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Social Security Reform with Heterogeneous Mortality

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Key Findings and Policy Implications

This paper develops a model of Social Security claiming, labor supply, and saving that enables researchers to assess the welfare implications of program reforms. It considers the effects on welfare of changes to the payroll tax rate, the earnings cap, the formula converting earnings history to the primary insurance amount (PIA), the normal retirement age, and the adjustment to benefits for claiming earlier or later than the normal retirement age. The model is calibrated using data from the Medical Expenditure Panel Survey (MEPS), the Health and Retirement Study (HRS), the Panel Study of Income Dynamics (PSID) and the Survey of Consumer Finances (SCF). The study finds that:

- Relative to current Social Security policy, the policy parameters that would maximize welfare would generally reduce work incentives, while redistributing resources from high to low earners. Under these policies, the PIA would be independent of lifetime earnings, and claiming adjustments would be smaller, while the upper bound on taxable earnings would remain close to its current value.

- Collectively these welfare-maximizing reforms cause both earnings and employment to fall by 1-2%. However, eliminating the earnings test and the income taxation of Social Security benefits reverses more than two-thirds of the fall in earnings and more than half of the fall in employment. Thus, combining the two sets of reforms results in even larger welfare gains.

- After recalculating the model to account for population aging, based on a hypothetical "2050 demographic" scenario, the Social Security changes that would maximize welfare are similar to those that would maximize welfare today.

The paper informs the evaluation of Social Security policy by highlighting and quantifying the trade-offs between system redistribution, work incentives and productive efficiency.

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