Creating Social Security Incentives For Older Workers To Remain In The Workforce

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ABSTRACT

This paper presents an innovative proposal for modifying the Social Security benefit structure. The purpose of the modification is to provide an incentive for people to remain in the work force for more years as well as help provide revenues needed to fund Social Security entitlement costs and, at the same time, increase employment, and help balance the federal budget.

Keywords: Social Security; Senior Citizens; Federal Deficit; Fiscal Policy

INTRODUCTION

This year, Social Security payments will exceed Social Security tax receipts. This signals the need to put Social Security on a more stable financial footing. The last time the issues of funding Social Security were addressed was 1983. Until very recently, Social Security tax receipts have exceeded payments and were expected to continue to do so until at least 2016. The Great Recession resulted in higher unemployment with a consequential significant drop in Social Security revenues. Therefore, Social Security funding needs to be addressed.

Discussion is already underway producing numerous ideas for putting Social Security back on a stable financial footing. Most of the ideas focus on some combination of revenue enhancement and benefit reductions, primarily for future retirees. Unfortunately, most of the ideas tend to ignore a much larger problem: the urgent need to increase economic growth and employment so everyone (including the rapidly increasing number of senior citizens) can enjoy increasing standards of living.

This paper details one way that fiscal policy pertaining to Social Security retirement benefits can be modified to provide workers with incentives that will:

1. Reward workers for continuing to work as they get older rather than retire.
2. Help lead to sustained, long-term economic growth.
3. Increase federal and state government tax revenues.
4. Position more Baby Boomers and other future retirees to enjoy financially secure retirements.

To start it is necessary to understand some basic facts about population demographics and Social Security benefits.

LITERATURE REVIEW

Perhaps no other modern social policy has fallen into a seeming black hole of impenetrability than Social Security and its related medical benefit program, Medicare. Far from the rarefied world of the actuary, the accountant, or the financial analyst, Social Security policy making touches upon our most deeply held values, including treatment of the young, the elderly and those with infirmities. By no means is this an American phenomenon, it should be noted. Significant social insurance policy making and reform efforts have taken place in

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Argentina (Kay, 2009) and China (Zhu, 2002), as well as in Germany, Japan, and the Republic of Korea (Campbell, Ikegami, and Kwon, 2009).

Yasar (2009) shrewdly associates this nexus of numbers and human values underlying policy making as an example of social mythmaking, reflected in both an illiteracy and a mis-conceptualization of how Social Security works in America. The frequently heard outcry that future retirees will have to be carried on the backs of today's workers reveals, he asserts, a misunderstanding of the system, namely, that Social Security has worked this way since 1935. He notes that intergenerational conflict has always been a feature of economic theory.

Another possible candidate for Yasar's "illiteracy" includes the assertion that Social Security is a Ponzi scheme (Stossel, 2009). Policy "mythmaking" of this nature reveals what Jerit and Barabas (2006) call a "bankrupt rhetoric," that is, a policy making surrounded by a poor quality of information.

These rhetorical factors notwithstanding, the historical record on Social Security reform appears clear. Jerit and Barabis (2006) remark that Roosevelt originally called Social Security "social insurance," a program where workers would contribute and provide for their own security. Social Security was not conceived as a welfare program at its inception.

Social Security policy has been subject to on-going reform since its origination. King and Cecil (2006) point to a 1939 amendment adding benefits to a spouse or minor of a retired worker. Benefits also were included for retirement, disability, premature death, and medical costs after retirement. King and Cecil also include important changes in 1950 with the addition of COLAs, the reduction of retirement age to 62 in 1961, and significant increases in benefits for those waiting until age 62 in 1972.

A significant Constitutional decision (Flemming vs. Nestor) in 1960 ruled that Social Security payments are not a contract between the recipient and the government (SSA Online – Flemming vs. Nestor). Accordingly, one does not have a legal right to Social Security, and the program is subject to political and economic policy changes. For example, the Social Security Reform Act of 1983 enacted major changes to the eligibility ages for benefits, in addition to the creation of a Trust Fund (SSA Online–Trust Fund Data). The Fund, wherein the anticipated reserves generated by additional payroll taxes would be held, was expected to keep the system solvent over a long period (CQ Researcher, 2008). The Trust Fund is the subject of controversy, one economic group suggesting that it has been subject to blatant undermining (E21, 2010) and a prominent think-tank calling it "phony" (Heritage, 2010).

Perhaps the most significant foray into Social Security reform has been privatization, whereby workers would be able to invest a portion of their contribution in private accounts. As one might predict, criticism is antipodal. A prominent think-tank views privatization as the answer to solving Social Security's long-term funding needs (Cato, 2010); an economist, by contrast, believes it is a "terrible idea" (Skidmore, 2005).

In what perhaps can only be regarded as a policy farrago, some challenges to Social Security appear to have substantial agreement. Reznik, Shoffner, and Weaver (2006) identify rising life expectancy and falling fertility rates in the United States as a major challenge. Yee (2005) identifies changing demographics and changes in the structure of the family, as well as the significance of Social Security as a hedge against poverty for a growing percentage of the population, as examples of a multifaceted, not a "one size fits all" program.

With specific regard to demographic changes, Reznik, Shoffner, and Weaver (2006) comment that policymakers have offered responses that both directly and indirectly address underlying demographic changes. Some proposals would tie benefits to changes in life expectancy; others, such as progressive price indexing, would address system financing issues but would not address demographics. Reznik, Shoffner, and Weaver also remark that agreement among workers on working longer and saving more to maintain their standard of living is an "open question."

Significantly, these researchers note that options calling for raising the early eligibility age under Social Security have met with substantial debate. Market (2005) comments that the Freedom to Work Act for those over 65

encourages workers to delay retirement; however, Market adds, retirement is not as compelling or powerful as it once was, especially considering the economic necessity felt by many workers to keep on working.

In what perhaps might be regarded as a "capstone" policy dictum, Alemayehu and Warner (2004) remark that old-age health care costs will impose increasingly severe pressure on private finances and government. Whether Social Security policy making succumbs to the "Malthusian fallacy" of doom and crisis because policymakers overstate the importance of a particular social phenomenon over the many others that affect society (Market, 2005), or whether a lack of political will may lead policy makers to walk away from "fixing" Social Security (Yee, 2005), the core issue, as Yasar (2009) suggests, appears to be a basic structural weakness exemplified by the gap between net benefits and net contributions.

DEMOGRAPHICS, PROVIDING FOR RETIREES, AND SOCIAL SECURITY PAYMENT LIMITATIONS

In 1935, the life expectancy of a 65-year-old was 12½ years; today it is 18 years and continuing to slowly increase. By 2034, the number of older Americans will almost double – increasing from 39.9 million today to 74.6 million. There are currently 3.2 workers for each Social Security beneficiary. By 2034, there will be only 2.1 workers for each beneficiary. Obviously, barring some tremendous increase in productivity, it will be necessary for people to work longer.

Fundamental economic analysis indicates that in any society, those people who work support not only themselves, but also everyone else. As a group, workers support themselves, their children, those who are unemployed or do not choose to work, those who are incarcerated, Senior Citizens – everybody.

It does not matter if Senior Citizens have accumulated great wealth that provides significant retirement income or manage only on Social Security. Once a person stops working (retires, is laid off, etc.), someone else has to provide the goods and services that person requires beyond what that individual provides for her/himself.

Ultimately, the cost of providing for Senior Citizens is borne almost entirely by the productive component of the country's labor force (i.e., those who are employed). Therefore, any additional contribution that Senior Citizens can make to provide for their own needs and the needs of others adds to overall output (increases the size of the economic pie) and benefits all Americans.

Current law provides Social Security Old Age and Survivors Insurance benefits for eligible recipients commencing at age 62. Earned income restrictions, however, limit eligibility to receive benefits. As a consequence, nearly all full-time workers face an either/or decision at age 62: either 1) continue working full-time or 2) retire from full-time employment, collect Social Security and, perhaps, work part-time, frequently at a low-paying job that may involve under-the-table compensation.

For purposes of determining the benefits to be received from Social Security, each person has a "full (normal) retirement age." One's full retirement age is very important. When a person reaches her/his full retirement age, then she/he may have unlimited earned income and still collect her/his full Social Security retirement benefits.

Under present law, one's full retirement age ranges from 65 to 67 depending on one's year of birth. For example, those born 1937 and earlier have a full retirement age of 65. Those born 1966 and later have a full retirement age of 67. Everyone else's full retirement age falls somewhere between 65 and 67.

PROPOSED MODIFICATION

This proposal is to eliminate the existing earned income restrictions imposed at age 62. As noted above, at present, when a worker attains her/his "full retirement age" (between 65 and 67 depending on the worker's year of birth), the worker may have unlimited earned income and still collect Social Security benefits. This proposal would eliminate the existing earning limits that currently start at age 62 and extend until a person reaches her/his full retirement age. Instead, it would allow workers to collect their Social Security benefits starting at age 62 regardless of their earned income.

SOCIAL SECURITY AS AN INCENTIVE TO WORK

The fact that one can have unlimited earned income after attaining one's full retirement age and collect full Social Security benefits provides a significant incentive for older people to continue working rather than retiring. Of course, the issue for many workers is that the incentive does not kick in until they reach their full retirement ages. For those who do continue to work after reaching their full retirement ages, receiving full Social Security benefits is like getting a pay raise – often a substantial pay raise.

In addition to providing an incentive for older people to remain productive members of the labor force, allowing older Americans to collect full Social Security benefits and have unlimited earned income has many other important economic benefits as discussed below:

1. When people work longer, the size of the workforce is increased. This increase in workforce size will ultimately result in greater total output of goods and services and lead to a higher standard of living for everyone. During the Great Depression many would have argued against encouraging older people to remain in the workforce. Many viewed a person's retirement as an opportunity for a younger person to obtain a job. Yes, when one person exits the workforce and enters retirement, it may open a position for another person who is unemployed. But the reality today is that with a rapidly aging population, it is imperative that people work longer; there are simply not enough younger workers to support the older workers without affecting negatively the standards of living for some or all members of our society.

2. When people work longer, federal tax revenues increase. In this case, "federal tax revenues" means the sum of federal income taxes and Social Security taxes. To understand this, consider the following real-life example. During 2009, a married worker age 67 worked full-time and collected $27,877 in Social Security benefits. Concurrently, both he and his employer paid Social Security taxes of $6,622 each (total $13,244). In addition, the worker paid incremental income taxes on his Social Security benefit amounting to $7,978. Thus, so far in the calculation, the net cost to the government was only $6,655: ($27,877 - $13,244 - $7,978 = $6,655).

   In addition, as a result of continuing to work, the worker enjoyed considerably greater taxable income from his earnings than he would have enjoyed if had retired. The Federal income taxes on his earned income were much greater than the federal income tax he would have paid on his anticipated pension income. The difference exceeded the $6,655 by a significant amount.

   Furthermore, had he retired, the federal government would not have received the $13,244 in combined employee/employer Social Security taxes but would still have paid him the $27,877 in Social Security benefits. By providing an incentive to remain employed, the federal government enjoyed a substantial net increase in revenues.

3. By continuing to work, the worker also paid more in state income taxes than he would have paid if he had been retired. This is particularly important now, during the Great Recession, when state budgets are severely strained.

4. Since the worker had more income than he would have had if he had been retired, he and his spouse spent more, thereby increasing consumer demand and helping to stimulate economic growth and, concurrently, employment.

5. The worker (and his employer) continued to contribute to the worker's defined contribution [401(k) type] pension plan. Had he been retired, instead of contributing to his retirement plan, he would have been drawing down his 401(k) accumulation. As detailed below, continuing the contributions leads to higher rates of economic growth and growth in employment.

   When people continue to work and contribute to 401(k) type plans (as opposed to retiring and drawing benefits from those plans), the result is cash flowing into both stock and interest bearing

investments. On a macroeconomic basis, the collective net result of the inflow of cash is upward pressure on stock prices and downward pressure on interest rates. The same arguments are applicable for those workers who are covered by defined benefit retirement plans still offered by some private-sector employers and most public-sector employers.

The upward pressure on stock prices (created by the added demand for stock) increases the general level of wealth for all stock market participants. Participants include not only individuals who invest in stock either directly or as a part of their defined contribution pension funds, but also state pension funds, charitable foundations, etc.

When stock prices increase, the "wealth effect" kicks in and precipitates an increase in consumer spending. In his testimony before the Committee on Banking and Financial Services, U.S. House of Representatives, February 17, 2000, Former FED Chairman Alan Greenspan noted that "Historical evidence suggests that perhaps three to four cents out of every additional dollar of stock market wealth eventually is reflected in increased consumer purchases."

Today, when most consumers have become more cautious and are saving more money, the wealth effect may not be as pronounced. Nonetheless, increased levels of wealth still result in greater levels of consumer confidence and purchases, thereby stimulating economic growth and employment.

Increasing pension fund investments in interest-bearing securities has the effect of increasing the demand for those securities. This places downward pressure on interest rates. Such investments not only result in lower interest rates, but also increase the amount of capital available for lending to both the private and public sectors. Lower consumer interest rates tend to stimulate the housing market and the purchase of automobiles, for example. Lower rates of interest on government debt allow government at all levels to finance at lower interest rates, thereby reducing total interest costs. This helps to alleviate serious budget deficits and/or allows the reallocation of scarce funds to other areas.

Finally, the combined increase in upward pressure on stock prices and downward pressure on interest rates results in the reduction of the cost of capital to business. When the cost of capital decreases, investments become more profitable. This encourages managers to increase their level of investment in plant, equipment, computer technology, and the like. Again, this stimulates economic growth and results in more jobs.

6. The worker continued to receive employer-provided healthcare. If he/she had retired, much of his healthcare expenses would have been paid by Medicare. Therefore, by continuing to work, the total cost to Medicare was reduced.

The opportunity to continue working (without limits on earned income) and receive "full retirement age" Social Security benefits is a great inducement for older workers to continue working. Given the rapid increases in the number and expected longevity of Senior Citizens, it is important that many of them remain as full-time workers. Unfortunately, as discussed below, Social Security also provides a great disincentive for workers to continue full-time work once they achieve age 62. Instead, it encourages retirement at age 62 and, in some instances, encourages people to work in positions that pay under the table.

SOCIAL SECURITY AS AN INCENTIVE TO STOP WORKING

Workers may start to collect Social Security benefits at age 62. But, if a person continues to have earned income, $1 is deducted from her/his benefit payment for every $2 the person earns above the "annual limit." For 2010, that annual limit is $14,160.

Certainly, penalizing a person by reducing her/his Social Security benefits when earned income exceeds $14,160 per year provides a strong incentive for the worker to limit his/her earned income to $14,160. If the worker needs added income, this incentive to limit earned income may result in the worker taking a job that pays under the table, thereby avoiding both federal and state income taxes and Social Security payroll taxes on her/his earnings.

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RECOMMENDED CHANGES

If workers are permitted to receive Social Security benefits at age 62 *without any limit to their earned incomes*, all of the benefits described in the prior section (Social Security as an Incentive to Work) would apply to many millions of additional workers. In addition, the following benefits would be enjoyed:

1. Starting at age 62, those workers who have seen large drops in the values of their defined contribution pension plans, as well as their homes, will realize a significant increase in income when they continue to work full-time and collect Social Security benefits. They will have a real incentive to continue working. Furthermore, there will be light at the end of the financial tunnel for millions of Americans who now live in fear of not being financially secure during retirement.

2. Many Baby Boomers will reset their retirement plans. At present, many workers feel pressured to retire at age 62. They want to collect their Social Security benefits as early as possible, fearing that benefits may be reduced or eliminated for some retirees in the future. But, if those same workers can start to collect their Social Security benefits at age 62, as well as continue to work full-time, many will view age 62 as a time to celebrate: the age when their total income will increase significantly – the age at which they will start to receive some return for their years of payments into Social Security – and receive it without any penalty!

3. Once older workers become accustomed to collecting Social Security benefits while still working full-time, they will feel a strong incentive to continue working full-time. The reason for this incentive is simple: once a person starts collecting Social Security benefits and then ultimately retires, her/his pension is likely to be lower than her/his salary, but she/he will not receive any additional Social Security benefits. So, her/his total income will likely decrease at retirement often leading to a lower standard of living – something most Americans want to avoid. If workers start to receive their Social Security benefits at age 62 and become accustomed to receiving them, they are more likely to continue to work longer.

4. The earlier a person starts to receive Social Security retirement benefits, the lower her/his benefits will be. For example, if a person starts taking benefits at age 62, and her/his full retirement age is 66, the person's benefits will be reduced by 25%. As a consequence, over the long term, the cost (to the government) of paying the person's total life-long Social Security benefits is likely to be less than if the person waited until her/his full retirement age to start taking benefits. Thus, over the long term, the per-beneficiary Social Security cost is likely to decrease (or not increase as rapidly as it otherwise would).

EXTENSIONS TO THE PROPOSAL

The first logical extension to this proposal is to offer tax credits or some other form of tax incentive to those workers age 70 and older to induce them to continue as active members of the workforce. The amount of the tax credit or other tax incentive would be based on the amount of their earned incomes; the more the person earns, the larger the tax credit. Such tax incentives would provide a solid economic reason for older people to continue working and to work in positions that do not involve under-the-table compensation.

The second extension is to change the laws having to do with minimum annual distributions from individual retirement accounts and other defined contribution [401(k) type] plans. The laws would be changed to postpone minimum required distributions from all such plans until a person is no longer employed in any capacity.

In addition, the minimum distribution laws could be changed to provide more economic flexibility for those age 70 and older who continue to work. For example, suppose a person's minimum required distribution for next year is $50,000. Further suppose that if the person works, she/he would earn $30,000 during the same year. Under current law, if the person earned the $30,000, federal income taxes on $80,000 would be due.

The law governing minimum distributions could be changed so that the following year the person would only be required to distribute her/his minimum distribution less the $30,000. For example, suppose the person's

minimum distribution for the following year is $53,000. Instead of having to distribute $53,000, the person would have the flexibility to elect to distribute as little as $23,000: ($53,000 - $30,000 = $23,000) without penalty.

CONCLUSION

Much of the existing tax structure is punitive in nature. The "progressive" federal income tax, for example, requires that, as workers' earnings increase, they must pay a larger portion of their incremental earnings in tax. This provides a strong incentive for those who own small businesses to under-report their earnings. It also acts as a disincentive for some workers to try to reach their full potentials as employees.

This paper provides one example of how government can provide an incentive for people to worker longer thereby increasing the total economic output and helping to stimulate employment growth. Implementation of this plan will certainly not solve all of the nation's serious economic problems, but it could prove to be a move in the right direction and, perhaps, provide a model for rethinking how we approach taxation.

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