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Public Pension Reform in the U.S. Presidential Campaign

The U.S. public pension system, known as Social Security, has a big problem. Within the next 15 years, it is expected to use up all its financial reserves. The looming revenue shortfall is hardly surprising. In fact, it has been predicted for more than a quarter of a century. A combination of below-replacement birth rates and rising longevity is boosting the share of Americans who have reached the pensionable age. Under current law, when Social Security reserves are depleted, monthly benefits will have to be financed solely by the dedicated payroll and income tax revenues flowing into the system. The Social Security actuary expects that in 2035 these dedicated revenues will cover just 80% of the pension payments promised under today's benefit formula. In other words, if future Congresses and Presidents do not change the law, pensioners' monthly benefits will have to be cut one-fifth in the next 15 years. One implication of this forecast is that workers who file claims for Social Security today can plausibly expect to see their monthly pensions cut before they reach advanced old age.

Aged Americans tend to have high rates of voter participation, and the opinions of today's elderly carry particular weight because there are so many of them. Under these circumstances, it seems reasonable to think Social Security's funding shortfall would be near the top of voter concerns. Yet the issue arouses little interest among U.S. voters. I doubt this situation will change before the November election. Voters' apparent unconcern has not deterred Democrats from trying to drum up interest in this topic. With only a couple of exceptions, all the Democratic presidential contenders offered plans to reform the Social Security program.

Benefit payments are currently financed out of four main sources:

- a payroll tax of 12.4% on annual earnings up to $137,700 (€124,000)
- part of the revenue from the income tax imposed on Social Security benefits
- interest income earned on the Social Security reserves
- withdrawals from Social Security reserves if the other three revenue sources are insufficient.

Most of the Democratic candidates agreed it would be a good idea to lift the ceiling on earnings that are subject to the payroll tax. This would boost payroll tax revenues in a politically acceptable way. Only 6% of American workers have earnings above the taxable earnings cap, meaning that the tax hike would boost taxes on only a small minority of workers. Increased wage inequality in the U.S. has meant that a growing percentage of labor earnings are now above the taxable wage ceiling, and hence go untaxed.

To be sure, under current law a higher tax cap would also boost future benefit payments to high-wage earners. Under the present pension formula, workers collect a pension that is calculated as a function of average indexed earnings in the best 35 years of a worker's career. The trade-off between extra revenues from a higher taxable wage ceiling and higher future benefit payouts is very favorable for Social Security finances, however. The reason is that the monthly benefit formula is quite generous for low-wage workers and far less generous for workers with earned incomes near the taxable wage ceiling. A higher taxable wage ceiling would lift high-wage workers' future tax liabilities far more than it raises their future benefits. If the taxable earnings cap is raised so that 90% of all earnings are below the cap, the Social Security actuary estimates

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that more than one-quarter of the long-run deficit in Social Security would be eliminated. Not surprisingly, Republican lawmakers are not enthusiastic about raising the taxable earnings cap.

Some Democratic candidates are more ambitious in their plans for raising taxes on high-income contributors. Senator Bernie Sanders proposed to leave the current taxable wage ceiling unchanged, but to introduce a new payroll tax bracket on annual earnings above $250,000 (€226,000). In addition, he would impose a new 6.2% tax on a family's investment income over $250,000 a year. However, benefits for high-income contributors would not be changed, severing the historical link between workers' taxed incomes and the pensions they receive. Former Vice President Joe Biden also proposed a new payroll tax bracket on earnings. In his plan, the tax would begin on annual earnings above $400,000 (€361,000). As in the Sanders plan, the extra taxes collected would not trigger higher benefits for the affected workers.

Both Sanders and Biden need a lot of new revenue because they wish to increase the generosity of the present system. Thus, in addition to finding revenues to close a huge funding gap, they must also cover at least part of the cost of their proposed benefit increases. Sanders recommends the biggest benefit hikes. Not only does he propose a major liberalization of the minimum pension, he also wants to change the basic pension formula so as to boost benefits for nearly all current and future pensioners. Biden joins Sanders in recommending a more generous minimum benefit, but he does not back a general pension increase. Both candidates agree that cost-of-living adjustments should be linked to a price index that produces faster annual benefit increases. Despite the benefit liberalizations, both candidates propose tax hikes that are big enough to postpone the depletion of Social Security's reserves.

Where does Donald Trump stand? Since winning the White House in 2016, he has had remarkably little to say on the subject. In the 2016 campaign, he distanced himself from the traditional Republican view that Social Security must be overhauled as part of a broader effort to trim entitlement spending. "People signed up for Social Security; it's kind of like a pledge," Trump told a television interviewer in December 2015. "The people who have their Social Security, with me, are going to keep their Social Security." With the exception of some modest tightening of the disability component of Social Security, he has honored this pledge. One result is that the U.S. has made no progress toward reducing the long-term deficit in Social Security during his term in office.

Voters do not seem bothered by the Administration's inaction. Older Americans have heard about Social Security's funding problems for several decades. Optimists may assume that the program will be tweaked by future lawmakers in ways that will ensure its survival (and their benefits) after 2035. There is considerable evidence to support this optimism. Social Security came close to exhausting its largest reserve in the early 1980s. Congress quickly devised stop-gap measures to keep benefits flowing. A little later, lawmakers agreed on a package of long-term reforms that kept the program functioning for the next four decades. The 1983 reform boosted revenues by including part of Social Security benefits in the income tax base, and it reduced future pensions by gradually raising the age for full pension eligibility from 65 to 67.

The 1983 reform represented a painful but necessary compromise between a conservative Republican President and a politically divided Congress. Politicians reached a compromise for a simple reason. Social Security is the main pillar of old-age security for an overwhelming majority of low- and middle-income families. Along with Medicare, it is also the most popular entitlement program in the US. Nine out of ten Americans over the age of 65 collect a monthly check from the program, as do millions of disabled workers, their dependents and the child survivors of deceased workers. Opinion polls suggest that sizeable majorities of Americans, even those under 35, favor tax increases over benefit cuts to restore the long-term solvency of Social Security. Raising payroll taxes in a politically acceptable way, while shoring up benefits for indigent retirees and gradually scaling back pensions for the high-income elderly, is not an impossible task. Most voters recognize this. Most voters expect lawmakers will act, and well before big pension cuts are needed.