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Politics at the Precipice: Fixing Social Security in 2033

Abstract: Social Security will be insolvent in 2033. If nothing is done, retirees will face an immediate 23% cut in their monthly benefits. The solvency cliff and its approximate date have been known for more than two decades. This paper examines why Congress has avoided fixing Social Security when the solutions were relatively affordable and when the baby-boom generation could have helped pay its share of the costs. It also examines what solutions will become politically feasible once the solvency cliff arrives. The surprise is that raising the wage base – in short, taxing the affluent – becomes the most politically appealing fix when insolvency arrives, despite the fact that this solution has no political appeal absent a crisis. Politics at the precipice is very different from ordinary politics.

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Introduction

Social Security is in trouble.¹ Government actuaries calculate that the program can pay all retirement benefits until 2033. At that point, the trust fund will be exhausted and the program will have enough revenue to pay only 77% of benefits (Board 2014). All retirees would face an immediate cut of 23% in their monthly benefits. Given that 65% of all Social Security recipients get half or more of their income from Social Security, a reduction this large would be calamitous for tens of millions of retirees (SSA 2012, 9.A.1).

All this is old news. Twenty years ago, Social Security actuaries forecast trust fund depletion in 2029 (Board 1994). Five years ago, they forecast 2037 (Board 2009). Although the exact year bounces around a bit, largely because of economic performance, the central message does not change: Social Security is rushing

¹ This essay is dedicated to Martha Derthick, the leading expert on the politics of Social Security, who died in January 2015, just as I was beginning to write.

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toward insolvency. If Congress and the president do nothing, the program will be unable to pay all promised benefits. Moreover, the date of insolvency is getting closer. Once 35 years distant, insolvency is now only 18 years away.

For many years, legislators labored happily on expanding and improving Social Security. Between 1935 and 1973, policymakers enacted 25 Social Security laws – more than one bill every 2 years (Derthick 1979, p. 430). They did so by huge margins and with bipartisan support. Since then, they have enacted only two major Social Security laws, first in 1977 and then in 1983. Each bill was enacted after nearly 2 years of wrangling.

Why has the politics of Social Security changed so dramatically?² Why are policymakers so reluctant to repair the system? What are the chances that Congress and the president will tackle and fix Social Security's problems in the next several years? What would politics at the 2033 precipice be like? Analyzing politics at the precipice requires grounding in the politics of Social Security during ordinary times.

The Politics of Expansion

Social Security began in 1935 as a small advance-funded system that included about half the workers in the American economy. It imposed a tax of 1% each on employees and employers and promised modest retirement benefits beginning in 1942. Before long, policymakers transformed this small advance-funded system into a large pay-as-you-go system. They accelerated workers' eligibility for benefits, adjusted benefits so that retirees received far more than their contributions, and postponed planned tax increases so that the trust fund became only a small buffer, not a large investment fund.

For legislators, the early politics of Social Security was delightful. Legislators regularly and enthusiastically voted for huge increases in retiree benefits. In the 1950s, they increased nominal benefits by 7, 13, 13, and 7%. In the next 13 years, they increased nominal benefits by another 7, 13, 15, 10, 20, and 11% (Derthick 1979, pp. 430–432). Expanding benefits for a rapidly growing group of retirees was never difficult for legislators. The fact that retirees happened to vote more regularly than younger people made it especially attractive. Republicans and Democrats were equally supportive. Indeed, some of the largest increases

² This paper is a sequel to Arnold 1998, which asked a similar set of questions about Social Security. The original paper explored the politics of enacting comprehensive reforms, such as replacing all or part of Social Security with advance-funded individual accounts. This paper focuses more on the politics of insolvency in the current program.

happened under divided government, as Republican presidents and Democratic congresses competed to claim credit for their generosity (Derthick 1979, p. 82).

In order to fund this growth in retiree benefits, legislators increased both the payroll tax and the wage base (the ceiling on earnings subject to the payroll tax). They discovered that slowly raising the tax rate and wage basis was sufficient to fund a rapid growth in benefits. The secret was the transformation from an advance-funded to a pay-as-you-go system. Workers were no longer saving for their own retirement; they were paying for current retirees. Since tax-paying workers vastly outnumbered benefit-collecting retirees – the ratio was 42:1 in 1945, 9:1 in 1955, and 4:1 in 1965 – policymakers could provide generous benefits with only modest taxes (Board 2014, p. 57). Along the way, policymakers increased the scope of the program, incorporating farmworkers, domestic workers, disabled workers, the self-employed, and some state and local government employees.

What made the politics of expansion so smooth was that retirees valued the benefits highly while workers seemed not to mind the payroll tax. It helped that tax increases were modest and gradual. It helped that the economy was prosperous, so that real income growth accompanied small tax increases. It helped that workers noticed only half the tax – the portion deducted from their paychecks – not the half paid by employers. It helped that corporations did not lobby heavily against the payroll tax, as they did against other taxes. It helped that policymakers continued to protect self-employed workers from paying the full rate, pegging their rate at 75% of the combined employee/employer rate. Put differently, policymakers did everything possible to make the benefits highly visible but the costs as invisible as possible.³

The Politics of Contraction

The last easy decision that legislators made about Social Security was in 1973, when they voted to adjust retirement benefits automatically and annually for inflation. The product of the best motives – retirees should not suffer from inflation; legislators should not be tempted to overcompensate them for inflation – this provision put benefits on an automatic escalator. Unfortunately, there was no automatic escalator for revenues.

The stagflation of the 1970s sent policymakers immediately back to work. High inflation triggered automatic increases for retirees; high unemployment diminished the number of workers paying into the system. Total expenditures

³ Of course, it also helped that many workers thought they were funding their own retirement.

exceeded total revenues in both 1975 and 1976 (Board 2014, p. 153). With a reserve containing enough money to pay benefits for only a few months, policymakers were forced to act. After much debate, Congress voted in 1977 to increase the payroll tax and the wage base, both increases phased in over a 10-year period. They also modified the benefit formula for future retirees.

The 1977 bill contained no new benefits. The entire 2-year debate was about allocating costs. That legislators felt the need to phase in the costs gradually over the next decade underlines how difficult it was for them to impose large early-order costs on their constituents. This was also the first Social Security bill where a partisan divide appeared, not because Republicans and Democrats differed about the need for change, but because they disagreed about how to allocate the costs.

Three years later, Social Security actuaries again forecasted deficits (Board 1980). There were near-term deficits, again a consequence of high inflation and unemployment, that threatened current retiree benefits. There were also long-term deficits, a consequence of the imbalance among generations, with too few younger workers available to support future retirees from the baby-boom generation (those born between 1946 and 1964). Political conflict was intense. President Reagan proposed large benefit cuts – some for current retirees, but most for future retirees. Democrats portrayed Reagan, and by extension all Republicans, as uncaring. The Senate voted unanimously against any “unfair” and “precipitous” cuts in Social Security benefits. Eventually, the president appointed a bipartisan National Commission on Social Security Reform – the Greenspan Commission – that assembled a plan for solving both the short- and long-term problems. Congress approved an amended version of this plan in 1983, just a few months before trust fund depletion (Light 1985).

The 1983 rescue allocated costs carefully. Everyone lost something. Current retirees faced postponement in their cost-of-living adjustments. Upper-income retirees would have some Social Security benefits taxed as regular income. Workers had both the payroll tax and the wage basis increased. Self-employed workers lost their special lower tax rate. Younger workers watched the normal retirement age rise from 65 to 67. New federal employees and all employees of non-profit organizations were required to join the Social Security system. Congress even mandated that members of Congress join Social Security. When possible, policymakers imposed these costs gradually. It would take 7 years to implement the increased payroll tax, 7 years before self-employed workers paid their fair share, and 44 years before the normal retirement age would reach 67 years. The only immediacy was that legislators no longer exempted themselves from Social Security. They could no longer be seen as imposing costs on everyone but themselves.

Three things stand out about the 1983 rescue. First, it took the impending insolvency of the trust fund to impel action. Absent that crisis, policymakers would not have made the painful modifications designed to prepare for the retirement of the baby-boom generation, still decades away. Second, the partisan divide deepened. Republicans seemed more concerned by the size of Social Security, more interested in restricting its growth, more worried about its effect on savings and the economy, and more amenable to cutting benefits for future retirees. Democrats seemed more concerned with preserving benefits for current and future retirees and more willing to tolerate increases in both the payroll tax and the wage basis. Third, elected officials began to think of Social Security as “the third rail of American politics,” meaning that touching it was as dangerous as grabbing the electrified rail that transmits power to underground trains (Safire 2007). The politics of Social Security was now hazardous, not delightful.

One consequence of the 1983 reform was the creation of a large trust fund. Unlike the trust fund in an advance-funded system, this reserve was designed merely to dampen the effects of generational size, accumulating funds when an extra-large generation was working, and then disbursing those funds when it retired. Over the past three decades, the trust fund has grown from \$25 billion – then sufficient to pay benefits for a single month – to \$2.8 trillion – now sufficient for 40 months (Board 2014, pp. 153–154). Large as it is, it is insufficient to deal with the generational bulge. Social Security actuaries now forecast that the trust fund will continue to grow until 2020, after which it will help fund retirement benefits for only 13 years (Board 2014). Unfortunately, trust fund depletion occurs around 2033, when the youngest boomers are only 69.

The Politics of the Precipice

Assume for a moment that Congress and the president never agree on how to fix the system. What happens next? What happens when the trust fund is empty? The march over the solvency cliff would be remarkably orderly. The revenue stream would continue unabated. Employers would continue to withhold payroll taxes from workers, matched by their own contributions. The Internal Revenue Service would continue to tax a portion of Social Security benefits for upper-income retirees and transfer those revenues to Social Security. The Social Security Administration would continue to pay benefits up to the limit of its monthly revenues. The actuaries currently estimate that monthly income when the trust fund is depleted would allow administrators to pay about 77% of monthly benefits

(Board 2014, p. 12). In short, no congressional action would force an immediate benefit cut of 23% for each retiree.

Would legislators allow beneficiaries to lose nearly a quarter of their monthly benefits in 2033? Before answering that question, we need to know how many retirees collect benefits and what alternative sources of income they have. In 2013, 47 million people received retiree or survivor benefits from Social Security. In 2033, the actuaries estimate 76 million people will receive these benefits (Board 2014, p. 124).⁴ After subtracting childhood beneficiaries (about 2 million), today's adult beneficiaries constitute about 20% of the voting-age population. In 20 years, they will constitute about 27% of the voting-age population.⁵ Moreover, senior citizens vote at much higher rates than do non-seniors.⁶ In 2010, 59% of people 65 and over voted in congressional elections, compared with 38% of those between 18 and 64 (Census 2012, p. 264). If seniors continue to vote at these higher rates, they will constitute more than 40% of the mid-term electorate in 2034. In short, a huge fraction of the electorate will be watching legislators struggle to avoid the solvency cliff in 2033.

For most retirees, Social Security benefits are central to their well-being. Among those currently collecting benefits, 36% of retirees receive 90% or more of their income from Social Security, as do 47% of those age 80 or older (SSA 2012, 9.A.1).⁷ For these retirees, a 23% cut in Social Security benefits is nearly a 23% cut in income. Although not all beneficiaries are so dependent on Social Security, they all paid into the system for many decades, expecting retirement benefits in return. Perhaps some retirees believed that their own funds were being stashed away for their retirement. Even those who knew otherwise believed that they were earning a right to benefits, a right no less powerful than those that their parents and grandparents earned in their working years and had redeemed in their retirement years. Very few beneficiaries will consider a 23% cut in benefits to be fair or just.

Focusing just on current retirees misses an important part of the story. Every day 10,000 people become eligible for Social Security benefits – nearly four

⁴ In addition, 11 million people received disability benefits in 2013, which is projected to rise to 12 million in 2033 (Board 2014, p. 133).

⁵ These estimates compare the number of adult retiree and survivor beneficiaries in 2013 and 2033 to the actual (2010) and projected (2030) populations, age 20 years and up (226 million in 2010; 276 million in 2030). See Vincent and Velkoff 2010, p. 10.

⁶ Senior citizens participate more actively in all aspects of politics, including voting, contributing money, and contacting elected officials (Campbell 2003).

⁷ These data, from the Current Population Survey, include money income but do not include capital gains or asset withdrawals (say from a defined contribution pension plan). Although this may be a problem for assessing wellbeing among upper-income retirees, it should not distort my message about lower-income retirees (SSA 2012, pp. 11–14).

million a year – and most of these near retirees have incorporated Social Security benefits into their retirement plans. To be sure, some people have the flexibility to postpone retirement, but even they will consider a 23% cut in their soon-to-be-collected benefits as a serious issue. It is safe to say that 60 year olds will be watching legislators almost as carefully as 70 year olds.

In short, if Social Security is about to go over the solvency cliff, most legislators will consider it the most perilous political issue of their elected lifetimes. They will not want to be associated with a 23% benefit cut. They will not want to travel home to see swarms of angry constituents. They will not want to face an electorate heavily dominated by retirees and near retirees. Legislators will be eager to solve the solvency crisis.

Unfortunately, every known solution to this crisis requires Congress and the president to impose huge costs on others. If policymakers are to protect retirees from harm, they must generate new revenues quickly. In short, it is 1983 again, only this time the hole is much deeper.

Policy Alternatives

Before discussing how legislators might impose costs in 2033, it is helpful to examine how they could impose those costs today. The analytic advantage of the present is that Social Security actuaries have already estimated the costs associated with a wide range of options. Although some of those options will be unavailable in 2033, and others will be much more expensive, today's alternatives provide a foundation for analyzing politics at the precipice.

In order to guide policymakers toward feasible solutions, Social Security actuaries regularly estimate the trust fund's shortfall over the next 75 years as a fraction of the estimated taxable payroll over the same period. For example, in 1992, they estimated that the long-range actuarial shortfall was 1.46% of taxable payroll. By 2014, the shortfall had nearly doubled, to 2.88% of taxable payroll.⁸ Policymakers intent on fixing Social Security can mix and match from a long list of alternatives, but the chosen repairs, whether revenue increases or benefit cuts, should collectively total 2.88% of estimated payroll in order to return Social Security to a sustainable path.

⁸ The doubling of the cost for making Social Security solvent is not a consequence of actuarial error. It is a consequence of Congress and the president doing nothing for two decades. Rather than repairing the system when the baby boomers were in their peak earning years – able to pre-fund more of their own retirement benefits – policymakers dawdled until many of the boomers were retired and the rest were nearing the end of their working lives.

One alternative is to increase the payroll tax, currently 12.4% of wages, half paid by employees and half by employers.⁹ In order to achieve actuarial balance over the next 75 years, the actuaries estimate that policymakers would need to raise the tax rate in 2015 to 15.5% – an increase of 25% over the current rate.¹⁰ If policymakers had chosen this option in 1992, an increase half the size would have been sufficient. Most of the cost doubling is a consequence of missing the opportunity for baby boomers to contribute to repairing Social Security, pushing all the costs on successor generations.

A second alternative for raising revenue is to increase the taxable wage base. The payroll tax is currently imposed on only the first \$118,500 of wages, a cap that increases annually with inflation. Removing the wage cap in 2015, so that all earnings are fully taxed, would eliminate 66% of the long-term actuarial shortfall. Since retirement benefits are based on each person's earnings history, this provision would produce enormous benefits when these affluent workers retired. An alternative approach is to remove the wage cap for taxes while retaining it for benefit calculations. Such a provision would eliminate 82% of the long-term actuarial shortfall.

Another alternative is to raise the so-called normal retirement age, originally set at 65 and now gradually rising to 67, to reflect the fact that today's retirees live much longer than they did at Social Security's inception.¹¹ One option is to continue raising the normal retirement age by 2 months per year until it reaches 69, and then raise it by 1 month each year. Such an option would eliminate 35% of the long-term actuarial shortfall. A more aggressive option is to raise the normal retirement age more rapidly to 70, and then index it to life expectancy. This option would eliminate 48% of the actuarial shortfall. Although increasing the normal retirement age is just a fancy way of cutting lifetime benefits, it reflects the reality that life expectancy continues to increase, putting enormous pressure on Social Security finances.

Various other options exist for cutting benefits. Some target all retirees; some target new retirees; some target high-income retirees. Policymakers could lower the annual cost-of-living adjustment for retirement benefits. Reducing the annual adjustment by 1 percentage point per year would eliminate 61% by the long-term

⁹ Of the 12.4% tax rate, 1.8% is for disability benefits and 10.6% for retirement benefits.

¹⁰ All estimates in this section are from Office of the Chief Actuary 2014. The actuary has calculated the financial effects for 120 possible modifications. The eleven options discussed in this section are labeled E1.1, E2.2, E2.1, C1.4, C2.5, A1, A2, A3, B1.1, B7.2, B3.1 in the report.

¹¹ For men at age 65 years, life expectancy increased 6.1 years between 1940 and 2013 (from 11.9 to 18.0 years) and for women 7.1 years (from 13.4 to 20.5 years). Demographers expect the increase to continue for many decades (Board 2014, p. 90).

actuarial shortfall. Reducing the adjustment by half as much would reduce the shortfall by 32%. Using the chained version of the consumer price index, which some economists argue is a better measure, would reduce the shortfall by 19%. Policymakers could also modify the benefit formula in countless ways. Establishing how much new retirees should collect by adjusting their lifetime earnings for price inflation rather than wage inflation during their working years would eliminate 89% of the long-term shortfall. Reducing benefits for newly eligible retirees by 5% would reduce the shortfall by 22%. Gradually modifying the formula so that new retirees with lucrative work histories would receive less generous benefits than they do now, while less fortunate workers would be untouched, would eliminate 53% of the shortfall.

In short, policymakers today have a rich menu of choices. Indeed, they have had a rich menu of choices for the past two decades. If policymakers had addressed the solvency issue in 1992, when actuaries first warned them and when the oldest boomers were just 46, it would have been easy to make midcourse corrections that made the entire baby-boom generation part of the solution. Policymakers could have increased the payroll tax, so that all boomers could contribute more to the system during their peak earning years. Alternatively, they could have altered the benefit formula, reducing what boomers would collect, but giving them fair warning to save more for their own retirement. Small changes in the early 1990s would have cost about half as much as the necessary changes cost today. Unfortunately, small changes no longer suffice. The baby-boom generation is already retiring. The best one can do is get the younger members of this generation – those in their fifties – to contribute to the solution. But even that solution will not be possible if Congress waits until 2033 to act.

The Politics of Costs

Merely listing some of the alternatives for restoring Social Security to actuarial balance provides a clue as to why legislators have been unwilling to fix the system. Just like 1977 and 1983, every fix requires that legislators impose large costs on their constituents. Fixing the system exclusively by raising taxes would require legislators to increase today's payroll tax by 25%, from 12.4% of taxable wages to 15.5%. For elected politicians on 2-year contracts, raising taxes immediately by 25% in order to forestall a 23% benefit cut 18 years away would be politically perilous.

When legislators make important policy choices, they invariably calculate whether their choices might endanger their reelection (Arnold 1990). Voting for

a 25% tax increase that would take effect immediately invites a host of problems. Even if workers were unaware of congressional action at the time, they would surely notice when their paychecks shrank. No doubt someone – perhaps an employer, friend, or politician – would explain that Congress raised the payroll tax and that their local representative voted in favor. This single vote would provide a powerful campaign issue, inviting talented candidates to challenge incumbents in the next primary and general elections.

If legislators are not careful when they impose costs on their constituents, they can lose elections. The dangers are especially large when those costs are large and directly traceable to legislators' individual actions (Arnold 1990, p. 47). One way to interrupt the traceability chain is to impose costs as slowly and imperceptibly as possible. When Congress increased the payroll tax from 2% to 12.4%, it did so over 55 years and with 20 distinct steps. The median step was a 0.50% increase, or 0.25% each from employee and employer (Board 2014, p. 140). When legislators increased the normal retirement age from 65 to 67, they phased in the change over 44 years. Although there is still time to impose some costs gradually, waiting until 2033 would make gradualism impossible.

Another way to interrupt the traceability chain is to delegate decisions to administrative agencies. Unfortunately, this is not an option for taxation, a core congressional function. A third option is to package unpleasant costs with attractive benefits in a large omnibus bill. Here the hope is that voters will appreciate the latter enough to forgive the imposition of the former. Unfortunately, there are no available benefits that are commensurate with the enormous costs that policymakers need to impose.

There are no other options. Fixing Social Security requires that legislators impose huge costs. They could have done so in the 1990s, imposing the costs very gradually. They could have done so last year, with a combination of less gradual alternatives. By 2033, gradualism will not be an option. They will need enormous revenues to forestall immediate benefit cuts. They will need similar amounts for many years to come.

If gradualism is the preferred way to impose costs, then why did not legislators bite the bullet in 1992? Unlike 1977 and 1983, there was no urgency. When Congress acted then, the trust fund was nearly empty and near-term revenues would soon be insufficient to pay full retirement benefits. Policymakers had to fix things or benefits would be cut. By 1992, the solvency cliff was thought to be 44 years distant. Not many people are good at making hard choices today that would not improve their lives for another four decades. Legislators are particularly bad at acting far in advance, both because their hard choices are to improve other people's lives, and because their myopic constituents tend to focus on

recent conditions when renewing legislators' 2-year contracts, not on what conditions might arise decades later.

The second reason why legislators failed to fix Social Security in the 1990s is that some policymakers became interested in downsizing the existing Social Security system and supplementing it with advance-funded individual accounts. It is hard to build coalitions for repair when some legislators seek to replace.

The Politics of Privatization

There are many good reasons to prefer advance-funded systems to pay-as-you-go systems (Advisory 1997; Arnold, Graetz, and Munnell 1998; Diamond 1999). They promote savings and thus propel economic growth. They insulate a retirement plan from the effects of large demographic shifts. If policymakers were establishing a retirement system from scratch, these arguments would be compelling. From a political perspective, however, they have one large liability: They deliver no benefits in the near term for which politicians can claim credit. Indeed, they deliver nothing but costs in the near term, costs for which politicians can be blamed (Arnold 1998).

Moving from a pay-as-you-go system to an advance-funded system is even more difficult. One must fund both systems for a while, simultaneously setting aside money for younger workers while honoring existing obligations to retirees, near retirees, and middle-aged workers. Put differently, one generation would need to pay twice – funding its own retirement with advance contributions while also paying for the retirement of the preceding generation. Clever people can devise ways to spread the costs over a longer period, so that perhaps two generations pay for the transition to an advance-funded system, but spreading the costs makes privatization no more attractive to voters or legislators.

The political perils of privatization are no longer hypothetical, as they were when I last discussed them (Arnold 1998). Soon after his 2004 reelection, President Bush announced that reforming Social Security was his top domestic priority and that he was determined to create individual, advance-funded accounts. In his words: "I earned capital in this campaign, political capital, and now I intend to spend it" (Galston 2007). But even with Republicans firmly controlling Congress, and despite Bush's 60-day national campaign to persuade the public of its virtues, the proposal died a few months later. Even legislators who admired privatization in principle were unwilling to impose the necessary costs to create private accounts for younger workers. The 2005 lesson is clear: Privatization does not need political capital; it needs economic capital to fund the transition. When

President Bush took office, the federal budget was in surplus. If the president had used the surplus to fund the transition costs to an advanced-funded retirement system, rather than squandering it on war and tax cuts, then privatization might have been possible. Without such funds, privatization was – and is – politically impossible.

The Finale

If legislators are unwilling to enact costly reforms to make Social Security sustainable, the solvency cliff will arrive around 2033. At that point, legislators will face their worst political nightmare: Do nothing and their retired constituents will lose a quarter of their benefits at dawn. The good news is that Congress will do something. Legislators did not let the nation go over the fiscal cliff in 2013. They will not let Social Security go over the solvency cliff in 2033. The bad news is that the cost of avoiding this cliff will be much greater than it would have been in 1995, 2005, or 2015. Moreover, legislators will no longer have the luxury of phasing in costs gradually. They will need enormous revenues immediately.

The most likely source for immediate revenue is the taxable wage base – the limit on taxable earnings (currently \$118,500). Whether policymakers raise the cap, raise the cap for contributions but not benefits, eliminate the cap, or eliminate the cap for contributions but not benefits, this move would instantly generate enormous revenues. As previously discussed, the fourth option would eliminate 82% of today's Social Security shortfall. If income growth among affluent workers continues, it would be even more lucrative by 2033.

To be sure, there would be fierce resistance to eliminating the taxable wage base. Some people would pay dearly. Consider a banker earning one million dollars who currently pays \$7347 for Social Security. If the wage cap were eliminated, she and her employer would each pay \$62,000. Congress has experience eliminating the wage cap, however, having done it twice for Medicare. For three decades, Medicare used the same wage base as Social Security. Then Congress enacted the Omnibus Budget Reconciliation Act of 1993 and eliminated the wage base. So, today's millionaire banker pays \$14,500 toward Medicare, rather than \$1718 if the cap were still in place. In 2010, the Affordable Care Act created an additional 0.9% Medicare tax on all earnings over \$200,000 – another \$7200 from our beleaguered millionaire.¹² If policymakers could twice eliminate the

¹² Unlike the regular Medicare tax, this tax is for employees only. There is no employer match. The trigger is \$200,000 for single taxpayers and \$250,000 for married taxpayers filing joint returns.

wage base for Medicare, when there was no imminent crisis, why can not they raise or eliminate it for Social Security when 76 million retirees are facing the immediate loss of one quarter of their benefits?

A solvency crisis changes everything. The affluent have been remarkably successful in keeping proposals to eliminate the Social Security wage base off the agenda because there was no urgent need for revenue. But a crisis, and particularly a zero-sum crisis like 2033, will expand the agenda. Legislators will have to choose among two of the most active groups in American politics: affluent citizens and senior citizens. Do legislators impose significant costs on affluent workers or do they allow the solvency crisis to impose immense costs on retirees?

Legislators know how to count and here the numbers are clear. Currently, about 6% of covered workers earn more than the taxable wage base (Whitman and Shoffner 2011). Most of these workers earn just over the base – say, between \$120 K and \$160 K – so eliminating the cap would hurt, but not much. It is hard to imagine these folks becoming single-issue voters if legislators eliminated the cap, especially since they would also care that their parents not lose a quarter of their Social Security benefits. Most of the costs would be concentrated on the top 1 or 2% of workers, who constitute 3 or 4% of the electorate. Against the distress of the affluent, legislators would consider the far greater pain that 76 million retirees would otherwise endure. Retirees will then constitute about 27% of the voting-age population and perhaps 40% of the mid-term electorate. In short, legislators would be refereeing a zero-sum conflict between the 4% and the 40%.

In addition to counting, legislators know how to weigh the intensity of constituents' concerns. The question is not merely where constituents stand, but whether they would allow a legislator's Social Security vote to influence their electoral choices. Here the retirees – if wronged – are the more likely single-issue voters. Losing a quarter of one's retirement benefits would be the ultimate catalyst for electoral retribution. Perhaps some of our millionaire bankers would also seek retribution, but their numbers are insufficient to overpower enraged retirees.¹³ In short, if legislators anticipate how their votes on saving Social Security would play out in the next campaign, they have much more to fear from retirees than from the affluent.

The point is not that legislators would welcome a proposal to eliminate the wage cap (although some would). The point is that the opponents to such a proposal would be unable to keep it off the table, both because it is so incredibly

¹³ Although the affluent could also punish legislators by withholding campaign contributions, no amount of campaign funds could compensate legislators for voting to allow their retired constituents to lose a quarter of their Social Security benefits.

lucrative and because the politics of eliminating the cap is less dangerous for legislators than adopting other lucrative options.

The other large source for immediate revenue is raising the payroll tax rate. Unfortunately, policymakers would need to increase this rate by nearly 25% to preclude benefit cuts. Imposing such a huge tax increase on all workers, rich and poor, seems unlikely, although a smaller increase might be part of a rescue plan. The better use of an augmented payroll tax would be to solve the other long-term Social Security problem, the increasing longevity of retired workers. Since Americans are not deferring their retirements as quickly as life spans lengthen, the only alternatives to tax increases are benefit cuts or raising the retirement age, neither of which is popular. Moreover, for the longevity problem, policymakers can increase the payroll tax gradually, whereas the solvency crisis needs huge revenues immediately.

Policymakers could also choose to cut retiree benefits in various ways. They could reduce or eliminate automatic inflation adjustments for a while, preserving nominal rather than real benefits. They could choose to target benefit cuts on affluent retirees or near retirees, who have alternative sources of income. None of these options is enough to solve the immediate crisis, but together they could be part of a share-the-pain solution.

Finally, policymakers could do the unthinkable and use debt to allow for a more gradual transition. Although Social Security has never borrowed funds, Congress regularly uses debt to fund tax cuts, wars, recessionary spending, disaster assistance, and indeed ordinary spending. If legislators agreed on how to impose the pain but needed to implement some changes gradually, debt financing might help. The justification would be even greater if the reform plan contained a solution to the longevity problem, thus helping to prevent future solvency crises.

Few legislators will advocate that retirees lose a quarter of their benefits. Not even the greatest fans of privatization, individual responsibility, and smaller government would welcome such an event unless they were prepared to end their congressional careers. Although Democrats and Republicans would be united in seeking a solution for the solvency crisis, they would not necessarily agree on how to share the pain among various groups and income classes. Choosing among the many options and assembling a comprehensive package is a task for elected politicians who are skilled at balancing political risks. Since the costs to be imposed are so substantial, Democrats and Republicans need to walk along the third rail together, as they did in 1983, lest one party blame the other for imposing large and traceable costs.

There is nothing inevitable about a solvency crisis in 2033. Congress and the president could tackle this persistent policy problem any time before it becomes an urgent political crisis. The greatest impediment to problem-solving today is that

many policymakers insist that privatization should be part of the solution. Unfortunately, the politics of privatization is even tougher than the politics of repair because the transition costs are so huge. The fact that a Republican president, a Republican House, and a Republican Senate could not solve the transition problem in 2005 – and the Democrats did nothing to block it – underscores that what is popular in principle is not necessarily feasible in practice. The one advantage of politics at the precipice is that it focuses legislators' minds on problem solving.

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