

SOCIAL SECURITY REFORM CHECK LIST #4

The Moynihan-Kerrey Plan

Overview

Senators Daniel Patrick Moynihan (D-N.Y.) and Robert Kerrey (D-Neb.) have introduced legislation that would make significant changes in Social Security. Their plan would establish voluntary private retirement accounts while instituting major reductions in guaranteed benefits, a large, temporary payroll tax cut, and some tax increases. Most notably, the plan would reduce the payroll tax that finances Social Security from 12.4 percent (divided equally between workers and their employers) to 10.4 percent, giving individuals the option of either contributing the two point difference to a savings account or keeping one percentage point to use as they see fit.

The guaranteed benefits received by today's retirees, currently adjusted for inflation as the consumer price index rises, would increase at a slower rate because in calculating benefits a percentage point would be subtracted from the rate of increase in the Consumer Price Index each year. By the end of the average retirement period of twenty years, that change alone would leave beneficiaries with monthly checks about 25 percent below what they would be under current law. Economist Alicia H. Munnell of Boston College calculates that by the year 2070, when all the plan's changes would be fully phased in, the cut in guaranteed benefits for a worker with an average earnings history who retires at age sixty-five would amount to 31 percent. That's substantially more than the 25 percent across-the-board cut in guaranteed benefits that the government estimates will be required in the year 2032 if no changes whatsoever are made to Social Security in the interim.

Summary of Key Features

Benefit Changes. In addition to subtracting a full percentage point from the rate of increase in the consumer price index each year when adjusting retirement benefits for inflation, the Moynihan-Kerrey plan reduces benefits in the following ways.

It would increase the age at which full retirement benefits could be collected by two months per year from 2000 to 2017, and by one month for every two years between 2018 and 2065. This means that workers who reach sixty-two in 2017 will not be eligible for full retirement benefits until age sixty-eight and workers reaching sixty-two in 2065 will only become eligible at seventy. Under current law, workers reaching sixty-two in 2022 will be eligible for full retirement benefits at age sixty-seven.

Benefit levels would be based on how much a worker earned over the course of thirty-eight years rather than over thirty-five years, which is the period currently used. On average, the change would reduce a worker's retirement benefits by about 3 percent because it includes in the average the earlier years in workers' careers when they likely earned less--or nothing at all. Because women are more likely than men to withdraw from the workforce for years at a time to raise children, this change would affect them disproportionately.

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Tax Changes. The Moynihan-Kerrey plan's payroll tax cut would begin in 1999 and last through 2024. After that, the payroll tax would increase according to the following schedule:

from 2025 to 2029, it would rise from 10.4 percent to 11.4 percent;
from 2030 to 2044, it would return to the current level of 12.4 percent;
from 2045 to 2054, it would be 12.7 percent;
from 2055 to 2059, it would rise to 13.0 percent,
in 2060 and thereafter, it would be 13.4 percent.

Other tax increases would be imposed sooner, however:

The cap on yearly earnings subject to the Social Security payroll tax would increase from \$68,400 in 1998 to \$97,500 in 2003, and thereafter would be indexed to wage inflation.

Social Security benefits would become taxable to the extent that a retiree's benefits exceed his or her tax contributions to the system. This change would result in more extensive taxation of benefits than under current law, which taxes only half of benefits received by retirees with total yearly incomes in excess of \$25,000 (\$32,000 for married couples).

Structural Changes. The largest structural change is the incorporation of voluntary private retirement accounts. This new component of Social Security would give an individual earning \$30,000 a year—who now pays \$1,860 in Social Security payroll taxes—the option of investing \$600 in a savings account or keeping an extra \$300 in take-home pay. The individual could put the \$600 either in investment funds that the government now offers to federal employees or in privately run accounts. Other structural changes include:

Newly hired state and local government workers would be required to participate in Social Security. They are the last group of workers now excluded from Social Security.

The earnings test, which may reduce current benefits for individuals who continue to work after electing to receive their Social Security benefits, would be eliminated beginning in the year 2003 for all beneficiaries aged sixty-two and over.

Evaluating the Plan

To assess the impact of various proposals to change Social Security, The Century Foundation organized a group of experts to develop principles for prudent reform. Here's how the Moynihan-Kerrey plan stacks up against those principles:



Principle 1

Social Security should continue to provide a guaranteed lifetime benefit that is related to past earnings and kept up to date as the general standard of living increases.

Analysis: Under the Moynihan-Kerrey plan, guaranteed retirement benefits would continue to be based on past earnings, adjusted for changes in the cost of living. But those benefits would be significantly lower than under reform proposals such as those put forward by former Social Security commissioner Robert M. Ball or Brookings Institution economists Henry J. Aaron and Robert D. Reischauer. That's mainly because of the annual one-percentage-point reduction in the cost-of-living adjustment and the increase in the retirement age.



Principle 2

American workers who have the same earnings history and marital status, and who retire at the same time, should receive the same retirement benefit from Social Security.

Analysis: While workers with the same earnings history and marital status would receive the same *guaranteed* benefits from Social Security, the introduction of personal retirement accounts would produce significant variations in overall benefits among workers with the same earnings history. Because these accounts are voluntary, some workers would choose not to participate. (Only 3 percent of Americans earning \$30,000 or less, for example, have elected to open Individual Retirement Accounts despite considerable tax advantages in doing so). Moreover, investment returns on the accounts are certain to vary widely. Investors with greater financial acumen and better luck, and those who retire when investment markets are strong, would receive higher payments than workers who invested less skillfully or retired during a bear market. As a result, under the Moynihan-Kerrey plan, Social Security would more closely resemble an investment program than retirement insurance.



Principle 3

Social Security benefits should continue to be fully protected against inflation, and beneficiaries should continue to rest assured that they will not outlive their monthly Social Security checks.

Analysis: Under the Moynihan-Kerrey plan, Social Security would continue to pay guaranteed lifetime benefits indexed for inflation. However, by reducing the benefit adjustment tied to the consumer price index by one percentage point each year, the plan would hurt many low-income elderly who are already struggling with rising medical costs (which rise more rapidly than the consumer price index). These costs have come to consume an ever-growing share of elderly Americans' personal expenses —20 percent of such expenses on average and an even higher share for poor seniors. Over the past fifteen years, adjustments in Social Security benefits have failed to take account of this rising burden. As for the assets accumulated in private retirement accounts, their value could be significantly reduced by a period of high inflation.



Principle 4

Retirees who earned higher wages during their careers should continue to receive a larger check from Social Security than those with lower incomes; but the system should also continue to replace a larger share of the past earnings of low-income workers.

Analysis: The Moynihan-Kerrey plan would retain this feature of the current program for determining guaranteed benefits.



Principle 5

Social Security's insurance protections for American families, including disability insurance, should be fully sustained.

Analysis: The Moynihan-Kerrey plan retains all of the disability and survivor's insurance features of the current Social Security program.



Principle 6

Social Security's long-term financing problem should not be aggravated by diverting the program's revenues to private accounts and benefits should not be reduced to make room for private accounts; any such accounts should be supplementary to Social Security, entirely as an add-on.

Analysis: By reducing the payroll tax in order to introduce personal retirement accounts, the Moynihan-Kerrey plan would deplete the asset buildup in the Social Security trust funds. This would shift a much greater share of the burden of financing Social Security to future workers after the retirement of the baby boomers. The benefit cuts will reduce those obligations to some extent but cutting revenues to the system now will add to, rather than lessen, the challenge of keeping Social Security sound in the next century.



Principle 7

In addition to securing Social Security as the foundation of income support for retirees, their dependents, the disabled, and survivors, more needs to be done to encourage private savings and pensions.

Analysis: The Moynihan-Kerrey plan includes no measures that would encourage private savings and pensions. Indeed, reducing payroll taxes (which by definition reduces the federal surplus or increases the deficit) without requiring households to save the money threatens to reduce further the nation's already low level of national savings.