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58 is the New 62

Rethinking American Retirement and Social Security

T. Ezra Drake & Patrick M. Brenner

Look before, or you'll find yourself behind.

– Benjamin Franklin,
Poor Richard's Almanack (1735)

This paper, in its entirety, can be found at **https://southwestpolicy.com/sppi05**

855.411.7774 | southwestpolicy.com | info@southwestpolicy.com
PO Box 1746 | Bernalillo, New Mexico 87004

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SOUTHWEST PUBLIC POLICY INSTITUTE

The Southwest Public Policy Institute (SPPI) is a research institute built to explore and build on sound, data-driven policies regarding education, crime, and economics that will encourage positive change in the American Southwest.

Many think tanks have fallen victim to the mentality of communicating only to the echo chamber: they only target individuals that agree with partisan messaging. SPPI's approach enables us to reach new audiences by micro-targeting constituents on issues like finance, energy, education, or public safety.

With SPPI's data-first approach and the inclusion of every state in the American Southwest in our efforts, there is tremendous potential for reinvigorating traditional American values with one motto: WE AGREE. By removing the stigma from conversations with constituents and addressing issues with solutions to solve problems, we truly believe that we can help move the American Southwest in a positive direction and set an example for the entire region to follow.

Our focus includes fostering innovative policy alternatives at the regional, state, and community levels to enhance individual initiative and entrepreneurship, broadening the role of volunteerism in confronting public problems and the sense of community among the public, government, and business.

The division in America comes from the unwillingness to communicate with one another and to discuss the problems and the issues in front of us. By working together, exchanging ideas, and bringing solutions to problems we face, we can accomplish what public servants are meant to do: deliver ***better living through better policy***.

INTRODUCTION

Elisabeth Anderson faced a turning point at the age of 50. Widowed and left with the responsibility of raising four children, aged between 11 and 18, she courageously confronted the challenges of navigating life as a single parent. As she approached 60, Elisabeth became eligible for survivor benefits under the Social Security program.

Upon visiting the Social Security Administration, she learned that while she could receive approximately $2,400 per month in benefits, her earned income would need to be capped at $1,400 per month to qualify. This condition was part of a means test, which reduced her benefits by one dollar for every two dollars earned above the threshold.

Elisabeth, recognizing the necessity to work full-time for her retirement savings and health insurance, and driven by her desire to continue her career, initially decided against applying for these benefits. However, the unforeseen challenges posed by COVID-19 abruptly ended her contract position, leaving her without employment and ineligible for the unemployment benefits that many others were receiving. At 61, facing financial uncertainty, Elisabeth was compelled to apply for survivorship benefits.

The process, however, was fraught with bureaucratic complications. The Social Security Administration's policy of withholding benefits based on estimated annual income meant that Elisabeth would not receive any benefits for the first six months of the year. This policy forced her into a difficult financial position, making it challenging to manage her expenses without significant lifestyle changes, such as finding a roommate, which she was reluctant to do.

Despite these challenges, by the end of the year, Elisabeth managed to supplement her $50,000 salary with approximately $17,000 in survivorship benefits. Reflecting on her experience, she expressed a wish that she had applied for the benefits earlier, despite the means test. While waiting until her full retirement age of 67 would yield higher monthly benefits, Elisabeth valued the immediate financial security and income, planning to continue working for many more years.

Elisabeth's story is not unique, and prompts an interesting question: ***How can Social Security provide greater assistance to beneficiaries while reducing administrative costs and maintaining solvency?***

ICEBERG DEAD AHEAD

In an era where political promises often eclipse pragmatic solutions, it is imperative to approach the pressing issue of Social Security reform with innovative and realistic strategies. For decades, the debate on Social Security has been mired in a cycle of predictable proposals and unfulfilled promises, often limited by a lack of financial expertise among policymakers.

Michael Markey, a seasoned financial adviser, deftly challenges the conventional discourse surrounding Social Security and retirement in America.[1] Markey's critique of this status quo lays the groundwork for exploration into transformative yet feasible reforms. Pivoting away from the traditional rhetoric of raising the retirement age can avoid the solution that inadvertently penalizes our aging population by diminishing their rightfully earned benefits.[2]

> "This whole plan is about choice — giving retirees the choice to control their retirement."
>
> Michael Markey

Lowering the early retirement age to 58 is a bold move that promises to rejuvenate the Social Security system by aligning it more closely with the realities of the modern workforce and the financial needs of retirees. By facilitating earlier access to retirement benefits, this reform proposes to ease the burden on the Social Security Trust Fund while empowering individuals with greater control over their retirement planning.

Reducing penalties on early IRA distributions and reforming tax policies to benefit Social Security recipients is equally important and further underscores the need for a multi-faceted approach to reform. These recommendations not only promise to enhance the solvency of the Social Security system but also encourage active participation of older adults in the workforce, thereby contributing to a healthier economy and society.[3]

It is time to shift the narrative from one of impending crisis to a future of opportunity and security, ensuring that Social Security remains a robust and vital support for generations to come.

> ***Policymakers, financial experts, and citizens alike should embrace and advocate for meaningful reforms that can safeguard and strengthen one of the most crucial pillars of American social welfare.***

THE HULK, ADRIFT

The Social Security system, a cornerstone of American social policy since its inception in 1935, provides financial assistance to retirees, disabled individuals, and survivors of deceased workers. Funded through payroll taxes under the Federal Insurance Contributions Act (FICA), the system is designed to offer a safety net for millions of Americans. As of now, the full retirement age is 67 for those born in 1960 or later, with the option for early retirement benefits starting at age 62, albeit at reduced rates.

Despite its critical role, the Social Security system faces significant challenges, largely stemming from demographic shifts and economic changes. The aging population, with a growing number of retirees and longer life expectancies, has increased the strain on the system. The ratio of workers paying into the system to beneficiaries receiving payouts has been steadily declining, raising concerns about the long-term solvency of the Social Security Trust Fund.[4]

Key Problems and Inefficiencies

Demographic Challenges: The current demographic trends, including an aging population and lower birth rates, result in fewer workers supporting more retirees. This imbalance strains the fund, as it relies on current workers' contributions to pay beneficiaries.

Financial Sustainability: The Social Security Trust Fund is projected to be depleted by the mid-2030s, according to the Social Security Administration. If no reforms are made, this could lead to across-the-board benefit cuts for all recipients.

Inadequate Benefit Adjustments: The current formula for calculating cost-of-living adjustments (COLAs) may not accurately reflect the inflation experienced by seniors, particularly in healthcare costs, leading to benefits that do not keep pace with actual living costs.[5]

Inequities in the System: The current structure of Social Security can be disadvantageous to certain groups. For instance, lower-income workers, who tend to have shorter life expectancies due to various socio-economic factors, may not receive benefits commensurate with their contributions compared to higher-income individuals.

Impact of These Problems

Retirees: The most direct impact is on retirees who rely on Social Security for a significant portion of their income. Inadequate benefits and potential future cuts threaten their financial security, particularly for those with limited savings or pension income.

Workforce: Current workers face uncertainty about the benefits they will receive upon retirement. The prospect of increased taxes or reduced benefits can affect their retirement planning and economic behavior.

Government: Policymakers are under pressure to address the solvency challenge without imposing undue burdens on current or future beneficiaries. Balancing the fiscal sustainability of the system with fair and adequate benefits is a key policy challenge.

Economy: The Social Security system is not just a retiree issue; it has broader economic implications. Changes in the system can influence national savings rates, consumer spending, and overall economic growth.

The demographic shifts, financial constraints, and inherent inequities in the system necessitate a comprehensive review and strategic adjustments to ensure its long-term viability and fairness.

CORRECTING COURSE

The sustainability and efficacy of the Social Security system can be significantly enhanced through a series of targeted reforms. These reforms aim to balance the need for fiscal sustainability to provide adequate support to retirees. The proposed changes include reducing the early retirement age, modifying the penalty structure for early IRA distributions, eliminating the earnings test, and implementing specific tax reforms.

Reducing Early Retirement Age to 58

Analysis of Impact: Lowering the early retirement age from 62 to 58 represents a fundamental shift in the system's approach to retirement. This change would allow individuals to start receiving benefits earlier, albeit at a reduced rate. The primary impact would be a reduction in the financial burden on the Social Security Trust Fund, as the benefits paid out at an earlier age would be lower than those paid at a later age.

Annual Discount Implications: Implementing a 5% annual discount for early retirement would serve as an actuarial adjustment to balance the system. This means that for each year retirement is taken early, the retiree's benefits would be reduced by 5%. While this reduces the system's liabilities, it also means lower lifetime benefits for those who opt for early retirement.

Reducing Early Distribution Penalty for IRAs

Current Penalty Examination: Currently, early distributions from Individual Retirement Accounts (IRAs) before the age of 59 1/2 are subject to penalties. This policy is designed to encourage long-term savings and ensure that retirement funds are available later in life.

Implications of Age Reduction: Reducing the early distribution penalty age to 58 would align IRA policies with the proposed new early retirement age for Social Security. This reform would provide greater flexibility for individuals in managing their retirement savings, potentially leading to increased private disbursements and reduced dependence on Social Security benefits.

Eliminating the Earnings Test

Current Test Analysis: The Social Security earnings test applies to beneficiaries who have not yet reached full retirement age and earn income above a certain threshold. This test reduces benefits for these earners, potentially discouraging continued work or leading to unexpected benefit reductions.[6]

Benefits and Drawbacks: Eliminating the earnings test would remove a disincentive for continued employment among pre-full retirement age beneficiaries. This could encourage more seniors to remain in the workforce, contributing to the economy and the Social Security system. However, it may also increase the short-term financial burden on the system by eliminating a mechanism that temporarily reduces benefit payouts.

Tax Reforms on Social Security Earnings

Proposal Overview: The reform proposes eliminating federal income tax on earnings up to $20,000 for Social Security recipients. This approach aims to lessen the tax burden on retirees while encouraging them to remain in the labor force.[7]

Reallocation of Tax Revenues: While this tax reform reduces the immediate tax revenue from Social Security beneficiaries, it is expected to be offset by increased labor force participation among seniors. Their continued contributions to FICA would bolster the Social Security Trust Fund, potentially enhancing its long-term solvency.

NOT JUST A LIFEBOAT

These proposed reforms aim to strike a balance between ensuring the financial health of the Social Security system and providing fair and adequate support to retirees. By adjusting the early retirement age, revising the IRA penalty structure, eliminating the earnings test, and reforming tax policies, the proposed changes seek to create a more flexible, equitable, and sustainable Social Security system.

Empowering Individuals to Control Their Benefits

Greater Flexibility in Retirement Planning: Lowering the early retirement age to 58 and adjusting IRA distribution penalties offer individuals more options in planning their retirement. This flexibility enables people to tailor their retirement based on personal circumstances, health, and career longevity.

Increased Autonomy Over Financial Decisions: The reforms, particularly the elimination of the earnings test and the tax adjustments on Social Security earnings, give retirees more control over their finances. They can choose to work longer without the fear of penalties or benefit reductions, thereby enhancing their financial stability.

Positive Impact on Health and Medical Costs

Correlation Between Extended Work and Health: Recent studies have shown a strong correlation between continued employment and improved health outcomes in seniors. This is attributed to factors such as maintained mental engagement, social interaction, and a sense of purpose.

Reduction in Medical Costs: By working longer, individuals are not only likely to stay healthier but also reduce their reliance on medical services. This can lead to a significant decrease in healthcare costs, both for individuals and public health systems. Healthier seniors translate to lower overall medical costs, easing the financial burden on programs like Medicaid and Medicare.

Extended Coverage through Employers: Eliminating the earnings test encourages seniors to remain in the workforce without the fear of reduced Social Security benefits. This means many will maintain their employer-sponsored health insurance for a longer period, delaying their dependence on Medicare.

Reduction in Medicare Claims: With more seniors retaining private health insurance, the immediate demand on Medicare is reduced. This not only alleviates the financial strain on Medicare but also potentially improves the quality of care due to decreased system overload.

Economic and Social Benefits

Reduced Burden on the Social Security System: By introducing a 5% annual discount for early retirement and modifying the benefits structure, the system can balance outflows more effectively. This approach helps in addressing the long-term solvency concerns of the Social Security Trust Fund.

Increased Financial Independence for Retirees: The reforms aim to boost the financial independence of retirees. By allowing earlier access to benefits and reducing penalties on early IRA withdrawals, retirees can better manage their transition from full-time work to retirement, potentially reducing their reliance on other government support programs.

Enhanced Labor Market Dynamics: The elimination of the earnings test and tax reform on Social Security earnings could encourage older Americans to remain in or re-enter the workforce. This participation can be particularly beneficial in sectors experiencing labor shortages. The presence of experienced, older workers can also foster knowledge transfer and mentoring opportunities in the workplace.

Stimulating Economic Growth: Increased labor force participation among seniors, coupled with their enhanced spending power due to improved financial security, can have a stimulative effect on the economy. More active seniors contribute to economic diversity and resilience.

Health and Social Engagement Benefits: Active engagement in the workforce or in the community can have positive health implications for seniors. Employment or voluntary work can provide a sense of purpose, community connection, and mental stimulation, contributing to overall well-being.

Addressing Inequities in the System: The proposed reforms also aim to address some of the inherent inequities in the current system. By providing earlier access to benefits for those who may not have the luxury of working until full retirement age due to health or job demands, the system becomes more equitable.

Intergenerational Knowledge Transfer: Extended workforce participation by seniors fosters an environment of intergenerational knowledge and skill transfer, benefiting the workplace culture and efficiency.

Enhanced Economic Security: Extended employment allows seniors to increase their savings, delay tapping into retirement funds, and continue contributing to Social Security. This financial bolstering provides a more secure economic foundation as they transition into full retirement.

Decreased Risk of Poverty: The longer individuals are gainfully employed, the lower their risk of falling into poverty in their later years. This is particularly significant for lower-income workers who may not have substantial savings or pension plans. By continuing to earn and save, these individuals can avoid the economic pitfalls that often accompany early retirement.

By providing more control to individuals over their retirement planning and benefits, and by enhancing economic and social dynamics, these reforms could lead to a more robust and fair retirement landscape.

AT WHAT COST

The financial viability of these reforms can be examined through two primary lenses: "Less Out" strategies, which focus on reducing the outflow from the Social Security Trust Fund, and "More In" strategies, which aim to increase the inflow into the system. This analysis provides a deeper understanding of the financial implications of each proposed reform.

"Less Out"

Under the current system, Social Security benefits are calculated based on the 35 highest-earning years. Lowering the early retirement age to 58 could potentially include lower-earning years in this calculation for many individuals, thereby reducing the average benefit. This adjustment might result in lower lifetime payouts, easing the financial burden on the Social Security system.

Reducing the benefit rate to 50% for early retirees could significantly decrease the outflow from the Trust Fund. While this reduction helps in preserving the fund, it may necessitate careful consideration of the financial impact on retirees who depend heavily on these benefits.

Aligning spousal, children, and survivor benefits with the reduced early retirement benefit structure could further contribute to lowering the system's outflow. These adjustments, however, must balance the need for fiscal sustainability with the provision of adequate support to these beneficiaries.

The Cost-of-Living Adjustments (COLA) applied to lower benefits will result in smaller absolute increases in dollar terms. This approach could help in maintaining the purchasing power of benefits while controlling the rate of growth in Social Security expenditures.

"More In"

Eliminating federal income tax on the first $20,000 of wages for Social Security recipients could incentivize continued work among retirees. Though this reduces immediate tax revenue, the increased labor participation could lead to greater FICA contributions, indirectly benefiting the Social Security fund.

Encouraging older individuals to remain in or re-enter the workforce could have a significant positive impact on the system. Increased labor participation translates to more contributions to the Social Security Trust Fund, potentially offsetting some of the costs associated with early retirement benefits. This strategy also has broader economic benefits, such as reducing labor shortages and enhancing productivity with the experience and skills of older workers.

CONCLUSION

As evidenced by Elisabeth's story, the need for reform in the Social Security system on behalf of Elisabeth and scores of beneficiaries like her is clear and pressing. A balanced approach to enhancing the system's solvency is crucial while also ensuring that it remains a robust safety net for current and future retirees. These reforms prioritize the financial independence and well-being of retirees, address systemic inequities, and contribute positively to the broader economy.

It is essential to recognize that the journey towards a reformed Social Security system requires bipartisan cooperation, informed public discourse, and a commitment to the long-term welfare of all Americans. The proposed reforms are not just fiscal adjustments but steps towards a more equitable, sustainable, and responsive Social Security system that meets the needs of an ever-evolving society.

NOTES

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