexed earnings (lower-income earner)
1970	$7,800	$13,909	$7,800	$5,563	$5,563	6.68		
1971	$7,800	$14,632	$7,800	$5,853	$5,853	6.36		$37,224
1972	$9,000	$15,700	$9,000	$6,280	$6,280	5.79		
1973	$10,800	$16,768	$10,800	$6,707	$6,707	5.45		
1974	$13,200	$18,025	$13,200	$7,210	$7,210	5.15	$67,980	
1975	$14,100	$19,197	$14,100	$7,679	$7,679	4.79		
1976	$15,300	$20,790	$15,300	$8,316	$8,316	4.48	$68,544	$37,256
1977	$16,500	$22,225	$16,500	$8,890	$8,890	4.23	$69,795	$37,604
1978	$17,700	$25,092	$17,700	$10,037	$10,037	3.92	$69,384	$39,344
1979	$22,900	$27,450	$22,900	$10,980	$10,980	3.6	$82,440	$39,529
1980	$25,900	$29,372	$25,900	$11,749	$11,749	3.3	$85,470	$38,771
1981	$29,700	$32,309	$29,700	$12,924	$12,924	3	$89,100	$38,771
1982	$32,400	$34,506	$32,400	$13,802	$13,802	2.84	$92,016	$39,199
1983	$35,700	$35,990	$35,700	$14,396	$14,396	2.71	$96,747	$39,013
1984	$37,800	$38,437	$37,800	$15,375	$15,375	2.56	$96,768	$39,360
1985	$39,600	$40,321	$39,600	$16,128	$16,128	2.46	$97,416	$39,676
1986	$42,000	$42,296	$42,000	$16,919	$16,919	2.39	$100,380	$40,435
1987	$43,800	$44,157	$43,800	$17,663	$17,663	2.24	$98,112	$39,565
1988	$45,000	$46,454	$45,000	$18,581	$18,581	2.14	$96,300	$39,764
1989	$48,000	$48,312	$48,000	$19,325	$19,325	2.06	$98,880	$39,809
1990	$51,300	$50,872	$50,872	$20,349	$20,349	1.97	$100,218	$40,087
1991	$53,400	$52,348	$52,348	$20,939	$20,939	1.9	$99,460	$39,784
1992	$55,500	$54,913	$54,913	$21,965	$21,965	1.8	$98,843	$39,537
1993	$57,600	$56,011	$56,011	$22,404	$22,404	1.79	$100,259	$40,104
1994	$60,600	$57,971	$57,971	$23,188	$23,188	1.74	$100,870	$40,348
1995	$61,200	$60,696	$60,696	$24,278	$24,278	1.67	$101,362	$40,545
1996	$62,700	$63,124	$62,700	$25,249	$25,249	1.6	$100,320	$40,399
1997	$65,400	$66,722	$65,400	$26,689	$26,689	1.51	$98,754	$40,300
1998	$68,400	$70,792	$68,400	$28,317	$28,317	1.43	$97,812	$40,493
1999	$72,600	$74,261	$72,600	$29,704	$29,704	1.36	$98,736	$40,398
2000	$76,200	$78,790	$76,200	$31,516	$31,516	1.29	$98,298	$40,656
2001	$80,400	$80,366	$80,366	$32,147	$32,147	1.26	$101,262	$40,505
2002	$84,900	$80,929	$80,929	$32,372	$32,372	1.24	$100,352	$40,141
2003	$87,000	$83,033	$83,033	$33,213	$33,213	1.21	$100,470	$40,188
2004	$87,900	$86,936	$86,936	$34,774	$34,774	1.16	$100,845	$40,338
2005	$90,000	$90,065	$90,000	$36,026	$36,026	1.12	$100,800	$40,349
2006	$94,200	$94,298	$94,200	$37,719	$37,719	1.07	$100,794	$40,360
2007	$97,500	$98,730	$97,500	$39,492	$39,492	1.02	$99,450	$40,282
2008	$102,000	$100,705	$100,705	$40,282	$40,282	1	$100,705	$40,282
2009	$106,800	$100,000	$100,000	$40,000	$40,000	1	$100,000	$40,000
AIME							$7,878	$3,310
First part of PIA (90% of amount up to first bend point—$761)							$685	$685
Second part of PIA (32% of amount between first and second bend point—over $761 and less than $4,586)							$1,224	$816
Third part of PIA (15% of amount above second bend point—over $4,586)							$494	$-
PIA (sum of three components)							$2,403	$1,501

Our proposal should have a similar effect, although no specific estimate exists. It is important to note that updating the special minimum benefit is a necessary change to help keep low-lifetime earners from entering old age poverty upon retirement but one that will likely deepen the long-term financial deficit for Social Security. Our proposed minimum benefit for low-lifetime earners would increase the projected deficit in the actuarial balance by approximately 0.13 percent of taxable payroll over the 75-year projection horizon, assuming that the updated special minimum benefit will start in 2010 for those retiring in 2010 and thereafter.[62]

Increase benefits for beneficiaries at age 85

There is currently no benefit in Social Security that automatically addresses the fact that poverty increases with age among Social Security beneficiaries. Congress should adopt a proposal from the National Academy of Social Insurance to improve benefits for the oldest of our senior beneficiaries. The proposal would raise benefits by a fixed dollar amount for all beneficiaries who reach age 85. The fixed dollar amount would be set so that the average increase for this beneficiary group is equal to 5 percent of the retired worker's benefit in the preceding year.

Consider a current 84-year old retiree who has been living in an assisted living facility for the past five years, drawing upon her Social Security payments and her private savings to cover her monthly rent and rising health care costs. Under our plan, her $1,000 in monthly Social Security benefits would rise with inflation and an additional $50 when she turns 85, then rising again by the annual inflation amount each year thereafter. Importantly, every beneficiary turning 85 will receive the same $50 dollars, regardless of her benefit level when she was 84. Beneficiaries with lower benefit amounts will consequently receive a larger relative benefit—in line with Social Security's mission as an insurance program.

We chose a woman for the example above for a telling reason. This benefit change would likely reduce old-age poverty most especially among widows. Women tend to live longer than men so that there is a larger share of women among beneficiaries 85 years old and older. And women tend to have lower benefits than men, reflecting lower lifetime earnings. The proposed benefit increase will give a relatively larger benefit increase to those beneficiaries who have lower benefits.

The estimated cost of implementing this benefit increase for beneficiaries who are age 85 and older in 2010 and thereafter is 0.09 percent of the payroll tax.[63] This additional benefit will also add to the long-term financial deficit of Social Security.

Improve survivorship benefits

The current system of survivorship benefits can lead to a disproportionately larger cut in Social Security benefits upon retirement for dual-earner couples compared to single-earner couples when one spouse dies. This can happen because the calculation of retirement income of a surviving spouse depends on whether the survivor was part of a dual- or single-earner couple as well as the earnings that each retiree receives upon retirement.

Here's how it works for dual-income couples and single-earner couples if one of them dies after retirement. The survivor of a single-earner couple presently receives benefits equal to two-thirds of the benefit that the couple had previously been receiving, but the survivor of a dual-earner couple with identical earnings histories will only receive benefits equal to half of what they had previously received.

Consider the following examples. The primary earner of a single-earner couple retires in 2010 and has a primary insurance amount of $20,000. The couple now receives 150 percent of this PIA, or $30,000. When one spouse dies, the annual benefit drops back to 100 percent of the PIA, or $20,000. In comparison, two spouses of a dual-earner couple retire with PIAs of $15,000 each, again for a combined family benefit of $30,000. When one spouse dies, the benefit of the deceased spouse disappears, too, such that the surviving spouse will receive only half of the family benefit or $15,000. The cut in the combined family benefit will either be one-third or half, depending on the earnings records of the couple.

Our proposal would ensure that a surviving spouse who is eligible for both a worker benefit upon retirement and a surviving-spouse benefit would receive 75 percent of the benefit that the married couple would be receiving if both were still alive beginning in 2010.

This rule would only apply only if 75 percent of the combined benefit is greater than the benefit under current law for the surviving spouse. This benefit improvement would only be available to a surviving spouse of a married couple where both spouses had become eligible for Social Security retirement benefits. It would not apply to a married couple where one spouse had not achieved insured status.

So, in the case of our two hypothetical retired couples, the survivor of the first couple would still receive $20,000 since both spouses were not eligible for Social Security benefits. The survivor of the second couple, though, would receive $22,500, instead of $15,000 annually.

This proposal will thus improve the retirement security of dual-earner couples and bring them in line with the benefit security of single-earner couples. This benefit improvement would also be limited so that the survivor's benefit would be capped at the benefit of a lifelong average earner. This cap is intended to limit the benefit improvements to low-income and medium-income lifetime earners.

This modification to the survivorship benefit would likely increase the benefit for widows since women are more likely to outlive their husbands. These widows' survivorship benefits would tend to be higher than would be the case under current law since the benefit change would primarily provide surviving widows with a higher share of their husbands' benefits. This would on average constitute a benefit increase since women still tend to have lower lifetime earnings than men and are therefore more likely to comprise a smaller share of a couple's combined income.[64]

The estimated cost of enacting the proposed changes to the survivorship benefit is an increase in the long-term financial deficit of Social Security equal to 0.06 percent of taxable payroll.[65]

Streamline divorcee benefits

Divorce is more widespread today in the United States, yet divorced spouses face obstacles to their retirement security under the current rules of Social Security. They need to have been married for at least 10 years before they become eligible for a divorce benefit, and they cannot remarry for another two years after divorce to remain eligible for this benefit.

Congress should therefore change benefits for divorcees so that starting in 2018 they are calculated such that eligibility is phased in over several years, rather than the 10-year cliff vesting under the current system. There should be a linear phase-in for people who have been married for at least five years so that a divorced spouse becomes eligible for an additional 20 percentage points of the full benefit with each year of marriage after five years of marriage.[66] Congress should also eliminate the two-year waiting period for divorced spouse eligibility.[67] These two changes will make it easier for divorced spouses to collect some benefits.

The cost of modifying the proposed changes to the divorcee benefit—waiving the two-year period—is negligible because it applies to very few divorced spouses eligible for this benefit. No estimate currently exists for phasing in the divorce benefit, but we assume that the cost will mirror that of changing survivorship benefits, amounting to a total of 0.06 percent of taxable payroll.[68] This provision will add to the long-term financial deficit of Social Security by 0.06 percent.

Gradually phase in progressive changes to benefit formula

Our proposal calls on Congress to adjust the growth rate of the PIA for the top one-third of income earners. A new bend point will be added at the 67th percentile. The multiplication factors above the bend point will be gradually replaced from .32 to .11 and from .15 to .05. The rate of adjustment is the difference between wage growth and inflation.

The effect of this change is that the initial benefit for beneficiaries in the top-third of the beneficiaries' income distribution will rise more slowly than is currently the case. This slowdown in the growth rate of new benefits will be much less pronounced for those with lower benefit amounts (and lifetime earnings) than for those with higher benefits and higher lifetime earnings.

We propose that Congress implement progressive changes to the benefit formula for workers with lifetime earnings in the top third of all income earners while protecting the current benefit formula for those with lifetime earnings at or below the 66th percentile. Workers at the 67th percentile will see no change relative to currently scheduled benefits.

In contrast, the initial benefit for maximum lifetime earners will see the largest change. The initial benefits for the maximum lifetime earners—those who earned taxable wages at or above the payroll tax cap for their entire careers, or over $106,800 for an individual per year in 2010—will grow more slowly than for all other, lower-income beneficiaries once the changes are implemented. The PIA for all workers in the top third of income earners—below the maximum lifetime benefit and above the 66th lifetime earnings percentile—will see their Social Security benefits grow faster than benefits for maximum income earners but slower than benefits for the bottom two thirds of income earners. The emphasis on price growth over wage growth will increase with lifetime earnings.

In technical terms, the progressive changes to the benefit formula proposal means that the multiplication factors of the PIA—0.9, 0.32, and 0.15—are adjusted by the difference between the wage growth and the price growth rate until the 0.32 multiplication factor has declined to 0.11 and the 0.15 multiplication factor has decreased to 0.05.

Our example demonstrates this is a limited change to the future benefit growth of beneficiaries with lifetime earnings in the top third. What's more, these benefit changes in our proposal for all workers with lifetime earnings above the 66th percentile will not take effect until 2016, and then will only affect retirees who become newly eligible for benefits—typically 62 years old—in 2016 or thereafter.

Our proposed change to the benefit formula will affect only the top 33 percent of lifetime earners, and then only those who are 55 and younger in 2009. And in inflation-adjusted terms, even maximum lifetime earners will fare better by 2037—when trust funds are exhausted and changes are necessary—than if nothing is done and benefits are reduced across the board by about one-fourth in 2038.

This proposed change has several implications. First, nothing changes for the majority of workers, which will protect strong middle-class Social Security benefits. Second, benefits for all workers except maximum earners will rise faster than prices, allowing benefits to pay for higher living standards over time. Third, the benefit change implies a growing emphasis on personal responsibility for retirement savings as lifetime incomes increase.

This is a substantial improvement for most retirees compared to what would happen if nothing changed and benefits are cut across the board when the trust funds run out. We estimate that this would decrease the long-term deficit by 0.24 percent of taxable Social Security payroll.[69] We calculate that this proposal would subtract from the long-term financial deficit of Social Security.

Social Security Cares

Caregiving responsibilities are rising for U.S. families as more and more Americans have to take time off to help an elderly relative or a sick child. It seems logical to add family leave insurance to Social Security since it is a family income insurance program.[70] Our colleague at the Center for American Progress, Heather Boushey, proposes a Social Security Care program to address this issue. The proposal will allow workers to access Social Security benefits for income before they retire when they experience any of the life events covered by the Family Medical Leave Act for the same amount of time as FMLA, which is a maximum of 12 weeks annually. The life events include:

- Prenatal care
- Care for an infant
- The placement of a child for foster care or adoption
- Care for a spouse, child, or parent
- One's own serious health condition

This program will cover every worker currently covered by Social Security. Eligibility for the program will be based on workers' lifetime employment history at the time they take this temporary pre-retirement leave. Social Security will use reasonable terms that allow young, part-time, and low-wage workers to qualify.

This new family-leave insurance will make it easier for families to juggle the responsibilities of work and family care giving. The new program could also have some positive long-term benefits for Social Security's finances. The new benefit could increase the number of women and workers with care responsibilities who are not now in the workforce, thus adding tax revenues to the system. Women who have access to paid maternity leave are more likely to return to work after they have a child, which increases the lifetime employment of women, putting more money into the Social Security system in the long-run.

Workers who have time off for a serious illness also recover more quickly, as do ill family members who have the care of a loved one. At least some portion of these workers will likely remain healthy enough to work longer than otherwise, which will also help to put more money into the system overall as workers are able to work longer.[71]

The cost of Social Security Cares is estimated to amount to about 0.3 percent of taxable Social Security payroll For the purposes of our overarching Social Security proposal, we suggest that two-thirds of the cost—an estimated 0.2 percent of payroll—will be covered by letting workers borrow against their Social Security benefits, with the greatest subsidies going to lower-income Americans. We estimate this proposal will add 0.1 percent of payroll to Social Security's financial shortfall. Subsequent papers from the Center for American Progress will examine the details of this proposal.

Social Security equality for married same-sex couples

The opportunities for same-sex couples to get married are growing with each passing year. The principles of providing basic family insurance benefits should apply to all married couples, regardless of their sexual orientation. We thus propose to extend the same rights to married same-sex couples as to married different-sex couples. This would make married same-sex couples eligible for spousal retirement and disability benefits, survivorship benefits, and death benefits.

The estimated effect of this provision will likely be small. The partners in married same-sex couples are more similar in their earnings histories and life expectancies than is the case for different-sex couples. Most are dual-income earners. Married same-sex couples will thus be less likely than different-sex couples to qualify for spousal benefits rather than their own retirement benefits.[72] Also, the actuarial value of survivorship benefits will likely be less for married same-sex couples than for different-sex couples due to life expectancies of the two partners that resemble each other more closely than is the case in different-sex couples.

It is difficult to arrive at any reasonable figure for the eventual effect of this benefit improvement for two reasons. First, the opportunity for same-sex couples to get married is a recent breakthrough and only in a handful of states, including Massachusetts, Connecticut, Iowa, Vermont, New Hampshire, and the District of Columbia. This means there are no reliable statistics on how many married same-sex couples will eventually qualify for Social Security. Second, data sets that provide some information on the income of same-sex couples rely on relatively small sample sizes, which make estimates of the potential benefit gains for married same-sex couples hard to quantify.

A simple back-of-the-envelope calculation, though, shows that the actuarial effect of this proposal on Social Security's long-term outlook will be comparatively small. The U.S. Census Bureau reported that there were 564,743 gay couples in 2008.[73] Of these couples, 150,000 self-identified as being in a relationship akin to husband and wife, although this is much larger than the 100,000 weddings and civil unions that Census analysts estimated had been performed up to 2008.[74] So, the number of potentially married same-sex couples ranged from a low of 100,000 to a high of about 600,000, assuming that all same-sex couples eventually would get married if the states they live in provide the opportunity or recognize their marriage licenses from other states.

Further, the difference in annual Social Security benefits for female partners of married same-sex couples over 65 amounted to $5,700 in 2005 and 2006, compared to a difference of $5,767 for male same-sex couples in that age group.[75] Some of this difference will be lost if a partner passes away since survivorship benefits will be lower than the combined benefits of both partners and since the partner with lower earnings may pass away first. But, some of this difference will be paid out as benefits to the surviving spouse of a same-sex couple under our proposal for dual-income married couples.

Even if all married same-sex couples gained the full amount, rounded here to a generous $6,000 per year, and if there were between 100,000 and 600,000 potentially married couples in 2008, then the total additional benefit payment would have amounted to between $600 million and $3.6 billion, or between 0.01 percent and 0.06 percent of taxable earnings in 2008. It seems thus safe to say that the cost of our proposal will amount to substantially less than 0.1 percent of taxable social security payroll, particularly since our figures are sure to overstate the overall impact. This would be a negligible contribution to the long-term financial deficit of Social Security.

Upgrading the structure to align with modern economic insights

Invest part of the trust funds in equity markets

The Social Security trust fund assets are legally required to "be invested, on a daily basis, in securities guaranteed to both principal and interest by the federal government."[76] All of the securities held by the both the Old-Age and Survivors Insurance Trust Fund and the Disability Trust Fund are "'special issues' of the United States Treasury" only available for the trust funds. The nominal interest rate that the trust funds' assets earn is determined by a formula that was established under the 1960 amendments to the Social Security Act. This interest rate is calculated at the end of every month and then applies to investments in the subsequent month. The average *numeric* monthly interest rate in 2008 was 3.635 percent, and the annual *effective* interest rate—the average rate of return on all investments for the combined funds over a one-year period—was 5.096 percent.[77] Some critics of the current Social Security system in academia and the media argue that the government is not adequately managing Social Security's assets because the funds are legally only allowed to be invested in the most conservative investments possible—the Treasury's long-term, low-yield, low-risk, special issues.[78] The trust funds assets are not diversified and thus do not provide an optimal risk return profile to tax payers, which other publicly and prudently managed pension plans could offer, and state pension plans utilize.[79]

We agree with some of these criticisms, which is why our proposal would should shift a 25-percent portion of the trust funds' assets into corporate securities, an idea that has enjoyed support from both conservative and progressive economists in the past.[80] This shift should be phased in gradually starting in 2010 so that by 2020 fully 25 percent of the two Social Security trust funds will be invested in a broad equity market index.[81]

The proposed equity allocation of trust funds assets may raise some political concerns that the government may insert itself in the operation of U.S. and foreign corporations, and that large equity holdings could pose some conflicts of interest for policymakers. So we propose that the trust funds' investment allocation be handled by an independent investment board that is separate from Social Security, akin to the National Railroad Retirement Investment Board. This independent investment board will define a well-diversified investment strategy and hire private asset managers to execute its investment strategy.

This proposal could reduce the long-term financial deficit of Social Security by 0.45 percent of taxable payroll over the next 75 years.[82] This is one of the major ways in our proposal to bring this long-term deficit down between now and 2037 to avoid having to slash benefits by 21 percent to 24 percent in 2038 if we do not update Social Security.

Improve the accuracy of the inflation measure

Social Security benefits are increased annually to take inflation into account. Congress enacted legislation in 1975 that allowed the Social Security Administration to automatically increase benefits with an annual cost-of-living adjustment. Since then, these cost-of-living-adjustments have been tied to the annual increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers. Yet this inflation measure does not accurately reflect the actual inflation that U.S. families experience year to year because actual changes in consumption behavior are not accurately reflected. The consumption pattern that underlies the price calculation changes in an ad hoc fashion.

We recommend that benefits instead be tied to the chained Consumer Price Index, which is sometimes referred to as the "superlative" Consumer Price Index.[83] This index is a more accurate measure of inflation than the current measure.

The Social Security Administration's actuaries estimate the difference will amount to an inflation measure that will show inflation that is 0.3 percentage points lower than the currently used inflation measure. The Social Security Administration should use this superlative, or chained, Consumer Price Index for the calculation of cost-of-living adjustments for beneficiaries beginning in December 2010.

This measure would reduce the actuarial deficit by 0.49 percent of taxable payroll. This assumes that the new inflation measure is used starting in December 2010.[84] This measure is another key component of our proposal to lower the long-term deficit of Social Security.

Interactions of benefit changes

This paper so far has presented our proposals in isolation. But it is likely that some of the benefit changes we propose will interact with each other. Interactions may reduce the savings or increase the deficit that is associated with each individual proposal. But many could also produce small savings and offset other adverse interactions.

One case in point: The new minimum Social Security benefit and the proposal for survivorship benefits will both improve retirement income security for dual-earner couples. But beneficiaries will only receive the larger of these two benefits. The overall effect will therefore be slightly lower than the sum of the two. Similarly, the new caregiving benefit and proposed minimum benefit could mean that low lifetime earners are more likely to qualify for the minimum benefit if they take up the caregiving credit and thus reduce their expected retirement earnings.[85]

In this paper we do not try to calculate the consequences of these interactions of our proposed benefit changes.[86] But policymakers in Congress and the Obama administration should be aware that the costs and benefits of these interactions will become apparent over time and should be studied by the Social Security Administration as these updates take hold over the course of the next 20 years. In this way, the federal government can ensure that all of the updates together operate as effectively and efficiently as possible.

Eliminate cap on employer share of payroll tax

The earnings of all employees covered by Social Security are subject to a payroll tax up to a maximum level—the so-called earnings cap, which in 2010 stood at $106,800. Over the last few decades, however, the share of total earnings above the cap has risen even though the share of taxpayers with earnings above the cap has been comparatively steady as a result of rising earnings inequality.

To help counter earnings inequality among workers, our proposal would eliminate the cap on taxable earnings for the 6.2 percent employer share of Social Security payroll taxes. We do not propose eliminating the cap of the employee share of Social Security payroll taxes so that there is no additional burden on the employee, but also no additional benefit to the employee. Under our proposal, there would be no commensurate rise in benefits for those earning more than the cap since there is no additional money from the employee.

This means the extra payroll tax revenue can be deployed to help reduce the long-term financial deficit of Social Security. This new tax would go into effect in 2010.[87] Without offsetting benefit increases, completely eliminating the cap on earnings for the employer share of the payroll tax would reduce the long-term financial deficit of Social Security by 1.0 percent of taxable payroll.[88]

Treat cafeteria benefit plans like 401(k) plans for purposes of calculating employer share of payroll tax

Wages and salaries workers earn are typically subject to Social Security taxes equal to 6.2 percent of wages and salaries from each the employer and the employee, for a combined total of 12.4 percent up to a taxable maximum—the cap—which currently stands at $106,800.

The tax code contains some exceptions to paying the Social Security tax on some parts of wages and salaries. Income tax rules, for instance, allow workers to voluntarily reduce their taxable wages and salaries by contributing to benefit plans that cover a number of employee benefits, such as flexible spending accounts for transportation or health care. These are known as "cafeteria plans." Voluntary salary reductions to divert some part of wages and salaries into cafeteria- plan benefits are exempt from federal income taxes and from Social Security taxes.

Other voluntary wage and salary deductions, most notably contributions to 401(k) retirement savings plans, are also exempt from federal income taxes, but are subject to Social Security taxes.[89] Cafeteria plan benefits receive a more favorable treatment because they are largely excluded from Social Security and other related taxes.[90] Thus, the tax law is inconsistent in its treatment of these pretax benefits.

Our proposal would make the tax treatment of cafeteria plans consistent with the treatment of 401(k) retirement savings plans for the purposes of calculating the employer Social Security tax. Employees would see no difference in the tax treatment of their contributions to cafeteria plans. We estimate that extending the employer-side Social Security tax to make cafeteria plans consistent with 401(k) plans will improve the solvency of Social Security by 0.11 percent of taxable payrolls. This will reduce the long-term Social Security financial shortfall.

Our update proposal is comprehensive and progressive

All of our proposals, taken together, represent a pragmatic way to put Social Security on sound financial footing for the next 75 years by preserving the system's generational compact for the common good of our country while updating the benefits to meet the realities of 21st century American society and our ever-changing economy. But is it politically feasible? That's the topic of our next section.

The politics of Social Security updates

Recent polls on Social Security largely focus on two questions. The first is how voters rank the issue as a priority for Congress and President Obama. And the second is how confident respondents are that they will receive their Social Security benefits. Finding more substantive polls requires going back at least to past presidential campaign coverage, as well as President George W. Bush's effort to privatize Social Security. Several trends emerge from these polls:

- Most Americans are concerned about their ability to retire comfortably.
- Most Americans expect to rely on Social Security in order to help them retire.
- Most Americans harbor strong doubts that Social Security will be able to pay for their benefits, and accordingly agree that Social Security is in need of reform.
- Most Americans support the progressive nature of Social Security, backing proposals to modernize the system and opposing privatization and drastic across the board cuts.

The bottom line—Americans appreciate and count on the basic income guarantees that Social Security offers, but they also want policymakers to ensure that those guarantees will be there for them when they need them.

Let's look at these poll numbers in more depth. Americans expressed doubt that they will have enough money for retirement, even before the most recent financial crisis decimated the value of personal wealth. For instance, 71 percent of respondents in a Pew Research Center poll in 2006 were very or somewhat concerned about not having enough money for retirement, compared to 68 percent for affording health care for family members, and 44 percent for losing their job or suffering a pay cut.[91]

Similarly, a Gallup poll in April 2007 found that 56 percent of those surveyed were very or moderately worried about not having enough money for retirement—more than any other economic worry tested, including covering unexpected medical costs, maintaining one's current standard of living, and paying rent, mortgage, and other housing costs.[92] Even a majority of those earning $75,000 or more said they were worried about their retirement income in 2007.[93]

General worries about retirement income security also grew prior to the financial crisis of 2007 and thereafter. A Gallup poll in April 2007 concluded that only 53 percent of nonretirees expect to have enough money to live comfortably in their retirement. That was down from 59 percent in similar polls conducted in 2002, 2003, and 2004.[94]

Much of the worries about retirement income security relates to the decline of private-sector retirement benefit provisions. This was true even before the current crisis occurred as corporate bankruptcies and the resulting high-profile terminations of some corporate pension plans—both defined-benefit plans and employer contributions to defined-contribution plans—gathered some attention along with so-called pension freezes, where employees would no longer accrue benefits under different types of existing pension plans. The possibility of employers cutting pension funds was a top concern.

A Peter D. Hart poll in 2006, for example, found that 91 percent of those surveyed said that losing some or all of their retirement benefits in bankruptcy was a "very serious" or "fairly serious" concern.[95] Moreover, 57 percent of respondents felt that it was a very or fairly serious problem that, "large profitable companies like IBM and Motorola have 'frozen' their pension funds, ending contributions and offering 401(k) plans instead." And 37 percent of Americans were very concerned by "employers cutting back contributions for employee's health insurance and pensions."

These worries were then exacerbated by the decline in private pension plans that offer lifetime guaranteed retirement benefits, similar to Social Security. This concern has likely only gotten worse. A majority of Americans consequently expect to rely on Social Security as a crucial report of retirement income. Asked how much they expected to rely on Social Security as a source of income during retirement, 30 percent of respondents in an April 2009 Gallup poll said that they expect to rely on Social Security as a major source of their retirement income, 49 percent as a minor source, and only 18 percent indicated that they did not expect Social Security to be a source of future retirement income for them.[96]

But Americans are doubtful about Social Security's future, especially its ability to pay full promised benefits. A 2009 poll by ABC News and *The Washington Post* asked how confident respondents were that the Social Security system would be able to pay their full benefits throughout retirement. Only 11 percent said that they were very confident. Another 28 percent indicated that they were some somewhat confident, and 23 percent were not so confident and 38 percent were not confident at all.[97]

Similarly, an October 2010 poll by AARP, the leading senior citizen group in the country, found that 52 percent of respondents had little or no confidence that Social Security will be there for as long as they need it, while 75 percent said they have little or no confidence that their children and grandchildren will enjoy a secure retirement.[98] And a Kaiser Health Tracking Poll found in April 2009 that 38 percent of those polled believed that Social Security was in financial crisis, 41 percent believed that it had major problems but no crisis, and 15 percent believed that it had only minor problems.[99]

The combination of serious public concerns about overall retirement income security and pessimism about the future outlook for Social Security translates into strong support for updating Social Security. A November 2008 poll by Democracy Corps and the Campaign for America's Future asked survey respondents whether they believed "we need to reform Social Security and protect it to ensure that it's a safety net the American people can count on" or that "we need to reform Social Security and establish personal savings accounts so individuals have more options." Fifty-three percent agreed strongly with the first statement, and another 10 percent agreed, but not strongly. Twenty-five percent strongly agreed with the second statement, and another 10 percent agreed, but not strongly.[100]

The fact that support for updating Social Security was strong in the first instance indicates that people consider Social Security reform an important policy undertaking. The fact that the overwhelming majority voted for overhauling the current system rather than privatization points the broad direction for comprehensive Social Security reform.

Individual proposals enjoy differing levels of support. Reducing benefits and increasing taxes among higher-income earners shows substantial support, while raising the retirement age—a proposal that the modernization approach avoids—does not. A 2005 survey by *The Washington Post*, Kaiser Family Foundation, and Harvard University found majority support for alternate wordings about benefit cuts for the wealthy. These included 60 percent support for "reducing the rate of growth in benefits for wealthy retirees only," and 54 percent support for "cutting guaranteed benefits for wealthy retirees only."[101]

A 2005 poll by CBS News and *The New York Times* similarly found that 63 percent of respondents favored raising the cap on earnings subject to Social Security taxes.[102] And AARP found in a poll on Social Security reform options conducted in 2007 that raising the cap enjoys the largest support, with 71 percent of respondents favoring this idea among a range of other proposals, far ahead of the 59 percent of respondents who favored increasing the payroll tax, the second-most popular reform option in this poll.[103]

Benefit reductions and tax increases on a broader scale garner significantly less support. Only 30 percent favored "reducing the rate of growth in benefits for future retirees" and only 13 percent supported "cutting guaranteed benefits for future retirees" in the 2005 *Washington Post*, Kaiser Family Foundation, and Harvard University poll.

Increasing Social Security taxes and the retirement age also polled unfavorably as a way to address Social Security's potential shortfalls. When asked "Do You Favor Any of the Following Ways to Address the Social Security System?" in a Time/SRBI Poll in January 2005, only 41 percent favored raising Social Security taxes, while 38 percent supported increasing the retirement age. AARP also found that only 33 percent of respondents in 2007 favored raising the retirement age, followed by 28 percent in favor of a 5 percent benefit cut for new retirees, and 26 percent in favor of modified price indexation (progressive price indexation).[104]

Support for raising the retirement age further eroded when respondents were not given a choice. Only 31 percent favored a higher retirement age when asked in the 2005 *Washington Post*, Kaiser Family Foundation, and Harvard University poll, "If it were necessary to keep the Social Security program paying benefits as it does now, would you favor or oppose raising the age at which a person can retire and receive full Social Security benefits?"[105] And only 19 percent answered favorably to the question "Would you favor or oppose raising the age at which a person can retire and receive Social Security benefits?" in a February 2005 CBS News and *New York Times* poll.[106]

The public opinion data, however, doesn't tell the whole story about how to proceed with Social Security reform. Respondents are clearly aware that Social Security will need to be fixed to put its expected revenues in line with its projected benefit payments. But the public's answers on reform options also show that policymakers will have to make hard compromises, which will include some unpopular reform options.

Policymakers should have some room to discuss these compromises and shape the debate to make sure that Social Security will be modernized and strengthened for generations to come. But additional work is necessary since most of the questions posed in these surveys do not ask respondents about a trade off. Respondents, for example, have not been asked if they would favor a higher retirement age if it would mean fewer benefit cuts or smaller tax increases elsewhere. The Social Security reform discussion will thus require political leadership. The public wants to see such leadership to protect Social Security's basic income guarantees through sensible reform efforts.

Comparing our approach to privatizing Social Security

Our comprehensive plan to update Social Security would, if enacted, put Social Security on a path to fiscal sustainability, modernized benefits, and an updated program structure. An important question that policymakers will have to ask themselves is if there are other policy measures that would achieve the same goals. There are several moving parts in our proposal, and a comprehensive comparison between all possible alternatives is not feasible.

So here we examine the major conservative alternative to our progressive plan, the continuing push to privatize Social Security, since it is the most fundamental alternative to updating Social Security. Social Security privatization would dismantle much of the basic progressive values and features of the program.

Social Security privatization refers to the diversion of some share of payroll taxes in individual accounts. President Bush proposed such a move in 2005, and conservative members of Congress subsequently offered their own privatization proposals. The public debate that ensued during 2005 showed two lessons that apply for this comparison to our own approach. First, privatization would make the expected long-term financing shortfall for Social Security much worse. And second, privatization seriously weakens the insurance protections that Social Security offers.

Privatization would worsen the financing shortfall

The federal government would incur additional debt under privatization because Social Security would no longer receive all of the funds it currently uses to pay for benefits. The Social Security Administration would have to borrow money immediately or within several years (depending on the privatization plan) from private financial markets or from the U.S. Treasury to cover this additional shortfall. All of the privatization proposals in 2005 would have increased the federal government's debt, although the size of the additional debt created by such proposals varied.

Under President Bush's proposal, the government would have incurred $17.7 trillion in additional new debt by 2050 in 2005 dollars The proposal introduced by then Sen. John Sununu (R-NH) and Rep. Paul Ryan (R-WI) at the time would have been even worse, increasing the government's debt by $85.8 trillion in 2005 dollars in 2050, because they wanted to divert larger amounts into private accounts in addition to minimum benefit guarantees.

Rep. Ryan introduced another version of his privatization proposal in 2010 as part of his "Roadmap for America's Future Act of 2007."[107] This privatization proposal adds to Social Security's long-term deficits but covers those deficits with transfers from general revenue totaling more than $1 trillion as well as with fewer benefits for 70 percent of beneficiaries in addition to a higher retirement age for everybody.

Then there was the proposal made by Sen. Jim DeMint (R-SC), which would have only allowed for the diversion of funds into private accounts as long as Social Security had a cash surplus. This would have increased the federal debt by $3.5 trillion in 2005 dollars in 2050, based on the expectation at the time that the Social Security fund would slip from black to red in 2017.[108]

The direct result of adding to the long-term deficits of Social Security is that those who favor Social Security privatization find themselves under increased pressure to fill the fiscal gap. This can translate into substantial benefit cuts, as President Bush's reform proposals showed. President Bush failed to detail a complete plan on how he would address the expected shortfall, but he proposed to reduce benefits to cover 59 percent of the anticipated shortfall.[109] The benefit cuts would have gone into effect for anybody earning more than $20,000 in 2005, and would have been larger for higher income earners. The benefit cut would have amounted to 16 percent of expected benefits for a medium-wage earner retiring in 2045. The benefit cut would have been 25 percent for a high-wage earner making $58,560 in 2005 and retiring in 2045.[110]

Others who favor privatization, such as former Sen. Sununu and Rep. Ryan, or Sen. DeMint, do not even specify additional benefit cuts in their proposals. That is, they propose to privatize Social Security but do not attempt to fill financing gap. Additional money to Social Security, where it exists in these proposals and helps to lower the long-term financing shortfall, is instead the result of general revenue transfers from the U.S. Treasury. This would simply shift the funding shortfall away from Social Security to other parts of the federal budget and thus helps to mask the costs of privatization.

The benefits cuts of a fully formed proposal by President Bush, who specified at least some changes to benefits in his proposal, would probably have been even higher than 59 percent of the expected Social Security shortfalls if there had been a final, comprehensive privatization proposal from the Bush administration. This simply follows from the fact that President Bush categorically ruled out any additional revenues, either from raising the Social Security payroll tax rate or by broadening the tax base. All additional adjustments to Social Security would thus have to come from more benefit cuts.

We argue that any successful Social Security update needs to find a balance between revenue and benefit changes, maintain the integrity of Social Security as a basic insurance for all Americans, and not expose those who paid into the system to the ups and downs of the market while also burdening them with massive new deficits, as privatization would.

Privatization weakens insurance protections

Without a doubt, privatizing Social Security would weaken the insurance protections built into the Social Security system today for future beneficiaries. This would happen because money that was meant to pay future retirees their monthly Social Security checks would no longer be available for that purpose—the money would be diverted toward individual accounts. Social Security would initially borrow money from the Treasury to continue to pay for the benefits of current retirees. Future retirees, who now divert some part of their payroll into private accounts, would have to repay this debt to the Treasury, when they retire. Privatization proposals essentially lend money to those willing to invest part of their payroll in private markets. Future retirees will have to repay those loans when they retire by giving up a portion of the money in their individual, private accounts. The bottom line, though, is that this will make it harder for Social Security to pay benefits for current workers since there would be less money coming in directly to do so, obliging the Social Security Administration to borrow the rest.

At the same time, workers who suddenly would have to invest some of their Social Security taxes themselves in Treasury bills or mutual funds, depending on the specific privatization proposal, under conservatives' privatization plan would be relying on the vagaries of the financial market for their basic retirement income instead on guaranteed Social Security benefits. This creates a potentially massive problem for individuals since they may retire in the middle of a bear market, when they have a lot less money in their retirement accounts than expected. There is often no possibility for individuals to recover those losses since it would require delayed retirement and continued work. Large institutional investors, including Social Security, in comparison have much longer time horizons and can wait until financial markets turn around again.

The bottom line is that privatizing Social Security means workers would lose insurance protection on their Social Security benefits because the entire system would receive less income and because individuals would be exposed to more financial risks. This would leave most Americans in retirement today or nearing retirement in serious jeopardy of their so called "golden years" becoming anything but golden. And future generations of Americans entering retirement would be counting on a Social Security system hobbled by debt and unable to protect their private accounts from the whip-saw nature of private financial markets.

Conclusion

Retirement income security ranks high among American families' economic worries, with good reason. Employers are abandoning their promises made under existing pension plans. They are reducing their contributions to existing retirement savings plans, and fewer employers than in the past are offering retirement savings plans for their employees to begin with. The chances of this trend reversing in the coming years are practically zero.

Workers know that they will have to increasingly rely on Social Security for their basic retirement income and in the event of disability or death of a primary bread winner. Yet Social Security faces financial shortfalls in the long run, just when many of today's workers will start to retire. Gradual updates are thus necessary to ensure that Social Security's basic income guarantees will be there when families need them.

Social Security is safe and can still pay the vast majority of promised benefits if nothing changes between now and 2037, and even then benefits cuts would range from 21 percent to 24 percent if reform is not undertaken. But Congress can take prudent policy steps sooner rather than later to guarantee strong benefits for generations to come. Taking action now will ensure that the necessary adjustments to Social Security are spread over several generations. If we wait, then we create an abrupt break in time between those generations that did not have to make any adjustments to their retirement benefits and those that will have to bear the full burden of the necessary adjustments. And if we take the alternative route favored by conservatives—privatization—then we doom Social Security to massive deficits alongside unnecessary individual retirement risks.

Comprehensive Social Security updates needs to balance several goals. First, reform needs to protect the basic income guarantees that Social Security now offers. Second, comprehensive updates must modernize Social Security benefits in line with demographic and economic changes to improve retirement income security for those who need it the most. Third, Social Security reform needs to make Social Security financially viable for the next 75 years.

Our proposal achieves all of these goals. It will put Social Security on a secure footing for future generations of Americans, phase in any changes to ensure each generation does its bit to sustain the system, and maintain and improve benefit security for the overwhelming majority of beneficiaries. American families will be able to continue counting on the basic income guarantees that Social Security offers upon retirement, disability, or death of the primary bread winner. Now that's progressive.

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60 Social Security Administration, "Provisions Affecting Level of Monthly Benefits, B5. Minimum Benefits, B5.2" (2009). Beginning in 2010, increase the special minimum benefit by making the following changes: (a) A year of coverage is defined as a year in which 4 quarters of coverage are earned. (b) At implementation, set the PIA for 30 years of coverage equal to 125 percent of the monthly poverty level (about $1,128 in 2009). The PIA per year of coverage (after the first 10 years) would be $1,128/20 = $56.40. (c) Index the initial PIA per year of coverage by wage growth for successive cohorts, so that the special minimum keeps up with the wage-indexed benefit formula.

61 Peter A. Diamond and Peter R. Orszag, *Saving Social Security: A Balanced Approach*.

62 Social Security Administration, "Provisions Affecting Level of Monthly Benefits, B5. Minimum Benefits, B5.2." The valuation of our proposals are based on scoring available from the Social Security Administration. The start dates for many proposals are unrealistically early, such as 2010. The financial impact will be little changed if the start dates are moved by one or two years. The Social Security Administration, though, does not provide estimates for the financial effect of a later onset of these proposals.

63 National Academy of Social Insurance, "Fixing Social Security: Adequate Benefits, Adequate Financing," (2009)..

64 Peter A. Diamond and Peter R. Orszag, *Saving Social Security: A Balanced Approach*. There are additional caveats to consider. First, this benefit improvement could render some retirees ineligible for Medicaid, when they otherwise would have been eligible. Diamond and Orszag (2004) suggest that Medicaid eligibility rules should be adjusted accordingly. Second, survivorship benefits for a higher-earner couple could be adjusted to treat the couple's combined Social Security like a joint and survivor annuity. This would mean that benefits would be reduced while both are alive to maintain the standard of living upon the death of one spouse.

65 National Academy of Social Insurance, "Fixing Social Security: Adequate Benefits, Adequate Financing" (2009); Social Security Administration, "Memorandum: Estimated Financial Effects of Several Social Security Reform Options Requested by the National Academy of Social Insurance" (2009).

66 Melissa Favreault and Frank Sammartino, "The Impact of Social Security Reform on Low-Income and Older Women" (Washington: Urban Institute, 2002).

67 Social Security Administration, "OASDI Financial Effects of the Social Security Guarantee Plus Act of 2005 (H.R. 750)"(2005), available at, http://www.ssa.gov/OACT/solvency/CShaw_20050512.pdf.

68 Social Security Administration, "OASDI Financial Effects of the Social Security Guarantee Plus Act of 2005 (H.R. 750)." We assume that a full phase-in for everybody who has been married and then divorced would cost 0.1 percent of payroll, so that a phase-in for people who have been married at least five years would cost approximately an estimated 0.06 percent of payroll.

69 No exact estimate exists for this proposal. We arrive at our estimate the following way. The calculations are based on Social Security's estimates of the effects of introducing progressive price indexation on an infinite basis. Our proposal differs from progressive price indexation in two ways. First, the reduction in the multiplication factors in the benefit formula for the top third of income earners stops once the top multiplication factors have decreased from 0.15 to 0.05 and from 0.32 to 0.11. Second, we do not apply progressive price indexation to the calculation of disability benefits. The estimates from the Social Security administration show that protecting 50 percent of beneficiaries from progressive price indexation reduces Social Security's long-term deficit by 0.87 percent of payroll and protecting 60 percent of beneficiaries reduces the deficit by 0.61 percent of payroll. We estimate that protecting 70 percent of beneficiaries from progressive price indexation would reduce the deficit by only 0.33 percent – a change of 0.28 percentage points for excluding an additional 10 percent of beneficiaries. Excluding an additional 7 percent of beneficiaries thus would shrink the benefit reduction from 0.61 percent of payroll to 0.41 percent of payroll. We further exclude disability benefits from the effects of this benefit change, which reduces the savings to Social Security by 15 percent to 0.35 percent of taxable payroll. Finally, progressive price indexation would reduce the multiplication factors above the newly created bend point – at the 67th percentile – eventually to zero. We reduce the multiplication factors 0.32 and 0.15 only by two-thirds. We consequently estimate that the savings equal two-thirds of the full progressive price indexation, or 0.23 percent of payroll.

70 Heather Boushey, "Helping Breadwinners When It Can't Wait: A Progressive Program for Family Leave Insurance" (Washington: Center for American Progress, 2009).

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72 Movement Advancement Project, Services and Advocacy for Lesbian, Gay, Bisexual and Transgender Elders, and Center for American Progress, "LGBT Older Adults and Social Security" (2010).

73 CBS News, "150,000 Gay Couples Married, Census Shows."

74 Ibid.

75 Naomi Goldberg, "The Fiscal Impact of Extending Federal Benefits to Same-Sex Domestic Partners."

76 Social Security Administration, "Office of the Chief Actuary, Trust Fund Data: Trust Fund FAQs" (2009).

77 Social Security Administration, "Office of the Chief Actuary, Trust Fund Data:

78 Robert Ball, *Insuring the Essentials: Bob Ball on Social Security* (New York: The Century Foundation Press, 2000).

79 Christian Weller and Jeffrey Wenger, "Prudent Investors: The Asset Allocation of Public Pension Plans," *Journal of Pension Economics and Finance* (Winter).

80 Robert Ball, *Insuring the Essentials;* Peter A. Diamond and Peter R. Orszag, *Saving Social Security: A Balanced Approach;* 1994-1996 Advisory Council on Social Security, "Report of the 1994-1996 Advisory Council on Social Security Volume 1: Findings and Recommendations" (1997).

81 Investments in a broad equity index will also prevent active management of assets, which can increase the investment costs substantially without commensurate increases in rates of return.

82 Social Security Administration, "Provisions Affecting Trust Fund Investment in Marketable Securities, G4" (2009). Gradually invest 15 percent of OASDI trust fund assets in a broad index of equity market securities (such as the Wilshire 5000). Increase the portion in equities by 1.5 percent each year 2010 through 2019. Maintain the percentage at 15 percent thereafter.

83 Michael J. Boskin and others, "Toward a More Accurate Measure of the Cost of Living, Final Report to the Senate Finance Committee from the Advisory Commission to Study the Consumer Price Index" (1996). Similar arguments about the accuracy of price measures that underlie public finance can be made about other public expenditures. The exact price measure that could be used will depend on the specific program.

84 Social Security Administration, "Estimated OASDI Long-Range Financial Effects of Several Provisions Requested by the Social Security Advisory Board" (2005).

85 This interaction is likely to be very small. There likely is also a positive offsetting effect since the care giving credit could increase labor force participation of probable care givers.

86 Please note that Table 3 does not account for potential interaction terms. The shortfall of two percent of payroll was estimated in 2009. The Social Security Trustees, though, estimated that the shortfall amounted to only 1.92 percent in 2010 [See Social Security Administration, "Trustees Report 2010"]. Our calculations rely on data from the 2009 Trustees Report since Social Security's actuaries had not updated their scores for individual policy provisions by the time of writing this report. This, however, also means that combined proposals generate more revenue than needed to fill the entire financial shortfall, consequently providing some room for possible interaction terms. Additionally, policymakers may consider delaying the onset of benefit enhancements to reduce their financial effects and covering potential, small interaction effects.

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88 Social Security Administration, "Provisions Affecting Payroll Tax Rates, E.2.1."

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108 James Horney and R. Kogan, "Private Accounts Would Substantially Increase Federal Debt and Interest Payments" (Washington: Center for Budget and Policy Priorities, 2005). All of the estimates are based on calculations made by the Social Security actuaries.

109 Jason Furman, "How Would the President's New Social Security Proposal Affect Middle-Class Workers and Social Security Solvency" (Washington: Center for Budget and Policy Priorities, 2005).

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