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Peter A. Diamond

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Proposals to Restructure Social Security

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The 1995 report of the trustees of Social Security projected that the combined Old-Age, Survivor's and Disability Insurance (OASDI) trust funds would run out in 2030. This report wasn't much news, because the problem was slightly less severe than had been projected the year before—the date receded by one year. It also wasn't much news because everyone already knew that there was a problem, and public confidence in the future of Social Security was already quite low. Indeed, the fraction of people reporting themselves very or somewhat confident in Social Security is only around 40 percent. This opinion should be taken with a grain of salt, since the same surveys show that over 90 percent of the interviewees are expecting to receive Social Security benefits and commonly expect it as a major source of income (Reno and Friedland, forthcoming).

Unlike the Medicare problem, the OASDI problem does not seem severe to me. With prompt legislation, we could easily muddle through, putting together a package of revenue increases and benefit cuts that would restore actuarial balance for the 75-year horizon.¹ In this paper, I will not consider the relative merits of alternative packages, but will discuss five proposals for basic changes in how Social Security functions, changes that go beyond changing some of the parameters in

¹ The country does not seem to have much taste for tax increases right now. Yet the polls asking about tax increases just for Social Security find the country solidly behind such increases. In an EBRI/Gallup poll, 64 percent of respondents favor raising taxes now to lessen tax increases in the future, while only 28 percent preferred no tax increase before 2010. A majority oppose (15 percent) or strongly oppose (38 percent) decreasing benefits by 10–20 percent for those born after 1960 in order to avoid a tax increase. Since it is always ambiguous how to interpret such a poll, and we do not want government by opinion poll, this should be viewed as a sampling of mood, not as a policy recommendation.

■ *Peter A. Diamond is Paul A. Samuelson Professor of Economics, Massachusetts Institute of Technology, Cambridge, Massachusetts.*

the current law. The five proposals are: 1) indexing the normal retirement age to life expectancy (as is being done in Sweden); 2) investing part of the trust funds in private bonds and equities rather than solely federal debt; 3) partial privatization of Social Security (as has been proposed by Senators Kerrey and Simpson, is being done in Sweden and has been implemented in Mexico); 4) replacing Social Security by individually mandated savings (as was done in Chile in 1981); and 5) mandating employer-provided retirement savings (as was recently legislated in Australia and is effectively the case in some European countries). Such changes might improve the economics of Social Security, or they might help with the politics of restoring and preserving actuarial balance.

Indexing the Normal Retirement Age

As legislated in 1983, the Normal Retirement Age (NRA) will slowly increase from its current value of 65 to age 67 for the cohort reaching age 62 in 2022. What does it mean to delay the NRA? The legislation did not change the minimum age of 62 for claiming retired worker benefits; nor did it change the age of 70 for receiving retired worker benefits independent of earnings.² What the legislation did change is the level of benefits as a function of the age at which they are first claimed. A worker retiring at the NRA receives 100 percent of the Primary Insurance Amount, an amount that is a function of lifetime average indexed earnings. A worker retiring either earlier or later receives a different amount. Changing the NRA changes the benefit level by changing the base age for calculating the Actuarial Reduction Factor (for lowering benefits when benefits are claimed before the NRA) and the base age for calculating the Delayed Retirement Credit (for raising benefits when benefits are claimed after the NRA). With an NRA of 67 rather than 65, the benefits of a worker retiring at 62 will be 70 percent of the Primary Insurance Amount instead of 80 percent, representing a one-eighth benefit cut. Thus, "delaying the NRA" is a form of benefit cut.

The impact of such a benefit cut on retirement behavior comes primarily from the income effect of lower benefits. There is little change in incentives from the altered pattern of Actuarial Reduction Factor and Delayed Retirement Credit, which leaves alone or decreases the rate of growth of benefits with later retirement. There may be a symbolic effect from the choice of NRA, including its possible impact on private pensions, whether or not formally integrated with Social Security.

Changing the NRA changes the interaction between Disability Insurance (DI) and Old-Age Insurance (OAI). Disabled workers can apply for disability benefits at any age up to the Normal Retirement Age. Disability benefits equal 100 percent of the Primary Insurance Amount; that is, there is no reduction for the early start of

² Nor did the legislation change the number of years (35 for persons attaining age 62 in 1991 and after) used for calculating Average Indexed Monthly Earnings, the first step in determining benefits.