ppi radically pragmatic

Reform That Rewards Work:

A New Vision for Strengthening Social Security's Intergenerational Compact

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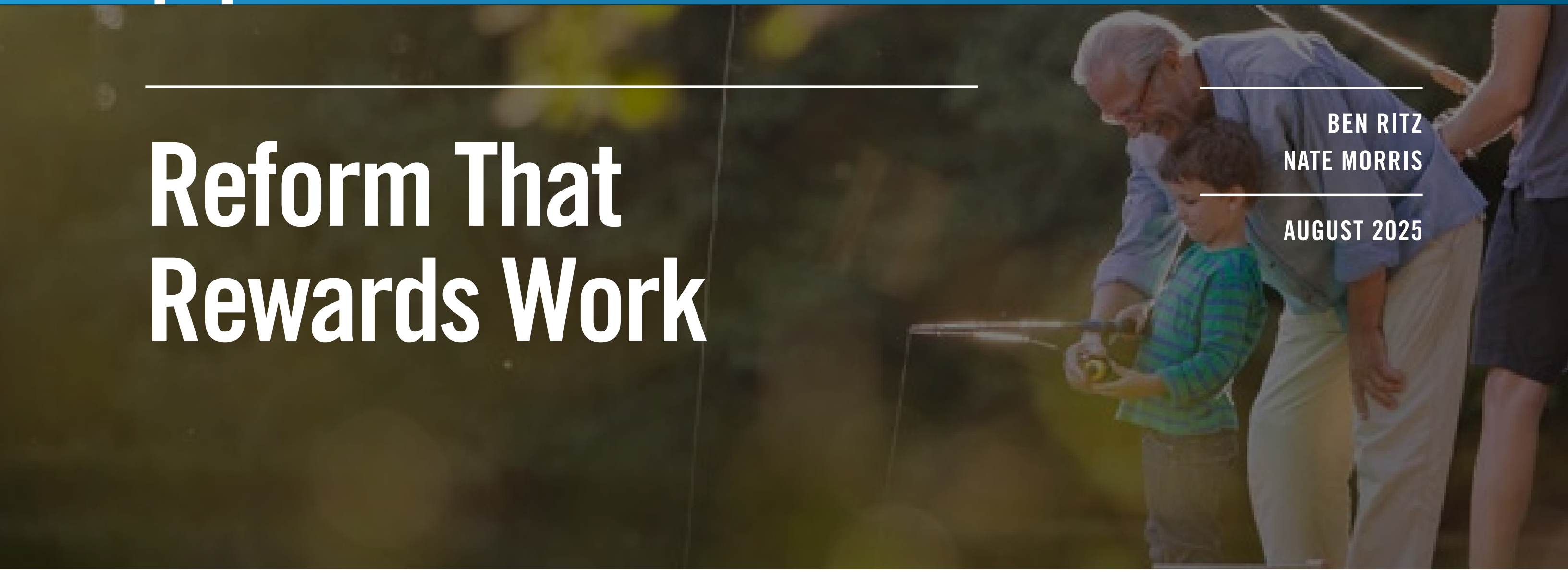

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INTRODUCTION

For 90 years, Social Security has served as the foundation upon which people plan for retirement in the United States. But changing demographics and decades of policy mistakes have put this vital program on unstable financial footing. Just seven years from now — before the end of the next president's term — the program will face a crisis if no action is taken. Policymakers are running out of time to prevent disaster and give Americans the retirement security they deserve.

At its conception, Social Security was designed to be an “earned benefit” — workers pay a dedicated payroll tax on wages up to a certain level, and once these workers reach retirement age, they receive benefits to replace some fraction of the wages upon which they were taxed. The benefit formula is progressive in the sense that workers with lower incomes receive a higher replacement rate for the wages on which they paid payroll taxes, but people with higher lifetime earnings ultimately receive higher benefits. To reinforce the link between contributions and benefits, an internal “trust fund” was established to ensure that spending on benefits would track payroll taxes over time.

But this structure has broken down due to a combination of demographic and policy changes, and Social Security now spends significantly more than it raises in revenue each year. The program's trust fund system allows Social Security to temporarily run deficits commensurate with the savings generated by past surpluses. But in 2032, Social Security's Old Age and Survivor Insurance (OASI) trust fund is projected to be depleted, and benefits will be automatically cut by 24% to match the program's incoming revenues. Even if lawmakers were to combine the OASI fund with Social Security's Disability Insurance fund, they would only delay insolvency by less than two years.

The prospect of such a steep and sudden benefit cut makes it difficult for current workers to plan for retirement and risks throwing vulnerable seniors into poverty. But simply continuing to fund scheduled benefits without any changes, whether by raising payroll taxes or by borrowing money to finance Social Security's deficits, would impose an unfair burden on working Americans to solve a problem they did not create.

Unfortunately, today's policymakers are not only failing to solve this problem — they are actively making it worse. Recent legislation has increased Social Security's shortfall through unfunded benefit expansions and tax cuts, both moving up the date of insolvency and increasing the size of automatic cuts that will happen when that occurs. The most popular proposals in Congress for "addressing" Social Security's insolvency rely on gimmicks that would strain the link between contributions and benefits while exposing the federal budget to massive fiscal risk.

If policymakers are unable or unwilling to make the current Social Security system sustainable in a way that's consistent with its founding principles, then now is the time to reimagine it from the ground up. PPI believes that lawmakers should take this opportunity to reassess Social Security's structure and build a new model that is fairer, more pro-work, and more sustainable for the future.

Through a groundbreaking new formula developed by PPI, we propose that Social Security award benefits based on the number of years someone worked, rather than their lifetime earnings. This innovative structure cements Social Security's status as an "earned benefit" but is far more progressive and affordable than the current formula. A low-income worker and their higher-earning boss would get the same benefit if they put in the same amount of work, and anyone who works for at least 20 years would receive a benefit that keeps them out of poverty. Parents would also receive up to five years of credit for caregiving to reflect both their hard work and their contributions to future Social Security solvency.

Our comprehensive package of benefit reforms also makes a number of other changes to improve the fairness and sustainability of Social Security spending. We propose increasing Social Security's retirement ages to keep pace with rising life expectancies, while preserving a special early retirement age for lower-earning workers, who have not experienced the same gains in longevity. We would change cost-of-living adjustments to more accurately reflect inflation but boost benefits for the oldest beneficiaries who are most at risk of outliving their savings. We would reform spousal and survivor benefits to better protect widow(er)s from falling into poverty. And we would make the recently passed "Social Security Fairness Act" live up to its name with fair treatment of people who work both in and out of the public sector.

Under PPI's plan, beneficiaries in the top fifth of the lifetime earnings distribution would absorb cuts relative to the current formula that are, on average, comparable to the ones already slated to occur under current law. At the same time, the majority of beneficiaries would see no reduction in their monthly benefit, and many low-income or long-career workers would even receive greater benefits than they could receive under the current formula. Altogether, PPI's proposed reforms would close half of the program's shortfall over the next 30 years through benefit changes while reducing old-age poverty.

PPI would close the remainder of Social Security's shortfall through new revenue. Under the current system, in which benefits are based on a worker's contributions, the only structurally coherent way to raise revenue is by increasing the payroll tax. But the payroll tax is regressive and depresses the wages of working Americans. By transitioning to a system that awards benefits based on years of work rather than tax contributions, there is an opportunity to transition to a more progressive and economically efficient funding structure.

PPI's framework proposes comprehensive changes to federal payroll and income taxes paired with broad-based consumption taxes that spread the cost of fixing the nation's fiscal challenges fairly among all Americans. We would also reform the use of trust-fund accounting to prevent structural deficits from threatening to impose another big benefits cliff in the future.

Taken together, the proposals in this blueprint offer a robust framework for radically pragmatic Social Security reform that is both generationally and politically balanced. PPI realizes that any plan that reduces scheduled benefits or increases taxes on anyone but the ultra-rich will nevertheless be politically challenging to enact. The mathematical reality, however, is that any plan to rescue Social Security will require some combination of these difficult choices. And the longer policymakers wait to admit this, the more painful the solutions will become. Now is the time to address Social Security's shortfall in a thoughtful way that is fair to working Americans and retirees alike, giving both groups retirement security they can depend on.

SOCIAL SECURITY FACES A MAJOR CRISIS

Social Security's Old Age and Survivors Insurance (OASI) was created 90 years ago to insure workers against the possibility that they outlive their ability to work and save for retirement, as well as provide income support to the elderly widow(er)s and dependent children of deceased workers.[1] Policymakers later added a Disability Insurance (DI) component that provides income to beneficiaries who become unable to work for medical reasons before reaching the normal retirement age.[2]

At its conception, Social Security was designed to function as an "earned benefit." Workers and their employers pay a dedicated payroll tax on wages up to a certain level, which is used to fund benefits for current retirees. Then, when the worker reaches an age at which they could no longer be expected to work, they receive benefits to replace some percentage of the wages upon which they paid taxes, paid for by payroll taxes from the new generation of workers. The program has been remarkably successful at addressing what was previously an epidemic of old-age poverty: the poverty rate for Americans over the age of 65 has fallen from over 50% before the Social Security Act's passage to just 10% today — lower than the poverty rate for American adults overall.[3,4]

But changing demographics and an outdated financing structure are putting Social Security's gains in jeopardy. Every year since 2010, the program has spent more on benefits than it collected in dedicated revenue. This growing shortfall is largely due to the aging of our population: until 2009, there were at least three workers paying taxes into the program for each beneficiary collecting from it. Now, thanks to rising life expectancies and falling birthrates, the ratio of workers to retirees is on track to hit just 2.4 by 2032 and eventually fall to just 2-to-1.[5] The budgetary challenges caused by these changing demographics are compounded by the fact that an increasing share of national income falls outside the payroll tax base.[6]

Social Security is temporarily allowed to run deficits thanks to the use of its "trust fund" accounting mechanism. In years when payroll tax revenue exceeded Social Security payments, as it did from 1984 to 2009, the Treasury Department credited the programs' trust funds with the surplus and used it to finance general government deficits in lieu of borrowing from the private sector. The Treasury also credited the trust funds with interest on their remaining balance each year, even though their "assets" generated no real return for the government. Now the program can draw upon those credits to make up the shortfall between spending and dedicated revenue with additional borrowing.[7]

However, the OASI trust fund will be exhausted by the end of 2032. At that point, benefits will be limited to what is payable only with incoming revenue, which will lead to an automatic 24% benefit cut.[8] Even if lawmakers were to combine the OASI trust fund with the DI trust fund, they would only delay the date of insolvency by less than two years. Allowing this cut to take effect would upend the retirements of more than 60 million Americans and increase the old-age poverty rate by more than half.[9, 10]

Lawmakers should act to prevent these devastating cuts. But if they wait until the last minute to do so, they may feel that the only plausible way to cover the funding shortfall is by raising payroll taxes on working Americans. Payroll taxes would need to be increased by more than a third to make Social Security sustainably solvent in 2032 — dramatically worsening the burden on low and middle-income Americans for whom these taxes already represent the majority of their federal tax bill.[11, 12] Meanwhile, this approach would ask nothing from older generations that benefited from tax cuts and benefit expansions enacted by their elected officials, undermining the core premise that Social Security benefits should fairly reflect an individual's past contributions.

Although closing the entirety of Social Security's shortfall by increasing the payroll tax would unfairly burden young Americans, allowing the program to continue covering its deficits with borrowed money would be even worse. Over the next 30 years, Social Security's annual deficits are projected to average one percent of gross domestic product (GDP). According to one analysis from the Yale Budget Lab, a permanent deficit increase of this size would impose a significant drag on our economy that reduces real household wealth by up to $36,000 by 2055.[13] It would also increase the cost of paying interest on our national debt, which is already higher than at any other point in American history. If policymakers continue funding the current benefits system without making reforms or raising new revenue, interest will surpass Social Security itself as the single-largest line item in the federal budget within the next 30 years.[14, 15]

This borrowing will also increase the risk of a debt crisis. Investors have historically been patient with growing federal budget deficits, but multiple short-term spikes in bond yields and the U.S. government losing its last AAA credit rating during this year's budget debate suggest that patience may be running out.[16] The exhaustion of Social Security's (and Medicare's) trust funds is arguably the last major action-forcing event on the horizon that could compel policymakers to grapple with the growing structural gap between taxes and spending on benefits. If they instead choose to resolve the situation by authorizing unchecked borrowing, that could easily be the final straw that causes investors to abandon U.S. government debt in droves. This selloff would cause interest rates to skyrocket, making it even more difficult for the government to repay its creditors and causing a vicious spiral that crashes the U.S. economy.

Each of the last-minute options to address insolvency would be deeply harmful: automatic benefit cuts would devastate low-income beneficiaries, payroll tax hikes would unfairly burden working Americans, and government borrowing would endanger the U.S. economy. To prevent these scenarios from occurring, Congress must tackle Social Security's financial challenges by enacting responsible reforms as soon as possible.

TODAY'S POLICYMAKERS ARE MAKING THE PROBLEM WORSE

Unfortunately, today's policymakers are not only standing idly by while Social Security marches towards its imminent demise — they are actively making it worse. At the end of last year, a bipartisan majority in Congress voted to accelerate program insolvency by eliminating two long-standing provisions designed to prevent higher income retirees with public pensions from getting more generous Social Security benefits than they should have been entitled to.[17] Then this year, Republicans compounded the problem by massively increasing the standard deduction for seniors, which indirectly cut income taxes on Social Security benefits that serve as a dedicated revenue source for the trust fund.[18] These changes both moved up the date of Social Security's trust fund depletion and increased the size of benefit cuts that will occur automatically when that happens.

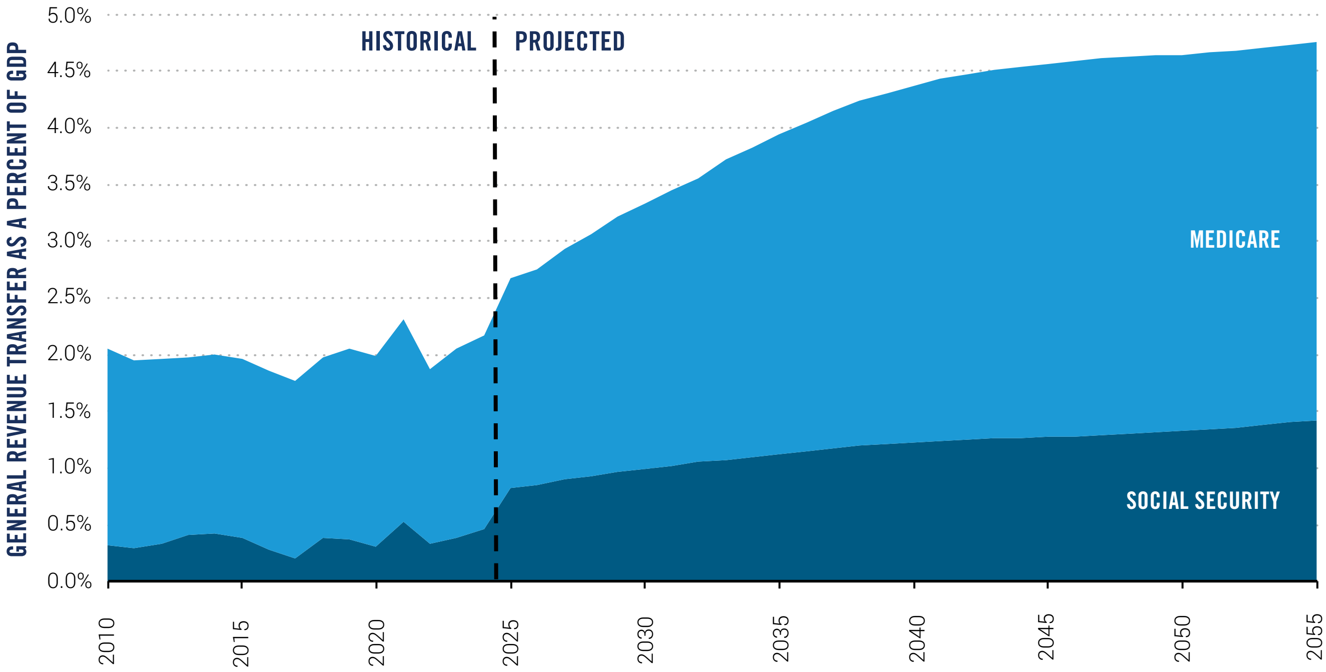
Democrats, who have long claimed to be the champions of Social Security, have their own proposals that would undermine the program while masquerading as improvements. A majority of House Democrats in the last two Congresses have rallied around a bill called the "Social Security 2100 Act", which would expand benefits for all current beneficiaries and "pay for it" by imposing the full payroll tax rate on income over $400,000.[19] Proponents say the bill would, on balance, reduce the program's financial shortfall, but that's only because the benefit enhancements are temporary while the tax increase is permanent. If all policies were enacted on a permanent basis, which is almost certainly the ultimate goal, the bill would actually leave the program on even worse financial footing than before.[20]

Even without the unaffordable benefit expansion, Democrats' go-to solution for improving Social Security's finances — applying the full payroll tax to income above the current "cap" of $176,100 — is not the panacea they often claim it is. Eliminating the payroll tax cap without increasing benefits for those paying the higher taxes would close roughly half of Social Security's long-term structural deficit while fundamentally eroding the program's status as an earned benefit.[21] Moreover, this would push the effective top federal tax rate on earned income to over 50%, which would be close to the revenue-maximizing rate after accounting for state income taxes.[22]

The problem here is that Social Security does not exist in a vacuum — its needs are just one of many in the federal budget. Over the next 30 years, the gap between spending and dedicated revenues for Medicare will *grow* by an amount equal to the *total* gap facing Social Security (**Fig. 1**). Critical public investments in education, infrastructure, and scientific research that form the building blocks of long-term economic growth are also declining.[23] PPI supports raising taxes on the ultra-rich, but if those taxes are spent just to keep funding Social Security's current benefit structure, it would be nearly impossible to address all these other national priorities without politically impossible levels of taxation on working Americans.[24]

Many policymakers are relying on fanciful ideas that economic growth alone can miraculously solve the mathematical dilemma they seek to evade. President Trump, for example, has repeatedly promised his economic policies will supercharge growth enough to close the program's shortfall without anyone needing to raise taxes or cut benefits.[25] The first problem here is that this growth is unlikely to materialize: many analyses have found Trump's debt-fueled tax cuts and onerous tariffs will hurt growth more than they will help.[26, 27, 28, 29] Furthermore, his anti-immigrant policies will further deprive

FIGURE 1. GENERAL REVENUE TRANSFERS FOR SOCIAL SECURITY AND MEDICARE



Note: Projections assume benefits continue to be paid as currently scheduled, even after the associated trust funds are exhausted.

Sources: Social Security Trustees,[30] Medicare Trustees,[31] and Committee for a Responsible Federal Budget.[32]

the economy of young workers who would otherwise pay payroll taxes and contribute to Social Security.[33] But even if Trump's agenda led to sustained economic growth that boosted payroll revenues, it would also increase costs because benefits are indexed to grow with average wages.[34]

While Trump is hoping for economic growth to passively fix the program, others — such as Sen. Bill Cassidy — are taking a more active approach, with potentially even worse consequences. Cassidy has proposed that the federal government borrow $1.5 trillion, and use it to create a second Social Security trust fund holding privately-held assets like stocks.[35] This trust fund would remain untouched for 75 years while Social Security's deficits would be financed by government borrowing. At the end of that window, Cassidy hopes the federal government could sell its stocks at enough of a profit to wipe away the cost of all the additional debt it accumulated.[36]

Back when Social Security had annual surpluses, it may have made sense to invest them in income-generating assets rather than using them to mask general government deficits. But there is considerable risk to just borrowing money to buy stocks with no limiting principle. The debt accumulated to make this plan work will likely lead to higher interest rates and lower economic growth, potentially depressing future asset values and leaving the government on the hook for trillions of dollars with no way to pay for it. Even if the government made money on its investments, it would be merely capturing returns that would have otherwise gone to private investors.[37] This approach would have all the same drawbacks as ordinary tax on capital, with the added complication of having the government actually owning shares of private companies and distorting the prices of stocks it buys and sells. Yet despite these serious problems, Cassidy's proposal has picked up bipartisan support.[38]

What all of these policies have in common is that they make no serious attempt to solve Social Security's financial shortfall, let alone do so in a way consistent with the premise that an individual's benefits should be based on their contributions into the program. If policymakers are not serious about preserving the current system, then it's time to reimagine it from the ground up. Doing so creates the opportunity to not only improve the finances of Social Security but also address other shortcomings in the current system that unnecessarily undermine retirement security for millions of Americans.

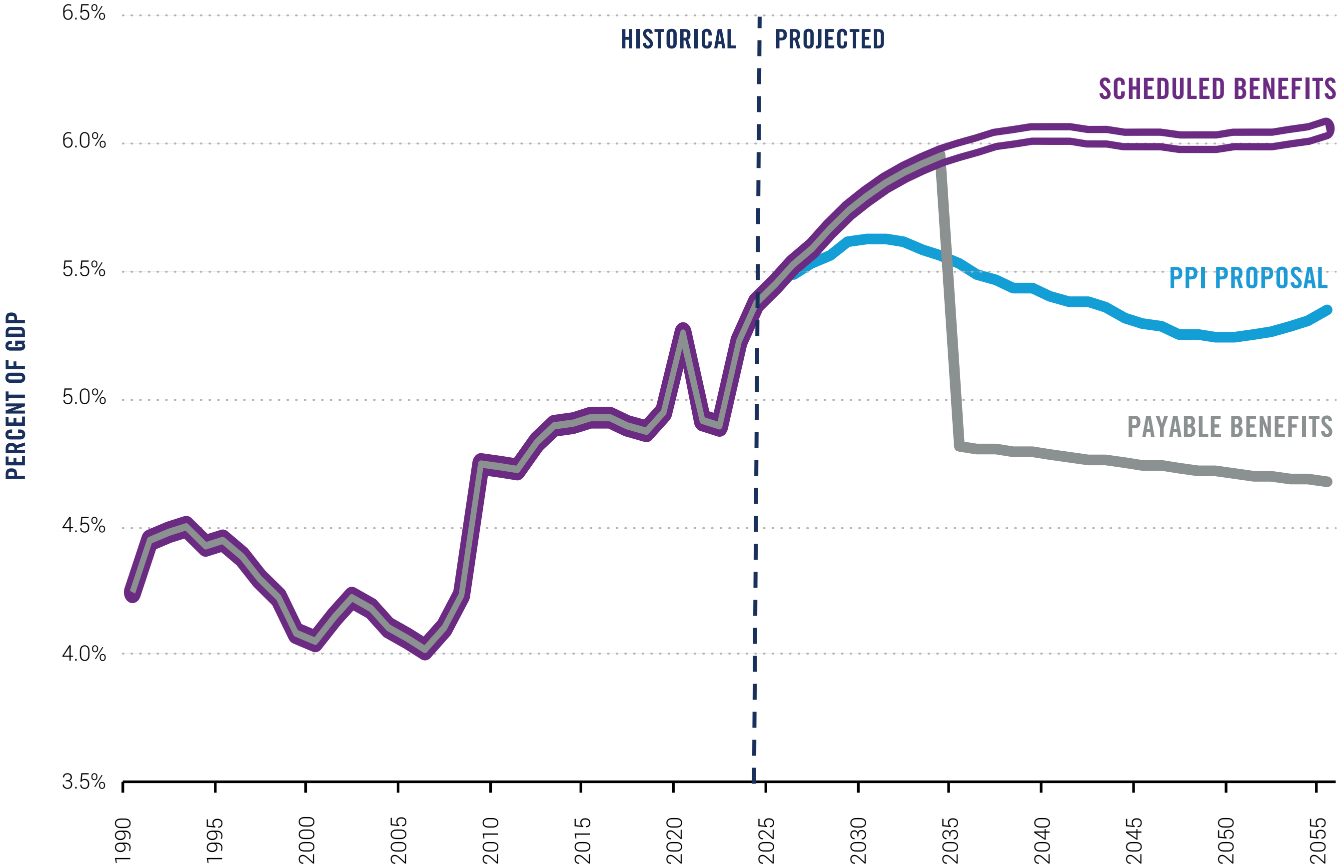
A NEW VISION FOR SOCIAL SECURITY BENEFITS THAT BETTER REWARDS WORK

PPI believes any real solution for the challenges facing Social Security must preserve or build upon the program's success in combating elderly poverty without imposing an unfair burden on working Americans. That means policymakers must be willing to curtail the growth of spending on high-income retirees, who currently receive the largest benefits but depend on them the least. At the same time, we believe that Social Security should remain a benefit that people earn through work, both to preserve the program's work incentives and to maintain the overwhelming political support that it has historically enjoyed.

It is difficult to simultaneously increase benefits for low earners and reduce benefits for high earners under a system in which benefits are based on a beneficiary's lifetime earnings. So instead of attempting to salvage this outdated structure, PPI proposes an ambitious package of benefit changes built around an innovative new concept: awarding benefits based on how many years someone works rather than how much they earned throughout their career. A low-income worker and their higher-earning boss would get the same benefit if they put in the same amount of work, and anyone who works for at least 20 years would receive a benefit large enough to keep them out of poverty. This approach would make Social Security more sustainable by reducing spending on wealthy retirees, while simultaneously strengthening benefits for low earners and preserving Social Security's status as a benefit that people earn through work.

In addition to this fundamental structural reform, PPI proposes other changes that would strengthen the program by increasing benefits for those most at risk of falling into poverty in old age, such as low-income workers, surviving spouses, and people with above-average lifespans who are likely to outlive their savings. Our reforms also fix problems with provisions that create unfair gender disparities or penalize work at a time when policymakers should be encouraging more of it.

FIGURE 2. SOCIAL SECURITY SPENDING UNDER PPI'S PLAN COMPARED TO CURRENT LAW



Note: All projections are based on modeling from 2024. The Scheduled Benefits scenario assumes benefits continue to be paid based on the current formula even after the trust funds are exhausted. The Payable Benefits scenario assumes benefit payments are limited to dedicated revenue after the exhaustion of the trust funds, which is what would occur automatically under current law.

Sources: Social Security Trustees,[40] Urban Institute DYNASIM,[41] and PPI calculations.

PPI developed and modeled these recommendations last year as part of a comprehensive blueprint to put the federal budget on a sustainable trajectory, ensuring they could be sustainably funded without jeopardizing other public priorities.[39] This modeling showed that enacting PPI's proposed reforms beginning in 2026 would close roughly half of Social Security's shortfall over the next 30 years through benefit changes (**Fig. 2**). Beneficiaries in the top fifth of the lifetime earnings distribution would absorb cuts relative to the current formula that are on average comparable to the ones already slated to occur under current law (**Fig. 3**). By contrast, workers in the bottom quintile would receive monthly benefits that are roughly a quarter higher than they could receive under the current formula once they retire. And while the median-income worker would receive a small cut if they work a shorter-than-average career, they would receive an increase in benefits over the current schedule if they stayed in the labor force longer (**Fig. 4**).

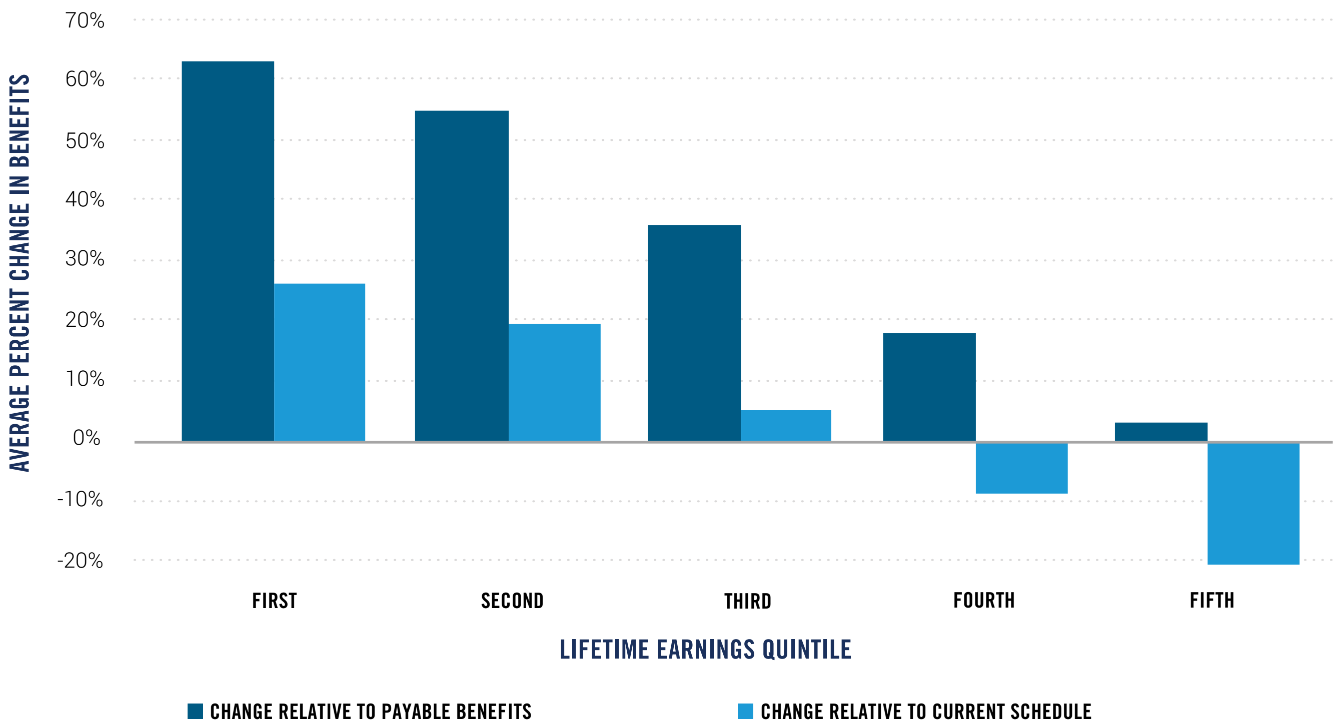
By 2055, PPI's plan would reduce the poverty rate for Americans 70 years or older by roughly 10% relative to the current schedule of benefits, and more than 40% relative to the scenario in which policymakers do nothing and Social Security's trust fund becomes insolvent.[42] In short, PPI's Social Security reforms would make the program substantially more anti-poverty and pro-work, which should appeal to both progressives and conservatives.

1. Calculate Benefits Based on Years Worked Instead of Lifetime Earnings

Social Security benefits are currently calculated based on the average of an individual's 35 highest-earning years (adjusted for wage growth). The monthly benefit for someone who claimed benefits at the normal retirement age in 2024 was equal to 90% of the first $1,174 in average monthly earnings, plus 32% of those earnings between $1,174 and $7,078, and 15% of those earnings above $7,078.[43] The system is somewhat progressive because Social Security replaces a higher proportion of pre-retirement income for lower-earners than higher-earners, but it nevertheless awards higher benefits to those who need them least.

Another problem with the current formula is that it provides poor incentives to remain in the labor force. Benefits are only based on an individual's 35 highest-earning years, so additional work

FIGURE 3. PPI PROPOSAL COMPARED TO PAYABLE AND SCHEDULED BENEFITS



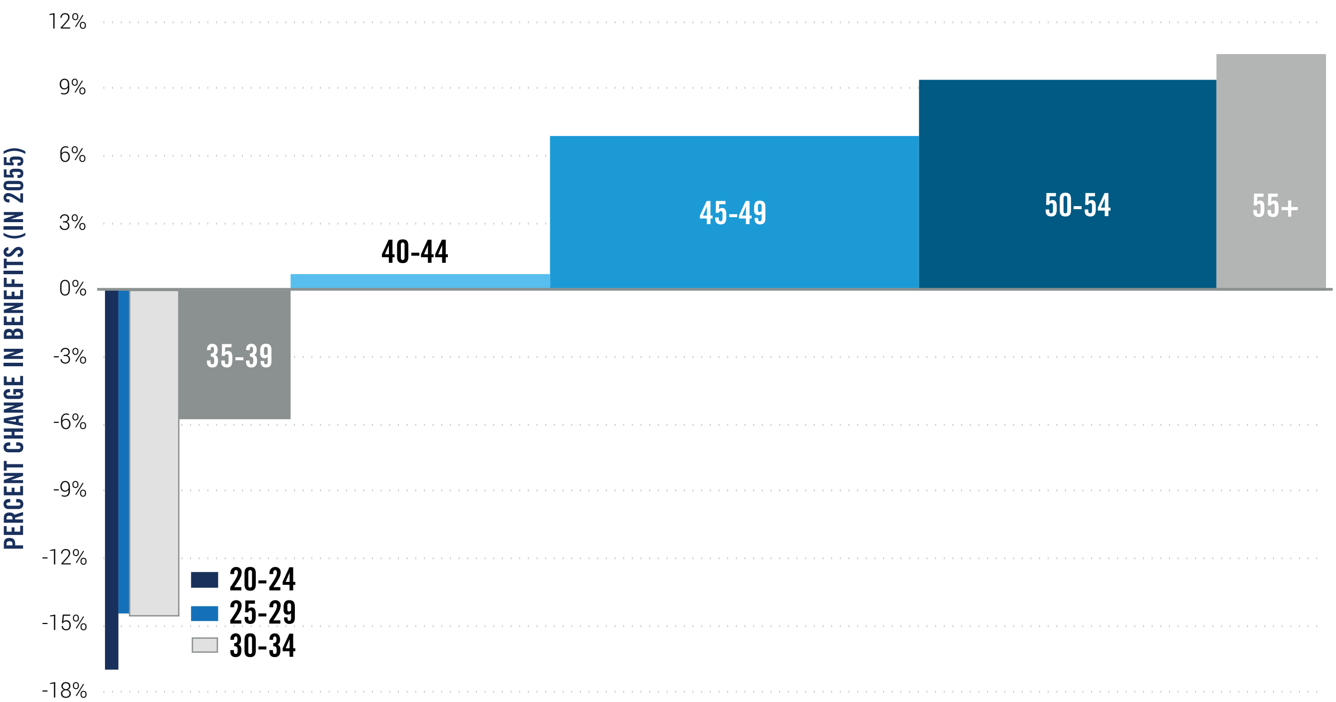
Note: All projections are based on modeling from 2024. The chart shows the average benefit change under PPI's plan for OASI beneficiaries who are claiming benefits under the new PPI formula in 2055. The Scheduled Benefits scenario assumes benefits continue to be paid based on the current formula even after the trust funds are exhausted. The Payable Benefits scenario assumes benefit payments are limited to dedicated revenue after the exhaustion of the trust funds, which is what would occur automatically under current law.

Sources: Social Security Trustees,[44] Urban Institute DYNASIM,[45] and PPI calculations.

years only increase benefits if earnings in those additional years are higher than in previous ones. Because most long-career workers will have already maximized their lifetime earnings in the high-replacement rate brackets, there is a low return to additional work.[46] These broken incentives result in diminished savings, a smaller workforce, and increased government spending on retirees who don't need it. The average woman's Social Security benefit is also over 20% lower than the average man's benefit, resulting in women having a lower standard of living in retirement than men.[47, 48] This discrepancy stems from the fact that women take more time out of the workforce to serve as caregivers than men do and, even among full-time workers, women's average annual earnings are only about 84% of what the average man earns.[49, 50]

PPI proposes to replace the current system with a "work credit" benefit structure. Beneficiaries would receive a monthly benefit based on how many years they worked rather than how much they earned. To qualify for a work credit, a beneficiary must have earned income that is roughly equivalent to working 40 hours per week for 50 weeks at a wage of $13 per hour (which is the 5th percentile of hourly wages for full-time workers, meaning 95% of full-time workers would qualify for a full work credit in a

FIGURE 4. PPI PROPOSAL IMPACT ON THE AVERAGE MIDDLE-QUINTILE BENEFICIARY BY YEARS WORKED



Note: All projections are based on modeling from 2024. Chart shows the average benefit change relative to scheduled benefits for a worker in the middle fifth of the lifetime earnings distribution in 2055 once that beneficiary begins claiming benefits. The Scheduled Benefits scenario assumes benefits continue to be paid based on the current formula even after the trust funds are exhausted. Changes in relative benefits are disaggregated by the number of years the beneficiary has worked. The width of each bar is proportional to the approximate percentage of middle-quintile earners with each range of work years. Fewer than 1% of beneficiaries with median quintile lifetime earnings are projected to work fewer than 20 years so the effects on their relative benefit change were omitted.

Sources: Urban Institute DYNASIM[51] and PPI calculations.

FIGURE 5. PPI'S PROPOSED WORK-CREDIT BENEFIT STRUCTURE

CREDIT LEVEL	YEARS EARNED	MONTHLY BENEFIT
Basic level	**1-20**	**$100.00**
Standard Credit (80% of Basic)	**21-50**	**$80.00**
Bonus credit (20% of Basic)	**51+**	**$25.00**

Note: Figures are in 2024 wage-indexed dollars and assume Social Security is claimed at the maximum benefits age.

given year).[52, 53] Workers who do not earn enough for a full work credit can earn a proportional partial credit, rounded to the nearest tenth. For example, if someone earned the equivalent of 40 hours per week working at federal minimum wage for 50 weeks in a given year, they would be awarded 0.6 credits for that year. Similarly, if someone earned the equivalent of 12 hours per week working at $13 per hour for 50 weeks in a given year, they would be awarded 0.3 credits for that year. Both the threshold for earning work credits and the value of the credit in retirement for each cohort would be tied to the average wage index.

The monthly benefit awarded for each work credit would depend on how many years a beneficiary has previously worked. The first 20 years would be awarded at the "Basic Credit" level, which would be set at roughly $100 in 2025 dollars for someone retiring at the maximum benefits age (currently age 70). Years 31-50 would be awarded "Standard Credits," which would be equal to 80% of the Basic Credit. After accumulating 50 years of work credits, additional "Bonus Credits" would continue to be awarded at 25% of the Basic Credit level (**Fig. 5**). With these benefit amounts, anyone who works at least 20 years will receive a benefit that keeps them out of poverty.

Basing benefits on work instead of income would make the system more progressive by ensuring that a low-level worker and their well-compensated boss receive the same benefit in retirement if they work for the same number of years, despite the fact that the former had much lower lifetime earnings. This new structure will cut costs by reducing benefits to retirees who have earned high incomes over their lifetimes, while alleviating poverty among lower-income retirees. Offering higher benefit credits for the first 20 years also provides additional support to low-income workers, who generally work shorter-than-average careers.[54] Additionally, the new system incentivizes Americans to work longer to accumulate more work credits and receive higher benefits. To encourage "partial retirements" that have a myriad of social and health benefits, Americans can continue to earn work credits after claiming Social Security. Partial retirement helps keep older workers, who tend to be well-qualified and productive, in the labor force for longer and smooths the harsh transition individuals face when they move from full-time work to retirement.[55]

PPI also proposes to allow caregivers to receive up to five years of work credit for the purposes of benefit calculation. While workers pay for Social Security with the taxes on their earnings, parents contribute to the program's long-term sustainability by providing the economy with future workers. It makes little sense not to provide benefits in return for this contribution. Caregiver credits can be awarded on a partial basis, so part-time caregivers can benefit from the credit for more than 5 individual years. For example, if a part-time caregiver would be eligible to receive only a half credit based on their earnings, they would actually be awarded one full credit for that year. The caregiver credit would continue to benefit this caregiver for 10 years of this arrangement instead of 5 because they are only claiming half a caregiver credit in each year.

We propose that the new formula be gradually phased in for new beneficiaries over 10 years. Beneficiaries who turn age 62 in 2027 would have benefits calculated under both the old and new system, then be awarded a benefit equal to 10% of the work-credit benefit plus 90% of their benefit under the current formula. The proportion of the benefit based on the new formula would increase by 10 percentage points per year until it reached 100% in 2036 (when the transition to the work-credit system is complete).

2. Adjust the Retirement Age to Improve Simplicity and Equity

Social Security benefits are adjusted based on when they are claimed by a beneficiary to ensure that, on average, lifetime benefits collected are the same no matter when the beneficiary chooses to begin claiming them. Someone who claims benefits at the normal retirement age, which will be 67 for anyone born in 1960 or later, receives 100% of the benefit as calculated above.[56] But people can claim benefits as early as age 62, with reduced monthly benefits, and as late as 70, with increased monthly benefits.[57, 58]

A key driver of Social Security's financial challenges is rising life expectancy. Since Social Security was created in 1935, the life expectancies of a 65-year-old man and woman have both increased by nearly half and are projected to continue growing further.[59, 60] The result is that retired Americans are collecting benefits for many more years than Social Security's creators initially envisioned.

To address this problem, PPI proposes to index the minimum and maximum benefit ages to grow at a similar rate as life expectancy. Beginning with beneficiaries who turn age 62 in 2027, the maximum-benefit retirement age would increase by one month every two years. If future gains in life expectancy slow down and Social Security is otherwise on sound financial footing, policymakers can easily reassess this gradual increase in the future.

The minimum-benefit retirement age would increase by two months every year until such time that it equaled the maximum-benefit retirement age minus six years, after which it would increase at the same rate as the maximum-benefit retirement age. PPI's plan would also ensure that the minimum and maximum benefit payments would be actuarially adjusted to ensure equal overall benefits for Americans, regardless of when they retire. The concept of a "normal" retirement age between the minimum and maximum benefits age is unnecessary and so would be eliminated under our plan to reduce any signal that suggests people should claim benefits before they need to.[61]

Although Americans are living longer overall, life expectancy gains have not been evenly shared. For example, for men born in 1930, the gap in life expectancy at age 50 between the top 20% of the income distribution and the bottom 20% of the income distribution was 5.1 years, while for men born in 1960, this gap rises to 12.7 years.[62] Additionally, chronically low earners work long careers in thankless jobs and can have difficulty finding employment towards the end of their working life. To enable these workers to enjoy a secure retirement, PPI proposes to allow beneficiaries to receive the average of their maximum and minimum benefit beginning at age 62, so long as:

- This benefit would be enough to replace 100% or more of their pre-retirement earnings (measured as a price-adjusted average of the previous 10 years of earnings); and

- The beneficiary meets an asset test similar to the one that exists for Supplemental Security Income (SSI), with asset limits that are made more accommodating than they are today.[63]

For example, someone who earned the minimum wage their entire life would be able to claim Social Security after 35 years, because at that point the average of their minimum and maximum benefits would be greater than the amount they would earn working full-time. The same would be true for someone who earned a high wage for 30 years, but then could no longer find employment above the minimum wage for several years after that. Individuals who earn wages above the median in their 50s and early 60s, however, would not be able to claim benefits before the minimum benefits age because the average of their minimum and maximum benefits would not replace 100% of the average of their last 10 years of income.

PPI's proposed adjustments to the early retirement age are designed to discourage beneficiaries from claiming benefits too early to give them sufficient lifetime incomes or from retiring early when they can continue to have productive working lives. At the same time, our plan would strengthen the safety net for those most in need. It would also allow earlier retirements for long-career workers because their averaged benefit will be higher than the averaged benefit of short-career workers.

3. Change Cost-of-Living-Adjustments

After a beneficiary begins collecting Social Security benefits, their benefits rise each year to account for rising prices. Currently, these cost-of-living adjustments (COLAs) are calculated based on the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W). Many economists, however, believe the more appropriate measure of inflation is a measure called the Chained Consumer Price Index for All Urban Consumers (C-CPI-U). Unlike CPI-W, C-CPI-U accounts for the reality that when the price of one good goes up, consumers will substitute towards purchasing other goods whose prices remain the same, lowering the impact of the price increase on the overall cost of living. Historically, C-CPI-U has grown more slowly than CPI-W by an average of between 0.25 and 0.3 percentage points per year.[64, 65]

We would also impose a dollar-value cap on COLAs for current beneficiaries, such that the maximum COLA received by any OASI recipient will be equal to the COLA that a person who retired at the maximum benefits age with 50 work credits could receive under the new formula. This measure will cut costs — particularly in the form of benefits for the wealthiest beneficiaries — and prevent Americans who retired under the current system, with high lifetime incomes, from receiving higher COLAs than the vast majority of Americans who retire under the new system.

The biggest concern about switching to C-CPI-U COLAs is that savings from the switch compound into excessively large benefit reductions for beneficiaries with above-average lifespans (who are also more likely to outlive their savings).[66] We propose to negate this problem by re-indexing COLAs to average wage growth, which grew roughly 1.1 percentage points more quickly than C-CPI-U each year over the past decade, 24 years after the beneficiary has reached the minimum benefits age.[67, 68] This change will result in COLAs which are more generous for beneficiaries who have lived longer than the approximate median life expectancy at the earliest eligibility age.[69] The enhanced COLA bump-up would take effect when the first retirees under the new system will have been eligible for Social Security for 24 years. Unlike the standard COLA, there would be no cap on the boosted COLA.

4. Reform Survivor Benefits to Reduce Poverty

When a Social Security beneficiary dies, their spouse is entitled to a survivor benefit. Under the current formula, a surviving spouse gets the larger of the couple's two Social Security benefits.[70] This structure presents a huge problem for couples with comparable lifetime earnings, who can see household benefits cut in half upon the death of the spouse, even though household consumption doesn't fall by an equal amount.

PPI proposes to allow the surviving spouse to keep 75% of the couple's Social Security benefits when the other spouse dies. Initial benefits for couples would be reduced by 10% to ensure that the average couple receives the same lifetime benefits under the new survivors benefit as it would under the current one. These changes are particularly important because widow(er)s have far higher poverty rates among the elderly than do married couples (who have the lowest).[71] It also further strengthens retirement security for women, who are more likely to outlive their spouses than are men. The reforms to survivor benefits would only apply to the dependents of beneficiaries turning age 62 in 2027 or later.

5. Reduce Spousal Benefits

Lower-earning spouses receive benefits that are at least equal to half those of the main breadwinner. This spousal benefit was created for an era in which fewer women worked, but the role of women in the workplace has changed dramatically over the past decades: the share of adult women who work has grown by more than 70% since 1950.[72] With women now having far more employment opportunities than they did when Social Security was created, far more couples are in two-earner households. The current spousal benefit now discourages work by providing a windfall to single-earning couples, especially those with higher incomes.[73] These high-income couples are most likely to benefit from the spousal benefit in the first place because they can afford to have only one earner.

Under PPI's proposal, spousal benefits claimed at the maximum-benefit retirement age would be capped at $1,200 per month in 2027 (with actuarial reductions for those who claim earlier) and would be means-tested based on assets and income to reduce unnecessary subsidies to the wealthy. This cap would grow with chained CPI instead of the average wage index after implementation. As with survivors benefits, the reforms to spousal benefits would apply to beneficiaries turning age 62 in 2027 or later.

6. Make the 'Social Security Fairness Act' Live Up to its Name

Social Security's current benefit formula is supposed to give lower-earning Americans more in benefits relative to their contributions because they face a greater risk of falling into poverty during retirement than people with high lifetime earnings. But it provides an unintentional windfall to high earners who split their careers between covered employment and one of six million "uncovered" public-sector jobs, at which workers neither pay payroll taxes nor get credit for their earnings towards Social Security because their jobs provide generous public pensions. Because the current formula awards benefits solely based on a beneficiary's lifetime covered earnings, it gives someone who earned an average annual income of $150,000 over a full career that included just 10 years in covered positions a higher return on payroll-tax contributions than someone who earned just $45,000 annually during a full career spent entirely in covered employment.

Congress enacted an imperfect fix for this problem in 1983, when it created the Windfall Elimination Provision and Government Pension Offset. But at the end of last year, both those policies were repealed, without being replaced, by the grossly misnamed Social Security Fairness Act. To make Social Security truly fair for retirees on the current system who split their careers between covered and uncovered employment, lawmakers should recalculate their benefits using a proportional adjustment. This methodology would first calculate an individual's Social Security benefits as if all earnings had come from covered employment, then reduce that benefit by the fraction of earnings that came from uncovered employment. Although SSA did not have adequate data on uncovered earnings to make this commonsense fix work in 1983, it does now. Implementing this change would save almost as much money in future years as the repealed provisions would have, but in a way that is far more fair than they were.[74]

7. Improve Disability Insurance

Social Security DI benefits are based on the same formula used to calculate OASI benefits, so the program will require some changes to conform with the work-credit benefit formula PPI proposes using for OASI.[75] Some policies in this package will also likely increase demand for DI benefits. Although this plan provides an exemption to our proposed increase in the early retirement age for low-income workers, not every worker in a physically demanding job will qualify, meaning some older workers will claim DI benefits when they would have otherwise claimed OASI benefits. To address these issues, PPI would reroute some savings from the other provisions in this document to increase DI funding. We also recommend that policymakers use some of this funding to address structural problems with DI that discourage beneficiaries from seeking work, such as a "cash cliff" that suddenly cuts benefits to zero if a beneficiary earns above a certain threshold.[76]

FIXING THE FINANCING WITH INTERGENERATIONALLY FAIR TAXES

Most of the aforementioned benefit reforms would have no effect on current beneficiaries. This principle is important for maintaining retirement security for Americans living on a fixed income, but it also prevents the current generation of retirees from contributing their fair share towards Social Security's solvency. Although the reality of our aging society means that working Americans will have to shoulder a higher tax burden than in decades past, they alone should not be responsible for solving a problem that they bear no responsibility for creating.

Accordingly, PPI believes the share of Social Security's financing gap closed through revenue increases should come from broad-based taxes that affect Americans of similar means similarly, regardless of whether they are working or retired. Below are the components of PPI's comprehensive tax reform proposals most directly relevant to Social Security. These policies are designed to secure increased contributions from wealthy retirees in addition to young Americans with high incomes, without hurting the most vulnerable seniors. We also recommend reforming the use of trust-fund accounting to both accommodate our other proposals and ensure retirees never again face the threat of sudden and deep benefit cuts.

8. Subject More High-Income Social Security Benefits to Income Taxes

Under current law, individuals for whom the combination of their adjusted gross income, non-taxable interest income, and half of their Social Security benefits totals more than $25,000 must pay taxes on up to 85% Social Security benefits.[77] Like payroll taxes, revenue from income taxes paid on Social Security benefits is earmarked to pay benefits, effectively recycling them into the program. PPI proposes to also make benefits 100% taxable for higher-income beneficiaries.

Higher-income retirees are also able to shield more of their benefits from taxation by taking advantage of an additional standard deduction for seniors in addition to the $15,000 standard deduction available to Americans of all ages. This benefit was generously but temporarily expanded in the Republicans' One Big Beautiful Bill, increasing from $2,000 under prior law to $6,000. This change indirectly worsens Social Security's solvency by both reducing the number of seniors who pay taxes, and cutting the tax rate that others will pay on their incomes and benefits. The result is less revenue flowing back in to support the program.[78]

PPI would not only reverse the deduction's expansion, but completely eliminate it. Although seniors typically have lower incomes than their working-age counterparts, they are more likely to have accumulated assets such as a paid-off home or money in a retirement account. As a result, seniors are generally better off than their working-age counterparts who have the same taxable income and are taxed at the same rates. Thus, there is little justification for giving seniors even lower tax rates through a higher standard deduction, especially considering that today's working-age Americans will already have to pay more in taxes to support the plan's Social Security benefits.

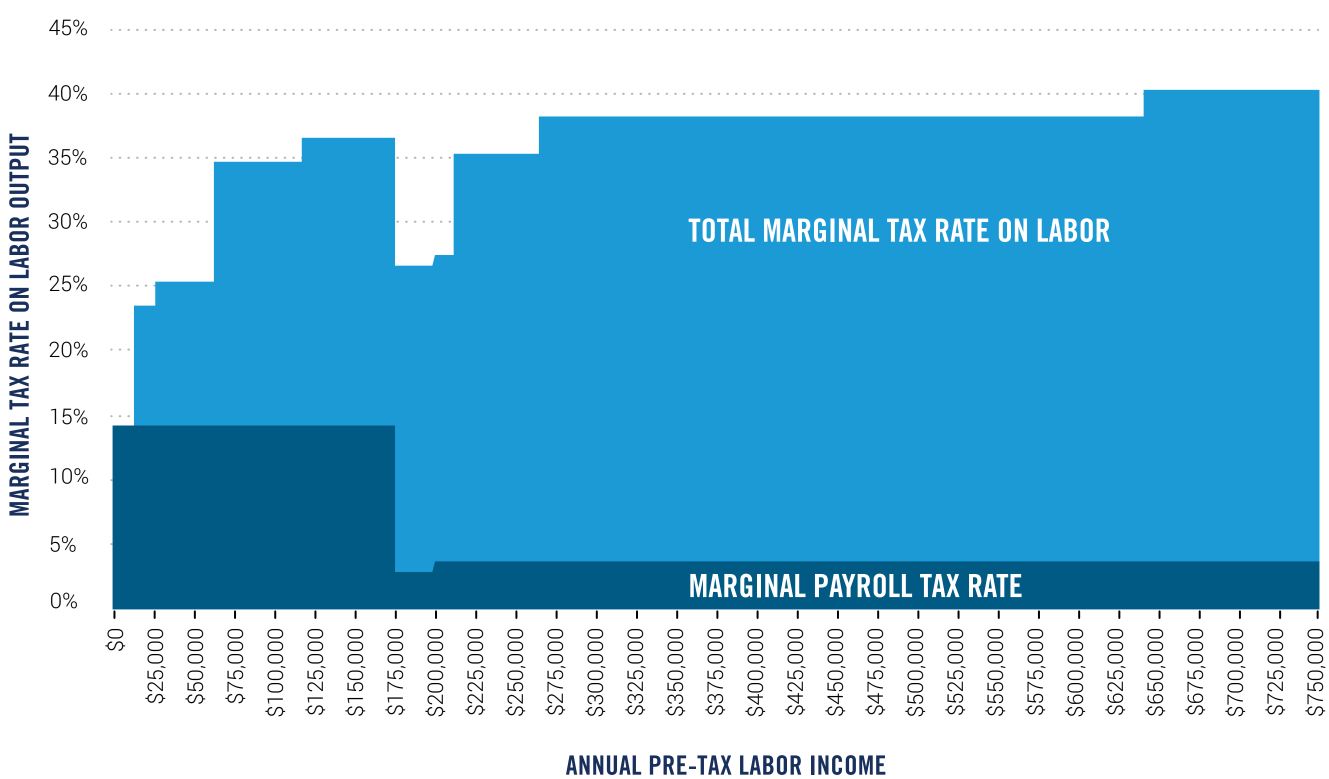
9. Move Away From The Payroll Tax

When Social Security was created, the payroll tax served an important political purpose: creating a link between a worker's lifetime contributions and the benefits they drew upon in retirement. This link both established Social Security as an "earned" benefit and showed beneficiaries exactly what they were getting in exchange for the taxes they were paying. But the link has become increasingly tenuous, as dedicated revenues have been insufficient to fund promised benefits for years.

The payroll tax also has several fundamental problems that make it a bad way to raise revenue even if the amount collected was adequate. Although employers nominally pay half of all payroll taxes, employers pass most of the impact of employment taxes along to their workers in the form of lower wages (and self-employed workers are required to pay the entire tax themselves).[79, 80] It also fails to capture the increasing share of national income that is going to owners of capital, or non-wage benefits such as health insurance, putting the tax on track to raise a 10% smaller share of economic output than it did at its peak in 1990.[81]

Those downsides may have been worth the benefit when the tax was set at a rate of just 2%

FIGURE 6. CURRENT EFFECTIVE MARGINAL TAX RATES ON LABOR



Note: Chart depicts the effects of both Social Security and Medicare payroll taxes as well as federal income taxes. Calculations assume the earner is a single filer who takes the standard deduction. Marginal tax rates are calculated based on an employee's marginal economic output. For example, an employee whose marginal output is $21.53 per hour faces a $1.53 employer-side payroll tax that is taken out before they receive a $20 hourly wage, which is then subject to a $1.53 employee-side payroll tax. This results in a payroll tax that imposes a 15.3% marginal tax rate when measured as a percentage of the employee's hourly wage but a 14.2% tax when measured as a percentage of their marginal output.

Sources: Internal Revenue Service[92, 93] and PPI calculations.

on the first $3,000 of income (roughly $67,000 in today's dollars).[82] But after being increased so many times alongside expansions of Social Security and parts of Medicare, the payroll tax rate is now a much more burdensome 15.3% on earnings below $176,100.[83, 84] This structure severely undermines the progressivity of federal income taxes (**Fig 6**.). In fact, the Joint Committee on Taxation estimated in 2023 that payroll taxes would account for more than 95% of net revenues raised from workers who earn less than $80,000 that year.[85]

There is no point in doubling down on such a regressive and anti-growth tax when it can't even fulfill the purpose for which it was created. Fortunately, the benefit reforms detailed in this report would cement Social Security's status as an earned benefit in a way that doesn't depend on payroll tax contributions. Policymakers should take that opportunity to make federal taxes on earned income fairer and more progressive, as PPI proposed in our blueprint last year.[86]

10. Adopt a National Consumption Tax

Perhaps the most intergenerationally fair source of new revenue to address the shortfalls in underfunded retirement benefits is a consumption tax. While payroll taxes disproportionately affect working-age Americans — who are currently employed and paying into the system — a consumption tax affects everyone who spends money, regardless of age or employment status. For example, high-income retirees who might not be paying payroll tax anymore will still purchase goods and services similar to their working-age counterparts, meaning that they will still be contributing to these programs' finances. At the same time, low-income seniors who rely more heavily on Social Security would be protected because any price increases caused by the tax would lead to corresponding cost-of-living adjustments to their benefits. And unlike payroll taxes, which discourage work, consumption taxes don't penalize productivity.[87]

The most efficient tax that meets this criteria is a Value Added Tax (VAT), a tax on consumption that is collected incrementally at each step in a product's supply chain.[88] Although the tax is levied on businesses, its economic impact is split between businesses and consumers, making it function much like a sales tax. However, economists generally prefer VATs to sales taxes because they are self-enforcing: businesses deduct the VAT that was already paid on their supplies, meaning they pay more if they buy from suppliers that did not pay the VAT themselves.[89]

In addition to its fairer distribution, a VAT offers several economic advantages over payroll taxation. Payroll taxes only apply to wages, effectively giving a tax break to Americans who earn their income through investment or business income. Furthermore, the payroll tax cap reduces the tax's ability to raise revenue from upper-income Americans. A VAT, in contrast, taxes consumption, ensuring that income from all sources is eventually taxed once it is spent. Furthermore, payroll taxes distort businesses' decisions by increasing the cost of labor but not of capital. VATs avoid this by taxing firms based on the value they add to a product, regardless of whether it comes from labor or capital. Finally, a VAT has a broader tax base than a payroll tax, allowing governments to raise the same revenue with lower tax rates.

11. Prevent the Abuse of Trust Fund Accounting

Social Security was designed to operate separately from the congressional budget process — the program has dedicated revenue sources, and its benefits are paid out automatically based on a formula rather than annual congressional appropriation. This design had two key advantages: it helped build support for politically difficult taxes by explicitly linking the program's revenues and benefits, and it made future benefit levels more predictable for workers to plan their retirements around. However, it also created a risk that the program's spending would start to exceed its revenues over time. To address this concern, the program's founders created a mechanism to ensure fiscal sustainability — trust fund accounting. This accounting system tracks past surpluses and allows them to offset temporary deficits, but it enforces long-term sustainability by automatically reducing benefits to match incoming revenues when the credit for previous surpluses is depleted.[90]

Trust fund accounting was intended to prevent Social Security from consistently spending more on benefits than it raised in taxes. But in recent decades, Congress has abused the system to do the exact opposite. When lawmakers last passed major Social Security reform in 1983, they did not set taxes at the level needed to sustainably fund the benefit formula they established. Instead, they relied on temporary surpluses to help the trust fund accumulate a multitrillion-dollar accounting balance. These lawmakers knew they were putting Social Security on track to eventually fall into chronic deficits, as it ultimately did in 2010, but that trust fund accounting would enable the unaffordable status quo to persist for decades thereafter.[91] Although this accounting system delayed the date that policymakers would have to address Social Security's growing shortfall, it also ensured the deficit they'd eventually have to close would be dramatically larger. By opening the possibility of such deep and abrupt benefit cuts, the very system that was designed to ensure retirement security is now endangering the retirements of millions of Americans.

Enacting all of PPI's proposals would close Social Security's shortfall in the context of a sustainable federal budget. But because our plan severs the link between Social Security and its historical funding sources, policymakers who want to keep Social Security independent from the regular budget process must design a new framework for its accounting and budget enforcement. We recommend that Congress set a target for future Social Security spending, determined as a percentage of GDP or as a percentage of the revenue sources described above. This target would be enforced by automatic tax increases and benefit reductions that gradually occur if the program's spending grows out of alignment with the intended levels. This system would address any structural imbalances in Social Security as they appear, rather than returning to a trust fund system that could once again enable chronic deficits and create another large fiscal cliff.

SOCIAL SECURITY CAN BE STRENGTHENED — BUT DOING SO REQUIRES REAL LEADERSHIP

Taken together, PPI's proposals offer a radically pragmatic blueprint for Social Security reform. Our plan would close Social Security's shortfall in a structurally coherent way that rewards work and reinforces the program's status as an earned benefit. It would protect older Americans by preventing automatic benefit cuts and by increasing benefits for the seniors who need them the most. And it would achieve these goals without forcing working Americans to shoulder the full burden of a problem that they did not create.

PPI's approach is not just intergenerationally balanced — it is politically balanced. Our proposed savings come from an even mix of tax increases and spending cuts. Our plan advances progressive values by redirecting government assistance from wealthy Americans to those who need it most. At the same time, conservatives should appreciate that this plan reduces deficits, rewards hard work, and minimizes anti-growth taxation. Most importantly, our plan benefits all Americans by offering retirement security they can depend on, rather than the unsustainable and uncertain status quo.

We recognize that any plan which reduces scheduled benefits or increases taxes on anyone but the ultra-rich will come with political challenges. But the mathematical reality is that any plan to rescue Social Security will require some combination of these difficult choices. And the longer policymakers wait to admit this, the more painful the solutions will become. So for the sake of retirees who depend on Social Security and the workers who pay into it, both parties must stop making the problem worse, and start working to solve it.

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