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Evaluating Senator Warren's Social Security Reform Plan

Introduction

Democratic presidential candidate Senator Elizabeth Warren has unveiled a plan to significantly overhaul the nation's Social Security system. Without changes to the system, the Social Security Administration's actuaries project that the trust fund underpinning the system will be insolvent by 2035. Under current law, once insolvent, benefits must be reduced to equal the revenue financing the system. It is unlikely that future lawmakers would allow this to happen, but the system's precarious financial status is a source of significant angst for many Americans.

Evaluating Senator Warren's Social Security Reform Plan

BY MARK ZANDI

Democratic presidential candidate Senator Elizabeth Warren has unveiled a plan to significantly overhaul the nation's Social Security system. Without changes to the system, the Social Security Administration's actuaries project that the trust fund underpinning the system will be insolvent by 2035. Under current law, once insolvent, benefits must be reduced to equal the revenue financing the system. It is unlikely that future lawmakers would allow this to happen, but the system's precarious financial status is a source of significant angst for many Americans.

Senator Warren's reform plan addresses Social Security's financial challenges while also substantially increasing benefits. Her plan does this by increasing revenues by more than the increase in benefits through higher payroll and investment income taxes paid by high-income households. Under the plan, the Social Security trust fund remains solvent until 2054—nearly 20 years more than is currently projected. The net macroeconomic impacts of the reform are small but positive in the long run; the economic benefit of smaller federal government deficits and debt load is largely offset as high-income people reduce their own work hours. The plan results in a much more progressive Social Security system, as high-income people shoulder the financial burden of the plan, while low- and middle-income people benefit substantially.

This brief paper outlines Senator Warren's reform plan and evaluates its actuarial, macroeconomic and distributional impacts.

Warren reform plan

Benefit enhancements are significant under Senator Warren's Social Security reform plan. It will:

- Increase average monthly benefits by $200 for all Social Security beneficiaries. Assuming the plan is implemented beginning in 2020, the monthly benefit for the typical beneficiary that year would increase from $1,395 to $1,595.
- Increase average monthly benefits by $200 for all recipients of Supplemental Security Income who are over the current federal retirement age and who do not receive the Social Security monthly benefit increase. This will benefit close to 1.1 million individuals.
- Repeal the Windfall Elimination Provision and Government Pension Offset for current and future Social Security beneficiaries. The WEP is an adjustment to Social Security benefits for those who receive non-covered pensions and qualify for Social Security benefits based on other Social Security-covered earnings. A non-covered pension is a pension paid by an employer that does not withhold Social Security taxes. Typically, they are state and local governments or non-U.S. employers. The WEP applies to nearly 1.9 million beneficiaries. The Government Pension Offset may apply if a person receives a pension from a government job in which no Social Security taxes are paid. In this case, some or all of that person's Social Security spouse's, widow's, or widower's benefit may be offset due to receipt of that pension.
- Close the benefits gap between dual-earner and single-earner survivors. A non-earning spouse in a single-earner household currently receives 100% in survivor benefits after the earning spouse has died. In dual-earner households, however, the surviving spouse must elect either the benefits from their own earnings at 100% or the spouse's benefits at 100%. This gap is closed by increasing the survivor benefits in dual-earner households to 75% of the total combined household benefits, capped at the benefit for a worker with average career earnings, or 100% of their own or their spouse's benefits, whichever is greater.
- Extend Social Security benefits to full-time students over the age of 19 until the age of 24 for those whose parent is disabled or has died. This restores the provision that was in place until 1983 and extends coverage by two additional years, from age 22 to 24.
- Eliminate the minimum age requirement for widows and widowers with disabilities, so that they can receive 100% survivor

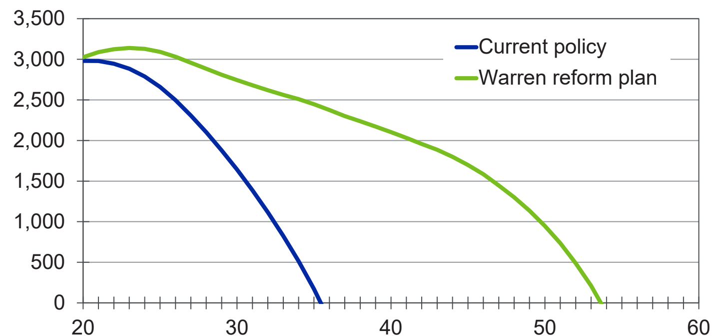
benefits. Current law has an age minimum of 50, at which point widows and widowers can claim highly reduced benefits. This change would permit widows and widowers with disabilities to receive full benefits when a spouse dies regardless of age.

» Provide a caregiver credit for caregivers of children under the age of 6, disabled family members, or the elderly, for any month away from or declined participation in the labor market. A credit would be provided for each month of caregiving, for individuals providing at least 80 hours of care a month, so that total earnings for the year are equal to 100% of that year's median annual wage for individuals who earned less than 100% of the median annual wage during the time of caregiving. The credit is provided to current beneficiaries retroactively by five years and to future beneficiaries.
» Provide a job training credit to individuals participating in a job training or an apprenticeship program. These beneficiaries could elect to have their income during these job training or apprenticeship years disregarded (and those years dropped from the 35 years used to calculate average earnings) for calculating their average indexed monthly earnings.
» Increase the Special Minimum Benefit to 125% of the Federal Poverty Level. The special minimum benefit is a benefit amount enacted in 1972 to provide adequate benefits to long-term low earners. The eligibility requirement for this benefit is also changed so that a year of coverage is achieved through four qualifying credits in a year.
» Use the increase in the Consumer Price Index for the Elderly, or CPI-E, rather than the increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers, or CPI-W, to calculate the cost-of-living adjustment. This change would increase the cost-of-living adjustment for Social Security benefits by an estimated average of close to 0.2 percentage point per year.

Senator Warren's plan also includes significant changes to the sources of revenue used to finance the Social Security system. It will:

» Apply a 14.8% payroll tax on annual earnings of over $250,000. Under current law, only earnings up to a specified maximum, which is $132,900 in 2019, are subject to a 12.4% payroll tax. Under the Warren reform plan, the taxable maximum would continue to grow with average wages, but the $250,000 threshold would not change, so the gap between the two would shrink. The taxable maximum is expected to exceed $250,000 by 2037. After that, all earnings from jobs covered by Social Security would be subject to the payroll tax. Below the taxable maximum, the payroll tax would remain at 12.4%. The current-law taxable maximum would still be used for calculating benefits, so scheduled benefits would not change under this alternative.
» Apply a separate 14.8% tax on investment income as defined in the Affordable Care Act's Net Investment Income Tax, with unindexed thresholds equal to $250,000 for a single filer and $400,000 for married joint filers.
» Broaden the investment income tax base to include gross income and gains from any trades or businesses of an individual not otherwise subject to the payroll tax. This would modify the current definition of net investment income to include the distributions received by active S corporation shareholders, active limited partners, and active LLC members, and the proceeds from the sale of business property by non-trading active business partners.
» Apply the payroll tax to pass-through business owners under the Self Employment Contributions Act. This would close the so-called Gingrich-Edwards SECA tax loophole and would apply to all chapter S corporations.

Chart 1:
Warren Plan Extends Trust Fund's Solvency



Source: Moody's Analytics

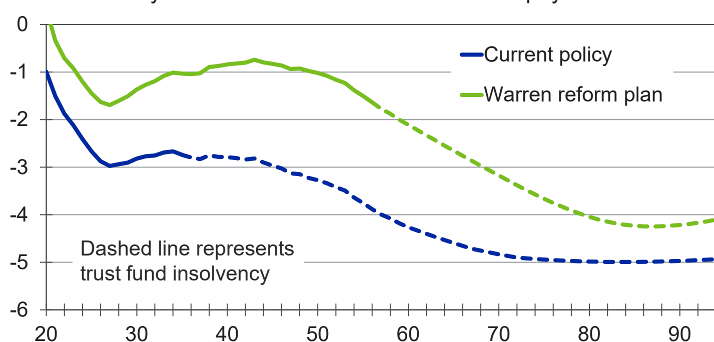
Actuarial impact of the Warren plan

Senator Warren's Social Security reform plan puts the Social Security system on much sounder financial ground. If the plan were fully implemented at the start of 2020, the trust fund would remain solvent until 2054, nearly 20 years longer than under current policy (see Chart 1). Moreover, the system is in substantially better financial shape throughout the 75-year actuarial horizon of the system (see Chart 2).

Table 1 shows the impact of each of the benefit and revenue changes in Senator Warren's reform plan on the system's finances based on the dynamic actuarial present-value balance ratio. This accounting measure is equal to the ratio of the sum of the value of the trust fund and the present value of projected revenues less payments over the 75-year actuarial horizon to the present value of taxable earnings. It is dynamic since it uses the Moody's Analytics model of the U.S. and global economies to account for both behavioral and macroeconomic changes that result from the benefit and revenue changes in the reform plan. For example, the estimates account for the fact that higher payroll taxes under the reform plan create an incentive for employers and employees to change the composition of compensation, shifting from taxable compensation to forms of nontaxable compensation.

Chart 2:
Trust Fund Is Put on Firmer Financial Ground

Social Security income less cost as a % of taxable payroll



Source: Moody's Analytics

Under current policy, the Social Security system's dynamic actuarial present value balance over the 75-year horizon is projected to be -3.3% of the present value of taxable earnings. This compares with a -2.8% intermediate static balance projection made by Social Security's actuaries in their 2019 annual report. The difference is due at least in part to the saving and labor supply responses of households to changes in policy, and the impact of changes in federal government deficits and debt on investment and capital formation.

The costliest changes to benefits in the reform plan are the immediate $200 increase in monthly benefits, the adoption of the Consumer Price Index for the Elderly to index benefit increases, and the repeal of the Windfall Elimination Provision and Government Pension Offset. The other benefit changes are significantly less costly. Far and away, the largest revenue increases come from subjecting earnings above $250,000 to a 14.8% payroll tax, and taxing investment income of individuals with earnings above $250,000 at the same 14.8% rate.

After accounting for the reform's benefit and revenue changes, the Social Security system's dynamic actuarial present value balance over the 75-year horizon narrows to -2.1%. More reforms will eventually be required to shore up the system's finances, but Senator Warren's plan goes a long way to addressing the system's financial shortfall.

From the perspective of the federal government's 10-year budget horizon, Senator Warren's reform plan would reduce the nation's deficits by more than $1.1 trillion cumulatively over the 2020-2029 period.

Table 1: Social Security (OASDI) Actuarial Balance Ratio

Dynamic long-run (2020-2094) actuarial PV balance as a % of PV of taxable earnings

Current policy	-3.31
Change in actuarial balance due to reform plan provision:	
$200 Increase In Monthly Social Security Benefits	-0.83
Adoption of CPI-E	-0.57
Repeal Windfall Elimination Provision & Govt Pension Offset	-0.40
Special Minimum Benefit to 125% of Poverty Level	-0.26
Close Dual-Earner, Single-Earner Gap	-0.16
Student Benefits to Age 24 For Dead/Disabled Beneficiaries	-0.10
SSI Benefits for Beneficiaries Over Current FRA	-0.06
Eliminate Age Minimum for Widows with Disabilities	-0.05
Caregiver Credit	-0.03
Job Training Credit	-0.03
Subject Earnings Greater Than $250k to 14.8% Payroll Tax	2.29
Investment Income Tax (14.8% with $250K/400K thresholds)	1.46
Broaden Investment Tax Base	0.22
Tax Pass-Through Business Owners Under SECA	0.07
Warren reform plan	-2.09

Note:

The changes in actuarial balances for the individual provisions do not add up to the total, as the individual estimates do not include the interaction effects among the provisions.

Source: Moody's Analytics

Macroeconomic impact of the Warren plan

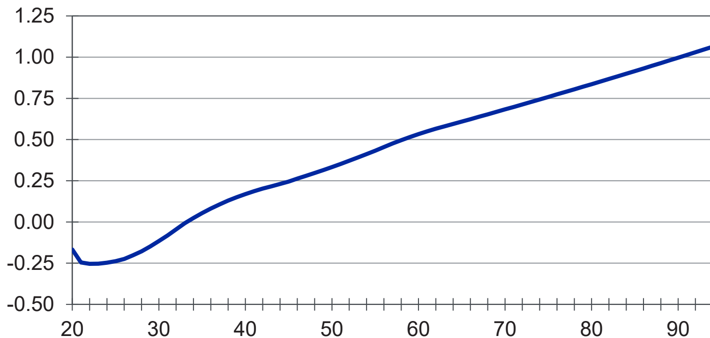
The macroeconomic impacts of Senator Warren's reform plan are small, but ultimately positive. The most immediate impact is to reduce real GDP growth in 2020, the year the plan is assumed to be implemented, by close to 0.2 percentage point. However, the reduction in GDP is smaller than that implied by the increase in payroll and investment income taxes, which is almost $100 billion more than the increase in Social Security benefits, equal to almost 0.5% of GDP. While high-income households, who pay the increased taxes, turn more cautious in their spending, they can use their savings to offset the impact of much of the tax increase. At the same time, low- and middle-income households, who enjoy the increased retirement and disability benefits, quickly spend the bulk of those benefits.

Real GDP growth is ultimately lifted by the increase in national saving under the plan. The federal government's budget deficits and debt load are meaningfully smaller, and high-income households who shoulder the financial burden of the plan also eventually save more. The resulting increase in national saving reduces long-term interest rates, prompting more investment, which results in more capital formation and stronger productivity growth. This macroeconomic benefit takes several decades to be meaning-

Chart 3:

Macroeconomic Impacts of Reform Are Small

% difference in real GDP under Warren plan and current policy



Source: Moody's Analytics

ful, but by the end of the 75-year actuarial horizon, real GDP is just over 1 percentage point higher because of the reform plan than it would have been otherwise (see Chart 3).

Offsetting the benefit of the plan on GDP to some extent is the negative impact on the supply of labor. The lower after-tax earnings of high-income households for each additional hour worked make other uses of time relatively more attractive, so these households work fewer hours, which lowers real GDP.

Distributional impact of the Warren plan

Senator Warren's plan to reform the Social Security system would make the system substantially more progressive than it is today. That is, it would substantially increase the tax burden on people with high incomes, and while everyone would receive more retirement benefits, the increase would be much more important for the finances of low- and middle-income households.

The increase in benefits under the plan would immediately lift an estimated 4.9 million elderly people out of poverty under the supplemental poverty measure. And for those in the bottom half of the income distribution, the plan increases average Social Security benefits by nearly 25%. Benefits for those in the top 10% of the distribution increase by less than 5%.

People with earnings above the maximum taxable earnings currently pay a smaller percentage of their total earnings in payroll taxes than do people whose total earnings are below the maximum. For example, those in the top 1% of the earnings distribution have an estimated effective payroll tax rate of about 2%, compared with over 10% for those in the middle 50% of the distribution, and 8% in the bottom 40% of the distribution. Making more earnings taxable at the higher rate envisaged in the Warren plan goes a long way toward leveling the payroll tax rate faced by these high earners. Those in the top 1% of the earnings distribution would see their annual payroll taxes increase by approximately $150,000, while those in the next 1% of the distribution would pay just over $10,000 more annually in taxes.

Some caveats

Given the complexity and scope of Senator Warren's Social Security reform plan, there is a substantial amount of uncertainty regarding its actuarial, macroeconomic and distributional impacts, especially over the 75-year horizon. This evaluation relies heavily on previous analysis done by the Social Security actuaries and the Congressional Budget Office, since many of the provisions in the senator's plan have been previously proposed and analyzed. Accounting for the potential interactions between the various benefit and revenue changes and people's behavioral responses to the changes is challenging.

Going to the reform plan itself, it weakens the link between the amount of taxes that workers pay into the system and the benefits they receive. Historically, that link has been an aspect of Social Security considered important to its widespread popularity and political insulation. Calling upon high-earning people to pay substantially more into the system than they receive in benefits, as the senator's reform plan envisages, could hurt its political appeal.

It is also important to consider that Senator Warren has put forth a number of other economic policy plans, including for affordable housing, student lending, clean energy and childcare, that are also financed in large part by substantially greater taxes on high-income and high net worth households. Given this financial burden, there could be significant behavioral changes by these households that are difficult to gauge.

Conclusions

The Social Security system is in desperate need of reform. If policymakers do nothing, the system will become insolvent in about 15 years, which, under current law, will result in significant cuts in Social Security benefits. For financially precarious low- and middle-income Americans, this is an especially scary possibility.

Senator Warren has put forward a thoughtful and comprehensive plan involving a range of changes to benefits and revenues to reform the Social Security system. The reforms put the system on much sounder financial ground, extending its solvency by almost 20 years into the middle of this century. More reforms will eventually be needed, but the plan goes a long way toward addressing the system's financial problems. There are significant macroeconomic cross-currents as a result of the plan, but the net impact is a small positive. The distributional impacts are much more substantive, with high-income earners shouldering the financial burden of the plan and low- and middle-income people enjoying increased benefits. The plan results in a much more progressive Social Security system.

About the Author

Mark Zandi is chief economist of Moody's Analytics, where he directs economic research. Moody's Analytics, a subsidiary of Moody's Corp., is a leading provider of economic research, data and analytical tools. Dr. Zandi is a cofounder of Economy.com, which Moody's purchased in 2005.

Dr. Zandi's broad research interests encompass macroeconomics, financial markets and public policy. His recent research has focused on mortgage finance reform and the determinants of mortgage foreclosure and personal bankruptcy. He has analyzed the economic impact of various tax and government spending policies and assessed the appropriate monetary policy response to bubbles in asset markets.

A trusted adviser to policymakers and an influential source of economic analysis for businesses, journalists and the public, Dr. Zandi frequently testifies before Congress on topics including the economic outlook, the nation's daunting fiscal challenges, the merits of fiscal stimulus, financial regulatory reform, and foreclosure mitigation.

Dr. Zandi conducts regular briefings on the economy for corporate boards, trade associations and policymakers at all levels. He is on the board of directors of MGIC, the nation's largest private mortgage insurance company, and The Reinvestment Fund, a large CDFI that makes investments in disadvantaged neighborhoods. He is often quoted in national and global publications and interviewed by major news media outlets, and is a frequent guest on CNBC, NPR, Meet the Press, CNN, and various other national networks and news programs.

Dr. Zandi is the author of *Paying the Price: Ending the Great Recession and Beginning a New American Century*, which provides an assessment of the monetary and fiscal policy response to the Great Recession. His other book, *Financial Shock: A 360º Look at the Subprime Mortgage Implosion, and How to Avoid the Next Financial Crisis*, is described by the New York Times as the "clearest guide" to the financial crisis.

Dr. Zandi earned his BS from the Wharton School at the University of Pennsylvania and his PhD at the University of Pennsylvania. He lives with his wife and three children in the suburbs of Philadelphia.

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