Affirmative Case for Social Security Reform

Among people of the same age, the greatest inequality exists among seniors**.** Yet Social Security is being administered in a way that exacerbates that problem. Social Security is abusing seniors in a way that harms the lowest income retirees the most. These same abuses are also inflicted on widows and widowers, surviving children and the disabled.

[Source on inequality: Laurence Kotlikoff, et. al., "U.S. Inequality and Fiscal Progressivity: An Intragenerational Accounting." Source on abuses: Laurence Kotlikoff and Terry Savage, *Social Security Horror Stories: Protect Yourself from the System – and Avoid Clawbacks*]

Robbery by Red Tape

The Social Security Administration admits that seniors face extraordinary delays when they try to contact SS by phone. When they finally get through, the advice is often incorrect. When seniors claim benefits by acting on that bad advice, they are not allowed to correct the mistakes. But if Social Security makes a mistake and overpays, it demands its money back. If the senior can't pay, Social Security stops sending monthly checks.

It is not surprising that Social Security personnel make so many mistakes. The system has 2728 rules and hundreds of thousands of pages explaining the rules, governing just 13 basic benefits. *Most employees of Social Security do not understand the system they are supposed to be administering.*

[Source: Laurence Kotlikoff and Terry Savage, *Social Security Horror Stories: Protect Yourself from the System – and Avoid Clawbacks*]

Bad advice on choosing a retirement date

Seniors can "retire" and start claiming benefits as early as age 62. But if they delay that decision, they get a larger monthly benefit check as a result. In fact, if they delay claiming benefits until age 70, their monthly benefit check will be 76% higher (in real terms) than what they would receive claiming benefits at age 62.

Delaying retirement is one of the best investments anyone can make. The investment is inflation proofed, guaranteed by the government, and pays a 3% real rate of return. If the senior has a normal expected life span (is not terminally ill) and is not cash constrained (can live on wages or other retirement savings), he is foolish not to wait until age 70. Yet only 2% seniors actually do that. One reason is that Social Security personnel actually encourage early retirement and do not carefully explain the benefits of delay.

Boston University economics Prof. Laurence Kotlikoff and his colleagues estimate that he typical retiree is

leaving $182,370 (in present-value terms) on the table by claiming benefits too soon.
[Sources: On retirement decisions: Kotlikoff et. al., *Get What's Yours: The Secrets to Maxing Out your Social Security*. On the cost of early retirement: Kotlikoff et. al., "How Much Lifetime Social Security Benefits Are Americans Leaving on the Table?"

Bad advice to widows and widowers

Social Security's own Inspector General estimates that more than 13,000 widows and widowers collectively have lost $130 million in Social Security benefits because of mistakes in claiming spousal benefits. Surviving spouses are entitled to a spouse's benefit (based on their partner's Social Security contributions) and to benefits in their own right (based on their own contributions) But they can't have both benefits at the same time. By law, Social Security personnel are supposed to advise the surviving spouse on how to make benefit claims in a way that maximizes their lifetime income. But apparently this almost never happens.

In one recent case, had a widow followed the Social Security personnel's instructions, she would have *lost $400,000 in lifetime income*.

[Sources: Office of the Inspector General, Higher Benefits for Dually Entitled Widow(er)s Had They Delayed Applying for Retirement Benefits and Laurence Kotlikoff, "My Unbelievable Conversation with Social Security"]

Demanding refunds for SS's past mistakes

When Social Security discovers it has made a past misstate, it can be ruthless in demanding the money back. For example, they can claw back a senior's monthly benefit check based on errors that are sometimes decades old and for amounts totally tens of thousands of dollars.

Last year, Social Security sent 2 million beneficiaries "clawback letters." Here are some particularly disturbing examples of past clawbacks:

- Social Security Sues 32-Year-Old for Benefits He Received 21 Years Ago, at Age 11
- Social Security Demands Widow Repay $300,000 for Its Own Mistakes
- Social Security Claws Back an 81-YearOld Widow for Benefits Allegedly Received 45 Years Ago
- Social Security Demands $24,436.60 from Retiree. Cuts Off Monthly Benefits When He Doesn't Pay

Every single Social Security beneficiary is a potential recipient of a clawback letter.

Penalties for Working

The Social Security earnings limit for people who have not yet reached the full retirement age is $22,320 in 2024. Above that limit, beneficiaries lose $1 in benefits for every $2 of earnings. During the year of their full retirement age, they lose $1 in benefits for every $3 of earnings above $59,520 up to the month of their full retirement. When this tax on earnings is added to income, payroll, and Social Security benefit taxes, middle-income seniors can face a 90% marginal tax rate.

The Social Security earnings penalty has undoubtedly caused millions of seniors to reduce their working hours or stay out of the labor market altogether. But here is something very few seniors know:

- Once seniors reach the full retirement age, Social Security increases their monthly benefit for the rest of their lives – to make up for the earnings penalty they were subjected to.
- In other words, the government taxes senior workers in one time period and then turns around and gives the money back in later time periods.
- But because they don't know about the give back, most seniors think the earnings penalty is lost forever.
- The reason they don't know any of this is because Social Security doesn't explain it to them.

[Source: on how the earning penalty works: Social Security, Receiving Benefits While Working; on how it affects marginal tax rates: Laurence Kotlikoff, Some Seniors Face Astronomical

Tax Rates and John Goodman, Agenda for Seniors; on the incentive effects for senior workers: Prof. Kotlikoff and Dr. Goodman.]

Taxation by Inflation

Although Social Security benefits are indexed for inflation, the tax on those benefits is not. This means every SS recipient pays higher taxes when there is inflation – even though they may have no increase in real income. When the benefit tax was first imposed, it hit only 1 or 2 percent of retirees. But because it wasn't indexed, we are now at a point where more than half of all retirees are paying it.

Treasury Inflation Indexed Securities, or TIPS bonds, work like this: if there is 6% inflation, you get an additional 6% interest payment. Yet even though the extra interest keeps you whole (full protections from inflation), you still have to pay taxes on it.

The value of pension income and IRA withdrawals is also diminished by inflation

[John Goodman, Agenda for Seniors]

Affirmative Plan:

- There should be a reliable online calculator that allows Social Security personnel to avoid mistakes and prospective beneficiaries to make informed judgments about claiming benefits. (Kotliioff already has a private calculator that does this.)

- Allow partial benefit claims, so that cash constrained seniors can claim some Social Security income early, and allow the remainder to grow.
- There should be a one-year statute of limitations on SS clawback claims.
- Seniors should be able to work without losing SS benefits.
- We should end the practice of taxation by inflation -- by inflation indexing all retirement income taxation, including indexing the Social Security benefits tax.

[Source: this plan actually comes from Goodman and Kotlikoff, who vouch for its credibility.]

A Note on Funding the Plan

In the short run, abolishing the earnings penalty would involve a redistribution of funds from taxpayers to senior workers – especially low- and moderate-income seniors. (High-income workers are not affected by the earnings penalty -- at least at the margin -- because their entire benefit has already been taxed away or, more likely, they are delaying “retirement.” However, Goodman and Kotlikoff believe that abolishing the earnings penalty would eventually pay for itself because when seniors work and earn wages, they will be paying income and payroll taxes. Think of this as *redistribution that pays for itself*.

implementing an accurate calculator would also pay for itself since it would reduce the need for human personnel. The savings might even cover the cost of ending clawback letters. This is another example of redistribution that pays for itself.

The way federal budgeting works, Congress only looks at a ten-year window. Suppose as a result of our reforms, the average senior puts off claiming benefits for two more years. That would produce an enormous budgetary savings for the federal government. That should be enough to pay for indexing the Social Security benefit tax and other taxes on private retirement income.

In the long run (beyond the ten-year window), the government will be paying larger Social Security benefits to seniors than it otherwise would. We expect this will require a substantial amount of additional redistributing from taxpayers to retirees – relative to the status quo.
However, since this is a long run problem, it gives us time to consider long-run solutions to Social Security's far-term financing problems – including raising the retirement age, making benefits less generous for high-income workers and even implementing private Social Security accounts.