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Responses to Questions for the Record
Testimony before the Subcommittee on Social Security
Committee on Ways and Means
U.S. House of Representatives
May 23, 2013

Attention: Kim Hildred
Staff Director
Subcommittee on Social Security
Committee on Ways and Means
U.S. House of Representatives
B-317 Rayburn House Office Building
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cc: Jessica Cameron via email

Question 1:

In your testimony, you discuss the fact that Social Security's retirement age influences when someone decides to stop working. What are your views regarding addressing longevity through increasing the retirement age versus changing the benefit formula?

> I prefer to address longevity issues through raising the retirement age to more accurately reflect that Americans are living longer, leading healthier lives, and, naturally, working longer. This approach would be more efficient and more equitable than changing the benefit formula, which could result in lower benefits later in life—often when beneficiaries face higher health-related costs.
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> If Congress chooses to address longevity issues through changes in the benefit formula, I would recommend the reform be accompanied by an increase in benefits for those in their in mid-80s and older, as suggested by many of the reform plans discussed during the hearing.

Question 2:

Should the early eligibility age (EEA) of 62 be increased? What is the effect on the claiming age if the EEA is or is not increased?

> The EEA should be raised because it would greatly increase incentives for seniors to remain in the labor force. Working longer and delaying taking benefits would help alleviate poverty among seniors later in their golden years.
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> Raising the EEA would also help the economy by keeping experienced workers in the labor force. With age 62 now the most popular age to claim benefits, raising the EEA would necessarily delay many claims and would likely correlate with continued employment. Research estimates that raising the EEA to 65 would lead to a long-run increase in GDP of 3–4 percent.
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> I share the concerns of my fellow panelists that an increase in the EEA would be a financial hardship for individuals who truly cannot work past 62. To address this, I would recommend some sort of hardship exemption.

Question 3:

If the full retirement age (FRA) is increased but the EEA is not, an individual who claims at 62 would see a larger benefit reduction. For example, if the FRA is increased to age 70, the actuarial reduction at age 62 would be 43 percent. What is the impact of changing the size of the reductions so they are not actuarially neutral?

> I prefer to keep the actuarial adjustment "neutral," otherwise the current incentives to retire early at age 62 would be maintained or possibly even increased. To address concerns that some may receive inadequate benefits if the FRA is increased but not the EEA, I prefer a better special-minimum benefit and/or a hardship exemption.
>
> I do not recommend changing the relative benefits so they are not actuarially neutral under a plan that would increase the FRA but not the EEA. To do so would exacerbate the perverse incentives in Social Security's current structure that discourage saving, and encourage early retirement and discontinuing work.

Question 4:

Since the Social Security Administration only has wage information, do you think it could administer a minimum benefit that includes child care credits?

> It would be very difficult for SSA to implement such a proposal. With wage data from a W2 tax form, SSA can only determine whether an individual was employed, how much he/she earned, and whether any income came from self-employment. SSA cannot determine whether an individual was employed full- or part-time, or whether he or she left the labor force voluntarily for reasons such as childrearing, vacation, or sabbatical.
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> Implementing such a proposal would require new forms and processes, and may require different data-sharing agreements with the Internal Revenue Service. W2 information would need to show whether dependent care benefits were provided by an employer. This

would require the creation of a separate reporting form. This would also add new administrative costs for monitoring and enforcing compliance.

Question 5:

The Bipartisan Policy Center Debt Reduction Task Force's plan highlighted the need for Social Security to improve its communications to better show how early claiming affects benefits. How can Social Security help people better understand the long-term impacts of their choices? Are there ways we should think about changing benefits or even the rules to make Social Security easier to understand and less about knowing which strategy will work best?

As a teacher, I see the benefits of education and knowledge daily. The SSA should do as much as possible to promote financial literacy and help people better understand the long-term effect of their choices. The cost of increasing SSA communications with the public would be marginal and should be done regardless of how Social Security is otherwise reformed.

As I pointed out in my written testimony, research links financial literacy and savings behavior, indicating that less financially literate individuals are less likely to adequately save for retirement. Research also finds that individuals expect to receive more in Social Security retirement benefits than what they actually receive.

Individuals who are better informed about the full costs of claiming benefits early may be more likely to delay claiming until full retirement age, or longer. This could improve labor-force participation, reduce poverty among seniors, and help the overall economy.

Finally, a better-informed public would be better equipped to assess the various "schemes" for maximizing Social Security benefits that are being promoted by some experts and financial planners. However well-intended these various claiming strategies may or may not be, the advice could lead to financially harmful decisions by those in society least able to bear them. As an immediate counter, SSA should continue to promote and distribute the two-page publication "When to Start Receiving Retirement Benefits" (attached).

With respect to benefit rules for a nonworking spouse, I recommend changing these rules to incentivize work and reduce the negative impact of the benefit-enhancement schemes noted above. The nonworking spouse benefit plays a useful role within Social Security by recognizing the value of stay-at-home work and of raising the next generation of wage earners. It is, however, inefficiently designed in that it is both regressive and a significant disincentive to paid employment.

It is not necessary to eliminate the nonworking spouse benefit to address these inequities. One option is simply to constrain its growth so that no future nonworking spouse can receive a benefit exceeding the inflation-adjusted value of the benefits that today's low-wage workers receive based on a full career of payroll tax contributions.

Another potentially important work-incentive reform is to redesign the basic benefit formula so it is based on each separate year of earnings, rather than on career-average earnings. The current progressive-benefit formula causes Social Security returns to drop with extended work, as career-average earnings rise. This causes problems in the treatment of those who move in and out of Social Security coverage. For example, the formula mistakes higher-wage state and local employees and immigrants for needy low-wage workers, necessitating complex fixes such as the Windfall Elimination Provision (WEP) and the Government Pension Offset (GPO). Such controversial complexities would be unnecessary if Social Security simply accrued proportional benefits with each additional year of taxpaying work, since all intermittent workers would be treated identically.

Question 6:

How does the replacement rate of Social Security benefits differ by generation? Does the current measure adequately reflect the contribution of Social Security towards an individual's retirement security?

The formula used to calculate initial Social Security benefits upon retirement is indexed so that benefits from one birth cohort to the next rise in proportion to growth in the national Average Wage Index (AWI). Because national-average wages tend to rise faster than price inflation over time, Social Security replacement rates also tend to rise for a given level of real (price-inflation indexed) wages. As my Mercatus colleague Charles Blahous showed in his paper "Understanding Social Security Benefit Adequacy: Myths and Realities of Social Security Replacement Rates," a worker retiring in 2055 with lifetime-average wages equal to roughly $43,800 in today's dollars would expect a replacement rate of 48.7 percent if claiming benefits at the normal retirement age. This is substantially higher than the 42.9 percent replacement rate a $43,800 worker retiring last year at the normal retirement age will receive. This indexation of benefits such that replacement rates continually rise for a given level of real wages is a key factor driving up Social Security costs over time.

It is unlikely that the replacement rates currently reported in the Social Security trustees' report accurately reflect Social Security's role in broader retirement security planning as most readers would interpret them. A primary reason for this is that replacement rates are not calculated in a way that relates individuals' Social Security benefit levels to their own prior earnings levels. Rather, they are calculated relative to those in the workforce at the time the individual claims benefits. This occurs because the calculation indexes the worker's prior earnings record for subsequent growth in the national AWI.

As Andrew Biggs and Glenn Springstead pointed out in their paper "Alternate Measures of Social Security Replacement Rates," replacement rates calculated on the basis of the AWI in the manner of the Social Security trustees will appear to be substantially lower than those that would be calculated based either on the nominal or the inflation-adjusted value of a worker's preretirement earnings. The Social Security trustees are aware of this issue, and wrote in this year's report that they are "exploring whether to expand or otherwise modify this presentation in the 2014 Trustees Report" (2013 annual Social Security Trustees report, p. 143).