SOCIAL SECURITY REFORM: FUNDAMENTAL RESTRUCTURING OR INCREMENTAL CHANGE?

by
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In light of Social Security's long-term deficit, reform of the system appears inevitable. Commentators and policymakers have offered a wide range of possible reforms. This Article describes and analyzes five possible types of reform: (1) individual accounts, (2) progressive price indexing, (3) general revenue and/or estate tax revenue financing, (4) increasing the maximum taxable wage base, and (5) increasing the normal retirement. The Article opposes the first two proposed changes, individual accounts and progressive price indexing, because they would fundamentally restructure the current system. The Article recommends that Social Security's financing difficulties be addressed by a combination of estate tax revenue financing, a higher taxable wage base, and a higher normal retirement age. A combination of these three reforms would retain the current structure of the system and distribute the costs of reform so that no single class of participants or beneficiaries would bear the entire brunt of reform.

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I. INTRODUCTION

Currently, the American Social Security system has a surplus of over $1.8 trillion, and that surplus is expected to grow to just under $4 trillion by the beginning of 2015.[1] The system's long-term financial future, however, is less sanguine. The Social Security Board of Trustees projects[2] that by 2017, the Social Security system will begin to collect less in contributions than it owes in benefits, and by 2040,[3] the Trust Fund will be exhausted.[4] At that point in time, absent an intervening change in the law, the system will only be able to pay

[1] U.S. SOC. SEC. ADMIN., THE 2006 ANNUAL REPORT OF THE BOARD OF TRUSTEES OF THE FEDERAL OLD-AGE AND SURVIVORS INSURANCE AND FEDERAL DISABILITY INSURANCE TRUST FUNDS, H.R. DOC. NO. 109-103, at 2 (2006), *available at* http://www.ssa.gov/OACT/TR/TR06/tr06.pdf. [hereinafter 2006 ANNUAL REPORT] (using intermediate assumptions). These figures refer to the combined assets of the OASI (Old Age and Survivors' Insurance) and the DI (Disability Insurance) Trust Funds.

[2] In their annual report, the Board of Trustees uses three different sets of assumptions, (1) intermediate, (2) low cost, and (3) high cost. The intermediate assumptions reflect "the Trustees' best estimate of future possibilities," and thus the projections set forth in the text are based on their intermediate assumptions. *Id.* at 6.

[3] Although little attention is paid to this date, it is worth noting that the Social Security program's interest income is projected to more than offset the shortfall in non-interest income until 2027. *Id.* at 50.

[4] *Id.* at 2.

74% of promised annual benefits, and by 2080, the system will only be able to pay 70% of promised annual benefits.[5]

In light of this sobering forecast, virtually all lawmakers and commentators agree that the system must be reformed. Agreement, however, ends there. Policymakers and analysts have offered widely divergent proposals to reform the Social Security system. Some, such as President Bush and the Cato Institute, contend that the current system is fundamentally unsound and should be fundamentally restructured by directing some Social Security contributions to individual accounts. Others believe that the system's basic structure is sound and only incremental reforms, such as increasing the taxable wage base and/or increasing the normal retirement age, are necessary to bring the system within actuarial balance. Finally, other experts have proposed reforms that would modify the current system's structure but not as profoundly as would the individual account proposals.

This Article provides an overview of the wide range of possible ways to reform Social Security.[6] Many reform proposals, particularly those that would bring Social Security into actuarial balance, or close actuarial balance, include a variety of changes.[7] Rather than attempt to describe and analyze the multitude of specific proposals, this Article describes and analyzes the principle types of possible changes.[8]

The Article begins by analyzing individual account proposals, the reform that would most fundamentally change the current Social Security system. It

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[5] *Id.* at 8.

[6] For additional studies of the range of options, see, for example, Virginia P. Reno & Joni Lavery, Nat'l Acad. of Soc. Ins., Options to Balance Social Security Funds Over the Next 75 Years (Feb. 2005), *available at* http://www.nasi.org/usr_doc/SS_Brief_18.pdf.; Cong. Budget Office, Projected Effects of Various Provisions on Social Security's Financial and Distributional Outcomes (May 25, 2005), *available at* http://www.cbo.gov/ftpdocs/63xx/doc6377/Social_Security_Menu-CBO_baseline.pdf; Craig Copeland, *Comparing Social Security Reform Options*, EBRI ISSUE BRIEF (Employee Benefit Research Inst., Washington, D.C.), May 2005, *available at* http://www.ebri.org/pdf/briefspdf/0505ib.pdf.; U.S. GEN. ACCOUNTING OFFICE, SOCIAL SECURITY: DIFFERENT APPROACHES FOR ADDRESSING PROGRAM SOLVENCY (1998), *available at* http://www.gao.gov/archive/1998/he98033.pdf.

[7] *See, e.g.*, Robert M. Ball, The Social Security Protection Plan: How We Can Cope—Calmly—With the System's Long-Term Shortfall (Jan. 2006), http://zfacts.com/metaPage/lib/Ball-2006-SSProtectionPlan.pdf (proposing three-part plan to bring Social Security into close actuarial balance); NANCY J. ALTMAN, THE BATTLE FOR SOCIAL SECURITY: FROM FDR'S VISION TO BUSH'S GAMBLE 299–301 (2005) (endorsing Ball's proposal); PETER A. DIAMOND & PETER R. ORSZAG, SAVING SOCIAL SECURITY 79–98 (2004) (offering different three-part plan); HENRY J. AARON & ROBERT D. REISCHAUER, COUNTDOWN TO REFORM 96–114 (1998) (proposing plan with seven different elements).

[8] The Article can not, and does not, attempt to describe every possible type of reform. For example, the Article does not address proposals to invest the assets of the Social Security trust fund in the private market. For an analysis of such a proposal, see, for example, U.S. GEN. ACCOUNTING OFFICE, SOCIAL SECURITY FINANCING: IMPLICATIONS OF GOVERNMENT STOCK INVESTING FOR THE TRUST FUND, THE FEDERAL BUDGET, AND THE ECONOMY (1998), *available at* http://www.gao.gov/archive/1998/a398074.pdf.

then discusses Robert Pozen's recent progressive price indexing proposal,[9] which on its face might appear to simply modify current benefits, but would in fact, if implemented for a long enough period of time, significantly change the structure of the current Social Security system. It then turns to proposals to introduce a new source of funding for Social Security, such as long-serving former Social Security commissioner Robert Ball's proposal to fund some of Social Security's long-term deficit with the estate tax. Finally, the Article reviews proposals to increase the current payroll tax and/or decrease benefits.

II. INDIVIDUAL ACCOUNTS

In recent years, a number of lawmakers and analysts have proposed that the Social Security system be amended to include individual accounts.[10] Although the specific details of the proposals vary widely, they all have one common effect: they would fundamentally transform the current Social Security system.

This section begins by providing an overview of the proposals. It then explains how individual accounts would fundamentally transform the Social Security system. It then explains why this type of reform would do little to solve Social Security's long-term deficit. Finally, it concludes with my recommendation as to whether individual accounts should be adopted.

[9] "Progressive price indexing" is the term Pozen used to describe his proposal. Undoubtedly, Pozen used the term "progressive" to describe his proposal because of its political appeal. The proposal is "progressive" in that benefits are not reduced for the lowest paid. A critic of the proposal, however, may prefer to describe it with a more "neutral" term such as "combined wage and price indexing." This Article will refer to the proposal as the "progressive price indexing" proposal because it is the term that is used by its creator. *See* Senator Max Baucus, Statement at the Hearing Before the Senate Finance Committee on Proposals That Achieve Sustainable Solvency, With and Without Personal Accounts (Apr. 26, 2005), *available at* http://www.senate.gov/~finance/hearings/statements/042605mb.pdf (Senator Max Baucus refers to Pozen's proposal as "progressive price indexing"); *see also* Robert C. Pozen, Chairman, MFS Investment Mgmt., Statement at the Hearing Before the House Ways and Means Committee on Alternatives to Strengthen Social Security (May 12, 2005), *available at* http://waysandmeans.house.gov/hearings.asp?formmode=view&id=3203 (where Pozen testifies about his "progressive indexing" proposal).

[10] *See, e.g.*, White House, Strengthening Social Security for the 21st Century (Feb. 2005), http://www.whitehouse.gov/infocus/social-security/200501/strengtheningsocialsecurity.pdf; PRESIDENT'S COMM'N TO STRENGTHEN SOC. SEC., STRENGTHENING SOCIAL SECURITY AND CREATING PERSONAL WEALTH FOR ALL AMERICANS 11 (2001), *available at* http://www.csss.gov/reports/Final_Report.pdf (proposing three different models); U.S. SOC. SEC. ADMIN., REPORT OF THE 1994–1996 ADVISORY COUNCIL ON SOCIAL SECURITY, VOL. I: FINDINGS, RECOMMENDATIONS AND STATEMENTS 28–30 (1997), *available at* http://www.ssa.gov/history/reports/adcouncil/report/findings.htm (proposing two different plans).

A. The Proposals

Over the last decade or so, there have been a multitude of proposals to amend the Social Security system to add individual accounts. The specific details of the proposals vary widely. For example, some proposals would "add" individual accounts on to the current Social Security system.[11] Others would "carve" such accounts out of the current system.[12] Some proposals would fund the accounts with contributions of as little as 1.6% of covered payroll.[13] Others would fund the accounts with as much as 5% of covered payroll.[14] Some would severely limit individual investment choice,[15] while others would allow participants wide latitude in investment choice.[16]

Despite the diversity in specific details, the proposals share a number of common elements. First, the proposals typically require, or sometimes just permit,[17] all workers (or all workers under a certain age) to contribute some percentage of their Social Security contributions to an individual account and invest those contributions in one or more private funds. The proposals then provide two tiers of benefits. The first tier may provide all workers with a flat benefit, regardless of their earnings. Or, the first tier may provide workers with a benefit that is related to earnings, as is the current Social Security benefit. The first tier benefit is typically lower than the current Social Security benefit to reflect the diversion of contributions to the individual account.[18] The second tier benefit then consists of the contributions to the account plus or minus any earnings or losses on those contributions.

B. How Individual Accounts Would Fundamentally Transform Social Security

Under the current Social Security system, workers are promised a benefit based on a complex benefit formula that takes into account the worker's earnings over a thirty-five-year period.[19] Participants have no ownership or

[11] For example, the 1994–1996 Advisory Council's Individual Account Plan would "add on" individual accounts by funding them with a mandatory additional 1.6 payroll tax. U.S. SOC. SEC. ADMIN., *supra* note 10, at 28.

[12] For example, the 1994–1996 Advisory Council's Personal Security Account Plan would "carve" individual accounts out of the current system by diverting five percent of the current payroll tax to fund them. *Id.* at 30.

[13] *See, e.g.*, *id.* at 28 (Individual Account Plan).

[14] *See, e.g.*, *id.* at 30 (Personal Security Account Plan).

[15] *See, e.g.*, *id.* at 28 (Individual Account Plan).

[16] *See, e.g.*, *id.* at 30 (Personal Security Account Plan).

[17] *See* Jeffrey R. Brown et al., *Top Ten Myths of Social Security Reform*, 13 ELDER L. J. 309, 332 (2005) (noting that one of President Bush's core reform principles is that participation be voluntary).

[18] Under the "add on" approach, new money is used to fund the individual accounts and thus current benefits need not be reduced to replace diverted contributions. *See* Regina T. Jefferson, *Privatization: Not the Answer for Social Security Reform,* 58 WASH. & LEE L. REV. 1287, 1300 (2001).

[19] 42 U.S.C. § 415 (2000). For a more detailed discussion of how benefits are calculated, see Section III.A *infra*.

control over their contributions to the system. Instead, their benefits are determined entirely by the applicable benefit formula.

Under a system of individual accounts, in contrast, each worker's contributions are placed in an individual account which the worker holds and manages. The worker's second tier benefit is not based on a predetermined formula. Instead, the second tier benefit consists of the worker's contributions and any earnings or losses on those contributions. Proponents of individual accounts argue that one of their principal advantages is that they would give workers ownership and control over their retirement funds.[20]

In a private White House memo, Peter Wehner, President Bush's Director of Strategic Initiatives, explained:

> As you know, our advocacy for personal accounts is tied to our commitment to an Ownership Society—one in which more people will own their health care plans and have the confidence of owning a piece of their retirement. Our goal is to provide a path to greater opportunity, more freedom, and more control for individuals over their own lives. That is what the personal account debate is fundamentally about—and it is clearly the crucial new conservative idea in the history of the Social Security debate.[21]

The current Social Security system is a system of social insurance. Ownership and individual control play no role in social insurance. Rather, solidarity and collective action lie at the core of social insurance.[22] If Social Security were transformed into a system of individual ownership and control, it would "rank as one of the most significant conservative governing achievements ever. The scope and scale of this endeavor are hard to overestimate."[23]

C. *Effect of Individual Accounts on Social Security's Long-Term Deficit*

In recent years, proponents of individual accounts have begun to concede[24] what economists have long known.[25] Individual accounts, standing alone, can

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[20] *See, e.g.*, White House, *supra* note 10, at 5; Michael Tanner, Cato Inst., Keep the Cap: Why a Tax Increase Will Not Save Social Security (June 8, 2005), http://www.cato.org/pubs/briefs/bp93.pdf; *see also* June E. O'Neill, *Why Social Security Needs Fundamental Reform*, 65 OHIO ST. L. J. 79, 80 (2004) (a system of individual accounts "would give individuals ownership of a significant component of their own pension assets, offering greater flexibility and more options").

[21] Memorandum from Peter H. Wehner, Presidential Director of Strategic Initiatives, Some Thoughts on Social Security (Jan. 5, 2005), *available at* http://www.house.gov/etheridge.WhiteHouseMemo.pdf.

[22] *See* Kathryn L. Moore, *President Bush's Personal Retirement Accounts: Saving or Dismantling Social Security*, *in* NEW YORK UNIVERSITY REVIEW OF EMPLOYEE BENEFITS AND EXECUTIVE COMPENSATION—2005 ch. 5, § 5.06, at 23 (Alvin D. Lurie ed., 2005).

[23] Memorandum from Peter H. Wehner, *supra* note 21.

[24] *See, e.g.*, Moore, *supra* note 22, § 5.02, at 6 (discussing 2005 White House memo to conservative allies that concedes that individual accounts alone cannot solve Social Security's long-term financing difficulties).

[25] Brown et al., *supra* note 17, at 321.

not solve Social Security's long-term deficit. This is because individual accounts can not and do not address the most significant reason underlying Social Security's long-term deficit, what Peter Diamond and Peter Orszag refer to as the system's "legacy cost" or "legacy debt."[26] This legacy cost arises from the fact that Social Security, like most social insurance systems, paid the first generations of retirees far more than their contributions to the system could finance.[27]As Robert Ball has explained:

> Financing the old-age and survivors insurance program presents difficulties largely because persons retiring in the first 5, 10, 15, or even 20 years of the program cannot be expected to contribute at a high enough rate to accumulate a sum that would provide reasonably adequate benefits. Yet for sound social reasons we are not willing to postpone adequate payments under the social insurance program to the time when the amounts accumulated would cover the cost of such payments.[28]

According to calculations by economists John Geanakoplos, Olivia Mitchell, and Stephen Zeldes, as a group, the Social Security beneficiaries born before 1937 received about $10 trillion more in benefits than the economic value of their contributions to the system.[29] The creation of individual accounts simply cannot eliminate that debt. "To restore the system to long-run financial balance, some generation must see its consumption reduced, either through higher taxes or through lower Social Security benefits than are currently scheduled."[30]

D. Recommendation

I recommend that the Social Security system not be amended to include individual accounts. First, individual accounts would not solve Social Security's long-term deficit. More importantly, as I have argued at length

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[26] DIAMOND & ORSZAG, *supra* note 7, at 6–7; *see also* Moore, *supra* note 22, § 5.02, at 7–11 (discussing three factors that contribute significantly to Social Security's long-term deficit: (1) increasing life expectancy, (2) the fact that the baby boom generation is reaching retirement age and followed by a much smaller generation, and (3) the legacy debt).

[27] *See* ROBERT M. BALL, INSURING THE ESSENTIALS: BOB BALL ON SOCIAL SECURITY 210 (Thomas N. Bethell ed., 2000) ("Most social insurance programs also give to the workers retiring in the early years of the program benefits that are much greater than can be bought by the contributions paid for their age group. This was true of the old-age benefit program under the original Social Security Act, passed in 1935; and in the 1939 amendments, older workers were given even larger benefits in relation to their contributions.").

[28] *See id.* at 210.

[29] John Geanakoplos et al., *Would a Privatized Social Security System Really Pay a Higher Rate of Return?, in* FRAMING THE SOCIAL SECURITY DEBATE: VALUES, POLITICS AND ECONOMICS 137, 146 (R. Douglas Arnold et al. eds., 1998).

[30] *See* Brown et al., *supra* note 17, at 321–22.

elsewhere,[31] they would fundamentally change the nature of the system and would be the first step toward dismantling it.[32]

III. PROGRESSIVE PRICE INDEXING[33]

Under current law, initial Social Security benefits are wage indexed. Once initial benefits are calculated, benefits are then price indexed each year. Robert Pozen, an investment executive and member of President Bush's 2001 Commission to Strengthen Social Security, has proposed that the Social Security benefit formula be amended to provide for indexing under a progressive price indexing formula.[34] Under this proposal, initial benefits for low-wage workers would be wage indexed while benefits for high-wage workers would be price indexed and benefits for average-wage workers would be partially wage indexed and partially price indexed.

At first blush, this proposal might appear simply to modify the current benefit formula and not have a significant impact on the fundamental structure of the Social Security system. In fact, however, if the proposal were implemented for a long enough period of time, it would in effect convert the current system which offers wage-related benefits to a flat benefit system.[35]

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[31] *See generally* Moore, *supra* note 22.

[32] For additional critiques of individual account proposals, see Kathryn L. Moore, *Partial Privatization of Social Security: Assessing Its Effect on Women, Minorities, and Lower-Income Workers,* 65 MO. L. REV. 341 (2000); Kathryn L. Moore, *Redistribution Under a Partially Privatized Social Security System*, 64 BROOK. L. REV. 969 (1998); Kathryn L. Moore, *Privatization of Social Security: Misguided Reform,* 71 TEMP. L. REV. 131 (1998) [hereinafter Moore, *Misguided Reform*].

[33] This section is based on section 8.02[2] of Kathryn L. Moore, *Social Security Reform in 2005 and Beyond*, *in* NEW YORK UNIVERSITY REVIEW OF EMPLOYEE BENEFITS AND EXECUTIVE COMPENSATION 2006 ch. 8 (Alvin D. Lurie ed., 2006) (Copyright 2006 LexisNexis Matthew Bender).

[34] Pozen's progressive price indexing plan is part of a broader proposal that includes individual investment accounts. Memorandum from Stephen C. Goss, Chief Actuary, U.S. Soc. Sec. Admin., to Bob Pozen, Estimated Financial Effects of a Comprehensive Social Security Reform Proposal Including Progressive Price Indexing (Feb. 10, 2005), *available at* http://www.ssa.gov/OACT/solvency/RPozen_20050210.pdf. (describing the Pozen plan). The plan, however, can stand on its own and need not be linked with private accounts. *See* Pozen, *supra* note 9. President Bush has endorsed the proposal. Elizabeth White, *Bush Again Calls for Private Accounts, Endorses "Progressive Price Indexing,"* 32 BNA PENSION & BENEFITS REP. 1008 (2005) (noting that Bush endorsed progressive price indexing in "a nationally televised news conference" on April 28, 2005).

[35] Memorandum from Patrick Purcell, Specialist in Social Legislation, Cong. Research Serv., to Senate Fin. Comm., "Progressive Price Indexing" of Social Security Benefits (April 22, 2005), *available at* http://www.tcf.org/Publications/RetirementSecurity/CRS_Price_Indexing_04-22-05.pdf. ("Under the method of progressive price indexing analyzed by SSA and described in this memorandum, all workers eventually would be paid the same monthly benefit . . . . CRS estimates that this would occur approximately 100 years following the implementation of progressive price indexing as described by SSA, assuming long-run real wage growth of 1.1% per year.").

This section begins by explaining how benefits are calculated under the current Social Security system. It then explains the difference between price indexing and wage indexing and describes Pozen's progressive price indexing plan in more detail. It then analyzes the costs and benefits of progressive price indexing. Finally, it concludes with my recommendation as to whether progressive price indexing should be implemented.

A. Calculating Benefits Under the Current Social Security System

In order to calculate initial benefits under the current Social Security system, workers' earnings[36] are indexed by multiplying each year's wage by an indexing factor equal to the ratio of the average national wage in the year the worker turns 60 to the average national wage in the year to be indexed.[37] For administrative ease, wages earned at age 60 or later are left at their nominal values in the indexing process.[38] Average adjusted earnings, or "average indexed monthly earnings" ("AIME"), are then calculated by taking the best 35 years of earnings adjusted for past wage inflation, adding them together and dividing them by 420 (the number of months in 35 years).[39]

Average adjusted earnings are then multiplied by a progressive benefit formula to determine the worker's primary insurance amount (PIA).[40] The formula replaces a higher percentage of average adjusted earnings the lower one's average earnings so that the ratio of benefits to average earnings is higher for those with low average earnings than for those with high average earnings. The benefit percentages (90%, 32%, and 15%) remain the same each year,[41] while the dollar amounts, or "bend points,"[42] are increased by the rate of growth of the national average wage.[43] For those reaching age sixty-two in

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36 Earnings are only taken into account to the extent that they are at or below the maximum taxable wage base. *See* Section V.A for a discussion of the taxable wage base. Of course, only earnings of workers covered by the Social Security program are taken into account. Currently, the Social Security program covers about 96 percent of the American workforce. *See* U.S. SOC. SEC. ADMIN., ANNUAL STATISTICAL SUPPLEMENT TO THE SOCIAL SECURITY BULLETIN, 2005, at 13 (2006), *available at* http://www.ssa.gov/policy/docs/statcomps/supplement/2005/supplement05.pdf.

37 42 U.S.C. § 415(b)(3) (2000).

38 "Earnings are indexed only up to age 60 because it can take up to two years for the national earnings data on which the wage indexing series is based to become available." Memorandum from Patrick Purcell, *supra* note 35, at 2 n.4.

39 42 U.S.C. § 415(b)(1).

40 42 U.S.C. § 415(a).

41 42 U.S.C. § 415(a)(1)(A).

42 "The amounts at which the PIA factors change are called *bend points* because when the PIA factors are graphed against the AIME, the graph appears as three lines joined at these points." Memorandum from Patrick Purcell, *supra* note 35, at 3 n.5.

43 42 U.S.C. § 415(a)(1)(B)(ii).

2006, the formula replaces 90% of the first $656 of AIME, plus 32% of AIME between $656 and $3,955, plus 15% of AIME above $3,779.[44]

By indexing earnings and adjusting the bend points each year for increases in the national average wage, the current Social Security system ensures that benefits for each generation of workers grow at the same rate as their wages grow, and the replacement rate, that is, initial benefits as a percentage of workers' career-average earnings, remains constant.[45] The Social Security Administration has estimated the replacement rate for low-wage workers to be 55%, for average-wage workers to be 41%, and for high-wage workers who have always earned the annual maximum taxable wage to be 27%.[46]

Once initial benefits are calculated, they are adjusted for increases in the consumer price index; that is, they are price indexed.[47] Price indexing ensures that initial benefits do not decline in value as prices increase over time and that the retiree's buying power remains the same.[48]

B. Price Indexing Versus Wage Indexing

In 2001, President Bush's Commission to Strengthen Social Security proposed three alternative plans for reforming Social Security.[49] Model 2, the model considered the most likely to resolve permanently Social Security's funding deficit, included, among other changes, a shift from wage indexing to price indexing.[50] Specifically, Model 2 proposed that, beginning in 2009, each year the PIA factors (90%, 32%, and 15%) be multiplied by the ratio of the Consumer Price Index (CPI) to the Average Wage Index in successive years while earnings and the bend points remain indexed for wage growth.[51] Due to

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[44] Cost-of-Living Increase and Other Determinations for 2006, 70 Fed. Reg. 61,677 (Oct. 25, 2005) (establishing bend points for 2006).

[45] *See* Memorandum from Patrick Purcell, *supra* note 35, at 2 ("Under current law, benefits for each generation of workers grow at the same rate as their wages grow. Consequently, (1) the *purchasing power* of benefits rises from one generation of workers to the next, and (2) the *replacement rate*—initial benefits as a percentage of workers' career-average earnings—remains constant for each successive generation of workers.").

[46] *Id.* at 5.

[47] 42 USC § 415(i).

[48] Memorandum from Patrick Purcell, *supra* note 35, at 1 ("Once enrolled in the program, beneficiaries' Social Security checks increase each year at the same rate as the Consumer Price Index (CPI) so that they do not decline in value as prices rise over time; i.e., they are *price indexed.*"); Am. Acad. of Actuaries, Social Security Reform: Changes to the Benefit Formula and Taxation of Benefits 3 (Apr. 2004), http://www.actuary.org/pdf/socialsecurity/benefit_04.pdf ("Indexing benefits to changes in the CPI helps ensure that the buying power of Social Security benefits remains the same after a worker begins receiving benefits.").

[49] PRESIDENT'S COMM'N TO STRENGTHEN SOC. SEC., *supra* note 10.

[50] *Id.* at 119.

[51] *Id.* at 120 n.39. For a discussion of alternative price indexing models and their effect on benefits and solvency of the Social Security system, see Andrew G. Biggs et al., *Alternative Methods of Price Indexing Social Security: Implications for Benefits and System Financing* (Nat'l Bureau of Econ. Research, Working Paper No. 11406, 2005).

increases in worker productivity, wages tend to rise faster than prices, and price indexing is expected to cause the PIA factors to decrease and the Social Security replacement rates to fall over time.[52]

To illustrate, suppose that in one year prices grow by 2.8% while wages grow by 3.9%, the long-term rates of growth projected by the Social Security Administration.[53] Based on these figures, each of the PIA factors would be multiplied by 1.028/1.039, or 0.989, that year. Assuming the Social Security Administration's projections are accurate and the long-term rate of price growth is 2.8% and wage growth is 3.9%, after seventy-five years of multiplying the PIA factors by this ratio of price growth to wage growth, the factors would fall from 90%, 32% and 15% to 40.5%, 14.4%, and 6.7% respectively.[54] Moreover, all three PIA factors would continue to fall into the indefinite future.[55] Based on these projections, the replacement rate for an average-wage earner would fall from 39% under current law to 16% in 2080 under a price indexed system.[56]

Because price indexing would decrease benefits so drastically, it is expected to more than restore solvency to the Social Security system. Specifically, the Social Security Administration projects that price indexing benefits would cut benefits by 2.07% of taxable payroll[57] while the current projected shortfall is only 2.02% of taxable payroll.[58]

C. *Progressive Price Indexing*

Recognizing that over time price indexing could substantially reduce benefits and have a particularly adverse effect on low-income workers,[59] Robert Pozen proposed a progressive price indexing plan that would be

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52 Memorandum from Patrick Purcell, *supra* note 35, at 6.

53 *See* 2006 ANNUAL REPORT, *supra* note 1, at 85–86 (intermediate assumptions).

54 Memorandum from Patrick Purcell, *supra* note 35, at 6.

55 *Id.*

56 *Id.* The replacement rate for an average-wage earner is expected to fall from 42% today to 39% in 2080 because the normal retirement age is scheduled to increase from 66 to 67 under current law. *Id.*

57 *Id.*

58 2006 ANNUAL REPORT, *supra* note 1, at 2.

59 In testimony before the Ways and Means Committee, Pozen described the rationale for his proposal as follows:

> I believe that when Social Security was passed, there were no Individual Retirement Accounts (IRA) or 401(k)s; there weren't really even very many defined benefit plans. Now, in 2004 alone, the tax revenue foregone for IRAs and 401(k)s was roughly $55 billion; if we include all private retirement programs, it was $100 billion in that year alone. Most of those tax subsidies go to high-wage and to some degree middle-wage workers, and so, I believe in order to create neutral government support among wage groups, we need to do more for low-wage workers in Social Security. Very few of them have retirement programs like 401(k)s or IRAs and they are totally dependent on Social Security.

Pozen, *supra* note 9.

effective for all those becoming eligible for benefits in 2012 or later.[60] This plan would be implemented through a three-step process. The first step would be to compute the percentage benefit reduction that would apply for a worker who had earned the maximum taxable wage throughout the worker's career if all three of the PIA factors (90%, 32%, and 15%) were fully price indexed.[61] Next, a new "bend point" in the Social Security PIA formula would be created for low-wage workers, which would be defined as workers with career earnings at or below the 30th percentile of earnings, and benefits at or below this new bend point would continue to be wage indexed.[62] Finally, the third step of the process would be to calculate the percentage reduction to the PIA factors above the new bend point (32% and 15%) that would result in the same benefit reduction for workers who earned the maximum taxable wage throughout their career as would have applied if price indexing had applied to all workers.[63]

Application of this three-step process would result in reducing benefits for workers who have earned the maximum taxable wage base throughout their careers by the same percentage as they would have been reduced if the benefit formula were fully price indexed for all workers at all earnings level.[64] It would reduce benefits by a smaller percentage for workers who have earned average wages throughout their careers, and it would not reduce benefits at all for workers with earnings at or below the 30th percentile of career-average earnings.[65] Thus, using current figures, workers who earn the taxable maximum—$94,200 in 2006[66]—over their lifetime would have their benefits calculated using price indexing, while workers at or below the 30th percentile of career-average earnings—about $20,000 today[67]—would have their benefits

[60] For a detailed description of the plan, see Memorandum from Stephen C. Goss, *supra* note 34, at 2.

[61] *Id.* ("Begin by computing the percentage benefit reduction that would apply for the highest career-average earner becoming eligible for a retired worker benefit in each year 2012 and later based on CPI-indexing the PIA formula (as specified in Model 2 of the President's Commission to Strengthen Social Security).")

[62] *Id.* ("Then create a new 'bend point' in the Social Security PIA formula at the level of the career-average earnings of the retiree at the 30th percentile of those becoming eligible for benefits in 2010, and wage index this bend point forward like the two current bend points. This new bend point is estimated to be 28.6 percent of the way up from the current first bend point to the current second bend point.").

[63] *Id.* ("Calculate the percentage reduction to the 'PIA factors' (32 and 15) that applies beyond the new PIA bend point that will provide the benefit reduction described above for the 'maximum' earner reaching retirement eligibility for each year 2012 and later.").

[64] *Id.* ("This proposal would replicate benefit reductions for the very highest career average earners that are provided under a CPI-indexed benefit formula.")

[65] *Id.* ("Benefit levels would be reduced to a lesser extent for workers with lower career-average earnings, with no reduction for those at or below the 30th percentile of career-average earnings (AIME).").

[66] *See* Cost-of-Living Increase and Other Determinations for 2006, 70 Fed. Reg. 61,677 (Oct. 25, 2005) (setting maximum taxable wage for 2006 at $94,200).

[67] *See* Alicia H. Munnell & Mauricio Soto, Ctr. for Retirement Research at Boston Coll., What is Progressive Price Indexing? 2 (Apr. 2005), http://www.bc.edu/centers

calculated under the current formula, and those earning between $20,000 and $94,200 would receive a benefit somewhere between the benefit provided under current law and that provided under price indexing.

D. Costs and Benefits of Progressive Price Indexing

Without a doubt, the greatest advantage of Pozen's progressive price indexing plan is its potential to reduce Social Security's long-term deficit. According to Social Security Administration projections, this proposal "would reduce [Social Security's] deficit by 1.4% of taxable payroll, or about 74% of the [then] estimated 75-year deficit of 1.9%[68] of taxable payroll."[69] A second advantage of the proposal is that it would protect the benefits of low-wage workers,[70] who rely most heavily on Social Security for their retirement income.[71]

The plan, however, would not be costless. First, it would reduce the benefits of average- and high-wage workers. For example, according to calculations by Patrick Purcell of the Congressional Research Service, assuming the Social Security Administration's predictions of price and wage growth of 2.8% per year and 3.9% per year are accurate, high-wage workers would receive a benefit cut of 17.4% and average-wage workers would receive

/crr/dummy/facts/jtf_17.pdf (describing "the bottom 30 percent of workers" as those making less than about $20,000 today).

[68] In their 2006 report, the Social Security Board of Trustees revised the estimated deficit to 2.02% of taxable payroll. U.S. SOC. SEC. ADMIN., *supra* note 1, at 2. The increase from 1.92% to 2.02% of taxable payroll is attributable to two factors: 1) the fact that the projection period moved forward to include a year with a large deficit, and 2) the fact that the assumed long-term interest rate was reduced from 3.0 to 2.9%, which increases the projected present value of projected deficits later in the 75 year valuation period. Alicia H. Munnell, Ctr. for Retirement Research at Boston Coll., Social Security's Financial Outlook: The 2006 Update in Perspective (Apr. 2006), http://www.bc.edu/centers/crr/issues/ib_46F.pdf.

[69] Memorandum from Patrick Purcell, *supra* note 35, at 8. *See also* Pozen, *supra* note 9 ("[Progressive indexing] alone closes 70 percent of the long-term deficit of Social Security, going from $3.8 trillion to $1.1 trillion . . . ."); Thomas N. Bethell, *Future Shock: Is the Latest Social Security Proposal for Indexing Benefits 'Progressive' or a Body Blow to the Middle Class?*, AARP BULL. ONLINE, June 2005, http://www.aarp.org/bulletin/socialsec/future_shock.html ("Bush touts his plan as a responsible way to restore Social Security to long-term solvency, claiming it would close about 70 percent of the anticipated shortfall, though some of these savings come from cutting disability and survivors benefits. (Protecting the disabled means the Bush-Pozen plan would close only 59 percent of the gap.)").

[70] Munnell & Soto, *supra* note 67, at 4 ("Progressive price indexing has the advantage of protecting the benefits of low earnings workers. These workers would be assured of receiving the same amount relative to previous earnings as they do today.")

[71] U.S. SOC. SEC. ADMIN., INCOME OF THE AGED CHARTBOOK 2002, at 22 (2004), *available at* http://www.ssa.gov/policy/docs/chartbooks/income_aged/2002/iac02.pdf (showing that Social Security benefits represent 83% of aggregate income for elderly persons in the lowest quintile of income).

a benefit cut of 13.3% by the year 2030.[72] Using the same assumptions, by the year 2055, high-wage workers would receive a benefit cut of 36.7% and average-wage workers would receive a benefit cut of 28%,[73] and by the year 2080, high-wage workers would receive a benefit cut of 51.5% and average-wage workers would receive a benefit cut of 39.3%.[74] Moreover, if real wages were to grow faster, benefit cuts would be even deeper.[75]

Second, by reducing the benefits for high- and average-wage workers while retaining the wage-adjusted growth of benefits for low-wage workers, progressive price indexing would necessarily flatten the Social Security benefit. For example, according to Jason Furman of the Center on Budget and Policy Priorities, in 2045, a high-wage worker, defined as a worker with earnings 60% above those of the average worker, would only receive a benefit that was 20% higher than that of an average wage worker, and by 2075, the high-wage worker's benefit would only be 7% higher than that of the average wage worker.[76]

Moreover, if implemented for a long enough period of time, progressive price indexing would, in effect, eliminate Social Security's progressive benefit formula because all workers with earnings above the second bend point (representing the 30th percentile of earnings) would receive the same flat benefit. The leveling of benefits would result from the fact that the PIA factors applied to the two higher earnings brackets would eventually be reduced to zero. According to Purcell's estimates, assuming long-run real wage growth of 1.1% per year, it would take about 100 years of progressive price indexing for the PIA factors for the two higher brackets to reach zero.[77] Thus, according to Furman, by 2100, the majority of workers would receive a benefit of $22,500 per year, which would only replace 9% of pre-retirement earnings for a worker who earns the maximum taxable wage throughout his or her career.[78]

By flattening benefits, progressive price indexing threatens to undermine public support for the Social Security system.[79] As Robert Ball, who served as Commissioner of Social Security under three Presidents, has said:

[72] Memorandum from Patrick Purcell, *supra* note 35, at 11 tbl.1.

[73] *Id.* at 12 tbl.2.

[74] *Id.* For additional discussion of estimates, see Jason Furman, Ctr. on Budget & Policy Priorities, An Analysis of Using "Progressive Price Indexing" to Set Social Security Benefits (May 2, 2005), http://www.cbpp.org/3-21-05socsec.pdf.

[75] Memorandum from Patrick Purcell, *supra* note 35, at 9.

[76] Furman, *supra* note 74, at 6.

[77] Memorandum from Patrick Purcell, *supra* note 35, at 10.

[78] Furman, *supra* note 74, at 6.

[79] *See* Nat'l Comm. to Preserve Soc. Sec. & Medicare, Viewpoint—Social Security: "Progressive" Price Indexing and Middle-Class Benefit Cuts (Feb. 2005), http://www.ncpssm.org/news/archive/vp_priceindex/. ("Over time, all workers would receive essentially the same poverty-level flat benefit, thus converting the current earnings-based program into a welfare payment, and seriously undermining public support for Social Security in the future.").

> [Progressive price indexing] really changes the entire philosophy of Social Security. Instead of partially replacing a worker's earnings, it gradually becomes a welfare program paying the same flat benefit to everyone—while protecting only the poorest 30 percent. I can't imagine people continuing to support it, once they realize that the more they contribute, the less they'll get.[80]

E. Recommendation

On the whole, I do not support progressive price indexing. While I agree with Peter Diamond and Peter Orszag that Social Security reform should include a combination of revenue increases and benefit reductions,[81] I do not believe that progressive price indexing is the best form of benefit reduction. First and foremost, I find it objectionable because of its potential to transform the Social Security system into a flat benefit program. Social Security has provided wage-related benefits since its inception and I believe that is one of the strengths of the program.

Although I would not necessarily object to progressive price indexing for a limited period of time, I do not see a principled time or way in which to limit progressive price indexing. One could decide to adopt it for a certain number of years—say, five, ten, or twenty. But the time period would seem to be wholly arbitrary.

To the extent that one should reduce benefits for higher wage workers, there is a much cleaner, more principled way to do so: establish a fourth bend point. For example, if the maximum taxable wage base were increased as discussed in Section V.A, it would be possible to amend the benefit formula to provide that less than 15% (say 7%, perhaps) of AIME between the old maximum taxable wage base and the new maximum taxable wage base be replaced. Gradually introducing the new maximum taxable wage base with the new bend point would minimize the disparity of treatment among cohorts.[82]

IV. GENERAL REVENUE AND/OR ESTATE TAX FINANCING

Currently, the Social Security Trust Fund[83] is funded principally by dedicated payroll taxes.[84] Specifically, in 2005, net payroll taxes accounted for

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[80] Bethell, *supra* note 69, at 4.

[81] *See* DIAMOND & ORSZAG, *supra* note 7, at 80. Robert Ball, in contrast, believes that solvency should be restored by relying solely on revenue increases. *See* Ball, *supra* note 7, at 7–8.

[82] For a discussion of the "notch" baby problem affecting those "people who reached retirement age just after 1977" and for whom benefits were ten percent lower than the benefits of individuals "who reached retirement just before," see AARON & REISCHAUER, *supra* note 7, at 83–84.

[83] For these purposes, the term "Social Security Trust Fund" refers to the Old Age Survivors Insurance Trust Fund. The percentages for the Disability Insurance Trust Fund are similar though not identical.

84% of the Social Security Trust Fund's income.[85] Interest on the Social Security Trust Fund's surplus accounted for 14% of the Trust Fund's income,[86] and revenue from federal income tax imposed on certain Social Security benefits accounted for two percent of the Trust Fund's income.[87]

In recent years, commentators[88] and lawmakers[89] have suggested that additional general revenues and/or estate tax revenue be transferred to the Social Security Trust Fund.[90]

Financing Social Security with additional general revenues and/or estate tax revenue could have a significant impact on the public's perception of Social Security as an "earned right." The creators of the Social Security program

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[84] *See* 26 U.S.C. §§ 1401(a), 3101(a), 3111(a) (2000).

[85] 2006 ANNUAL REPORT, *supra* note 1, at 4.

[86] *Id.*

[87] *Id.* at 5.

[88] *See, e.g.*, Ball, *supra* note 7, at 2 (recommending that beginning in 2010, the estate tax be dedicated to funding Social Security); ALTMAN, *supra* note 7, at 299–301 (endorsing Ball's proposal); Richard Kogan & Robert Greenstein, Ctr. on Budget & Policy Priorities, President Portrays Social Security Shortfall as Enormous, But His Tax Cuts and Drug Benefit Will Cost at Least Five Times as Much (Feb. 11, 2005), http://cbpp.org/1-4-05socsec.pdf ("the cost of the 2001 and 2005 tax cuts, if made permanent, is 1.95 percent of GDP – or $11.1 trillion – over the same period, or triple the size of the Social Security shortfall"); Hans Riemer, Chairman, 2030 Ctr., Prepared Testimony Before the President's Commission to Strengthen Social Security (Oct. 18, 2001), *available at* http://www.csss.gov/meetings/Reimer_Testimony.pdf ("Redirecting general revenues that are projected to go to the recently enacted tax cut to Social Security would go a long way towards closing Social Security's project shortfall" and is a better option to strengthen Social Security for future generations than private accounts.); *See also* William H. Gates Sr. & Chuck Collins, *Tax the Wealthy: Why America Needs the Estate Tax*, AM. PROSPECT, June 17, 2002, at 21 ("Congress should explore the possibility of linking estate tax revenue to the Social Security trust fund, providing long-term solvency for the fund without increasing payroll taxes or reducing retiree benefits.") *Cf.* Michael J. Graetz, *100 Million Unnecessary Returns: A Fresh Start for the U.S. Tax System*, 112 YALE L. J. 261, 272 (2002) ("Down the road, some use of general revenues to fund income and health care for retirees seems inevitable. And if the alternative is an increase in payroll taxes paid by low- and moderate-income families, turning to general revenues also seems right.")

[89] In 1999, President Clinton proposed to make annual general revenue contributions to the Social Security Trust Fund beginning in 2011 as the Social Security surplus was used to draw down the public debt. *See* BALL, *supra* note 27, at 230 ("For the years 2011 through 2016, the contribution would be the estimated amount of interest saved in those years on the publicly held debt because of reduction made in the debt beginning in the year 2000 as the growing Social Security surpluses were used to buy back debt from the public. From 2016 on, the amount of the annual payment would be fixed at the 2016 level. The payments would end with 2044, the estimated exhaustion date (as of 1999) for the non-Social Security budget surplus."). *See also* H.R. 5179, 108th Cong. § 4 (2004) (providing for retention of estate tax and transfer of revenue from that tax to Social Security Trust Fund).

[90] In addition, proponents of partial privatization often propose that the transition costs of partial privatization be financed with general revenue. *See, e.g.*, PRESIDENT'S COMM'N TO STRENGTHEN SOC. SEC., *supra* note 10, at 23.

chose to finance Social Security benefits with "contributions" or payroll taxes[91] because they believed that payroll tax financing would give workers a "right" to benefits and garner long-term support for the system.[92] Indeed, President Franklin D. Roosevelt told a reporter:

> Those taxes were never a problem of economics. They are politics all the way through. We put those payroll contributions there so as to give the contributors a legal, moral, and political right to collect their pensions and their unemployment benefits. With those taxes in there, no damn politician can ever scrap my social security program.[93]

This section begins by providing an overview of the financing debate. It then turns to Ball's proposal to earmark the estate tax for Social Security. It discusses the arguments that have been advanced in favor of and against repeal of the estate tax and whether estate tax revenue should be earmarked for Social Security. Finally, it concludes with my recommendation as to whether Social Security should be financed with more general revenues and/or estate tax revenue.

A. *Overview of the Financing Debate*

As discussed in Section II.C above, Social Security's long-term deficit is due in large part to what Peter Diamond and Peter Orszag refer to as the system's "legacy cost" or "legacy debt." The original architects of the Social Security system, the Committee on Economic Security ("CES"), recommended that this legacy cost be financed by general revenues beginning in 1965.[94]

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[91] Under the Social Security Act as originally enacted, Social Security benefits were not directly funded with payroll taxes. In order to avoid a constitutional challenge to the Social Security program,

> Title II of the Social Security Act created "an account in the Treasury of the United States to be known as the 'Old-Age Reserve Account.'" Title VIII of the Social Security Act imposed taxes on employers and employees. These taxes were paid into the general fund. But the legislation went on to authorize an annual appropriation from the general fund to the Old-Age Reserve Account in the exact amount of the proceeds from the Title VIII tax.

ALTMAN, *supra* note 7, at 82–83. In 1939, however, the Social Security Act was amended to provide for direct funding of Social Security benefits with payroll contributions. *See* Social Security Amendments of 1939, Pub. L. No. 76-379, § 201, 53 Stat. 1360, 1362 (1939). *See also* 42 U.S.C. § 201 (2000).

[92] *See* Moore, *Misguided Reform*, *supra* note 32, at 141 n.63.

[93] *See id.* at 141 n.64 and authorities cited therein. *Cf.* Milton Friedman, *Payroll Taxes, No; General Revenues, Yes, in* THE CRISIS IN SOCIAL SECURITY 25, 28 (Michael J. Boskin ed., 1977) ("The imaginative packaging has served a very important political function: it has made the public at large willing to pay much heavier taxes than they otherwise would have been willing to bear; it has made them willing to accept a capricious system of benefits and to support a mammoth bureaucracy that could never have arisen separately. The ultimate effect has been to foster the growth of government and, above all, of central government.").

[94] *See* BALL, *supra* note 27, at 211, *quoting* COMM. ON ECON. SEC., REPORT TO THE PRESIDENT 31–32 (1935), *available at* http://www.ssa.gov/history/reports/ces5.html ("The allowance of larger annuities than are warranted by their contributions and the matching

President Roosevelt, however, objected to general revenue financing and advised Frances Perkins, chair of the CES, that he could not support the program with general revenue financing.[95] He insisted that the provision be removed from the report before it was submitted to Congress "and the report [be] rewritten so that the CES recommendation concerning tax rates and benefit schedules be presented as simply one possible approach that Congress might or might not adopt."[96] Robert Myers has speculated that Roosevelt rejected general revenue financing: "in view of the public criticisms of his unbalanced budgets (not very large, even relatively, in light of the current situation!) and his desire not to be criticized for proposing legislation with built-in large federal subsidies for long-distant future years."[97]

Congress concurred in the President's judgment that the system should not be financed with general revenues, and the system, as originally enacted, was designed to accumulate a large reserve and be financed solely with payroll taxes.[98] In 1938, the Advisory Council on Social Security recommended that funding of the Social Security program be shifted from a reserve system to a pay-as-you-go basis so that benefits for the first generation of retirees and their families could be expanded. The Advisory Council further recommended that the enhanced benefits be financed with general revenue transfers.[99] The Advisory Council warned:

> The planning of the old-age insurance program must take full account of the fact that, while disbursements for benefits are relatively small in the early years of the program, far larger total disbursements are inevitable in the future. No benefits should be promised or implied which cannot be

contributions of their employers to the workers who are brought into the system at the outset, will involve a cost to the Federal Government which payments are begun immediately will total approximately $500,000,000 per year. Under the plan suggested, however, no payments will actually be made to the Federal Government until 1965, and will, of course, be greater than they would be if paid as incurred, by the amount of the compound interest on the above sum.").

95 *See* ALTMAN, *supra* note 7, at 60.

96 *Id.* at 61.

97 ROBERT J. MYERS, SOCIAL SECURITY 496 (4th ed. 1993). Nancy Altman has noted that a member of the CES, Secretary of the Treasury Henry Morgenthau, objected to the provision of general revenues and speculates that President Roosevelt may have been influenced by Morgenthau. ALTMAN, *supra* note 7, at 60–61 ("It is lost to history whether Roosevelt truly discovered the deficit himself by a perusal of various tables appended to the report, as he claimed and as contemporaneous accounts state, or whether Morgenthau, despite his assurances to Perkins not to object, nevertheless raised his concern privately with the president.").

98 ALTMAN, *supra* note 7, at 82; Edward D. Berkowitz, *The Historical Development of Social Security in the United States*, *in* SOCIAL SECURITY IN THE 21ST CENTURY 22, 24–25 (Eric R. Kingson & James H. Schulz eds., 1997).

99 MYERS, *supra* note 97, at 496.

> safely financed not only in the early years of the program but when workers now young will be old.[100]

In 1939, Congress converted Social Security to a largely pay-as-you-go system to increase the benefits for early retirees and their families but declined to introduce general revenue financing.[101] Commentators and Congress have debated the proper role for general revenue financing since then.[102]

Like the CES and the early Social Security Advisory Councils,[103] many proponents of general revenue financing contend it is more appropriate to fund Social Security's redistributive elements,[104] including its transfers to the early generations of Social Security beneficiaries, by a more redistributive tax than the payroll tax.[105] Critics of the current system respond that rather than funding Social Security's redistributive elements with general revenues, Social Security should be divested of its redistributive elements and benefits should be based purely on individual equity.[106]

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[100] FINAL REPORT OF THE 1937–1938 ADVISORY COUNCIL ON SOCIAL SECURITY, *reprinted in* REPORT OF THE COMMITTEE ON ECONOMIC SECURITY OF 1935, at 173, 199 (Nat'l Conference on Soc. Welfare, 50th anniversary ed. 1985).

[101] MYERS, *supra* note 97, at 496.

[102] *See, e.g.*, ALICIA H. MUNNELL, THE FUTURE OF SOCIAL SECURITY 149–51 (1977) (summarizing debate among commentators in 1976).

[103] *See* MYERS, *supra* note 97, at 496 (discussing recommendations of 1937–1938 and 1948–1949 Advisory Councils).

[104] For a discussion of the ways in which Social Security redistributes income, see, for example, Kathryn L. Moore, *Redistribution Under the Current Social Security System*, 61 U. PITT. L. REV. 955 (2000); *see also* C. EUGENE STEUERLE & JON M. BAKIJA, RETOOLING SOCIAL SECURITY FOR THE 21ST CENTURY: RIGHT & WRONG APPROACHES TO REFORM 91–132 (1994).

[105] *Cf.* Wendell Primus, Director of Income Security, Ctr. on Budget & Policy Priorities, Statement at the Hearing Before the Senate Special Committee on Aging on Infusing Money into Social Security (Mar. 1, 1999), *available at* http://www.cbpp.org/3-1-99socsec.htm ("Compensating Social Security on a one-time, temporary basis for benefit payments in excess of payroll contributions . . . for the first several generations of Social Security beneficiaries" supports use of general revenue contributions); BALL, *supra* note 27, at 230 ("Some have argued that the cost of modifying the equity principle of quid pro quo to carry out a social purpose—the weighted benefit formula, for example—ought to be carried by the general taxpayer, not solely by the better-off contributors."); U.S. SOC. SEC. ADMIN., REPORT OF THE 1994–1996 ADVISORY COUNCIL ON SOCIAL SECURITY, VOL. II: REPORTS OF THE TECHNICAL PANELS ON TRENDS AND ISSUES IN RETIREMENT SAVINGS 87 (1997), *available at* http://www.ssa.gov/history/reports/adcouncil/tirs1.wpd ("The use of general revenues rather than the payroll tax has certain attractive features. It is administratively simple and is potentially more redistributive within generations than is an increase in the payroll tax.").

[106] U.S. SOC. SEC. ADMIN., *supra* note 105, at 87 ("There are also analysts who argue that the redistributional component of Social Security should be explicitly identified and recognized, and funded from the same sources used for other public programs."); MUNNELL, *supra* note 102, at 150 ("Those opposing the use of general revenues . . . were not persuaded by the argument for the use of general revenues to finance the social adequacy components of the program, since they felt that the program should be divested of its welfare function and be based on individual equity.").

Critics of general revenue financing often object because general revenue financing would weaken the link between benefits and taxes.[107] Some contend that weakening the link between benefits and taxes would reduce the system's inherent fiscal discipline and fear that the system would grow unchecked if general revenue financing played too great a role in financing benefits.[108] Other critics of general revenue financing fear the opposite result—that general revenue financing might erode public support for the program by drawing it more explicitly into annual budget debates.[109] Proponents respond that the Social Security system is "mature enough to withstand an infusion of general revenues without undermining its basic principles."[110]

Currently, general revenues play a limited role in financing Social Security benefits. Specifically, since 1983 up to 50% of the Social Security benefits is

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107 *Cf.* AARON & REISCHAUER, *supra* note 7, at 109 (some "would argue that general revenue financing would weaken the program's social insurance rationale through which payroll tax contributions create an 'earned right' to benefits"). In contrast, one critic of the current system supports general revenue financing precisely because it would "help to dissolve the public belief, so carefully and dishonestly fostered by the social security bureaucracy, that social security is an insurance system." Friedman, *supra* note 93, at 28.

108 *See, e.g.*, Alan Greenspan, Chairman, Fed. Reserve Bd., Statement at the*:* Hearing Before the Senate Special Committee on Aging on General Revenue Transfers for Social Security and Medicare (Mar. 27, 2000), *available at* http://www.federalreserve.gov/boarddocs/testimony/2000/20000327.htm ("when payroll taxes are no longer projected to be sufficient to pay even currently legislated benefits, moving toward a system of general revenue financing raises the concern that the fiscal discipline of the current social security system could be reduced."); STEUERLE & BAKIJA, *supra* note 104, at 171 ("If payroll taxes are not raised to cover future Social Security deficits, should the system rely even more heavily on general revenue financing? Probably not. Such shifts would make even weaker the tie between benefits and taxes – a tie that at least provides some fiscal discipline to the program. A hybrid financing system that relies partly on earmarked payroll taxes and partly on general revenues gives a misleading impression of the amount we are actually spending on programs for the elderly, since people tend to focus only on the earmarked taxes."); Robert L. Bixby, Executive Director, The Concord Coalition, Statement at the Hearing Before the President's Commission to Strengthen Social Security (Sept. 6, 2001), *available at* http://www.concordcoalition.org/issues/socsec/old-doc/010806csssdtestimony.htm (contending that general revenue financing "would weaken fiscal discipline within the system"); MUNNELL, *supra* note 102, at 150 ("Those opposing the use of general revenues agreed that there would be more of a tendency to expand the program without the 'countervailing constituency' created by the payroll tax. However, they felt that further increases in social security benefits should have a low priority and saw more pressing needs for general revenues.")

109 *Cf.* Greenspan, *supra* note 108 ("One argument was that using general revenues would blur the distinction between the social security system, which was viewed as a social insurance program, and other government spending programs."); U.S. SOC. SEC. ADMIN., *supra* note 105, at 87 ("On the other hand introducing general revenues to balance the system would substantially change the nature of Social Security, and it might also eventually erode public support. The additional use of general revenues would change the public's perception of Social Security benefits as earned rights, and might further politicize Social Security by drawing it more explicitly into annual budget debates.")

110 MUNNELL, *supra* note 102, at 149.

subject to income tax,[111] and the revenue from that tax is transferred to the Social Security Trust Fund.[112] In 2005, that revenue accounted for 2% of the Trust Fund's income.[113]

B. Earmarking the Estate Tax

For many years Robert Ball recommended that general revenues be used to finance Social Security's legacy debt. He later changed his mind because he

> just could not see a commissioner of Social Security, as [he] had been, successfully arguing before Congress for the huge amounts of general revenue that the accrued liability rationale required. . . . Considering the great resistance on the part of the public to general taxes, [he] was fearful that sufficient general revenue would not be voted. On the other hand, the public generally seemed quite willing to pay a hefty tax earmarked for Social Security, so [he] and most other experts gave up on general revenue financing and adopted the "self-financed" principle.[114]

In light of the recent enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA),[115] Robert Ball now advocates that the estate tax be earmarked for Social Security.[116] Under EGTRRA, the estate tax

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[111] Social Security Amendments of 1983, Pub. L. No. 98-21, § 86(a)(1), 97 Stat. 65, 80 (1983). Since 1993, up to 85 percent of Social Security benefits are subject to income taxation. 26 U.S.C. § 86(a)(2)(B) (2000). These additional revenues are dedicated to the Medicare Trust Fund and not to the Social Security Trust Fund.

[112] Social Security Amendments of 1983, Pub. L. No. 98-21, 97 Stat. 65. General revenue transfers have also played a limited role in a few other instances. *See* C. Eugene Steuerle, Senior Fellow, The Urban Inst., Statement at the Hearing Before the Senate Special Committee on Aging on General Fund Transfers to Entitlement Programs (Mar. 27, 2000), *available at* http://www.urban.org/url.cfm?ID=900250 ("Historically, Social Security has also had some general revenue infusions to cover the cost of military service wage credits (1956), transition benefits for those aged 72 and older with fewer than three quarters of coverage (1966), wage credits for U.S. citizen internees of Japanese ancestry (1972), and for taxes which would have been collected on deemed post-1956 military service wage credits (1983)."); AARON & REISCHAUER, *supra* note 7, at 178–79 n.20 (stating that "when minimum Social Security benefits were eliminated in 1981, they were preserved for those born before 1920 and financed through a general revenue transfer"); U.S. GEN. ACCOUNTING OFFICE, *supra* note 6, at 37 n.39 ("The 1983 amendments directed the Treasury to make payments to the OASDI Trust Funds from general revenues for unfunded gratuitous military service credits for military service after 1939, the value of uncashed benefit checks issued in the past (including interest), revenues from the income taxation of up to 50 percent of Social Security benefits paid, and tax credits given for Federal Insurance Contributors [sic] Act and Self-Employed Contributions Act taxes paid by workers from 1984 through 1989.").

[113] 2006 ANNUAL REPORT, *supra* note 1, at 5.

[114] BALL, *supra* note 27, at 229.

[115] Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, §§ 501–521, 901(a)–(b), 115 Stat. 39, 69–72, 150 (2001).

[116] *See* BALL, *supra* note 27, at 3; ALTMAN, *supra* note 7, at 299–301 (endorsing Ball's proposal). Although not part of their three part plan, Peter Diamond and Peter Orszag also support using the estate tax to fund a portion of Social Security benefits. DIAMOND & ORSZAG, *supra* note 7, at 93–96.

exemption is scheduled to gradually increase from $1 million in 2002 to $3.5 million (or $7 million for a couple) in 2009, and be abolished in 2010.[117] EGTRRA, however, includes a "sunset" clause which causes the entire Act to expire in 2011.[118] Thus, under current law, the estate tax will be revived at its 2000 levels beginning in 2011.[119] President Bush, and many Republicans, call for the permanent abolition of the estate tax beginning no later than 2010.[120]

Ball proposes freezing the estate tax at the 2009 level and earmarking the proceeds for Social Security from 2010 on.[121] According to estimates by Social Security actuaries, earmarking estate tax proceeds for Social Security would reduce Social Security's long-term deficit by about 0.5 percent of payroll.[122]

The proposal has intrinsic appeal. It requires some members of the earlier generations of Social Security beneficiaries to use some of their legacies to help pay for the legacy debt created for the benefit of their generations. Of course, it is not a perfect fit. First, many of the early retirees have already died and thus would not be required to use their legacies to pay for the legacy debt.[123] More importantly, the estate tax, whether it is frozen at the 2009 level (with a $3.5 million exemption for individuals or $7 million exemption for couples)[124] or returned to the 2000 level,[125] would only affect a tiny percentage of Social Security beneficiaries. Nevertheless, there is something appealing about using legacies to pay for a legacy debt.

Ball's proposal naturally raises two questions: (1) should the estate tax be permanently repealed?, and (2) if not, should the revenue from the estate tax be earmarked for Social Security?

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[117] Economic Growth and Tax Reconciliation Act of 2001 §§ 501–521, 115 Stat. at 69–72.

[118] *Id.* § 901(a), 115 Stat. at 150.

[119] *Id.* § 901(b), 115 Stat. at 150. Virtually everyone expects some sort of change in the estate tax between now and 2011. The question is what form it will take. *Cf.* DIAMOND & ORSZAG, *supra* note 7, at 94.

[120] Leonard E. Burman et al., Urban-Brookings Tax Policy Ctr., Options to Reform the Estate Tax 1 (Mar. 2005), http://www.taxpolicycenter.org/UploadedPDF/311153_IssuesOptions_10.pdf ("The president [sic] and many members of Congress would like to repeal the [estate] tax permanently, and many would like to do so before 2010.")

[121] *See* Ball, *supra* note 7, at 3; ALTMAN, *supra* note 7, at 299–301 (endorsing Ball's proposal).

[122] Ball, *supra* note 7, at 4; Memorandum from Stephen C. Goss, Chief Actuary, U.S. Soc. Sec. Admin., to Robert M. Ball, Estimated OASDI Financial Effects for a Proposal With Six Provisions That Would Improve Social Security Financing (Apr. 14, 2005), *available at* www.ssa.gov/OACT/solvency/RBall_20050414.html.

[123] *Cf.* Moore, *supra* note 22, § 5.02, at 9–10 (noting that Ida May Fuller, the first recipient of monthly Social Security benefits, died in 1975 at age 100).

[124] *Cf.* Gene Sperling et al., Ctr. for Am. Progress, Repeal/Reform of the Estate Tax (June 30, 2005), http://www.americanprogress.org/kf/cap%20estate%20tax.pdf (noting that by 2009, less than 0.3% of estates will owe any estate tax).

[125] *See infra* Section IV.B.1 (noting that two percent or less of US decedent population generally affected by estate tax).

1. Should the Estate Tax Be Repealed?

The estate tax is a remarkably unpopular tax. Although it only affects a very small percentage of the population,[126] most Americans object to the tax.[127] Michael Graetz believes this anomaly may be due to the unflappable optimism of most Americans: most people must believe that they will be among the one to two percent richest in the nation when they die.[128] Yet, surprisingly, according to a survey by the U.S. Trust, more than half of the affluent (defined as Americans in the top one percent of income and thus most likely to be affected by the estate tax) believe that the federal estate tax should not be repealed, but that it should be continued at the rate of 18%.[129]

Whether the estate tax should be repealed has been the subject of major debate in recent years.[130] Indeed, as Richard Kaplan has noted, "entire forests

126 *See* Diane Lim Rogers, *'Death Tax' Repeal Unfair to Those Who Owe 'Birth Tax,'* S.F. CHRON., May 31, 2006 (noting that according to the Urban-Brookings Tax Policy Center's estimates, in 2006, there will only be 12,600 taxable estates—thus a tax will be only be assessed on ½ of one percent of all deaths in 2006); Barry W. Johnson & Jacob M. Mikow, *Federal Estate Tax Returns, 1998–2000*, IRS STAT. OF INCOME BULL., Spring 2002, at 133, *available at* http://www.irs.gov/pub/irs-soi/00esart.pdf (noting that an estimated 103,982 Federal estate tax returns were filed for individuals who died in 1998, that the returns represented 4.4% of all individuals who died that year, and less than half of the returns reported any tax liability); Barry W. Johnson & Martha Britton Eller, IRS, Federal Taxation of Inheritance and Wealth Transfers 3, 19 tbl.6 (March 2001), *available at* http://www.irs.gov/taxstats/article/0,,id=112193,00.html (showing percentage of adult deaths with taxable estate never exceeded eight-six percent between 1934 and 1993, and in most years was less than two percent),

127 *See, e.g.*, Michael J. Graetz, *2001 Erwin N. Griswold Lecture Before the American College of Tax Counsel: Erwin Griswold's Tax Law—and Ours*, 56 TAX LAW. 173, 175 (2002) (noting that according to a Zogby poll, the public favored repeal of the estate tax by a 71–29% margin); Deborah Geier, *The Death of the "Death Tax"?: An Introduction*, 48 CLEV. ST. L. REV. 653, 653 (2000) ("A [June 2000] Gallup poll, for example, indicated that 60% of those polled favored elimination of the estate tax 'even though only 17% [believed that] they 'would personally benefit.'"); Dennis J. Ventry, Jr., *Straight Talk about the 'Death' Tax: Politics, Economics, and Morality*, 89 TAX NOTES 1159, 1159–60 (2000) ("In surveys conducted in late August and early September, the Pew Research Center reported that 71 percent of respondents favored 'eliminating the inheritance tax.'").

128 Graetz, *supra* note 127, at 175.

129 *A Few Thoughts*, BEACON HILL TIMES, July 18, 2006, at 14, *available at* 2006 WLNR 13326073.

130 *See, e.g.*, William G. Gale & Joel Slemrod, *Overview*, *in* RETHINKING ESTATE AND GIFT TAXATION 1 (William G. Gale et al. eds., 2001); Edward J. McCaffery et al., *Should We End Life Support for Death Taxes?*, 88 TAX NOTES 1373 (2000); Deborah H. Schenk, *Symposium on Wealth Taxes Part I—Foreword*, 53 TAX L. REV. 257 (2000); David Shakow & Reed Shuldiner, *A Comprehensive Wealth Tax*, 53 TAX L. REV. 499 (2000)**;** Ventry, Jr., *supra* note 127; Charles Davenport & Jay A. Soled, *Enlivening the Death-Tax Death-Talk*, 84 TAX NOTES 591 (1999); Edward J. McCaffery, *The Uneasy Case for Wealth Transfer Taxation*, 104 YALE L. J. 283 (1994); John E. Donaldson, *The Future of Transfer Taxation: Repeal, Restructuring and Refinement, or Replacement*, 50 WASH. & LEE L. REV. 539, 541 (1993); Michael J. Graetz, *To Praise the Estate Tax, Not to Bury It*, 93 YALE L. J. 259 (1983).

have been decimated in the process."[131] A comprehensive analysis of the estate tax[132] goes well beyond the scope of this Article. I will simply try to highlight some of the principal arguments presented in the debate.

When Congress introduced the estate tax in 1916, it was said to have had two purposes: (1) to break up concentrations of wealth,[133] and (2) to produce revenue.[134] In recent years, a third goal or purpose has been attributed to the estate tax: adding progressivity to the federal tax system.[135]

Critics of the estate tax contend that it has done little to break up concentrations of wealth.[136] Some proponents of the tax concede that it has done little to break up the greatest concentrations of wealth[137] while other proponents assert that the tax does in fact decrease dynamic wealth concentration.[138] Other proponents of the tax assert that the failure of the tax to break up large concentrations of wealth is due to lack of political will, which is "hardly condemnatory of the tax."[139]

As for producing revenue, critics of the tax note that it only produces a tiny percentage of total federal tax revenue (about one percent)[140] and may even

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[131] Richard Kaplan, *Crowding Out: Estate Tax Reform and the Elder Law Policy Agenda*, 10 ELDER L. J. 15, 20 (2002).

[132] "Federal law imposes an integrated set of taxes on estates, gifts, and generation-skipping transfers." Gale & Slemrod, *supra* note 130, at 4. Generally, when discussing the estate tax, most commentators address the gift tax or the entire transfer tax system together. This Article will simply refer to the estate tax, but much of the discussion is applicable to the entire transfer tax system.

[133] For an exhaustive discussion of why high concentrations of wealth should be broken up, see James R. Repetti, *Democracy, Taxes and Wealth*, 76 N.Y.U. L. REV. 825, 828–50 (2001).

[134] *See, e.g.*, Edward J. McCaffery & Linda R. Cohen, *Shakedown at Gucci Gulch: The New Logic of Collective Action*, 84 N.C. L. REV. 1159, 1180 (2006) ("The tax was designed both to raise revenue and, in the progressive spirit of the times, to break up large concentrations of wealth."); Jay A. Soled, *Reassigning and Assessing the Role of the Gift Tax*, 83 B.U. L. REV. 401, 402–03 (2003) ("There were two purposes that underlay the passage of this [estate] tax: to raise revenue and to impede the buildup of large wealth concentrations"); Douglas A. Kahn & Jeffrey H. Kahn, *"Gifts, Gafts, and Gefts"—The Income Tax Definition and the Tax Treatment of Private and Charitable "Gifts" and a Principled Policy for the Exclusion of Gifts from Income*, 78 NOTRE DAME L. REV. 441, 475 n.125 (2003). ("A major reason for having estate taxes is to reduce large concentrations of wealth.").

[135] Whether this is a recent claim or a long-standing defense is actually subject to debate. *Compare* Gale & Slemrod, *supra* note 130, at 29 ("Progressivity has long been a principal justification for the estate tax.") *with* Donaldson, *supra* note 130, at 541 ("More recently, the system has been 'justified' for its role or potential in adding an element of progressivity to the overall federal tax system.").

[136] Barbara Redman, *Rethinking the Progressive Estate and Gift Tax*, 15 AKRON TAX J. 35, 36 (2000); Donaldson, *supra* note 130, at 541.

[137] Graetz, *supra* note 130, at 271.

[138] *See, e.g.*, Repetti, *supra* note 133, at 856–59.

[139] Davenport & Soled, *supra* note 130, at 598.

[140] McCaffery, *supra* note 130, at 301.

cost the federal government more to administer than it collects from the tax.[141] Critics label the tax "voluntary"[142] because so many methods have been developed to avoid it[143] and contend that the extraordinary amount of money devoted to avoiding the tax, relative to the revenue collected, causes the tax to impose an unacceptably high social cost.[144] Proponents of the estate tax concede that it produces a relatively small percentage of total tax revenue but contend that critics overstate the administrative costs associated with the tax.[145] Moreover, while the estate tax may produce a relatively small percentage of total tax revenue, it still raises sizeable dollars;[146] by one estimate, permanently repealing the estate tax would cost the nation $800 billion between 2011 and 2021.[147] Indeed, earmarking the estate tax for Social Security would reduce about 25% of Social Security's seventy-five year actuarial deficit.[148]

141 *See, e.g.*, Redman, *supra* note 136, at 36; McCaffery, *surpa* note 130, at 300–04. For an overview of the debate regarding administrative issues, see Gale & Slemrod, *supra* note 130, at 37–43.

142 GEORGE COOPER, A VOLUNTARY TAX? NEW PERSPECTIVES ON SOPHISTICATED ESTATE TAX AVOIDANCE (1979).

143 *See, e.g.*, Richard Schmalbeck, *Avoiding Federal Wealth Transfer Taxes*, *in* RETHINKING ESTATE AND GIFT TAXATION 113, 120–44 (William G. Gale et al. eds., 2001) (describing methods for avoiding the estate tax and suggesting these devices may reduce the aggregate tax base by about one-third). It is worth noting that EGTRRA did not address the estate tax's many loopholes. *See* DIAMOND & ORSZAG, *supra* note 7, at 94.

144 Johnson & Eller, *supra* note 126, at 20 ("The annual costs of estate tax avoidance schemes, including lawyer fees, accountant fees, costs of subscriptions to estate planning magazines, and opportunity costs of individuals involved in tax avoidance activities, have been shown to represent a large percentage of the annual receipts from estate and gift taxes."); Alicia H. Munnell, *Wealth Transfer Taxation: The Relative Role for Estate and Income Taxes,* NEW ENG. ECON. REV., Nov.–Dec. 1988, at 19 (asserting that tax avoidance costs approach billions of dollars each year which is "an inordinately high social cost for a tax that only yielded $7.7 billion in 1987.").

145 *See, e.g.*, Davenport & Soled, *supra* note 130, at 618–25. *See also* Repetti, *supra* note 133, at 869–70 (stating that cost to IRS in administering tax appears to be proportional to revenues generated and noting that with respect to compliance costs, it is difficult to distinguish between costs incurred to minimize estate taxes and those to provide for orderly succession of property).

146 Graetz, *supra* note 127, at 175 ("In 1999, fewer than 50,000 taxable estates contributed $28 billion to finance the federal government. Estate tax receipts had been projected to grow to about $40 billion by 2008."); Repetti, *supra* note 133, at 852–83 (finding estate tax revenue significant relative to income tax revenue collected from low and moderate income individuals).

147 Gates & Collins, *supra* note 88. *See also* Davenport & Soled, *supra* note 130, at 593 ("While not a large percentage of receipts, [transfer taxes] are sufficiently great that elimination or reduction of them would force some fiscal offset: other taxes would have to be raised; other taxes could not be cut; borrowing would be greater; or spending would have to be cut.").

148 DIAMOND & ORSZAG, *supra* note 7, at 94–95. *See also* Ball, *supra* note 7, at 4. (stating that earmarking estate tax revenues would reduce Social Security's then long-term deficit of 1.9 percent of payroll (the level at the time of the calculation) to 1.4 percent of payroll).

To the extent that the estate tax is borne by decedents,[149] it is undoubtedly progressive.[150] At most, only about four percent of decedents must file an estate tax return, and only about half of those decedents pay any estate tax.[151] Thus, at most, only about the richest 2% of the nation's decedents have taxable estates.[152] Nevertheless, the desirability of progressive taxes in general,[153] and estate taxes in particular,[154] has been the subject of considerable debate.

Critics of the estate tax offer at least two other objections to the estate tax.[155] First, and perhaps foremost, critics of the estate tax argue that it has an adverse effect on savings and investment and thus on capital formation.[156] Proponents of the estate tax claim that the economic studies are equivocal and do not clearly establish that increased savings will result from the elimination or reduction of estate taxes.[157]

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[149] Even if the estate tax is borne by recipients, it may still be viewed as progressive. *See* Gale & Slemrod, *supra* note 130, at 28–29.

[150] *See* Geier, *supra* note 127, at 654–55 ("[I]t's undeniable that the estate tax is extremely progressive for the very reason that it collects tax from fewer than 2% of all decedents each year."); *but see* Donaldson, *supra* note 130, at 544 (arguing that "[t]he existing transfer tax system simply cannot be justified by reference to its contribution to progressivity [because it affects such a small percentage of the decedent population]").

[151] Gale & Slemrod, *supra* note 130, at 23.

[152] *Id.* Indeed, under current law with much higher exemptions as few as one-half of one percent of decedents are expected to pay the estate tax.

[153] *Compare* Walter J. Blum, *Revisiting the Uneasy Case for Progressive Taxation*, 60 TAXES 16 (1982), *and* Walter J. Blum & Harry Kalven, Jr., *The Uneasy Case for Progressive Taxation*, 19 U. CHI. L. REV. 417 (1952), *with* ROBERT H. FRANK & PHILIP J. COOK, THE WINNER-TAKE-ALL SOCIETY 20–21, 58, 121–23, 212–17 (1995).

[154] *Compare* Davenport & Soled, *supra* note 130, at 598 ("Because we believe in progressivity we think that the contribution the estate tax makes to it is on the whole good"), *and* James R. Repetti, *The Case for the Estate and Gift Tax*, 86 TAX NOTES 1493, 1500–03 (2000) (by increasing tax burden of the wealthy, estate tax contributes to progressivity of income tax), *and* Graetz, *supra* note 130, at 272 (finding that about one-third of the progressivity in the federal tax system is due to the estate tax), *and* Gates & Collins, *supra* note 88 (describing estate tax as one of most progressive taxes; "taxing dead multimillionaires is eminently more fair than taxing the not-so-rich living."), *with* Redman, *supra* note 136 (contending that to the extent that bequest or gift is recognition of and compensation for past services rendered, progressive taxation loses much of its logic), *and* McCaffery, *supra* note 130 (favoring progressive consumption tax but not estate tax).

[155] For a response to a third argument against the estate tax, that it constitutes double taxation, see Ruth Carlitz & Joel Friedman, Ctr. on Budget & Policy Priorities, Why the Estate Tax Is Not "Double Taxation" (June 17, 2005), http://www.cbpp.org/6-17-05tax.htm.

[156] Graetz, *supra* note 130, at 278 ("The basic argument is quite straightforward. Our nation needs more savings if it is to enjoy economic growth. The estate tax is levied on savings, and taxing such savings will cause people to save less."); Johnson & Eller, *supra* note 126, at 3 ("Opponents claim that transfer taxation creates a disincentive to accumulate capital and, thus, is detrimental to the growth of national productivity."). For an overview of the debate regarding the estate tax's effects on saving and labor supply, see Gale & Slemrod, *supra* note 130, at 43–45.

[157] *See, e.g.*, Davenport & Soled, *supra* note 130, at 608 ("Because of Slemrod's concern, we suggest an inquiry into whether taxing the very rich has a special effect on the economy. Short of that inquiry and results from it, no case has been made for the estate tax

In addition, some critics contend that the estate tax hurts small farms and family-owned businesses.[158] "To pay the estate tax after the owner dies, the heirs face a stark choice: sell the machinery and go out of business, or make all the other kinds of cost-cutting decisions—layoffs, deferring new investment—that hurt the company's competitiveness."[159] Proponents of the estate tax respond that the estate tax should have a minimal impact on most small businesses because of a number of provisions in the estate tax law, including the exemption for small estates,[160] that are intended to provide relief to small business and farms.[161] Proponents concede that the law is complex and imperfect, but argue that the law should be reformed rather than repealed.[162]

2. Earmarking Estate Tax Revenues for Social Security

Whether estate tax revenues should be earmarked for Social Security raises many of the same issues as using general revenues to fund some portion of Social Security benefits. For example, using estate tax revenues to fund some Social Security benefits would weaken the link between benefits and taxes. Weakening the link between benefits and taxes, however, may not have the same ramifications when estate tax rather than general revenue financing is involved. First, one of the objections to general revenue financing is the fear

having much effect on savings or capital formation."); Repetti, *supra* note 133, at 858–66 (reviewing theory and empirical studies and finding that most empirical evidence suggests that estate tax does not decrease savings); Graetz, *supra* note 130, at 283 ("[o]n balance, . . . the economic evidence available to date simply fails to make a case for the elimination or reduction of estate and gift taxes on the grounds that increased savings will result."); *see also* Johnson & Eller, *supra* note 126, at 21 ("There are economists who also reject the postulate that moderate transfer taxes have an adverse effect on capital accumulation. Embracing an idea first proposed by the mid-19th century English economist J.R. McCulloch, they argue that transferors adjust their bequest plans when faced with transfer taxes.").

[158] Johnson & Eller, *supra* note 126, at 20 ("Federal transfer taxes are often cited as impediments to the livelihood of small businesses and farms."). For an overview of this debate, see Gale & Slemrod, *supra* note 130, at 45–50; ROBERT MCCLELLAND, CONG. BUDGET OFFICE, EFFECTS OF THE FEDERAL ESTATE TAX ON FARMS AND SMALL BUSINESSES (2005), *available at* http://www.cbo.gov/ftpdocs/65xx/doc6512/07-06-EstateTax.pdf.

[159] John Engler, '*Death Tax' and Folks Who Make Things*, AKRON BEACON J., June 8, 2006, at B2, *available at* 2006 WLNR 9792763.

[160] *See, e.g.*, Gale & Slemrod, *supra* note 130, at 47–49 (describing favorable treatment of family farms and businesses under pre-EGTRRA law); Repetti, *supra* note 133, at 866–68 (same).

[161] Some contend that the claim that the estate tax harms farms and small businesses is nothing more than a myth. *See* Geier, *supra* note 127, at 655 ("While commentators agree that there must surely be some farm or small business somewhere that was, indeed, sold to pay estate taxes, no one seems to have ever been able to find it."); McCaffery et al., *supra* note 130, at 1374 ("While there are reports of businesses being sold to pay estate taxes, there is no work validating this. Some anecdotal information suggests the contrary.").

[162] *See, e.g.*, Graetz, *supra* note 127, at 175; Repetti, *supra* note 133, at 868–69; Ventry, *supra* note 127, at 1168–69.

that the program would grow unchecked if general revenue financing played too great a role in financing benefits. While the estate tax raises "sizeable dollars," and earmarking estate tax revenues for Social Security would reduce Social Security's long-term deficit by 0.5% of payroll, estate tax revenue represents a very small percentage of total federal tax revenue. Unless the estate tax were dramatically restructured and increased (which appears unlikely), the limited amount of estate tax revenue would necessarily keep any growth in Social Security under check.

A second objection to general revenue financing is that it might erode public support for the program by drawing it more explicitly into annual budget debates. Partially financing Social Security benefits with estate tax revenue would keep Social Security out of the annual budget debate.[163] Instead, it would draw Social Security explicitly into a debate with the estate tax: one of the most popular federal programs[164] against an unpopular federal tax. I expect that Social Security would win that debate. Indeed, Robert Ball recommends estate tax revenue financing as a way to "save" the estate tax.[165]

C. Recommendation

Overall, I find a great deal of merit in Robert Ball's proposal to earmark estate tax revenue for Social Security. The estate tax may be imperfect and in need of reform, but it should be retained because of the role it plays in adding progressivity to the federal tax system. Moreover, in light of the progressive nature of the estate tax, and the fact that one of the reasons Social Security faces a long-term deficit is because the system redistributed income to the early generations of Social Security beneficiaries, it seems appropriate to use a highly progressive tax, rather than the regressive payroll tax, to fund this redistribution. Although an imperfect fit, using legacies to pay for a legacy debt is an appealing idea.

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[163] DIAMOND & ORSZAG, *supra* note 7, at 95 ("Moreover, dedicating estate or inheritance tax revenue to Social Security would support the important tradition of keeping Social Security out of the annual budget discussion. Given that so many Americans rely so much on Social Security, its provisions should be adjusted only from time to time, not every year, and with lead times to help workers adapt.").

[164] *See, e.g.*, Jefferson, *supra* note 18, at 1290 ("Social Security is one of the most popular and successful social programs in this country's history."); Herman B. Leonard, *In God We Trust—The Political Economy of the Social Security Reserves*, *in* SOCIAL SECURITY'S LOOMING SURPLUSES: PROSPECTS AND IMPLICATIONS 57, 59 (Carolyn L. Weaver ed., 1990) (noting Social Security enjoys nearly unassailable political support); Bruce K. MacLaury, *Foreword*, *in* MARTHA DERTHICK, AGENCY UNDER STRESS: THE SOCIAL SECURITY ADMINISTRATION IN AMERICAN GOVERNMENT vii (1990) (noting Social Security is no less sacred politically today than in 1979); Felicity Skidmore, *Overview of the Symposium*, *in* SOCIAL SECURITY FINANCING 1, 7–8 (Felicity Skidmore ed., 1981) ("That social security was one of the most popular social programs was accepted without question.").

[165] Ball, *supra* note 7, at 3.

Of course, using estate tax revenue to fund some Social Security benefits would weaken the link between contributions and benefits and could erode public support for the program. Nevertheless, I believe the program is "mature enough to withstand an infusion of [estate tax] revenues without undermining its basic principles."[166]

Moreover, estate tax revenue financing is more appealing than increased general revenue financing. First, given that unified budget deficits are projected for the foreseeable future, it does not make sense to dedicate general revenues to Social Security from an unspecified source.[167] Second, to the extent that earmarking the estate tax for Social Security would "save" a tax that would otherwise be permanently repealed, earmarking it for Social Security would not make the problem of reducing the current federal deficit more difficult.[168]

V. INCREASING PAYROLL TAXES AND/OR DECREASING BENEFITS

In recent years, policymakers and analysts have recommended a variety of payroll tax increases and benefit reductions to address Social Security's long-term deficit. For example, experts have recommended that the maximum taxable wage base be increased[169] and/or the Social Security tax rate be increased.[170] They have also recommended that the age at which full benefits are available (the normal retirement age) be increased, or at least the currently scheduled increase in the age be accelerated,[171] and/or that benefits be based on thirty-eight or even forty years of earnings rather than thirty-five years as under current law.[172] This section will discuss two of the most common proposals in more detail: (1) proposals to increase the maximum taxable wage base, and (2) proposals to increase the normal retirement age.

A. Increasing the Maximum Taxable Wage Base

Current law imposes on both employees[173] and employers[174] a tax of 6.2% of wages, up to a maximum taxable wage base,[175] indexed to the increase in

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166 MUNNELL, *supra* note 102, at 149.

167 *See* DIAMOND & ORSZAG, *supra* note 7, at 94.

168 *Id.*

169 *See infra* notes 180–81.

170 *See, e.g.*, S. 1792, 105th Cong. § 2 (1998) (proposing that payroll tax gradually be increased to 6.7% by 2060); U.S. SOC. SEC. ADMIN., *supra* note 10, at 30 (Personal Security Account plan proposing a 72-year payroll tax increase of 1.52%).

171 *See infra* notes 273–75.

172 *See* AARON & REISCHAUER, *supra* note 7, at 97; S. 1383, 106th Cong. § 204 (1999); S. 1792, 105th Cong. § 8; U.S. SOC. SEC. ADMIN., *supra* note 10, at 25, 29 (Maintain Benefits and Individual Account Plans).

173 26 U.S.C. § 3101(a) (2000).

174 26 U.S.C. § 3111(a) (2000).

175 26 U.S.C. § 3121(a)(1) (2000); 42 U.S.C. § 430(a) (2000).

average wages nationwide and equal to $94,200 in 2006,[176] to finance Social Security benefits.[177] Under current law, the maximum taxable wage base also serves as a benefits base which establishes the maximum amount of earnings that are used to calculate benefits.[178] In 2006, the benefit for an individual who earned the maximum taxable wage for at least thirty-five years (the number of years on which benefits are based) and retired at the full retirement age (sixty-five years and eight months for workers reaching age sixty-five in 2006), is equal to $2,053 per month or $24,636 per year.[179]

In recent years, a number of commentators[180] and lawmakers[181] have recommended that the taxable wage base be increased to reduce Social Security's long-term deficit. This section begins with a brief history of the maximum taxable wage base. It then describes some of the leading proposals to increase the taxable wage base. It then analyzes the costs and benefits of increasing the taxable wage base. Finally, it concludes with my recommendation as to whether the maximum taxable wage base should be increased.

1. History of Social Security Maximum Taxable Wage Base

As originally drafted, the Roosevelt Administration's proposal did not include a maximum taxable wage base. Rather, in its original proposal, President Franklin Roosevelt's Committee on Economic Security excluded from coverage non-manual workers with monthly wages of $250 or more.[182] Presumably, the committee excluded these high wage workers because the program's drafters were focused on alleviating the poverty a large number of

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[176] Cost-of-Living Increase and Other Determinations for 2006, 70 Fed. Reg. at 61,677 (Oct. 25, 2005) (announcing 2006 taxable wage base).

[177] The self-employed are required to pay similar taxes. 26 U.S.C. § 1401(a) (2000).

[178] 42 U.S.C. § 430 (2000).

[179] U.S. Soc. Sec. Admin., Fact Sheet: 2006 Social Security Changes, *available at* http://www.ssa.gov/pressoffice/factsheets/colafacts2006.pdf.

[180] *See, e.g.*, Ball, *supra* note 7, at ; ALTMAN, *supra* note 7, at 301–03; Christian E. Weller, Ctr. for Am. Progress, Restore Tax Fairness for Social Security's Solvency (May 2005), http://www.americanprogress.org/kf/restore_tax_fairness.pdf; DIAMOND & ORSZAG, *supra* note 7, at 84–85; Riemer, *supra* note 88; Timothy M. Smeeding, Carroll L. Estes & Lou Glasse, Social Security in the 21st Century: More Than Deficits: Strengthening Social Security for Women 5, http://www.geron.org/journals/income.htm ("Increasing the earnings base to the intended level is an attractive alternative to benefit cuts alone and should be considered as part of any well-rounded reform package.").

[181] *See, e.g.*, H.R. 440, 109th Cong. § 12 (2005) (gradually raising base to $142,500 in 2010 and then indexing it to eighty-seven percent of total payroll thereafter); H.R. 3821, 108th Cong. § 12 (2004) (gradually raising base to $133,200 in 2008, and indexing it to eighty-seven percent of total payroll thereafter); S. 1383, 106th Cong. § 205 (1999) (setting taxable wage base at eighty-six percent of total payroll); S. 2774, 106th Cong. § 205 (2000) (setting taxable wage base at 84.5% of total payroll).

[182] THE REPORT TO THE PRESIDENT OF THE COMMITTEE ON ECONOMIC SECURITY, *reprinted in* REPORT OF THE COMMITTEE ON ECONOMIC SECURITY OF 1935, at 15, 49 (50th anniversary ed. 1985).

people faced at the time, and they were not concerned with high-wage workers.[183]

The maximum taxable wage base first appeared in a bill reported by the House Ways and Means Committee.[184] The Committee replaced the exemption for high wage workers with a maximum taxable base, which it set at $3,000 per year (which equals $250 per month).[185] Although the Committee report did not provide a clear explanation for replacing the high wage exemption with a taxable wage base, Debra Whitman of the Congressional Research Service speculates that the Committee may have added the taxable wage base to promote administrative ease and tax equity.[186] Excluding high wage workers could have created administrative difficulties for workers whose earnings fluctuated above and below the $250 monthly threshold. In addition, low and average wage workers may have objected to paying taxes from which high wage workers were exempt.[187]

When the Social Security program was ultimately enacted in 1935, it included a maximum taxable wage base set at $3,000.[188] When the taxes were first collected in 1937, the $3,000 threshold taxed 92% of all wages in covered employment,[189] and 96.9% of covered workers were taxed on all of their wages;[190] that is, only 3.1% of covered workers had wages that exceeded the taxable wage base.

The maximum taxable wage base was increased on an ad hoc basis six times between 1935 and 1972.[191] Then, in 1972, Congress amended the Social Security program so that the benefit formula (including the taxable wage and

[183] DEBRA WHITMAN, CONG. RESEARCH SERV., SOCIAL SECURITY: RAISING OR ELIMINATING THE TAXABLE EARNINGS BASE 1 (2005), *available at* http://opencrs.cdt.org/rpts/RL32896_20050502.pdf ("Being in the midst of the Depression, the Administration's attention was on the large number of aged people living in poverty. . . . Not concerned about high-income retirees, the Administration's proposal exempted non-manual workers earning $250 or more a month from coverage (i.e., $3,000 on an annual basis). Manual workers were to be covered regardless of their earnings, but few had earnings above this level.").

[184] *Id.*

[185] *Id.*

[186] *Id.* at 2.

[187] *Id.* ("The committee's report and floor statements made at the time give no clear record as to the reasoning for the taxable limit, but concerns about tax equity and attaining as much program coverage of the workforce as possible were suggested as factors for rejecting the high-earner exemption. Not covering them meant that they would not pay the tax where lower wage earners would, and coverage would be erratic for workers whose earnings fluctuated above and below the $250 monthly threshold.").

[188] Social Security Act, ch. 531, § 811(a), 49 Stat. 620, 639 (1935).

[189] U.S. SOC. SEC. ADMIN., *supra* note 36, at 4.12 tbl.4.B1.

[190] *Id.* at 4.18 tbl.4.B4.

[191] *See* 2006 ANNUAL REPORT, *supra* note 1, at 125 (showing that contribution base was increased to $3,600 in 1951, $4,200 in 1955, $4,800 in 1959, $6,600 in 1966, $7,800 in 1968, $9,000 in 1972).

benefit base) was indexed to adjust automatically to changes in the cost of living.[192]

In light of the rampant inflation at the time, the indexing formula turned out to be flawed,[193] and Congress amended the formula in 1977.[194] In addition, because the Social Security program faced both short-term and long-time financing difficulties at that time, Congress enacted four separate increases in the maximum taxable wage base to help address the system's deficit.[195] The increases were designed so that the taxable wage base would cover 90% of all wages by 1982.[196] The House Ways and Means Committee Report explains,

> Your committee's bill provides for increasing the contribution and benefit base—in four steps—to a level where about 90 percent of all payroll in covered employment would be taxable for social security purposes (and about 93 percent of all workers would have their full earnings credited for benefit purposes). When the social security program began in 1937, about 92.5 percent of all payroll in covered employment was covered, and about 97 percent of the workers in covered employment had their full earnings counted for benefit purposes. Your committee believes that it would be desirable to move toward taxing a higher proportion of total payroll in covered employment than the 85 percent that is now taxable.[197]

Moreover, "[a]s a result of the automatic adjustment," it was expected that "the proportion of total payroll covered by the base [would] be eliminated at a constant level over the long run."[198] That prediction, however, has not turned out to be true. Due in large part to the fact that salaries for top earners grew faster than for lower wage workers,[199] the share of earnings subject to the tax has decreased from 90% of all earnings in 1982 to just under 85% in 2004,[200] and is expected to further decrease to 83% of all earnings by 2015[201] and remain stable thereafter.[202] On the other hand, the share of workers who have

[192] Social Security Amendments of 1972, Pub. L. No. 92-336, § 202, 86 Stat. 412, 493–503.

[193] *See* AARON & REISCHAUER, *supra* note 7, at 83.

[194] Social Security Amendments of 1977, Pub. L. No. 95-216, § 201, 91 Stat. 1509, 1514.

[195] These changes were contained in Title I of the Act, entitled "Provisions relating to the Financing of the Old-Age, Survivors, and Disability Insurance Program." Social Security Amendments of 1977 § 101, 91 Stat. at 1509–10.

[196] Social Security Amendments of 1977 § 103, 91 Stat. at 1513 (increasing the base to $17,700 in 1978, $22,900 in 1979, $25,900 in 1980, and $29,700 in 1981).

[197] H.R. REP. NO. 95–702, pt. 1, at 18 (1977), *reprinted in* 1977 U.S.C.C.A.N. 4155, 4175.

[198] *Id.*

[199] WHITMAN, *supra* note 183, at 3.

[200] U.S. SOC. SEC. ADMIN., *supra* note 36, at 4.12–4.13 tbl.4.B1.

[201] *See* Reno & Lavery, *supra* note 6, at 3.

[202] WHITMAN, *supra* note 183, at 5.

income that exceeds the taxable wage base has remained at a relatively constant 5 or 6% since the 1980s.[203]

2. Proposals to Increase the Taxable Wage Base

In recent years, commentators and lawmakers have proposed that the taxable wage base be increased. For example, Robert Ball has proposed that in addition to the automatic annual increases in the maximum taxable wage under current law, the maximum taxable wage base (for purposes of both taxes and benefits) be gradually increased until the base covers 90% of all wages paid to covered employees.[204] (A wage base that covers 90% of wages would be about $150,000 in 2005.[205]). Specifically, he proposes that the maximum taxable wage base be increased by 2% each year (in addition to the currently scheduled automatic increases due to the growth in average wages) until the base reaches 90% of taxable payroll.[206] Under his proposed approach, it would take about forty years to reach the 90% level.[207]

Similarly, Peter Diamond and Peter Orszag have recommended a gradual increase in the taxable wage base until it reaches 87% of payroll. Specifically, under their proposal, "starting in 2005, the maximum taxable earnings base would increase by 0.5 percentage point more than the percent increase in average wages each year, until 87% of covered earnings are subject to payroll taxation in 2063 and later."[208]

3. Costs and Benefits of Increasing the Taxable Wage Base

a. Reducing the Long-Term Deficit

The most obvious benefit of increasing the taxable wage base is its potential to reduce Social Security's long-term deficit. How much it would reduce the long-term deficit would depend on how the increase were structured.[209] According to Social Security Administration projections in 2003, if the taxable wage base were eliminated both for purposes of determining earnings subject to payroll taxes and for purposes of crediting earnings in determining benefits, the long-range actuarial deficit would be reduced from the then-deficit of 1.92% of taxable payroll to 0.22% of taxable payroll.[210] If

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[203] *Id* at 3.

[204] Ball, *supra* note 7, at 2; ALTMAN, *supra* note 7, at 302 (describing and endorsing Ball proposal).

[205] WHITMAN, *supra* note 183, at 6.

[206] Ball, *supra* note 7, at 2. ALTMAN, *supra* note 7, at 302.

[207] Ball, *supra* note 7, at 2.

[208] DIAMOND & ORSZAG, *supra* note 7, at 86.

[209] *See* Reno & Lavery, *supra* note 6, at 10 (showing how three different options could reduce the deficit from forty percent to more than one hundred percent).

[210] Memorandum from Alice H. Wade, Deputy Chief Actuary, & Chris Chaplain, Actuary, Soc. Sec. Admin., to Steve C. Goss, Chief Actuary, Soc. Sec. Admin., Estimated Long-Range OASDI Financial Effects of Eliminating the OASDI Contribution and Benefit Base (Oct. 20, 2003), *available at* http://www.centristpolicynetwork.org/legislative_updates/files/OACT_taxmax.pdf (based on the intermediate assumptions of the 2003 Social Security Trustees Report).

the taxable wage base were eliminated for purposes of determining earnings subject to payroll taxes but not for purposes of crediting earnings in determining benefits, the long-range deficit would be entirely eliminated and the actuarial balance would be a positive 0.25% of taxable payroll.[211] The reason that the second proposal would result in a greater reduction in the long-range actuarial deficit than would the first is that under the first proposal, workers with earnings above the current taxable wage base would be entitled to higher benefits as well as being required to pay higher taxes while under the second proposal, workers with earnings above the current taxable wage base would be required to pay higher taxes but their benefits would remain the same as under current law.[212]

If the taxable wage base were increased but not eliminated, it would still reduce the deficit but not by as much. For example, according to Social Security Administration projections, Robert Ball's proposal to gradually increase the taxable wage base over a forty year period would reduce the long-range actuarial deficit from its then level of 1.9% of payroll to 1.3% of payroll.[213] If the maximum taxable wage base were increased faster, it would reduce even more of the system's long-range actuarial deficit.[214] The Diamond/Orszag proposal to gradually increase the taxable wage is projected to reduce Social Security's actuarial imbalance by 0.25% of payroll.[215]

Opponents of proposals to increase the taxable wage base do not deny that increasing the taxable wage base would reduce Social Security's long-term actuarial deficit. They contend, however, that reducing the system's long-term actuarial deficit is essentially meaningless[216] because adding money to Social Security's trust fund "does nothing to change Social Security's actual solvency."[217] Rather, they contend that "[a] far better measure of Social Security's finances and the impact of changes such as raising the tax cap is the annual cash-flow surplus or deficit, that is, the yearly gap between Social Security's revenue and expenditures."[218] If the taxable wage base were

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211 *Id.*

212 *Id.* at 2.

213 Ball, *supra* note 7, at 2; Memorandum from Stephen C. Goss, *supra* note 122.

214 Ball, *supra* note 7, at 2 (noting that implementing the change over 10 years rather than 40 years would reduce the deficit by .1% of payroll rather than .6% of payroll).

215 DIAMOND & ORSZAG, *supra* note 7, at 86.

216 *See, e.g.*, Tanner, *supra* note 20, at 5 ("[T]hose claims [that removing the wage cap would reduce Social Security's long-term deficit] are based on a fundamental fallacy: the assumption that Social Security surpluses accumulated today can be saved through the Social Security Trust Fund.").

217 *Id.* at 6.

218 Tanner, *supra* note 20, at 6. *See also* Concord Coalition, Raising the Social Security Taxable Earnings Cap: Real Reform or Another Placebo? 5 (July 6, 2005), http://www.concordcoalition.org/issues/socsec/issue-briefs/SSBrief9--Tax-Cap.pdf ("What matters most to the economy and budget is not the 75-year aggregate impact on the trust funds of raising the tax cap but how much it would reduce Social Security's annual cash deficits as they emerge and grow over time."); Matt Moore, Nat'l Ctr. for Policy Analysis,

increased as Ball has proposed, the Social Security system would begin to run cash-flow deficits in 2021,[219] just four years after the system is projected to run cash-flow deficits under current law.[220] If the cap were eliminated for both tax and benefit purposes, the system would begin to run cash-flow deficits in 2024,[221] and if the cap were eliminated for tax purposes but no additional benefits were paid, the system would begin to run cash-flow deficits in 2025.[222] Thus, opponents argue that increasing the taxable wage base would increase taxes substantially with little offsetting benefit.[223]

b. Addressing Earnings Inequality

Proponents of increasing the taxable wage base often point to the growing inequality of wages in the United States[224] and suggest that increasing the taxable wage base would be a way to restore fundamental fairness to the Social Security system.[225] Opponents of increasing the taxable wage base do not dispute that over the last twenty years "earnings have risen most rapidly [for workers] at the top of the earnings distribution, that is, among those workers who already were receiving the highest earnings."[226] Instead, opponents of increasing the taxable wage base note that historically the share of earnings subject to the Social Security tax has varied widely, ranging from a low of 71.3% in 1965 to a high of 92.4% in 1940,[227] with the percentage below 85% more than half the years the Social Security tax has been in effect.[228] Critics of increasing the taxable wage base contend that there is no normatively

Eliminating the Social Security Payroll Tax Cap: A Bad Idea (Mar. 23, 2004), http://www.ncpa.org/pub/ba/ba470/ba470.pdf.

[219] Tanner, *supra* note 20, at 7.

[220] *See* 2006 ANNUAL REPORT, *supra* note 1, at 2.

[221] Concord Coalition, *supra* note 218, at 5.

[222] *Id.* at 5.

[223] Tanner, *supra* note 20, at 9; Concord Coalition, *supra* note 218, at 5–6 ("As the table shows, even the most extreme of the three measures (eliminating the cap without crediting additional earnings) would not generate enough revenues to cover the future Social Security cash deficits."); Moore, *supra* note 218, at 2 ("While eliminating the Social Security payroll tax cap would reduce the funding gap somewhat, it has only a marginal effect and comes with a huge economic cost.").

[224] *See, e.g.*, Ball, *supra* note 7, at 2; Weller, *supra* note 180, at 3; DIAMOND & ORSZAG, *supra* note 7, at 84–85.

[225] Primus, *supra* note 105 ("Taxing a higher level of earnings is justified not only because earnings at high levels have been increasing faster than average earnings, but also because cash earnings are becoming a smaller proportion of total compensation."); Weller, *supra* note 180, at 2 ("Raising or eliminating the cap would restore tax fairness for Social Security"); Riemer, *supra* note 88 ("Raising the payroll tax cap so that high earners pay Social Security taxes on more or all of their income, *like the rest of us*, would also help [strengthen Social Security for future generations].") (emphasis added).

[226] DIAMOND & ORSZAG, *supra* note 7, at 64.

[227] U.S. SOC. SEC. ADMIN., *supra* note 36, at 4.12.

[228] Concord Coalition, *supra* note 218, at 3. *See also* Gareth G. Davis & D. Mark Wilson, Heritage Found., The Impact of Removing Social Security's Tax Cap on Wages 3–4 (Jan. 19, 1999), http://www.heritage.org/Research/SocialSecurity/CDA99-01.cfm; Tanner, *supra* note 20, at 2.

appropriate level to set the maximum taxable wage base and thus the wage base need not be increased to address increasing earnings inequality.[229]

c. Impact on Workers and the Economy

Proponents of increasing the taxable wage base contend that it would only affect the highest-paid 6% of workers, and if gradually phased in over time, could significantly reduce Social Security long-term deficit with little noticeable pain.[230] Under current law, employers are required to collect the employee's share of the Social Security tax from the employee's wages as and when the wages are paid.[231] For employees who earn less than the taxable wage base, Social Security taxes are collected throughout the year. For the 6% or so of workers whose wages exceed the taxable wage base, Social Security taxes are collected each pay period until wages reach the taxable wage base. For the remaining weeks or months of the year (depending on the employee's total wages), no Social Security taxes are collected from the employee's wages. Thus, under Ball's proposal to gradually increase the taxable wage base by 2% per year over the currently scheduled increases until the base reaches 90% of wages, "deductions from earnings for the highest-paid 6 percent of workers would simply continue for a few days longer into the year . . . . Such a gradual adjustment would be virtually painless . . . ."[232]

Opponents of increasing the taxable wage base, in contrast, assert that "[i]n the end, proposals for changing the taxable wage cap are all pain and no gain."[233] Critics ignore the possibility of gradually increasing the wage base to 90% or even just 87% of taxable wages as Robert Ball as well as Peter Diamond and Peter Orszag have proposed. Instead, they focus on proposals to immediately eliminate the taxable wage base and decry such a change as constituting "the largest tax increase in American history—some $461 billion over the first five years alone."[234]

Again, focusing solely on the possibility of immediately eliminating the wage cap,[235] critics contend that such a change would harm the economy in at

[229] Concord Coalition, *supra* note 218, at 3; *see also* Tanner, *supra* note 20, at 2.

[230] Ball, *supra* note 7, at 2.

[231] 26 C.F.R. § 31.3102–1 (2006).

[232] Ball, *supra* note 7, at 2. Diamond and Orszag would also phase in their "reform over an extended period to allow workers time to adjust to the change." DIAMOND & ORSZAG, *supra* note 7, at 86.

[233] Tanner, *supra* note 20, at 1.

[234] *See* Moore, *supra* note 218, at 2. *See also* Tanner, *supra* note 20, at 4 (claiming that elimination of wage cap would result in $472 billion tax increase); Concord Coalition, *supra* note 218, at 6 (asserting that elimination of wage cap would amount to more than $1.3 trillion in new taxes over next ten years); Davis & Wilson, *supra* note 228, at 5 ("[E]liminating the Social Security taxable wage cap would: [r]esult in the largest tax increase in the history of the United States—$425.2 billion in nominal dollars over five years," or $367 billion in 1998 inflation-adjusted dollars.).

[235] *Cf.* Rea S. Hederman, Jr. et al., Heritage Found., Keep the Social Security Wage Cap: Nearly a Million Jobs Hang in the Balance 2 n.8 (Apr. 20, 2005), http://www.heritage.org/Research/SocialSecurity/cda05-04.cfm. ("The same number (and type) of

least two ways. First, they contend that eliminating the taxable wage base would reduce the incentive to work by increasing the marginal tax rate on labor.[236] "Should Social Security's tax cap be removed, many workers will immediately find that federal taxes alone consume almost 55 cents of every additional dollar they earn from employment."[237] In addition, critics contend that increasing the taxable wage base would reduce national savings because the tax increase would reduce the after-tax income of those workers who are most able to save.[238]

Relying principally on intuition for their arguments,[239] critics have little hard data to support their position that increasing the taxable wage base would harm the economy.[240] Indeed, Michael Tanner of the Cato Institute concedes that "there has been relatively little analysis of the economic consequences of . . . eliminating the payroll tax cap."[241] He relies on work by Edward Prescott, the 2004 Nobel Prize winner in economics, that compares work effort in high-tax societies in Europe with the United States to support his supposition that "it seems fair to assume that [the economic consequences of raising the payroll tax cap] would be considerable."[242]

A 2005 study by analysts with the conservative Heritage Foundation found that eliminating the taxable wage base would decrease the rate of economic growth by 0.4 percentage points in 2005 and 0.2 percentage points in 2006, and the unemployment rate would average about 0.3 percentage points higher from

workers would be affected by either an increase in or the outright elimination of the taxable wage cap. Only the magnitude of the tax increase and its impact on family budgets and the economy would differ.").

[236] *See, e.g.*, Moore, *supra* note 218, at 2 ("[i]ncreasing the marginal tax rate will have adverse economic consequences."); Press Release, Sen. Jon Kyl, We Can't Tax Our Way Out of the Social Security Crisis (Feb. 8, 2005), *available at* http://kyl.senate.gov/record.cfm?id=231656. ("Moreover, increasing or eliminating the wage cap would stunt the growth of the entire national economy."); Davis & Wilson, *supra* note 228, at 5 ("An increase in the marginal tax rate on labor income would damage the economy by reducing the incentive to work.").

[237] Davis & Wilson, *supra* note 228, at 5.

[238] *See, e.g.*, Tanner, *supra* note 20, at 5; Davis & Wilson, *supra* note 228, at 8. Indeed, Davis and Wilson contend that increasing the taxable wage base would also reduce charitable contributions by reducing the after-tax income of the workers who contribute the most to charity. Davis & Wilson, *supra* note 228, at 8–9 ("removing the maximum taxable wage cap would reduce charitable contributions by $15.5 billion . . . from 2000 to 2004, or 1.9 percent of all charitable giving over the same period.").

[239] *See, e.g.*, Concord Coalition, *supra* note 218, at 7 ("Workers may not sit around calculating their after-tax return from each additional hour of work, but at some point they do notice. Older workers certainly do as they weigh the consequences of continuing to work or retiring.").

[240] *See* Martin A. Sullivan, *Economic Analysis: Budget Magic and the Social Security Tax Cap*, TAX NOTES TODAY, Mar. 15, 2005, *available at* LEXIS, 2005 TNT 49–8. ("Because additional work effort would generate less after-tax income, there is concern that labor supplied to the economy would shrink. Of course, the amount of that reduction is unknown and is the subject of vigorous debate.").

[241] Tanner, *supra* note 20, at 5.

[242] *Id.*

2006 to 2015.[243] Christian Weller, an economist with the Center for American Progress, however, has criticized that study because:

> it assumes that the tax increases are spread out across all taxpayers and not just over the 5.4 percent of individuals earning more than [the taxable wage base]. Because the effect would be limited to a small share of taxpayers, the employment effects would likely be much smaller than estimated.[244]

4. *Recommendation*

I recommend that the taxable wage base be gradually increased, either to 87% of taxable payroll as Peter Diamond and Peter Orszag propose, or to 90% of taxable payroll as Robert Ball proposes. In addition, I recommend, as these experts propose, that the benefit base be increased in conjunction with the wage base so as to retain the link between contributions and benefits.

The first, and most important, reason for increasing the taxable wage base is that it would reduce Social Security's long-term actuarial deficit. While critics of increasing the taxable wage base are right that in many ways Social Security's annual cash-flow position is more important than its long-term deficit, reducing the long-term deficit is not meaningless.[245] Moreover, gradually increasing the taxable wage base would in fact improve the system's annual cash flow position by increasing tax receipts, particularly in later years when the system will be in the greatest need of increased revenues.

Second, increasing the taxable wage base makes sense in light of the growing inequality of wages in the United States. The legislative history of the taxable wage base shows that there is no single, normatively accurate level for the taxable wage.[246] Nevertheless, 87% to 90% of wages seems reasonable. I do not, however, believe that the wage base should be entirely eliminated. Eliminating the wage base runs the risk of either politically unacceptably high benefits if the benefit base were simultaneously increased[247] or an unprecedented, and potentially politically damaging, break between contributions and benefits if the benefit base were not increased.[248] As discussed in Section III-E, however, I would not object to introducing a fourth

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[243] Hederman et al., *supra* note 235, at 8.

[244] Weller, *supra* note 180, at 8.

[245] *Cf.* Alicia H. Munnell, Ctr. for Retirement Research at Boston Coll., Are the Social Security Trust Funds Meaningful? (May 2005), http://www.bc.edu/centers/crr/dummy/issues/ib_30.pdf (explaining that accumulating a surplus in the Social Security trust funds is meaningful if it results in increased national savings).

[246] Congress explicitly selected 90 percent as the level in 1977, but it did not offer any normative justification for the 90 percent. *See* H.R. REP. NO. 95–702, pt. 1, at 18 (1977), *reprinted in* 1977 U.S.C.C.A.N. 4155, 4175.

[247] WHITMAN, *supra* note 183, at 10 ("eliminating the base would raise public cynicism about a publicly financed system that pays enormous benefits to people who already are well off").

[248] Reno & Lavery, *supra* note 6, at 3 ("Ever since Social Security began, the level of wages that are taxed has been linked to the level of wages that count toward benefits. This proposal would break that link.").

bend point and providing that contributions above the current taxable wage base be replaced at lower rate than the current 15%.

I agree with the critics that increasing the taxable wage base would not be entirely painless, particularly for the 6% or so of workers who would be required to pay increased taxes. That, however, does not mean that the proposal should be rejected. There is simply no entirely painless way to address Social Security's long-term deficit. Gradually increasing the base over a long period of time should help to minimize the pain for these individuals. Moreover, while it is possible that gradually increasing the taxable wage base and thus increasing the marginal tax rate on labor would decrease work effort, it is unlikely to have a very significant impact. Under Ball's proposal to gradually increase the taxable wage base, Social Security taxes would simply be collected, at most, for an additional week each year.[249] It is hard to imagine that such a variation in take-home pay would have a significant impact on work effort. I do not believe that the risk of reduced labor supply outweighs the benefit of reducing Social Security's long-term deficit.

B. Increasing the Normal Retirement Age

Under current law, a retired worker is entitled to receive full benefits at her "normal retirement age" or "NRA."[250] The NRA is sixty-five for workers who reached sixty-two before 2000 and is scheduled to increase gradually to sixty-seven by the year 2022.[251] Specifically, in 2000, it began to increase two months each year until it reached age sixty-six for workers who reached age sixty-two in 2005.[252] In 2017, it will again increase two months each year until it reaches age sixty-seven for workers who reach age sixty-two in 2022 and after.[253] A worker may elect to receive actuarially reduced benefits as early as age sixty-two.[254] This age is usually referred to as the "earliest eligibility age" or "EEA."[255]

In recent years, a number of policymakers and commentators have recommended that the currently scheduled increase in the NRA be accelerated and/or that the NRA be further increased. This section begins with a brief history of the Social Security retirement ages. It then describes some of the proposals to increase the NRA. It then analyzes the costs and benefits of increasing the NRA. Finally, it concludes with my recommendation as to whether the NRA should be increased.

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[249] *See* ALTMAN, *supra* note 7, at 302 ("Those earning at or above the maximum taxable wage base would have the same tax rate provided under present law deducted from wages a bit longer in the year—one additional week a year, at most.").

[250] 42 U.S.C. § 402(a) (2000).

[251] 42 U.S.C. § 416(l) (2000).

[252] 42 U.S.C. § 416(l)(3)(A).

[253] 42 U.S.C. § 416(l)(3)(B).

[254] 42 U.S.C. § 402(q).

[255] *See* Kathryn L. Moore, *Raising the Social Security Retirement Ages: Weighing the Costs and Benefits*, 33 ARIZ. ST. L. J. 543, 545 n.12 (2001).

1. History of the Social Security Retirement Ages

When the Social Security program was originally enacted, sixty-five was the earliest age at which benefits could be elected.[256] The legislative history of the Social Security Act shows that this age was not based on any scientific, social, or gerontological study.[257] Rather, it was chosen as a result of general consensus that sixty-five was the most acceptable age.[258]

In 1956, Congress lowered the age at which all women beneficiaries could begin to collect benefits.[259] Specifically, it provided that all women beneficiaries could begin to collect benefits as early as age sixty-two, but required an actuarial reduction in benefits for working women and wives who elected to receive benefits before age sixty-five.[260] A number of justifications were given for making benefits available before age sixty-five, including the fact that wives are typically a few years younger than their husbands and that women who are widowed a few years before age sixty-five often have difficulties finding jobs.[261] In 1961, Congress amended Social Security to permit men to begin to collect reduced benefits as early as age sixty-two.[262] Although women had been permitted to receive benefits at age sixty-two since 1956, equity was not the prime motivation for this change.[263] Rather, the principal justification for introducing the EEA for men was that it would help older workers who have a difficult time finding a new job when they lose their job.[264]

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256 Social Security Act, ch. 531, § 202(a), 49 Stat. 620, 623 (1935).

257 Moore, *supra* note 255, at 547–48.

258 *Id.*

259 Social Security Amendments of 1956, ch. 836, § 102, 70 Stat. 807, 809–10.

260 *Id.*

261 Moore, *supra* note 255, at 549–51.

262 Social Security Amendments of 1961, Pub. L. No. 87-64, § 102, 75 Stat. 131, 131.

263 As originally enacted, a different, less favorable, formula was used to calculate benefits for men who retired early than for women who retired early. Specifically, men's eligibility and benefits were based on earnings through age 65 while women's eligibility and benefits were based on earnings through age 62. Social Security Amendments of 1983, Pub. L. No. 98-21, § 201, 97 Stat. 65, 109–18. Congress adopted the less favorable formula for men in order to permit the law to be changed without imposing any additional cost on the Social Security Trust Fund. In 1972, Congress amended Social Security to base men's eligibility and benefits on earnings through age 62. Although costly (an estimated $6 million in additional benefits the first year), the amendment was designed to equalize the treatment between men and women. *See* Moore, *supra* note 255, at 553–54. Similarly, during the 1970s, a number of Supreme Court cases called for equality in treatment between men and women beneficiaries. *See, e.g.*, Weinberger v. Wisenfeld, 420 U.S. 636 (1975) (widowed fathers); Califano v. Goldfarb, 430 U.S. 199 (1977) (widowers); Califano v. Silbowitz, 430 U.S. 924 (1977), *aff'g* Silbowitz v. Califano, 397 F. Supp. 862 (S.D. Fla. 1975) (husbands). The Social Security Act was also amended a few times in the 1970s and 1980s to equalize the treatment between men and women beneficiaries. *See, e.g.*, Social Security Amendments of 1972, Pub. L. No. 92-603, § 104, 86 Stat. 1329, 1340; Social Security Amendments of 1977, Pub. L. No. 95-216, § 334, 91 Stat. 1509, 1544; Social Security Amendments of 1983 §§ 301–310, 97 Stat. at 109–18.

264 Moore, *supra* note 255, at 552–53.

In 1983, Congress amended the Social Security program to provide for a deferred, gradual increase in the NRA.[265] That provision, introduced by Representative Pickle, was intended to address Social Security's long-term deficit. [266] In introducing the provision, Pickle insisted that an increase in the NRA was inevitable due to increased longevity and demographic changes early in the 21st century.[267] He noted that his proposal offered the additional advantage of implementing the change over a long period of time and thus permitting workers to adjust to the change.[268]

2. Proposals to Accelerate the Currently Scheduled Increase in the Normal Retirement Age or Increase It Even Further

Since the Social Security system was enacted, life expectancy has increased. When Social Security first began to pay benefits in 1940, life expectancy at age 65 was 11.9 years for men and 13.4 years for women.[269] By 2005, life expectancy at age 65 had increased to 16.3 years for men and 19.0 years for women.[270] Moreover, the Social Security Trustees predict that by 2025, 65-year-old men will have a life expectancy of 17.6 years while 65-year-old women will have a life expectancy of 20.0 years, and by 2080, 65-year-old men will have a life expectancy of 20.5 years while 65-year-old women will have a life expectancy of 22.8 years.[271] Increasing life expectancy contributes to Social Security's long-term deficit because Social Security pays benefits for life, and any increase in life expectancy at the age at which benefits begins necessarily increases Social Security's costs, unless, of course, there is an offsetting reduction in benefits.[272]

In light of the role that increasing life expectancy plays in Social Security's long-term deficit, in recent years, a number of policymakers and commentators have recommended that the currently scheduled increase in the NRA be accelerated and/or that the NRA be further increased.[273] For example,

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[265] Social Security Amendments of 1983 § 201, 97 Stat. at 107–08.

[266] Moore, *supra* note 255, at 555.

[267] *Id.*

[268] *Id.*

[269] 2006 ANNUAL REPORT, *supra* note 1, at 81 tbl.V.A.3.

[270] *Id.*

[271] *Id.* (using intermediate assumptions). For a critique of the Trustees' assumption and an argument that life expectancy may level off or even decrease in the first half of the twenty-first century, see S. J. Olshansky et al., *A Potential Decline in Life Expectancy in the United States in the 21st Century*, 352 NEW. ENG. J. MED. 1138 (2005).

[272] *See* DIAMOND & ORSZAG, *supra* note 7, at 58–64 (explaining in detail how increasing life expectancy contributes to Social Security's long-term deficit).

[273] *See, e.g.*, Robert J. Myers, *Is the Only Way to Save Social Security to Destroy It?*, BENEFITS Q., 3d Quarter 1997, at 40, 44 (recommending that NRA be increased by two months each year beginning in 2003 until it reaches 70 in 2037); COMM. FOR ECON. DEV., FIXING SOCIAL SECURITY: A STATEMENT BY THE RESEARCH AND POLICY COMMITTEE OF THE COMMITTEE FOR ECONOMIC DEVELOPMENT 39 (1997), http://www.ced.org/docs/report/report_socsec.pdf; COMM. FOR ECON. DEV., FIXING SOCIAL SECURITY: A STATEMENT BY THE RESEARCH AND POLICY COMMITTEE OF THE COMMITTEE FOR ECONOMIC DEVELOPMENT 39 (1997), *available at* http://www.ced.org/docs/report/report_socsec.pdf (recommending

Henry Aaron and Robert Reischauer have recommended that the NRA be increased to sixty-seven by 2011 and that it thereafter be adjusted to increases in life expectancy.[274] Similarly, a majority of the members of 1994–1996 Social Security Advisory Council recommended that the currently scheduled increase in the NRA be accelerated and that the NRA be increased in conjunction with increases in life expectancy thereafter.[275]

3. The Costs and Benefits of Increasing the Normal Retirement Age

As with any change, there are costs and benefits associated with increasing the NRA. The most obvious benefit of accelerating the currently scheduled increase in the NRA and/or increasing it even further is that it would reduce Social Security's long-term deficit.[276] According to 2005 projections by the Congressional Budget Office, eliminating the current hiatus and phasing in the increase in the NRA to sixty-seven between 2006 and 2011 would reduce Social Security's long-term deficit by 0.14% of taxable payroll.[277] Eliminating the hiatus and further increasing the NRA to sixty-eight by 2017 would reduce the long-term deficit by 0.58% of taxable payroll.[278] Finally, eliminating the hiatus and further increasing the NRA to 70 by 2029 would reduce the long-term deficit by 1.19% of taxable payroll.[279]

The most obvious cost of increasing the NRA is that it would constitute a reduction in Social Security benefits. If the NRA were increased and no adjustment were made to the EEA, workers could either (1) retire later (that is, begin to collect benefits at a later age) and receive the same level of benefits for fewer years, or (2) begin to collect benefits at the same age and receive lower benefits for the same number of years.[280] If the EEA were also increased, workers' choices would be limited to receiving the same level of benefits for fewer years.[281] Either way, an increase in the NRA is almost economically identical to an across-the-board reduction in retirement benefits.[282]

Increasing the NRA also raises some more subtle costs and benefits. Proponents contend that such a change, particularly if accompanied by an increase in the EEA, would promote general economic gains by encouraging older workers to remain in the work force longer and thus increase national

gradually increasing the NRA to 70 by 2030); Social Security Solvency Act of 1998, S. 1792, 105th Cong. § 9 (1998); Twenty-First Century Retirement Plan, S. 1383, 106th Cong. § 209 (1999).

274 AARON & REISCHAUER, *supra* note 7, at 97.

275 U.S. SOC. SEC. ADMIN., *supra* note 10, at 21.

276 This assumes that any such change would be accompanied by an actuarially fair adjustment to benefits claimed before and after the NRA. *See* Moore, *supra* note 255, at 561 n.107.

277 Cong. Budget Office, *supra* note 6, at 4–5 tbl.I.

278 *Id.* (element 3.2).

279 *Id.* (element 3.3).

280 *See* Moore, *supra* note 255, at 563.

281 *Id.*

282 *Id.* at 562–63.

productivity.[283] In a detailed study of this claim,[284] I found that the weight of evidence supports this proposition because (1) such a change should encourage workers to extend their working lives and thus increase the supply of older workers; (2) most, though not all, older workers should be healthy enough to extend their working lives; and (3) the demand for older workers is likely to increase as the baby boom generation ages.[285]

On the other hand, increasing the NRA, without a concurrent increase in the EEA, could dramatically increase the risk that older workers and their dependents end their lives in poverty. Currently, about half of all retired workers elect to begin collecting benefits at the EEA.[286] If the NRA were increased, and many workers continued to begin collecting benefits at the EEA, those workers could face dramatically reduced benefits. Under current law, workers' benefits are reduced by 5/9 of one percent for each month that a worker retires before the NRA, or 6.67% for each year of early retirement.[287] Once the NRA reaches age sixty-seven, a worker who retires at age sixty-two will receive a 30% reduction in monthly benefit payments.[288] If the NRA were increased to seventy, and benefits continued to be actuarially reduced under the same schedule, a worker who retired at age sixty-two would receive a 45% reduction in monthly benefit payments.[289] Increasing the EEA in conjunction with any further increase in the NRA could eliminate the risk that workers would elect to receive dramatically reduced early retirement benefits. It would not, however, eliminate the risk of poverty faced by individuals who are unable to work until the new, higher EEA, unless another source of income were available to them.[290]

Critics of increasing the NRA also point out that such an increase is likely to have a disproportionately adverse effect on older individuals with poor health, individuals with lower life expectancies, and individuals who rely disproportionately on Social Security for their retirement income.[291] Most likely to be included in these vulnerable populations are blue collar workers, lower income workers, blacks, and to some extent, Hispanics.[292] The current Social Security Disability Insurance program[293] and Supplemental Security

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283 *Id.* at 567.

284 *Id.* at 565–90.

285 *Id.* at 590–91.

286 U.S. SOC. SEC. ADMIN., *supra* note 36, at 6.16–6.17 tbl.6.B5 (showing that in 2004, 49 percent of male and 54.1 percent of female new retired worker beneficiaries elected to receive benefits at age 62).

287 42 U.S.C. § 402(q)(1)(A) (2000).

288 Moore, *supra* note 255, at 592–93.

289 *Id.* at 593.

290 *See id.* at 593–99.

291 *See, e.g.*, Christian E. Weller, Econ. Policy Inst., Raising the Retirement Age: The Wrong Direction for Social Security 3–5 (Sept. 2000), http://www.epinet.org/briefingpapers/raisingretirement/raising_retirement.pdf.

292 *Id.*; Moore, *supra* note 255, at 599.

293 42 U.S.C. § 421 (2000).

Income program[294] may provide benefits that soften the impact for some of these vulnerable individuals, but these benefits are unlikely to eliminate all of the adverse impact.[295]

4. Recommendation

Overall, I support an increase in the Social Security NRA. The first, and foremost, justification for increasing the NRA is that it would help reduce Social Security's long-term deficit. In addition, it could help promote economic gains.

Nevertheless, increasing the NRA would not be costless. It is essentially economically equivalent to an across-the-board benefit cut that would reduce all workers' benefits. Moreover, it would likely have a disproportionately adverse impact on certain workers, particularly blue-collar workers, lower income workers, blacks, and to some extent, Hispanics.

In order to minimize the adverse effects of increasing the NRA, I believe that the EEA should be increased in conjunction with any increase in the NRA to prevent workers from voluntarily electing drastically reduced early retirement benefits. In addition, consideration should be given to modifying the Social Security Disability Insurance program and the Supplemental Security Income program to ensure that workers who are unable to work beyond age sixty-two for health or other reasons have a safety net on which they can rely.

VI. CONCLUSION

Although Social Security reform has fallen from center stage in recent months, it is not dead.[296] The Social Security Trustees' long-term projections make it clear that the system must be reformed.[297] The only questions are how and when.

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[294] 42 U.S.C. § 1381 (2000).

[295] Moore, *supra* note 255, at 599–608.

[296] Indeed, when signing the Pension Protection Act of 2006 into law on August 17, 2006, President Bush said that he and Treasury Secretary Hank Paulson would continue to push Congress to enact Social Security reform. Bush declared, "Now is the time to move; now is the time to do our duty." Sheila R. Cherry & Brett Ferguson, *President Signs Pension Reform Bill; Urges Congress to Reform Entitlements*, 33 BNA PENSION & BENEFITS REP. 1985 (2006). *See also* Nancy Ognanovich, *Bush Says Social Security Plans Back on Front Burner After Election*, 33 BNA PENSION & BENEFITS REP. 2451 (2006) (noting that "President Bush said Oct. 11 he plans to revive his proposals to restructure Social Security programs after the November congressional elections").

[297] Although virtually all lawmakers and commentators agree that the system must be reformed, a defender of the system might point to the Social Security's trustees' projections based on their low cost estimates to contend that the system does not need to be reformed. *See* 2006 ANNUAL REPORT, *supra* note 1, at 51–52 (noting that the "program would be able to cover cost for the foreseeable future under the more optimistic low cost assumptions."). *See also id.* at 6 (noting that Trustees use three sets of assumptions in their projections and that the intermediate assumptions reflect their best estimates of future experience).

Solving Social Security's long-term deficit requires that taxes be increased, benefits reduced, or some combination of the two.[298] I believe comprehensive Social Security reform should consist of a combination of the two so that no single class of participants or beneficiaries bears the entire brunt of reform.

Among the changes I recommend are earmarking estate taxes for Social Security, increasing the maximum taxable wage base until it covers 87 to 90% of taxable payroll, and increasing the NRA. The first two changes, earmarking the estate tax for Social Security and increasing the maximum taxable wage base, would have a disproportionately adverse effect on the wealthiest and highest paid, while increasing the NRA would likely have a disproportionately adverse effect on blue-collar workers, lower-income workers, blacks, and to some extent, Hispanics. If the NRA is increased, the Social Security Disability Insurance and Supplement Security Income programs should be modified to ensure that those who need it would have a safety net on which to rely.

I object to the creation of individual accounts; they would do little to nothing to solve Social Security's long-term funding deficit and they would convert Social Security from a system of social insurance to a system of ownership and control. I also object to progressive price indexing; if implemented for a long enough period of time, progressive price indexing would convert the current system of wage-related benefits to a flat benefit system.

[298] Proponents of the current system have offered proposals, such as extending coverage to all new state and local workers and investing part of the trust fund assets in the private market that would not require increasing taxes on currently covered workers or reducing benefits. Such changes, however, are unlikely alone to eliminate all of Social Security's currently estimated long-term deficit of 2.02 percent of taxable payroll. *See, e.g.*, ALTMAN, *supra* note 7, at 304 & 307 (contending that diversifying the Social Security trust fund portfolio to include investments in a broadly diversified indexed equity fund or funds would reduce Social Security's long-term deficit by 0.37 percent of taxable payroll while extending Social Security coverage to all new state and local employees hired on or after January 1, 2010 would save .19 percent of taxable payroll).