Next Social Contract Initiative and Economic Growth Program

# Expanded Social Security

## A Plan to Increase Retirement Security for All Americans

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### Executive Summary

The conventional wisdom about Social Security is profoundly misguided. According to today's mistaken consensus, the U.S. as a society cannot afford to allocate the money to pay for the present level of Social Security benefits for retirees in future generations. The solution, it is widely argued, is to cut benefits – either directly by means-testing or indirectly by raising the retirement age or allowing inflation to erode their real value over time. In this narrative, tax-favored private savings vehicles like 401(k)s and IRAs should be expanded in order to compensate for the allegedly necessary cuts in Social Security.

This consensus is not only misconceived in its diagnosis but also mistaken in its prescriptions and potentially disastrous in its consequences. Retirement security is often thought of as three-legged "stool" consisting of Social Security, employer retirement plans, and private savings. Social Security has been far more stable and successful than the other two legs of the stool. The reliance on these other legs of the system has resulted in a retirement security crisis for most Americans, shifting costs and risks onto individuals, even as the benefits of these programs go overwhelmingly to upper-income earners. Yet the current debate is arbitrarily restricted to the chief public component of the American retirement system, Social Security.

In reforming America's retirement security system, we should build upon what works. Instead of compounding failure by expanding private benefits, a category that includes rapidly-disappearing defined benefit pensions, employer-provided 401(k)s and individual retirement accounts (IRAs), we should substantially expand the successful, purely public Social Security program.

In this policy paper, we offer one possible way to increase the overall public component of retirement security in the U.S. that we call Expanded Social Security. Just as Medicare already has different components called Medicare A, B, C, and D, the Expanded Social Security program that we propose would have two elements: Social Security A and Social Security B.

Under our proposal for Expanded Social Security, today's Old Age and Survivors Insurance (OASI), commonly known simply as "Social Security," would be retained, possibly with modifications, as an earnings-based defined benefit program. This would be renamed Social Security A. The expected shortfall in funding for promised benefits that is predicted to occur in the 2030s would be made up for by revenue increases, not benefit cuts.

To supplement Social Security A, we would add a universal flat benefit for all retirees eligible for OASI called "Social Security B." Social Security B could be funded by revenues other than the payroll tax. Today's Supplemental Security Income (SSI), a means-tested antipoverty program that helps poor children and the disabled as well as the elderly, has always been funded out of general revenues. SSI thus provides a precedent for expanding the funding base for Social Security B. Indeed, one option would be to convert SSI into Social Security B.

The two components of Expanded Social Security, Social Security A and Social Security B, in combination would provide a much greater share of pre-retirement income than today's OASI does by itself for most Americans. This expansion of the public share of the average American's retirement income would make both tax-favored employer-based pensions and tax-favored individual savings accounts less necessary, allowing federal tax expenditures for those private programs to be reduced or eliminated. Combining major reductions in tax-favored private retirement savings programs with a substantial increase in the public portion of the American security system would make the retirement security system as a whole more progressive, more efficient, and more stable. Designed properly, a new retirement security system could substantially boost public retirement benefits for most Americans without increasing the percentage of GDP devoted to the combined public and private elements of our nation's retirement system as a whole.

In addition to increasing the public contribution to the retirement security of most Americans, Expanded Social Security would have other benefits for individuals, businesses and the economy. Unlike employer-provided pensions or 401(k)s, Social Security B would be universal and would not depend on the generosity of particular employers. At the same time, funding Social Security B with revenues other than payroll taxes could maintain or increase the publicly-funded share of retirement security without expanding the payroll tax beyond the levels needed to maintain benefits under Social Security A (today's OASI).

Other reforms might achieve similar results by different methods. Any strategy that expands the reliable and efficient public share of retirement security in America would be an improvement over today's system, which is biased toward the affluent and skewed toward private savings. Our purpose in proposing the Expanded Social Security Plan is to challenge the conventional wisdom about Social Security and to provoke a debate about whether and how to expand the public element of the American retirement security system. At present the discussion is dominated by those who want to privatize or shrink Social Security and those on the defensive who propose merely incremental reforms to preserve it. We seek not merely to move the ball, but also to move the goalpost in order to enlarge the boundaries of the national conversation about the future of retirement security in America.

## Retirement Security in America: A Three Legged-Stool

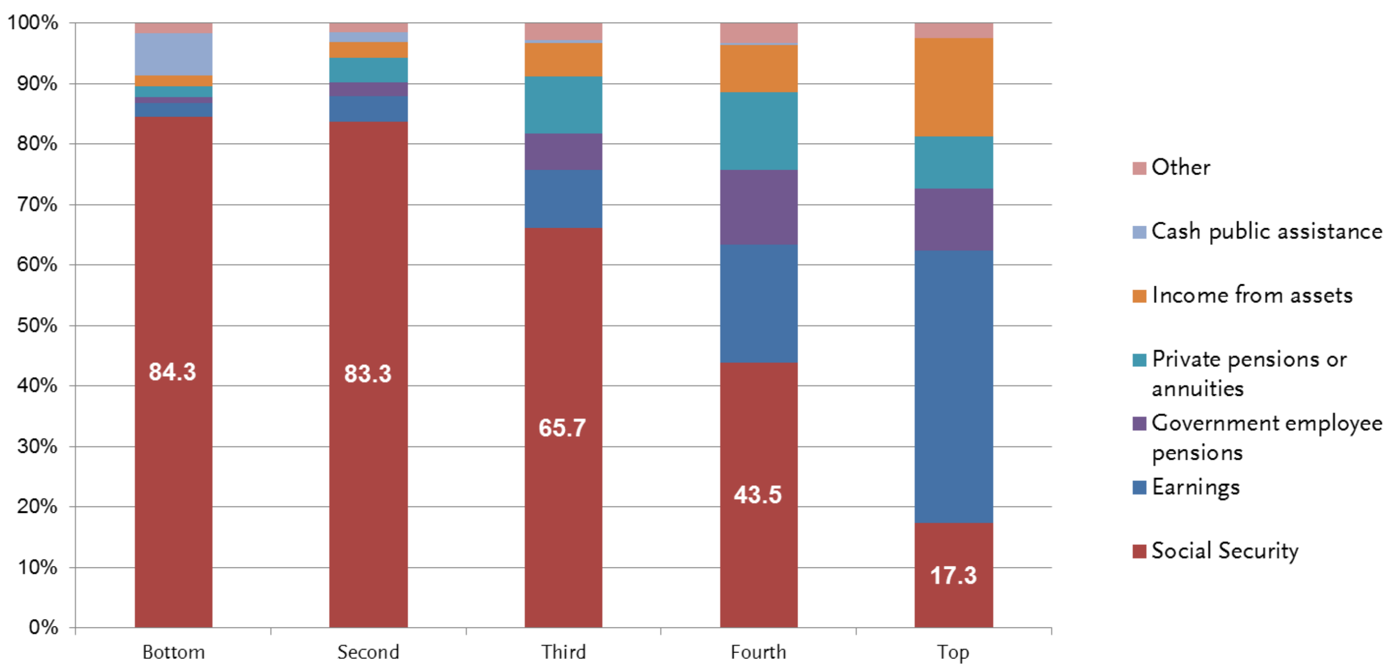
Today, individual retirement policy in the United States can be compared to a three-legged stool. The three legs are the public programs of Social Security (OASI) and the portion of Supplemental Security Income (SSI) that goes to the elderly poor, employer-based retirement plans like defined benefit pensions and defined contribution 401(k)s, and personal assets, chiefly the value of one's home.

Social Security is the largest and most stable component of this amalgam, providing 37 percent of all income for Americans ages 65 and older in 2010.[1] Social Security is an especially important source of income for lower-income older Americans, providing 84 percent of the income of older Americans in the bottom 40 percent of the income distribution. [2]

The other major public source of retirement income, Supplemental Security Income (SSI), makes up less than 0.5 percent of all older Americans' income. SSI is the source of 7 percent of income for elderly Americans in the lowest income quintile.[3]

The combination of traditional pensions and defined contribution plans such as 401(k)s and IRAs provides 18 percent of all income for older Americans. Both defined benefit pensions and defined contribution plans are much more important to more affluent elders: they provide 25 percent of all income for older Americans in the second-highest income quintile compared to just 3 percent of income for those in the lowest income quintile (see Figure 1). Although the share of older Americans' income from tax-favored private savings has stayed relatively constant over the past 30 years, the source of that income has shifted dramatically. Defined contribution plans like 401(k)s are now responsible for an increasing share of that income, as income from defined benefit pensions has declined.

**Figure 1**: Sources of Income for Americans aged 65+, by Income Quintile




*Source: U.S. Social Security Administration, Income of the Population 55 or Older, 2010*

The rest of the income of older Americans comes largely from asset income (income from savings accounts, investments, or reverse mortgages on homes, for example) and earnings, which are responsible for 11 percent and 30 percent, respectively, of all income of Americans aged 65 and older. By contrast to today, in which people rely more on earnings than assets, less than a generation ago the relative importance of these sources was reversed. In 1984, older Americans received 28 percent of income from assets and just 16 percent from earnings, and assets still accounted for a greater share of income as recently as 1992.[4]

The problem of an insecure retirement is not reserved for the lowest income earners. Fewer than half of the middle quintile (40th – 60th percentile) of the elderly have any form of pension income, and only a slim majority have any form of asset income. These problems predate the recent downturn: even before the Great Recession that began in 2008, 43 percent of middle-income and 54 percent of lower-income Americans already were at risk of having insufficient retirement funds.[5]

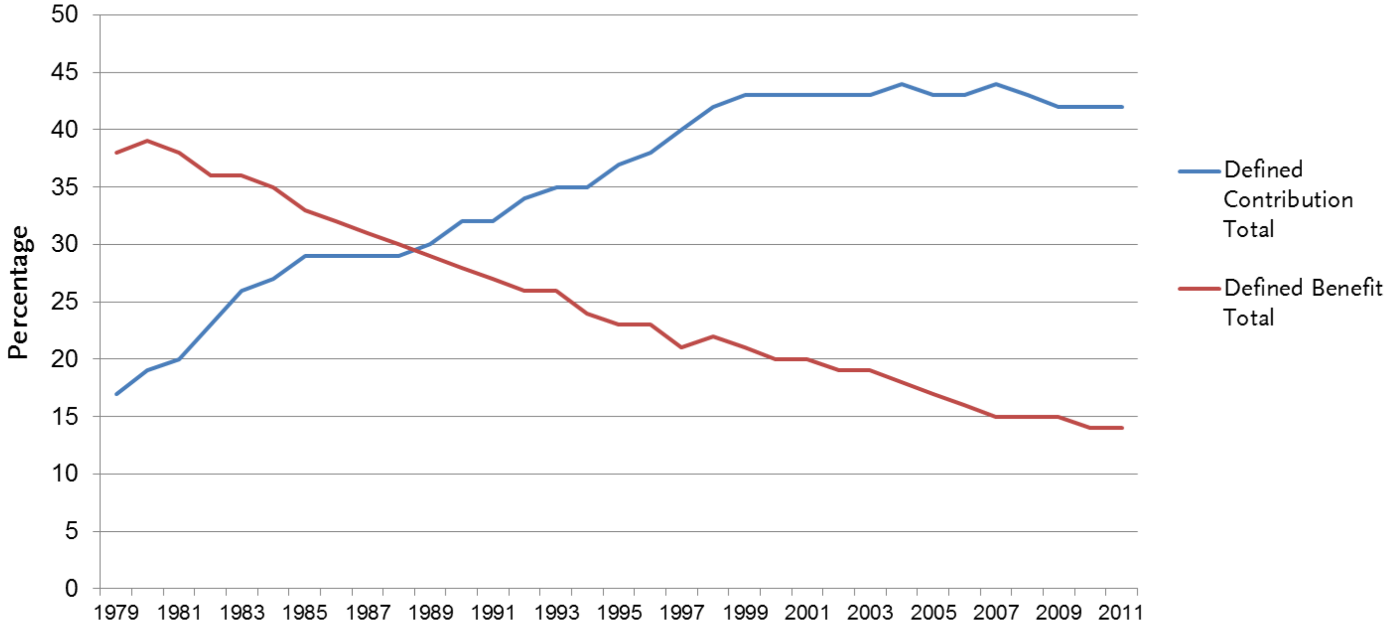
But the economic collapse has made the situation worse. The financial crisis has taken its toll on the private retirement resources of most Americans that are intended to supplement Social Security: employer retirement plans and individual savings and investment. Two out of three of the legs of retirement security have proven insufficient, with Social Security remaining as the only stable leg. This leaves retirement security as an unstable, one-legged oddity for the majority of retired Americans who now depend almost exclusively on Social Security. But even though Social Security has become, by default, a de facto national retirement system for most Americans, the Social Security payout at its present level is not adequate to compensate for the crumbling of the other two elements of retirement security.

## The First Failing Leg of Retirement Security: Employer Retirement Plans

Employer-based retirement plans always have been the least broadly distributed asset, with fewer than 40% of elderly Americans today (those 65 and over) earning income from any type of pension program.[6] The traditional defined benefit pension, in which employees receive a guaranteed payout during retirement from their employer, once provided a secure stream of retirement income on top of Social Security for many Americans. However, it has been disappearing over the past four decades, and now covers fewer than a third of all workers.[7]

Among private-sector workers, the number is even lower. In 1980, approximately 40 percent of private sector workers were covered by a pension with a guaranteed payout, and about 80 percent of employees in medium-size and large companies had such plans in 1985, according to data from the Labor Department.[8] In 2006, only about 15 percent of private sector workers had guaranteed payout pensions (see figure 2), including 32 percent at medium and large organizations. In the public sector, a higher percentage of workers still are covered by guaranteed payout pensions, but the number of public sector workers has declined dramatically in recent years, accelerating as a result of the Great Recession. There are now a million fewer federal employees than when Ronald Reagan left office, and public sector employment as a percentage of the population is at a 30-year low.[9]

**Figure 2**: Private Sector Workers Participating in Employment-Based Retirement Plan, 1979-2011




*Source: Employee Benefit Research Institute*

Many public pension plans are plagued by a serious threat to their stability due to underfunding by state and local governments. According to some calculations, states have funded only about 80 percent of their pension liabilities, leaving a $3.32 trillion funding gap – an estimate which understates the shortfall due to investment declines from the latter half of 2008.[10] One study concluded that there is a less than 5 percent chance that the current pattern of pension fund investments can fulfill obligations to retirees in 15 years. In addition to pension liabilities, states are responsible for more than $530 billion in other unfunded benefits, including retiree health and dental insurance, life insurance, and legal services.[11] The public pension funding gap extends to major U.S. cities as well. All of this underfunding predates the Great Recession, which has made the shortfall even more severe.

In addition to dwindling in importance, employer defined benefit pensions have shown poor economic results. American pensions were some of the hardest hit in the world by the Great Recession and stock market collapse, falling in value by 37% from their peak in 2007. They have still not fully recovered.[12] Even at the largest corporations in the United States, pension plans are underfunded. Only 18 of the 338 companies in the S&P that offer defined benefit plans are fully funded, and seven companies, including the nation's largest, ExxonMobil, had more than a $10 billion funding deficit in 2011.[13]

As private employers have shifted away from providing defined benefit pensions, they have turned to defined contribution plans like 401(k)s instead. Unlike traditional defined benefit pensions, defined-contribution plans allow employees to set aside fixed amounts of money into investment accounts. That amount is excluded from their gross wage when calculating taxable income, lowering their tax burden. One advantage of this method is that the 401(k)s and IRAs are somewhat portable from job to job. But workers' eventual retirement income from these accounts depends entirely on how much money they set aside during their working lives and how well the stock market and investments in their accounts performed. Employers have greatly preferred

401(k)s over defined-benefit pensions because workers shoulder the primary responsibility for funding them rather than the employer.

The growth of the 401(k) stems from legislation in the late 1970s. In the Revenue Act of 1978, Congress inserted a new section into the tax code, section 401(k), that allowed workers to take part of their pay as tax-free deferred compensation. Section 401(k) was not the first tax provision that allowed Americans to save for retirement in tax-deferred accounts: Individual Retirement Accounts had been created as part of the 1974 Employee Retirement Income Security Act (ERISA) and 403(b) accounts (tax-deferred accounts for employees of non-profits) have been around since the 1930s. But section 401(k) was the first provision that allowed workplace-sponsored tax-deferred retirement accounts for all types of employees, and thus opened the door for the proliferation of such accounts that has occurred in the decades since.

Since 1979, defined contribution and 401(k) retirement plans have gone from covering only about 17 percent of the private workforce to about 42 percent today (see Figure 2, above).[14] In some businesses, the employer contributes to the 401(k) plans that are managed by the employees, but the contribution amount is much less than under a defined payout pension.

These individual retirement plans – most prominently, 401(k)s – have been sold to American workers as the new and improved successors to traditional pensions. 401(k)s, however, have proven to be more costly for both the government and employees than the system they replaced. They force workers as individuals to face a number of significant risks, including losing their savings to a stock market downturn, through investing their money unwisely, or outliving their savings. US workers were insured more efficiently and more securely under the traditional pension system.

The risks individuals face in a defined contribution plan include:[15]

*Market risk*: workers who have 401(k)s risk losing a chunk of their savings in a market downturn or crash, a particularly damaging prospect for workers nearing retirement. The costs of this risk were shown clearly in the financial crisis: individuals lost 2.8 trillion in the value of their 401(k) or IRA plans.[16]

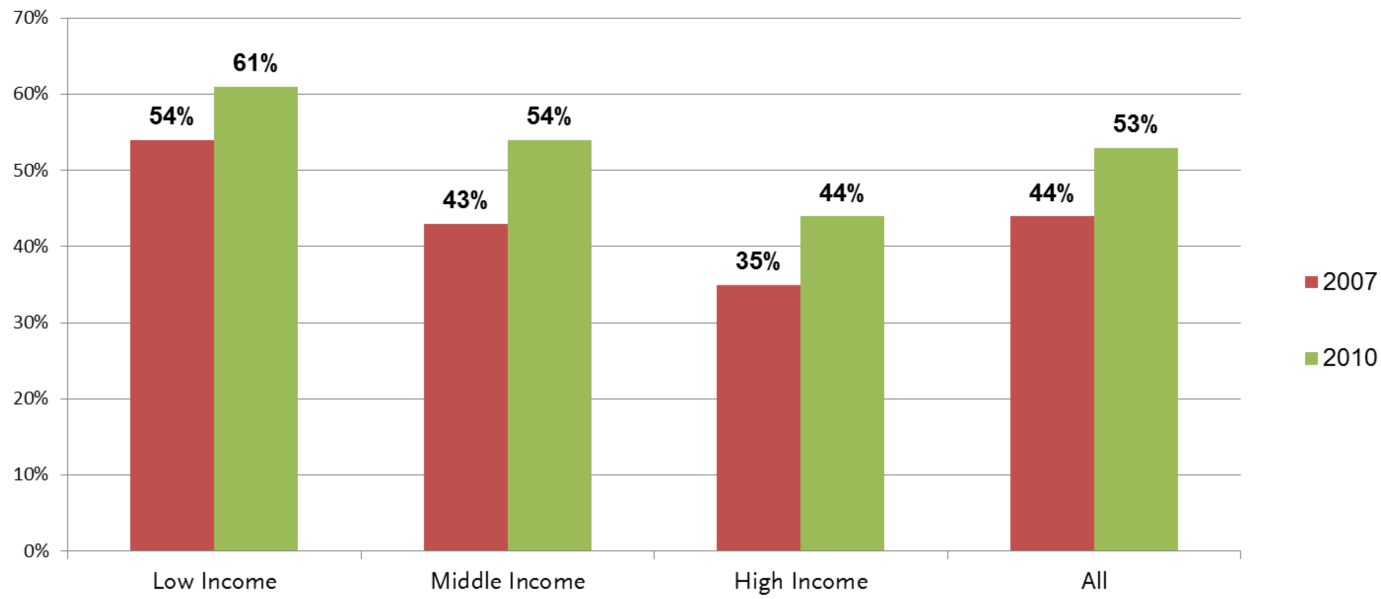
*Investment risk*: in addition to the overall volatility of the market, 401(k)s force workers to manage their own portfolios, which often leads to lower-than-optimal performance for many reasons: workers sell winning investments while holding losing ones, tend to hold undiversified portfolios, are invested in too many high-risk stocks, and generally lack the expertise necessary to earn high returns.[17] A study by the National Bureau of Economic Research found that more than one-quarter of baby boomer households (who are due to begin retiring over the next decade) thought "hardly at all" about retirement, and that financial literacy among boomers was "alarmingly low." Half could not do a simple math calculation (divide $2 million by five) and fewer than 20 percent could calculate compound interest.[18]

*Longevity risk*: retirees relying on their 401(k) to supplement Social Security may outlive their savings.

*Contribution risk*: workers often contribute too little or too inconsistently to their accounts to accumulate a sufficient nest egg. Financial experts say it will take a monthly retirement income of about 70 to 80 percent of pre-retirement income levels – in addition to $200,000 to $300,000 in personal savings – for the average American to have a secure retirement.[19] Yet most older Americans have saved only a fraction of that. In 2010, 75 percent of Americans nearing retirement age had less than $30,000 in their retirement accounts.[20] About half of all Americans are at risk of not having sufficient retirement income, and three-fifths of low-income households are at risk of not having sufficient retirement income to maintain their pre-retirement standards of living at age 65 – which was already a low standard to begin with. All of these problems were exacerbated by the Great Recession (see Figure 3).[21]

*Leakage risk*: workers often whittle away their savings by cashing out assets when they change jobs, by borrowing from their 401(k)s, and by making hardship withdrawals from their accounts before retirement.

**Figure 3**: Percent of Households At Risk of Not Having Enough Income to Maintain Standard of Living at Age 65




*Source: National Retirement Risk Index, Center for Retirement Research at Boston College. "At Risk" is a measure of households whose projected replacement rates are more than 10% below NRRI targets.*

High account fees charged by investment management firms exacerbate these risks and take a big bite out of already-inadequate savings. The "hyper-individualized" administration and investment management generates excessive costs that are ultimately absorbed by the workers themselves.[22] By some estimates, these costs are more than twice as high as they would be under a more efficient retirement system.[23]

It is important to emphasize that these risks and costs are an inherent part of the 401(k) system. It follows that reforms like stricter regulations on brokers, disclosure of 401(k) fees, or requiring plan sponsors to offer lower-cost index funds would fail to fix this fundamentally broken system. Fees would still remain high and workers would still be forced to shoulder most of the risks.

Thus both the private and public components of the U.S. employer-based retirement system are under severe strain, as the Great Recession combined with pre-recession patterns of rising inequality and a diminishing social contract have taken their toll. Even when significant numbers of workers were covered by a guaranteed payout pension, the lack of portability provided a powerful disincentive for workers to change jobs or shift their careers. While 401(k)s can be more portable, they have shifted risks and costs onto employees and have failed to provide sufficient support for retirees.

With defined benefit pensions covering fewer workers and defined contribution plans by definition riskier and more costly for employees, this leg of the three-legged retirement stool has grown too short and is too unstable to provide retirement security.

## The Second Failing Leg of Retirement Security: Asset Ownership

The second failing leg of retirement well-being consists of individual asset ownership, centered on homeownership. For tens of millions of Americans, security in their elderly years has been directly linked to the value of their homes. Yet the rupture of the housing bubble illustrated in dramatic fashion the danger of over-reliance on home values for retirement security.

Homeowners lost approximately $8 trillion in home equity during the Great Recession, a 53 percent drop in the overall value of the national homeownership stock.[24] About 10.7 million Americans – 22 percent of all homeowners – are still underwater today, owing more on their mortgage than their home is worth.[25] These homeowners are, in effect, flat broke if they have no other accumulated savings or retirement vehicle.

This has been devastating for Americans' retirement well-being because home ownership accounts for a large proportion of the assets owned by much of the population. During the 2000s, before the housing market crash, real property accounted for between 77 and 85 percent of tangible household assets.[26]

Individual levels of non-home assets are also too low to serve even as a personal buffer, let alone the basis of a secure retirement. A recent study found that nearly half of Americans (43.6%) do not have enough savings to cover basic expenses if they were to lose their source of stable income. These 132.1 million "liquid asset poor" Americans include many members of the middle class and upper middle class: more than a quarter of households earning between $55,465 and $90,000 per year – the entire range of which is above the median household income of $50,054 – have less than three months of liquid savings. Over 30% of all households do not have a savings account at all.[27]

The lack of private savings has weakened the other legs of the retirement stool. More than one in four households has had to withdraw savings from their 401(k) or 403(b) retirement accounts before retirement to pay for emergency savings (the "leakage risk" of 401(k) plans). These early withdrawals totaled $60 billion out of a total of $176 billion (40%) contributed by employees to defined contribution accounts in 2010, and early withdrawals come with heavy penalty fees.[28] With defined contribution plans already insufficient to cover retirement needs, the lack of private savings to cover working-age contingencies has made the problem worse.

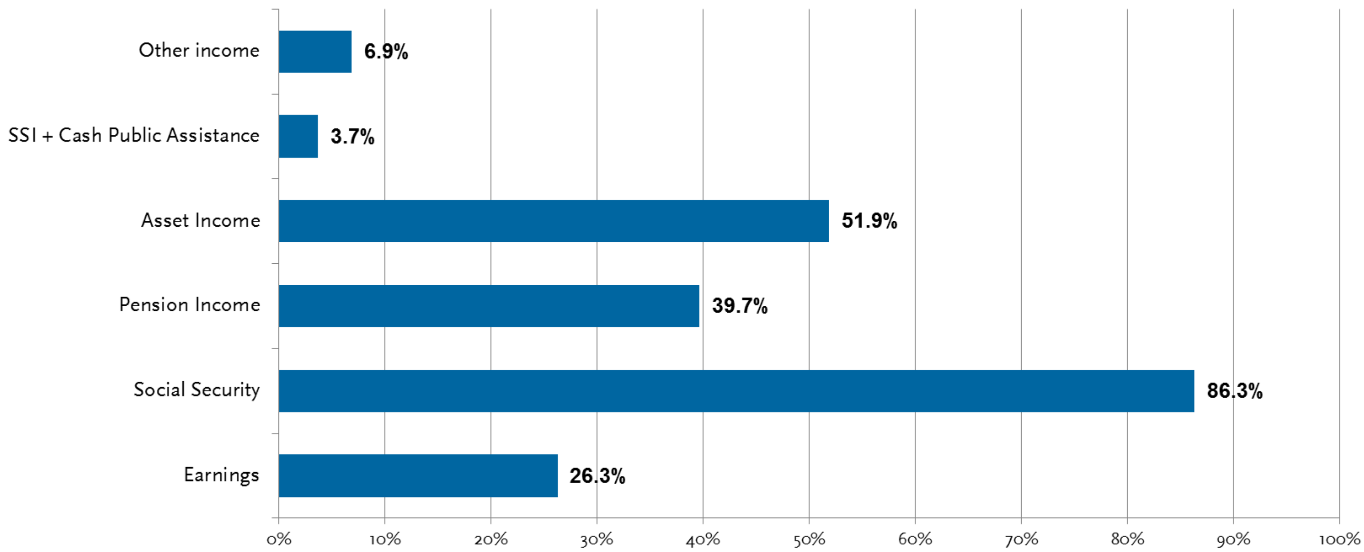
The second leg of the three-legged retirement stool, other savings and asset ownership, has proven to be as weak and unreliable as employer pensions and defined contribution plans. And with home prices recovering at a glacial pace in most parts of the country, this loss in equity has significantly reduced the economic security of the lower and middle classes, which are less likely to have pensions and other assets such as private savings (beyond homeownership) to sustain them.

## Building on Success: Increasing the Public Benefit Share of Retirement Income

In the decades ahead, the vast majority of baby boomers and other retirees will be almost completely dependent on the single leg of Social Security for their retirement.

The bottom two income quartiles for those aged 65 and over depend on Social Security for at least 80 percent of their income, but even the second richest quintile still depends on Social Security for nearly half of its retirement income. Middle–income elderly – the 40th to 60th percentile – currently rely on Social Security for 2/3 of their income.

**Figure 4**: Percentage of Americans 65+ with Income from Each Source




*Source: U.S. Social Security Administration, Income of the Population 55 or Older, 2010*

Due to the inadequacy of pension plans and miscellaneous household savings, the one-legged stool of the U.S. retirement system is increasingly unstable. For more and more Americans, the dream of a secure retirement is threatened.

Social Security has become a single pillar national retirement system, a role for which it was never intended or designed. This development is not to be lamented, however. On the contrary, the centrality and stability of the public component of the American retirement security system should be embraced and built upon.

Social Security is already one of the most popular public programs in the country. Numerous surveys show much greater support for preserving benefits for Social Security and Medicare than reducing them, even if it means raising taxes. A December 2012 Pew Research Center poll showed that 56% of people were opposed to raising the eligibility age for either Social Security or Medicare, and, even among Republicans only, more people disapproved of raising the eligibility age (and thus reducing benefits).[29] A Kaiser Poll from January 2013 had nearly identical results: 58% opposed any reduction to either Social Security or Medicare.[30]

Given the popular consensus about the looming budgetary shortfall, many polls have explored public opinion on reductions in these social insurance programs. But few have looked at whether there is support for *expansion* of these programs. A late 2012 poll by the National Academy of Social Insurance asked this question, however, and found strong public support. Three out of four respondents said that we should consider increasing Social Security benefits, and 84% said that current benefits are inadequate.[31] In the wake of budget negotiations in February 2013, Pew found that 41% would increase spending on Social Security while only 10% would decrease it.[32]

The United States is also less generous to its seniors than other advanced nations. The U.S. gross replacement rate for the average earner – how much of a person's income is covered by mandatory pension programs – is 39.4 percent, below the average of 57.3 percent for countries in the Organisation for Economic Co-operation and Development (OECD) and 61.6 for countries in the European Union.[33] On other pension replacement metrics like gross pension wealth, which is indexed for life expectancy and retirement age, the United States also lags behind.[34]

These measurements by definition only assess pensions, which use income as a proxy for relative levels of well-being. But that income is used to purchase the services, food, shelter, medical care and other items that a retiree needs. In many developed nations, health care, transportation and mass transit, and senior care in institutions are more cost efficient and less expensive. The United States ranked 19th globally in a recent retirement security index – behind nearly every advanced nation except the United Kingdom. Due to high health costs on seniors and the inadequacy of defined contribution savings plans, the United States even ranked behind countries including Slovenia, Slovakia, and the Czech Republic (see Table 1).[35] Using pensions/retirement income as the main measure of elderly well-being fails to provide a complete picture of quality of life and makes the relatively stingy U.S. public retirement system seem more generous than it really is.

**Table 1: Natixis Global Retirement Index: Top 20 Nations**

| | | | |
|---|---|---|---|
| 1 | Norway | 11 | Australia |
| 2 | Switzerland | 12 | Israel |
| 3 | Luxembourg | 13 | Canada |
| 4 | Sweden | 14 | Belgium |
| 5 | Austria | 15 | Japan |
| 6 | Finland | 16 | Slovenia |
| 7 | Netherlands | 17 | Czech Republic |
| 8 | Denmark | 18 | Slovakia |
| 9 | Germany | **19** | **United States** |
| 10 | France | 20 | United Kingdom |

Instead of trying to diminish the importance of Social Security as a share of retirement income, we should increase it and expand it so that it becomes a more robust core of Americans' retirement system.

## Expanded Social Security: A Proposal for a New Retirement Security System

Insanity has been defined as repeating the same action and expecting a different result. By that definition, the conventional wisdom that Social Security, the most successful element of retirement security, should be reduced, while Americans should be compelled to rely more on less-successful private alternatives, is insane. The private alternatives to Social Security – tax-favored employer pensions, tax-favored individual savings accounts, and individual asset ownership – have all failed in comparison to Social Security. Rather than hoping that private sources of retirement income will show better results in the future, we should reduce the reliance of most American workers on those unreliable alternatives by expanding the popular, efficient and successful Social Security system.

We propose to replace most of the country's current, inadequate, hybrid public and private retirement system with a two-part, wholly public system called Expanded Social Security. [36] Expanded Social Security would have two distinct parts. The first part, Social Security A, would be similar to the current Social Security Old Age and Survivors Insurance (OASI) program, which provides a retirement benefit related to earnings. The second part of Expanded Social Security would be a new universal flat benefit, Social Security B, to supplement the traditional earnings-related benefit that would continue to be provided by Social Security A.

Some version of this "double decker" public system is similar in form to that in a handful of other countries. Japan, Canada, and Luxembourg, to name a few, have both a basic flat public pension and a public defined benefit program based on earnings.[37]

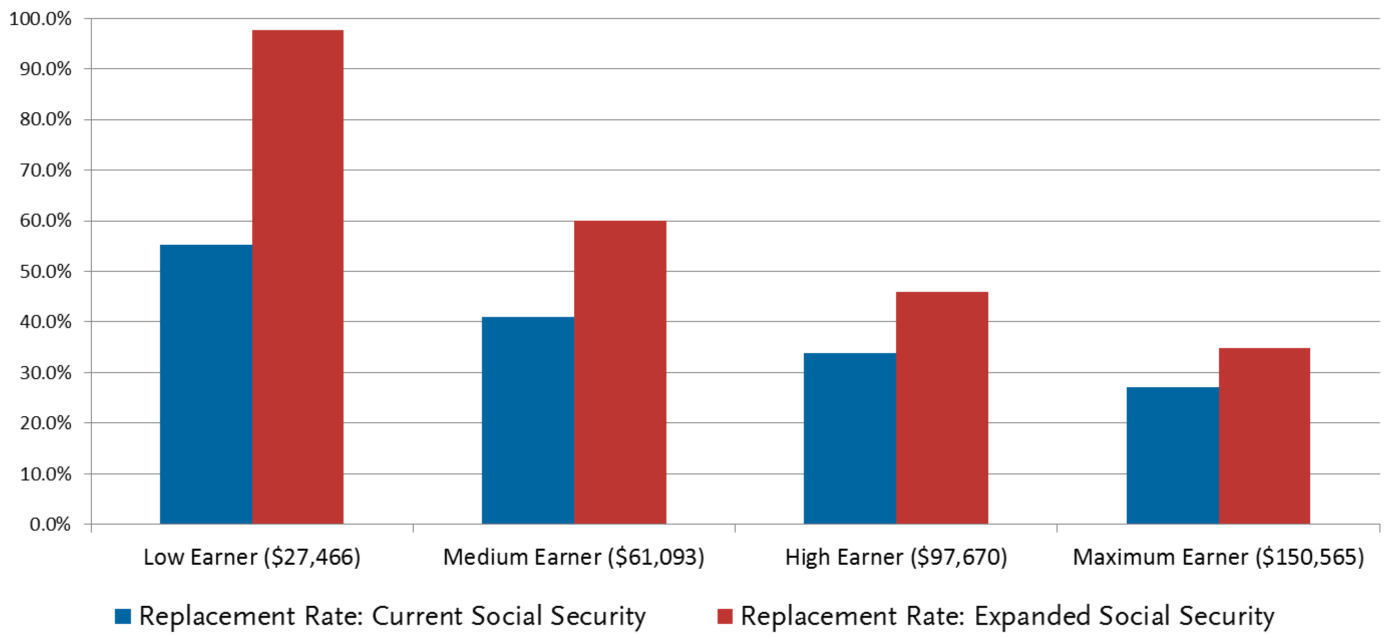
In order to illustrate our proposal, we have designed a scenario in which, when Social Security A and B are combined, a career-medium earning worker would be guaranteed 60 percent of his or her average working wage in retirement income. This amount provides a much sturdier foundation than the current system, which replaces only about 40 percent of income for the average worker. This level also makes Social Security B's flat benefit similar to the poverty line, thus essentially eliminating poverty among the elderly. We use the year 2035 as our example year for our calculations because it allows for medium-term projections and is the first year of data available after the estimated exhaustion of the Social Security trust fund (and thus is the focus of contemporary discussions).

For the sake of clarity, the scenario excludes some factors, like arrangements for a transition from the old system to the new, which would be significant if a version of our proposal were adopted.[38] Nevertheless, the example provides a useful glimpse at one form that Expanded Social Security could take and basic estimations of its cost and its benefits for elderly earners across the income spectrum.

If we assume that Social Security benefits are maintained at current levels and that there are no additional cuts to the program,[39] we propose to set Social Security B at $11,669 per year for all elderly earners. This will guarantee a replacement rate of 60 percent for a medium earner based on calculations derived from Social Security Administration data. With this flat benefit, low-income earners will see their replacement rates boosted to nearly 100 percent. High-income earners – those making around $100,000 per year – will have a public replacement rate of 46 percent, and very high earners ($150,000 per year) will have a public replacement rate of 35 percent (see Figure 5).

The proposed system would be much more progressive than the current retirement security landscape. Because of the flat benefit, lower-income and middle-income earners would have higher levels of income in retirement. Upper-middle income earners would also likely be at least equally as well-off: the increase in income from the flat benefit would offset most or all of the income they derive from employer retirement programs. The highest-income earners would bear the burden of these proposed changes, as they would no longer be able to rely on the tax-favored programs that primarily benefit affluent individuals. However, they would still receive a higher level of direct public benefits than they do currently due to the universal addition of Social Security B.

**Figure 5**: Replacement Rates by Earnings Level, 2035, Current Social Security vs. Proposed Expansion (60% Replacement Rate)



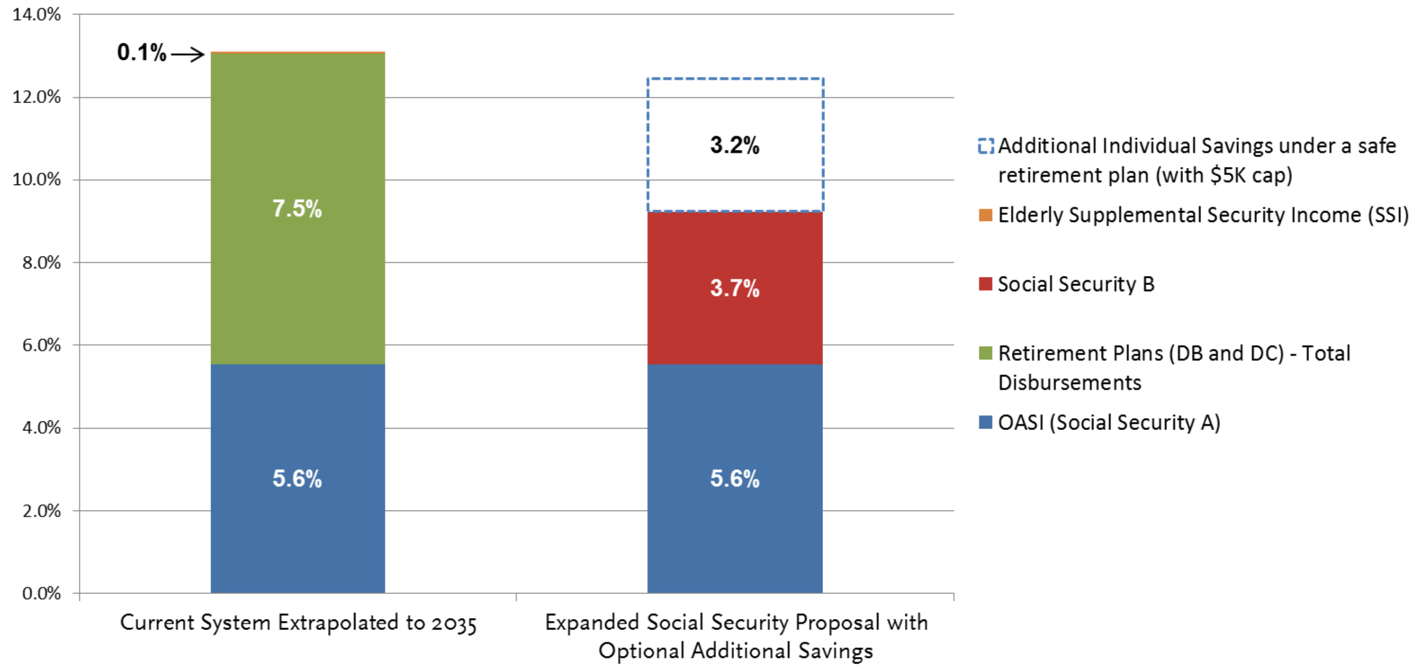

## Expanded Social Security: How Much Would It Cost?

The 2012 Trustees' Report projects that the existing Social Security program (OASI) will have 78.1 million beneficiaries in 2035. We add to this total the approximately 1.5 million elderly Americans who currently receive SSI but not OASI for a total of 79.6 million people projected to be eligible for Social Security B in 2035.

Providing Social Security B's flat benefit to the projected eligible population would initially cost $928.9 billion in 2035.[40] The program's cost would rise yearly in step with the growth rate of the retiree population. The Trustees' Report estimates this rate will be 0.5 percent in 2035, so we can expect the cost of Social Security B to grow at the same pace. (For full details on how these calculations were made, see Appendix B).

This cost estimate might sound large, but it must be taken in proper context. Figure 6 contrasts the present retirement security system, extrapolated to 2035, with our hypothetical alternative. As the graph indicates, if the current system were unchanged, the publicly-sponsored retirement system in 2035, defined as Social Security and SSI plus disbursals from tax-favored employer and individual retirement plans, would be equal to 13.1 percent of GDP. Of this total, a greater share would be tax-favored private retirement plans (7.5 percent) than Social Security or OASI (5.6 percent). Because these tax-favored plans skew disproportionately toward upper-income Americans, this plan is not only inefficient but also inequitable.

**Figure 6:** Estimated Total Publicly-Sponsored Retirement as Share of GDP, 2035, Current System vs. Proposal




*Source: Authors' calculations from CBO and SSA projections*

The bar on the right shows a version of our Expanded Social Security Plan, consisting of Social Security A, Social Security B, and an optional, limited tax-favored private savings plan with a cap of $5,000 per year (for more on the optional third part, see section below). The two-part public core of the proposed Expanded Social Security system would cost 9.3 percent of GDP, and the optional additional tax-favored private savings component would add, at most, 3.2 percent of GDP for a total cost of 12.4 percent of GDP. Thus, as this illustration shows, spending from Social Security A and B, combined with disbursals under a modest tax-favored private savings plan, adds up to less as a share of the economy than the 2035 version of today's far less fair and far riskier publicly-sponsored retirement system as a whole.

For additional comparison, this projected cost of the proposed two-part program would still be less than that *currently* spent by some OECD countries on their retirement systems. France, for example, spends 12.5 percent of GDP on its retirement programs.[41] Thus, the combined costs for Social Security A and B seem like a relative bargain considering that they would be providing retirement income for a considerably older population than exists in any OECD country today.

## Paying for an Expansion of Social Security

One benefit of Expanded Social Security is that it would allow the total public retirement benefit for most Americans to be dramatically increased without increasing the payroll tax rate. Under our proposal, the two components of Expanded Social Security would be paid for by separate revenue streams. Social Security A would be paid for by payroll taxes. Social Security B, the new universal, flat benefit, would be financed by revenues other than payroll taxes – either general revenues or a dedicated tax or taxes.

Although there is no short-term Social Security "crisis," there is a long-term Social Security problem. In 2010, the program began paying out more than payroll taxes brought in.[42] The Social Security trust fund is projected to make up the difference for two decades, but around 2033 the trust fund will run out. Thereafter the gap between Social Security's revenue and spending is projected to be between 1 and 1.5 percent of U.S. GDP.[43] This shortfall needs to be addressed to maintain the current base level of benefits so that the additional expansion of the program can be implemented.

The reform of OASI/Social Security A should consist solely of payroll tax increases, rather than benefit cuts. Today OASI is paid for by the combined employer-employee payroll tax, which is set at 12.4 percent of wages below $113,700.

Because of increasing wage inequality in America in the last generation, Social Security taxes, which covered 90 percent of wages in 1980, now cover less than 84 percent.[44] Increasing the payroll tax until it covers 90 percent of wages once again would plug half of the shortfall. Lifting the lid on Social Security payroll taxes as a percentage of wages entirely could eliminate the current funding gap altogether.[45]

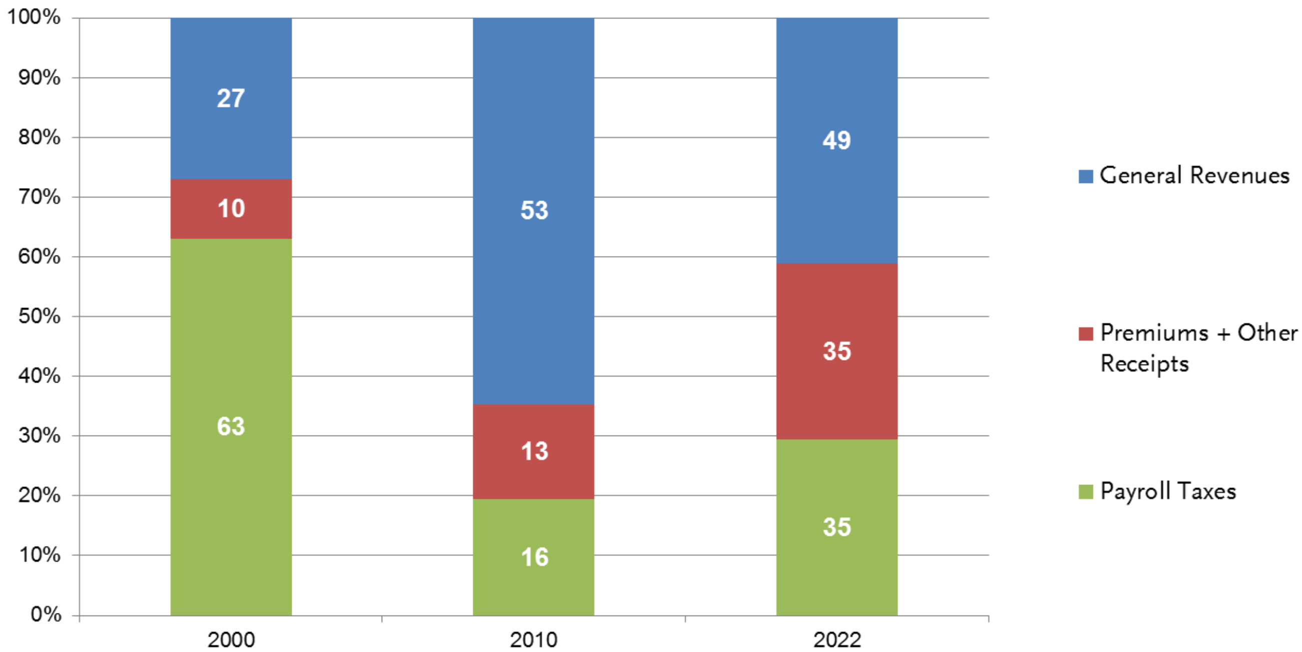
Another financing option would be to broaden the base of tax income by taxing unearned income such as capital gains, investment income, and dividends at the same payroll rate that affects earned labor income. As it stands, unearned income is exempt from payroll taxes. Expanding the taxable base by including both earned and unearned income would generate more revenue for Social Security and would be very progressive, as most unearned income accrues to the wealthiest individuals. Other legislation is moving in this direction: the 2010 health care reform law included a provision to tax unearned income at 3.8 percent to help finance Medicare.[46]

While a reformed payroll tax would continue to pay for OASI (Social Security A in the new proposal), we need to look elsewhere to fund the expansion of Social Security that we believe is necessary. The new flat benefit, Social Security B, could be paid for out of either general revenues or a new dedicated tax or taxes, which might include portions of a federal value-added tax (VAT). (For a discussion of how today's SSI program could be converted into Social Security B, see Appendix A).Many defenders of the current payroll tax-only system of financing fear that mingling other funds with payroll taxes would undermine public support for the direct public benefits portion of the program. The example of Medicare, however, suggests otherwise.

According to Congressional Budget Office data, in 2010 payroll taxes and other earmarked taxes covered more than 93 percent of the cost of Social Security. But in the same year, little more than a third of Medicare's costs were covered by payroll taxes. Slightly more than half were paid for by general revenues, while roughly a seventh of Medicare's costs were provided by beneficiary premiums and other earmarked receipts (see Figure 7). If premiums are factored out, then other revenues covered roughly 60 percent of Medicare's costs while payroll taxes covered around 40 percent.[47]

The difference between Social Security and Medicare arises from the fact that Medicare consists of multiple programs: Medicare Part A, which covers hospital insurance, is financed by payroll taxes, while Medicare Parts B and D, which cover doctors and prescription drugs, are paid for by general revenues and premiums (Medicare Part C consists of private plans).[48] If public support for a social insurance program depends on whether it is financed wholly by payroll taxes, with no infusion from general revenues or other sources of revenue, then public support for Medicare should be weaker than public support for Social Security. But there is no evidence for this. On the contrary, both Medicare and Social Security enjoy strong public support. Indeed, it is likely that few Americans understand how the programs are financed. Their popularity arises from the perceived need for them and the perceived as well as actual benefits, not from the specific details of how they are paid for.

**Figure 7**: How Is Medicare Financed?




*Source: Donald Marron, Tax Policy Center from CBO data*

The long-term funding gap for the main part of Social Security can be fixed by broadening the payroll tax base to high incomes or untaxed gains, and the addition of the universal flat benefit can be funded with general revenues or a new dedicated tax or taxes. Together, this will create a solvent, more robust social insurance system.

## A Third Part? Optimal Designs for Optional Private Savings

The Expanded Social Security system that we propose is designed to increase the public component of retirement income for most Americans and to reduce the need for reliance on tax-favored or taxable private savings without increasing payroll taxes that hurt American businesses. The fact that, under the Expanded Social Security plan, a majority of Americans would be less dependent on vanishing employer pensions, unreliable IRAs and 401(k)s and inadequate household wealth is a *feature* of the Expanded Social Security plan, not a *bug*.

Nevertheless, individuals and families would be free to amass additional private savings for retirement, to supplement the more generous public retirement system that we propose. This would be most relevant for higher-earning individuals for whom Expanded Social Security will not replace as large of a share of their pre-retirement earnings.

It is not clear, however, that such optional, additional private retirement savings should be subsidized by taxpayers through favorable tax treatment, if the benefits for tax breaks for private retirement savings are enjoyed chiefly by the affluent, as is currently the case.[49] This year, the government will spend $165.4 billion through these tax expenditures to subsidize individual retirement savings, nearly 80 percent of which will accrue to the top 20 percent of earners.[50] With all Americans receiving Expanded Social Security, the need for these regressive tax-based benefits will be much less pressing. No public interest justifies the provision of subsidies through the tax code for the private retirement savings of the affluent – yet that is exactly what current policy does.

If Congress, after enacting a version of Expanded Social Security, also wanted to promote individual savings for middle-class Americans, it should consider abolishing 401(k)s and other tax-favored individual retirement accounts and replacing them with simple, universal private retirement savings vehicles with strict contribution limits that are more efficient and equitable.

Defined contribution plans can exploit economies of scale in order to lower management fees and other administrative costs if individual savings are pooled and if "churn" is minimal, as in index funds. This is the logic behind proposals that all Americans, not only federal employees, be allowed to invest in the federal government's Thrift Savings Plan. The same logic underlies Senator Tom Harkin's proposal for Universal, Secure, and Adaptable (USA) Retirement Funds and economist Teresa Ghilarducci's proposal for Guaranteed Retirement Accounts (GRAs).[51] While the details differ, all of these social insurance plans would promote risk sharing and minimize administrative costs by creating large pools of savings. In addition, the USA Retirement Funds and GRAs would be designed to protect savers to varying degrees against the tumult of stock market fluctuations.

The addition of a private retirement savings element to Expanded Social Security would need a cap on contributions so that the program helps middle-income earners without becoming a lavish subsidy for the rich. In our scenario, we have a cap of $5,000 per year into either a GRA or equivalent universal retirement account.

But a warning is in order here. It is easy to imagine the private money management industry, threatened by the Expanded Social Security proposal, adopting a version of our Social Security B proposal for a flat benefit and combining it with an expanded tax-favored private retirement system, perhaps along the lines discussed above – while cutting or eliminating today's earnings-based contributory Social Security program (which would become "Social Security A" in Expanded Social Security). Indeed, many past proposals for the partial or complete privatization of Social Security have included a flat, means-tested public benefit to be supplemented by an expansion of tax-favored private savings.

In our view, any such policy would defeat the purpose of our Expanded Social Security program, which is to reduce, not increase, the reliance of American retirees on tax-favored pensions and tax-favored private retirement savings accounts alike. Any proposal to create a public flat benefit as an alternative to Social Security's public contributory benefit, rather than as an add-on, should be rejected as an attempt at backdoor privatization of Social Security.

## Expanded Social Security: Toward Greater Retirement Security for All Americans

The three-legged stool of retirement security in the United States – Social Security, employer plans, and private savings, mostly derived from homeownership – has become wobbly and unstable. With employers walking away from their traditional role of providing a private pension, with defined contribution plans like 401(k)s and IRAs dependent on the vagaries of the stock market, and with low levels of personal asset ownership, Social Security now is the only stable leg remaining that is able to prop up retirement security for hundreds of millions of Americans.

We propose to replace a wobbly stool and its failing private components with a single, sturdy, portable and purely public column made up of a strong pillar atop a solid foundation: Expanded Social Security.

An expansion of Social Security along the lines that we envision not only would be good for America's retirees, it also would be good for the broader macroeconomy. It would act as an "automatic stabilizer" during economic downturns, keeping money in retirees' pockets and stimulating consumer demand, especially among low- and middle- income individuals who are more likely to spend an extra dollar on goods and services than are affluent individuals. In addition, unlike some elements of the current retirement system, such as pensions, no component in the Expanded Social Security plan is contingent on benefits provided by particular employers. By replacing all or most employer-provided, tax-favored retirement savings plan with a new flat public benefit and, perhaps, a modest optional savings plan, Expanded Social Security would completely unlink the retirement income of individual Americans from particular jobs and particular employers. And Expanded Social Security would help American businesses trying to compete with high value-added foreign companies that don't have to provide pensions to their employees, because those countries already have national retirement plans.

The combination of today's Social Security A with our proposed Social Security B to create Expanded Social Security would provide a stable, secure retirement for every American and contribute greatly toward a solid foundation from which to build a strong and vibrant 21st century economy. America's hard-working citizens deserve no less.

## Appendix A: Expanding Social Security by Repurposing Existing Programs

Our proposal is to create a double-decker Expanded Social Security system by adding a universal flat benefit called Social Security B to supplement a modified version of today's Old Age and Survivors Insurance (OASI), which would be renamed Social Security A.[52] One way to achieve this outcome would be to create a completely new Social Security B program. But it would also be possible to achieve the same outcome by repurposing three of today's existing federal programs: OASI, DI and SSI.

Disability Insurance (DI) is a universal, earnings-based program for nonelderly disabled workers, paid for out of the Social Security payroll tax. DI now accounts for 17.8 percent of total Social Security expenditures.[53] (OASDI refers to the combined resources and spending of OASI and DI.)

Supplemental Security Income (SSI) is a means-tested welfare program, providing benefits to the elderly poor as well as to disabled poor working-age adults and disabled poor children. About one quarter of SSI recipients are 65 or older.[54]

Expanded Social Security could be created in two steps, by repurposing DI and SSI.

First, all disabled working-age adults and children would be removed from SSI and enrolled in DI. It is unnecessary to have two distinct federal income programs for the disabled. As a universal, earnings-related program funded by part of the payroll tax, DI can be expected to enjoy greater political support than SSI, a means-tested welfare program. As the saying goes, "Programs for the poor are poor programs."

Shifting all disabled nonelderly from SSI into DI would leave SSI as a means-tested program of income support exclusively for the elderly poor. The second step of repurposing would be to remove the means test and turn SSI into Social Security B, a universal, flat benefit for all retirees, regardless of whether they are eligible for additional earnings-related benefits. This universal benefit would render the need for a targeted elderly antipoverty program obsolete.

Because SSI is already funded out of general revenues, creating Social Security B by modifying and enlarging SSI would also achieve the goal of adding new revenues to an expanded public retirement system without increasing the payroll tax. Even conservative economists tend to agree that a minimum basic income for the elderly, as a redistributive welfare program rather than an earnings-based annuity, should be paid for out of general revenues or other broad taxes, rather than out of payroll taxes.[55] Indeed, this is generally the practice in countries with double-decker public retirement systems.[56]

In the interests of continuity, the existing names of the three programs might be kept, even after the reallocation of responsibilities: Old Age and Survivors Insurance (OASI) or Social Security A, Supplemental Security Income (SSI) or Social Security B, and Disability Insurance, now a program for the nonelderly disabled only.[57]

## Appendix B: Assumptions and Estimates for Expanded Social Security

What follows are the assumptions and calculations we used to arrive at the proposed flat retirement benefit and its costs. Since the proposal is intended to complement Social Security, we use the Social Security Administration's projections from the 2012 Trustees' Report, available at http://www.ssa.gov/oact/tr/2012/tr2012.pdf. Though our own opinions may differ from some of the Report's assumptions, for consistency's sake we adopt wholesale the report's intermediate cost assumptions for our own projections for the cost of Expanded Social Security. The trustees consider the intermediate cost assumptions, reproduced in Figure B.1 below, to be their baseline, and thus so do we. For continuity's sake, all of our figures derive from those from the Social Security Administration.

Figure B.1: Social Security Trustees' Long-Range Economic Assumptions, 2012

**Table II.C1.—Long-Range Values[a] of Key Demographic and Economic Assumptions for the 75-year Projection Period**

| Long-range assumptions | Intermediate | Low-cost | High-cost |
|---|---|---|---|
| Total fertility rate (children per woman), starting in 2036 | 2.0 | 2.3 | 1.7 |
| Average annual percentage reduction in total age-sex-adjusted death rates from 2011 to 2086 | .77 | .39 | 1.18 |
| Average annual net immigration (in thousands) for years 2012-86 | 1,080 | 1,375 | 790 |
| Productivity (total U.S. economy), starting in 2024 | 1.68 | 1.98 | 1.38 |
| Average annual percentage change in average wage in covered employment from 2021 to 2086 | 3.92 | 3.51 | 4.31 |
| Consumer Price Index (CPI), starting in 2021 | 2.80 | 1.80 | 3.80 |
| Average annual real-wage differential (percent) for years 2022-86 | 1.12 | 1.71 | .51 |
| Unemployment rate (percent), starting in 2021 | 5.5 | 4.5 | 6.5 |
| Annual trust fund real interest rate (percent), starting in 2022 | 2.9 | 3.4 | 2.4 |

*Source: Social Security Administration, 2012 Trustees' Report, Page 8.*

Figure B.2 below shows the scheduled Social Security benefits and income replacement rate for medium-earning workers retiring in future years, based on the aforementioned "intermediate cost" economic and demographic assumptions. This table is the starting point for our calculations for the cost of our proposal, since the proposal's goal is to provide benefits large enough so that the average earner has a retirement income "floor" of 60 percent of her/his pre-retirement income. We chose this number because 60 percent is large enough to be a substantial increase in benefits for middle and low income earners, and it also coincides with a flat benefit level that guarantees an income that meets the national poverty level to ensure that no elderly person is impoverished. Alternately, we could choose a lower floor of 50 percent, which would cost less but require that more households took part in either taxable private savings or the optional third part we propose. The numbers for this calculation are also included in this Appendix.

The hypothetical medium earner earns, on average over her/his career, an amount equal to 100 percent of the Average Wage Index (AWI)[58]; in other words, they are the quintessential statistically-average earner. The yearly benefit amounts shown in the table are *scheduled* benefits, not *payable* benefits: because Social Security cannot legally run a deficit, the benefit amount scheduled will only be paid if the projected shortfall is closed through increased taxes or better-than-average economic performance. If benefits are cut or if the economy performs as expected and Congress takes no action to close the shortfall, "payable" benefits will be just 75 percent of scheduled benefits. Our estimates assume, as detailed in the paper, that Congress closes the shortfall in some manner. If no changes are made and we want to maintain our guaranteed 60 percent replacement rate for the medium earner, Social Security B would have to be increased additionally to close this gap.

Our cost estimate is based off of the projection from Figure B.2 showing that a medium-earning worker who retires at normal retirement age (age 67) in 2035 is scheduled to receive a yearly benefit of $24,987, an amount which replaces 40.9 percent of her/his average pre-retirement earnings; other categories of workers (low, high, and maximum) are projected to receive benefits as shown in the table as well.

By working backwards, we can determine how to calculate the flat benefit needed to meet our goal of a retirement income of 60 percent of the medium earner's AWI. From the data in Figure B.2, we calculate that a medium earner's career average salary in 2035 will be $24,987/0.409 = **$61,093**. Thus, Social Security A and B together should provide a medium worker with a benefit of 60 percent of this, or $36,656.

Social Security A will provide this medium earner $24,987. To supplement this income to reach $36,656, Social Security B would need to be $11,669. To reach a 50 percent replacement rate, Social Security B would need to be $5,559.

Figure B.2: Future Scheduled Social Security Benefits for an Average Worker

**Table V.C7.—Annual Scheduled Benefit Amounts[a] for Retired Workers With Various Pre-Retirement Earnings Patterns Based on Intermediate Assumptions, Calendar Years 2012-90**

| | Retirement at normal retirement age | | | Retirement at age 65 | | |
|---|---|---|---|---|---|---|
| Year attain age 65[b] | Age at retirement | CPI-indexed 2012 dollars[c] | Percent of earnings | Age at retirement | CPI-indexed 2012 dollars[c] | Percent of earnings |
| **Scaled low earnings:[d]** | | | | | | |
| 2012 . . . . . . . . . . . . | 66:0 | $11,390 | 57.8 | 65:0 | $10,648 | 55.0 |
| 2015 . . . . . . . . . . . . | 66:0 | 11,327 | 53.7 | 65:0 | 10,582 | 51.4 |
| 2020 . . . . . . . . . . . . | 66:2 | 12,481 | 53.9 | 65:0 | 11,503 | 50.4 |
| 2025 . . . . . . . . . . . . | 67:0 | 13,643 | 55.5 | 65:0 | 11,827 | 49.2 |
| 2030 . . . . . . . . . . . . | 67:0 | 14,347 | 55.3 | 65:0 | 12,436 | 49.0 |
| 2035 . . . . . . . . . . . . | 67:0 | 15,161 | 55.2 | 65:0 | 13,134 | 48.9 |
| **Scaled medium earnings:[e]** | | | | | | |
| 2012 . . . . . . . . . . . . | 66:0 | 18,771 | 42.9 | 65:0 | 17,534 | 40.8 |
| 2015 . . . . . . . . . . . . | 66:0 | 18,667 | 39.8 | 65:0 | 17,441 | 38.1 |
| 2020 . . . . . . . . . . . . | 66:2 | 20,575 | 40.0 | 65:0 | 18,966 | 37.4 |
| 2025 . . . . . . . . . . . . | 67:0 | 22,498 | 41.2 | 65:0 | 19,492 | 36.5 |
| 2030 . . . . . . . . . . . . | 67:0 | 23,644 | 41.0 | 65:0 | 20,491 | 36.3 |
| 2035 . . . . . . . . . . . . | 67:0 | 24,987 | 40.9 | 65:0 | 21,652 | 36.3 |
| **Scaled high earnings:[f]** | | | | | | |
| 2012 . . . . . . . . . . . . | 66:0 | 24,891 | 35.5 | 65:0 | 23,255 | 33.8 |
| 2015 . . . . . . . . . . . . | 66:0 | 24,745 | 33.0 | 65:0 | 23,124 | 31.6 |
| 2020 . . . . . . . . . . . . | 66:2 | 27,252 | 33.1 | 65:0 | 25,122 | 30.9 |
| 2025 . . . . . . . . . . . . | 67:0 | 29,817 | 34.1 | 65:0 | 25,836 | 30.2 |
| 2030 . . . . . . . . . . . . | 67:0 | 31,337 | 34.0 | 65:0 | 27,159 | 30.1 |
| 2035 . . . . . . . . . . . . | 67:0 | 33,110 | 33.9 | 65:0 | 28,694 | 30.0 |
| **Steady maximum earnings:[g]** | | | | | | |
| 2012 . . . . . . . . . . . . | 66:0 | $29,902 | 28.7 | 65:0 | $27,762 | 27.4 |
| 2015 . . . . . . . . . . . . | 66:0 | 30,115 | 26.5 | 65:0 | 28,002 | 25.3 |
| 2020 . . . . . . . . . . . . | 66:2 | 33,338 | 26.5 | 65:0 | 30,619 | 24.7 |
| 2025 . . . . . . . . . . . . | 67:0 | 36,667 | 27.3 | 65:0 | 31,545 | 24.0 |
| 2030 . . . . . . . . . . . . | 67:0 | 38,600 | 27.2 | 65:0 | 33,207 | 23.9 |
| 2035 . . . . . . . . . . . . | 67:0 | 40,803 | 27.1 | 65:0 | 35,109 | 23.9 |

*Source: Social Security Administration, 2012 Trustees' Report, Page 142.*

Figures B.3 and B.4 below detail the replacement ratios and benefit levels for Social Security A and B for the same four different types of earners detailed in the Trustees' Report: a low-earning (career average 40 percent of the AWI); medium-earning (100 percent AWI); high-earning (160 percent AWI); and maximum-earning (250 percent AWI, which earns her the maximum Social Security benefit). Figure B.3 shows the numbers for a 60 percent replacement and B.4 for a 50 percent replacement.

**Figure B.3:** Replacement Rates and Benefit Levels, Social Security A and B, 2035
60% AWI Replacement Level

| Replacement ratio<br>*Benefit level* | **Medium earner (100% AWI)** | **Category of earner (Multiple of AWI)** | | |
|---|---|---|---|---|
| | | Low (40%) | High (160%) | Maximum (250%) |
| ***Career Average Earnings (AWI)*** | *$61,093* | *$27,466* | *$97,670* | *$150,565* |
| **Social Security B** | 19.1% | 42.48% | 11.95% | 7.75% |
| ***$ per year*** | *$11669* | *$11669* | *$11669* | *$11669* |
| **Social Security A** | 40.9% | 55.2% | 33.9% | 27.1% |
| ***$ per year*** | *$24,987* | *$15,161* | *$33,110* | *$40,803* |
| **Total** | 60.0% | 97.7% | 45.9% | 34.9% |
| ***$ per year*** | *$36,656* | *$26,830* | *$44,779* | *$52,472* |

**Figure B.4:** Replacement Rates and Benefit Levels, Social Security A and B, 2035
50% AWI Replacement Level

| Replacement ratio<br>*Benefit level* | **Medium earner (100% AWI)** | **Category of earner (Multiple of AWI)** | | |
|---|---|---|---|---|
| | | Low (40%) | High (160%) | Maximum (250%) |
| ***Career Average Earnings (AWI)*** | *$61,093* | *$27,466* | *$97,670* | *$150,565* |
| **Social Security B** | 9.1% | 20.2% | 5.7% | 3.7% |
| ***$ per year*** | *$5559* | *$5559* | *$5559* | *$5559* |
| **Social Security A** | 40.9% | 55.2% | 33.9% | 27.1% |
| ***$ per year*** | *$24,987* | *$15,161* | *$33,110* | *$40,803* |
| **Total** | 50.0% | 75.4% | 39.6% | 30.8% |

| | | | | |
|---|---|---|---|---|
| ***$ per year*** | *$30,546* | *$20,720* | *$38,669* | *$46,362* |

To determine the comparative levels of spending as a share of GDP as shown in Figure 5 in the text, we worked backwards from figures in the Trustees' Report Table IV.B1. This table shows that the cost rate of OASI as a share of taxable payroll is 15.22 in 2035. From Table VI.F5, which shows taxable payroll as share of GDP, we know that in 2035 it will be 0.365. Thus, we can calculate that the cost share of GDP is 5.56 in 2035.

Our estimates of the levels of spending on private plans under the current system in 2035 come from the CBO report, "Tax-Deferred Retirement Savings in Long-Term Revenue Projections." Figures 2 and 4 (pages 17 and 19, respectively) estimate distributions out of defined contribution plans to be 4.5 percent in 2035 and distributions out of defined benefit plans to be about 3 percent. Thus, in total, the amount of spending from private plans is 7.5 percent of GDP. We chose distributions, rather than contributions, to be our metric of "cost" because that is the closest equivalent to expenditures, and all of these disbursements are publicly-sponsored because they are subsidized or tax-favored by the government. For a fair comparison, the cost for the Expanded Social Security plan's optional third tier also refers to distributions, not contributions.

The cost of Supplemental Security Income (SSI) is estimated to be about 0.1 percent for all aged units (aged only and aged disabled) in 2035, according to the annual report from the Social Security Administration.

To determine the estimated cost of an additional third-part safe private savings mechanism, we assume a 3 percent real return for maximum savings ($5,000 under the proposed cap) for half of the whole elderly population. Because incomes are low and replacement rates are high for lower and lower-middle income earners, they will either not have to or not be able to save, so we believe our estimate is a conservative one. An individual investing the maximum amount, compounded and annuitized over 37 years, will get an approximate disbursement of $20,238. The total cost will be $805.5 billion, or 3.2 percent of GDP.

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[34] Gross pension wealth is the value of the lifetime flow of retirement income. American males receive 5.8 times annual earnings and American females 6.8 times (due to higher life expectancy), while males and females in the OECD on average receive 9.6 and 11.1 times annual earnings respectively. See: OECD (2011), "Gross Pension Wealth", in Pensions at a Glance 2011: Retirement-income Systems in OECD and G20 Countries, http://dx.doi.org/10.1787/pension_glance-2011-22-en.

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[36] Predecessors for the Expanded Social Security Plan can be found in proposals for converting Social Security into a "double decker" system, which have enjoyed the support of many experts all the way back to the 1930s. Purely public two-tier or double-decker plans must not be confused with plans put forth by proponents of partial or total Social Security privatization who have sought to combined purely private, tax-favored defined contribution plans with public flat minimal benefits for the poor.

[37] OECD (2011), "Architecture of National Pension Systems", in Pensions at a Glance 2011: Retirement-income Systems in OECD and G20 Countries, OECD Publishing, http://dx.doi.org/10.1787/pension_glance-2011-10-en.

[38] If a version of this policy were to be enacted, it would be important to preserve benefits for existing investments in tax-favored accounts. However, it would also be important to design the program to ensure that individuals with large quantities of tax-favored savings under the current system should not enjoy a windfall from the transition.

[39] Because the exhaustion of the trust fund will only allow Social Security to pay out 75% of scheduled benefits after 2033, maintaining benefits would require policy changes to meet this shortfall. For the purposes of this paper, we assume that this shortfall will be bridged; if it is not, and benefits drop, Social Security B's flat benefit would have to be increased to maintain a replacement rate of 60 percent.

[40] All dollar amounts in this report are in constant 2012 dollars, unless otherwise noted. For details on these calculations and specific tables from the Trustees' Report, see Appendix B.

[41] OECD, "Pensions at a Glance," 2011, page 155.

[42] Board of Trustees, Federal Old-Age and Survivors Insurance and Federal Disability Trust Funds, The 2012 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds, April 25, 2012, http://www.ssa.gov/oact/trsum/index.html.

[43] Congressional Budget Office, "The 2012 Long-Term Projections for Social Security: Additional Information," October 2012, Exhibit 2, http://www.cbo.gov/sites/default/files/cbofiles/attachments/43648-SocialSecurity.pdf.

[44] Board of Trustees, Federal Old-Age and Survivors Insurance and Federal Disability Trust Funds, 2012 Annual Report, page 136. The report projects that the number will decline to 82.5 percent by 2021 under intermediate assumptions.

[45] Dean Baker, "Debt, Deficits, and Demographics," New America Foundation, November 2012, http://nsc.newamerica.net/sites/newamerica.net/files/policydocs/Baker_Dean_DebtDeficitsDemographics_November2012.pdf.

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[49] Approximately 80 percent of the benefits from tax-favored retirement plans (of any kind) will accrue to the top quintile of earners. These earners will gain a benefit equal to 3.2 percent of their income, while individuals in the three middle quintiles – who already make much less money, will benefit about 0.9% on average. See: Josh Freedman, "The Tax Break Myth: They're Not Really for the Middle Class," *The Atlantic*, November 1, 2012, http://www.theatlantic.com/business/archive/2012/11/the-tax-break-myth-theyre-not-really-for-the-middle-class/264388/.

[50] Ibid.

[51] Senator Tom Harkin, "The Retirement Crisis and a Plan to Solve It," U.S. Senate Committee on Health, Education, Labor and Pensions (Washington, D.C.: July 2012); Theresa Ghilarducci, "Guaranteed Retirement Accounts: Toward Retirement Income Security," EPI Briefing Paper # 204, November 20, 2007.

[52] The formula for OASI benefits, which today compromises between earnings-based benefits and progressive redistribution, might be altered to more closely reflect earnings, because the new flat Social Security A benefit would be purely redistributive.

[53] Social Security Trustees' Report, 2012, Table II.B1.

[54] Social Security Administration, "Annual Report of the Supplemental Security Income Program," 2012, Table IV.B6, http://www.ssa.gov/oact/ssir/SSI12/ssi2012.pdf.

[55] Conservative and libertarian plans for double-decker systems, with tax-deferred private savings as one element, often include a flat, universal minimum benefit paid for out of general revenues. See, for example, the first item in the Heritage Foundation's "Saving the American Dream," available at http://savingthedream.org/what-it-covers/social-security/. Our proposal differs because both elements would be public and the minimal benefit would be universal, not means-tested, so that it would increase the overall public retirement benefits for the middle class and working class as well as the poor.

[56] In Canada, for example, the universal program (Old Age Security, or OAS), is financed from general revenues. For more, see: Michael Wiseman and Martynas Ycas, "The Canadian Safety Net for the Elderly," *Social Security Bulletin,* Social Security Administration, Vol. 68, No. 2, 2008, http://www.ssa.gov/policy/docs/ssb/v68n2/v68n2p53.html.

[57] Questions about the further reform of DI are beyond the scope of this paper, but they might include a minimum benefit for low earners, rethinking eligibility standards and providing for separate funding of DI from a fixed portion of the payroll tax, as an alternative to the present practice of funding both OASI and DI from a combined OASDI revenue base.

[58] "National Average Wage Index," U.S. Social Security Administration, last modified October 16, 2012, http://www.ssa.gov/oact/COLA/AWI.html.

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