R. Douglas Arnold: Fixing Social Security: The Politics of Reform in a Polarized Age. Princeton University Press, 2022

Peter Diamond[1] [2]

Under current law, Social Security benefit payments can not exceed Social Security resources in the Trust Fund balances plus the revenues received (from the payroll tax and the income taxation of benefits). The 2022 actuarial projection of Social Security shows the combined Trust Fund balances[3] becoming depleted in 2035 and continuing income being sufficient to finance only 80 percent of scheduled benefits at that time. The big questions are whether legislation will change this outcome, and, if so, when and how. Doug Arnold's clear and balanced presentation provides both economic and, primarily, political science framing for these three questions.

The book includes a quick history of Social Security legislation from its beginning through 1983 and of the lack of significant legislation since then. This lack occurred despite serious legislative pushes by Presidents Clinton and Bush.[4] And the book also has a balanced short presentation of the economics of proposals, with the focus of the book being the politics around proposed benefit and revenues changes, along with discussion of the privatization option. As Arnold concludes that privatization does not readily address the projected 2035 financing shortfall, I ignore it in this review.

Arnold's approach to Social Security politics is through discussions of agenda setting (how an issue becomes a focus of legislators' attention) and decision making (actual legislation). He provides an extended and detailed discussion of the prime political players, including the policy makers (Congress and Presidents), the prime lobbyists (AARP and employer groups), and voters (both attentive and inattentive). The discussion includes the views of these players about alternative revenue and benefit changes as manifested in public surveys, political stances, and legislative proposals. An important part of the political process is the role of actuaries. As noted by Arnold, "Social Security's actuaries have earned the respect of politicians of every stripe." This is a key part of the political process, and not the case everywhere. As restoring actuarial balance involves extensive bad news (benefit cuts and/or tax increases) the reluctance of politicians to act is not surprising. With this extensive background, the book considers potential

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[1] Institute Professor Emeritus, MIT.
[2] Doug Arnold and I both served on a panel about the privatization of Social Security (Issues in Privatizing Social Security, Report of an Expert Panel of the National Academy of Social Insurance, Cambridge: MIT Press, 1999). I do not recall any other extended interactions with him. Also, the book cites favorably my 2005 book on Social Security, written together with Peter Orszag.
[3] There are separate Trust Funds for the retirement and disability programs, but analyses regularly combine them, assuming legislated transfers between them would operate as if there were just one Fund.
[4] Also, President Obama was willing to include Social Security in a "grand bargain."

outcomes under the common assumption of no legislative action until the projected benefit cuts are imminent ("Politics at the Precipice").

From its start in 1935 until the introduction of automatic annual cost-of-living benefit increases in 1972, Social Security was subject to repeated expansions of coverage, benefits, and contributions on an often-erratic schedule. High inflation changed a public appreciation of more Social Security benefits (along with their financing) into a public consideration (concern) of whether Congress had increased benefits enough. This shift (and the need for frequent legislation) led to the 1972 introduction of automatic COLAs. Unfortunately, that automatic adjustment was poorly designed. Benefits were based on the history of earnings in nominal terms and benefits also increased for inflation. With high inflation in the 70s this design had the effect of exploding benefits and so the cost of Social Security. Congress knew this 1972 structure was not properly designed, but passed the legislation anyway.

By 1977, Trust Fund balances looked to be depleted within a few years and the long-range actuarial projection was badly out of balance.[5] The 1977 legislation introduced the current structure with wage-indexing of annual earnings in the determination of initial benefits, along with price-indexed COLAs, fixing the mistake in the 1972 design that had exploded benefits.[6] This structural change greatly reduced projected benefits and was accompanied by a significant revenue increase.[7] The change in structure varied by birth cohort, with older cohorts (retirees and those very close to benefit eligibility) getting the higher 1972 rules, younger cohorts getting much lower benefits under the new rules, and five intermediate cohorts getting a special calculation, which triggered the "notch babies" controversy over their benefit reductions. The law also phased in increases in both the tax rate and taxable maximum,[8] making significant progress overall toward restoring actuarial balance, but not sufficient for the full 75-year projection.[9] In part, the projected growth of baby boomers in the labor force aided an extended period with sufficient funding. Unfortunately, Arnold does not recognize the role of the 1977 legislation in reducing benefits and refers to it as relying fully on tax increases. This incorrect description makes some of the discussion of legislative possibilities in Chapter 12 not directly relevant.

But the economy did not cooperate with the 1977 actuarial projections; Trust Fund depletion was looming in 1983, implying an inability to pay full scheduled benefits, and so triggering a need

[5] The 1977 Trustees Report had the DI fund exhausted in 1979 and OASI fund exhausted in 1982-84 across three projections. For the 75-year horizon, the intermediate projection saw outlays of 19.19% of taxable earnings and tax income of 10.99% and so an actuarial deficit of 8.20%.

[6] The actual structure is more complicated in the face of lags in the availability of wage data.

[7] According to the Ways and Means Committee print entitled "Actuarial Cost Estimates for the Old-Age, Survivors, Disability, Hospital, and Supplemental Medical Insurance Systems as Modifies by Public Law 95-216" (dated March 3, 1978), of the 8.20% actuarial deficit, 5.16% was removed by benefit changes and 1.74% by revenue changes, leaving an imbalance of 1.46%.

[8] Tax rates increased slightly in 1979 and 1980, and more significantly in 1981 and later. The ultimate OASDHI tax rate would be 7.65% on employees and employers, each, in 1990. (Formerly, the rate in 1990 was 6.45%, and the ultimate rate 7.45% in 2011.)

The earnings base increased, on an ad hoc basis, to $22,900 in 1979, $25,900 in 1980, and $29,700 in 1981. After 1981, the base would be adjusted automatically to keep up with average wages as under the prior law.

[9] The 1978 Trustees Report projected "financial soundness … throughout the remainder of this century and into the early years of the next one."

for further reform, this one at the last minute. The 1983 bill had a carefully negotiated balance of near-term adjustments.[10] A common view is that the Greenspan Commission was charged with producing a bill and it did. However, in "The Greenspan Commission: What Really Happened," former Social Security Commissioner and Greenspan Committee member Bob Ball has provided details of a somewhat different picture. Ball describes 'secret negotiations,' organized for President Reagan and Speaker O'Neill that produced a compromise for the short term, which was then accepted by the Commission. As Arnold notes, the Commission still filled a political role.[11] As the Commission did not reach a long-term agreement, Congress relied on a legislative process in the House that allowed consideration of only a pair of proposed amendments. An amendment to raise payroll taxes failed, while an amendment to raise the age for full benefits passed.[12] This reflected close to uniform Republican voting with a considerable split among the Democrats. Further steps in the Senate and the House-Senate conference were part of completing the legislation in time to avoid delivery of reduced benefits.[13]

Since 1983, no legislation has occurred to avert the risk of Trust Fund depletion and benefit cuts, despite many annual reports of eventual inadequate financing. The current political environment, described by Arnold, and its resemblance to the period between the 1977 and 1983 laws, suggest we will have a further wait for a last-minute bill, and perhaps some use of a commission for help in shaping a bill. As Arnold notes: "We should not be surprised if Congress does nothing to fix Social Security before 2034." (p. 224.)

With the 1983 legislation as a direct example, what should we expect if we approach Trust Fund depletion and benefit cuts without new legislation?[14] Immediate options include (a) passing legislation to put Social Security on track, at least for a significant period even if not 75 years; (b) letting the automatic benefit cuts happen; and (c) stalling. General revenues could be part of providing a sustained fix or of stalling (until after the next election for example), thereby spreading out the need for revenue and benefit changes. This could be done as a transfer (as in some other countries) or as a "loan" to Social Security, to be repaid over time.[15] Arnold discusses the politics around the historic absence of the use of general revenues. I wish he had also explored the distinction between general revenues as a loan or as a transfer, as I think that use of a loan seems more likely. And, I share Arnold's view that the automatic benefit cuts are not likely to happen and a negotiated solution will be used.

The 2035 party makeup of the President and the Congress will be a key ingredient in what will happen. Paralleling Arnold's discussion of comprehensive solvency plans from legislators between 2010 and 2020, here are two reform proposals by the majority and minority chairs of the Ways and Means Subcommittee charged with Social Security, both evaluated based on the 2016

[10] The bill introduced the taxation of benefits, with some of the revenue going to Social Security. The Democrats labeled this a tax increase, while the Republicans called it a benefit cut.
[11] This picture is also presented in Light (1995), cited by Arnold.
[12] The two amendments were put forward by Representatives Pepper and Pickle, leading to reference to a condiment battle.
[13] For details, again see Light (1995).
[14] The setting in 1977 included a need to repair a widely acknowledged bad basic design.
[15] In 1981, Congress allowed the Social Security trust funds to borrow from each other and from Medicare for a brief period.

Trustees Report.[16] Both of these bills restored actuarial balance over the 75-year projection period – Johnson by cutting benefits and Larson by raising revenues. These bills are shown in the Table, along with the impacts on actuarial balance.

Comparison of two bills[17]

Social Security Reform Act of 2016 Sam Johnson		Social Security 2100 Act John Larson	
No change in payroll tax rate		Increase the payroll tax rate, reaching 14.8% in 2042	+1.78
No change in payroll tax base		Apply OASDI tax rate to earnings above $400k, with an increase in benefits	+1.88
Change benefit formula	+1.19	Increase benefit formula	-0.24
Increase age for full benefits	+0.84	No change in age for full benefits	
End taxation of benefits	-0.40	Change taxation of benefits	-0.19
Decrease COLA	+1.25	Increase COLA	-0.39
Change special minimum	-0.23	Change special minimum	-0.13
Other	+0.12		

The actuarial deficit in the 2016 Trustees Report was 2.66% of taxable payroll. The Johnson plan's benefit cuts provided 3.28%; the Larson plan tax increases provided 3.66%.[18] One can wonder how far either party would actually go in its preferred direction if it had full political control (including being filibuster-proof).

Arnold's closing chapter ("Doing Better") considers some policy issues and potential political actions. I want to add a little to the issues in the section "Retirement Age." Social Security has two key ages. An early entitlement age (EEA) is the first age at which one can start one's own worker retirement benefit (as opposed to a disability benefit). This age has been 62 and was not changed in 1983. The age for full benefits, (also called the normal retirement age, NRA) is the age for which the benefit formula applies, followed by an adjustment for an earlier or later start to benefits. The 1983 reform moved the NRA from 65 to 67 slowly and after a significant delay and did not change the EEA.[19] It is helpful to compare moving each of these retirement ages with simply changing the benefit formula.

[16] Arnold notes that there have been no Republican solvency plans since 2016.

[17] Descriptions of the bills and Office of the Chief Actuaries projections of their effects are available on the web at https://www.ssa.gov/OACT/solvency/provisions/index.html

[18] The press releases for these two bills did not use the expressions "tax increase" or "benefit cuts." Instead, they used "strengthening" and "modernizing."

[19] The 1983 law raised the NRA beginning with people born in 1938 or later and reached 67 for people born in 1960 and later.

The benefit formula is set each year for the newly eligible cohort.[20] A straightforward way to reduce expenditures would be to lower the percentages (factors) in the benefit formula, for example by multiplying the current formula by a constant less than one. With such a benefit decrease, some workers would delay starting benefits and some would work longer (before or after starting). Delayed benefit starts would affect overall financial balance only to the extent that the adjustment for the starting age differs from being actuarially neutral for those delaying. Additional work provides tax revenue and may increase benefits.

Increasing the age for full benefits (NRA) lowers the benefit paid with any starting age, similarly to reducing the benefit formula.[21] And, similarly, some workers would respond by delaying their ages for starting benefits and/or for stopping work. Changing the NRA also has a behavioral effect, influencing thinking about the retirement decision, an effect not present from simply lowering the benefit formula. Thus, discussion of the NRA needs to consider the benefit cuts insofar as retirement behavior does not change, along with the effects from changes in starting benefits and in working. Some people can readily work longer and may end up with a later start resulting in the same monthly benefits, but vulnerable populations that cannot readily work longer will simply see a benefit cut from a larger actuarial reduction to their monthly benefits from starting benefits at the same age as before.

In contrast, an increase in the EEA from 62 would prevent some people from starting benefits at 62. Those workers may or may not increase earnings during the period of delay. If the adjustments for early benefits were actuarially neutral for the affected population, delayed starts by themselves would have no aggregate financial effect. This is in sharp contrast with an increase in the NRA, which is a benefit cut, paralleling a simple change in the benefit function.

It is also worth noting that life expectancy for early retirees is less than that for late retirees, and that the gap in life expectancy between late retirees and early retirees has been widening and is likely to continue to widen (Waldron 2002, 2015). Some proposals for changes in the NRA include a linked change in EEA, but it is important to recognize that the two ages have different impacts across the population and should be considered separately.

Just as changes in the two retirement ages have important distributional effects as well as an impacts on overall financial balance, the same is true of changes in the COLA, the second topic in Arnold's discussion in Doing Better. As with a change in ages, a change in COLA can be combined with a change in the benefit formula focused on distributional concerns.[22]

Appropriately, the chapter continues with interesting insights into what might encourage earlier legislation, in light of the wider options available with earlier actions. This rounds out the extensive insights that Arnold provides about the politics of reform, about whether legislation will change the outcome, and if so, when and how.

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[20] The formula is 90% of average indexed monthly earnings (AIME) up to a first bend point, 32% between the first and second bend points, and 15% above that. Bend points are adjusted each year based on changes to the Average Wage Index.

[21] Such reductions do not match a uniform decrease, but are not very different.

[22] Some proposals for a lower COLA also include a benefit increase at an advanced age, such as 85.

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