PRIVATE ENTERPRISE RESEARCH CENTER
TEXAS A&M UNIVERSITY

WINTER 2021

PERCSPECTIVES ON RESEARCH

SOCIAL SECURITY WEALTH AND FEDERAL LIABILITIES

Concern continues to mount over the issues of growing wealth inequality and the disappearing middle class in the United States. However, past estimates of wealth inequality tend to ignore Social Security benefits, even though these accrued benefits are almost 40% of the size of conventional measures of household wealth. Social Security benefits have also been shown to affect the savings behavior of current and future recipients. In working paper 2011, Executive Associate Director Andrew Rettenmaier estimates the degree to which Social Security reduces wealth inequality in the U.S.

Income inequality has steadily risen in recent years and this rise has been linked to the corresponding rise in wealth inequality. As incomes earned by households continue to spread further apart and with savings rates that rise with income, more of the nations' wealth will be concentrated among the richest families. Indeed, a study by Saez and Zucman (QJE 2016) shows that wealth inequality has been on the rise since the late 1970s with 22% of the share of wealth owned by the top 0.1% of families in 2012. The wealth of the bottom 90 percent of families was only 23% in 2012 – a decline attributed to a fall in the savings rate of the middle class and rising income inequality.

This study assigned total wealth to households based on capitalized income tax data. Net worth is defined as the sum of a family's assets at market value, less any liabilities. Assets are included if the family possesses a legal claim to those assets. Examples of such assets include the market value of a family's home, less the remaining mortgage amount, as well as stocks and bonds held outside of retirement accounts, and the value of sole proprietor-owned businesses or partnerships. Wealth also includes the value of defined contribution retirement accounts and pensions.

Benefits like accrued Social Security and Medicare benefits are noticeably left out of these measures of wealth. Court rulings from as far back as the 1930s assert that Social Security benefits are not legally recognized as liabilities of the federal government, as these benefits have been increased or decreased many times at the will of the government and are still subject to future reforms. Because of this, Social Security benefits are considered "obligations" of the federal government, not liabilities. As they are not considered government liabilities, they are not legal assets of workers and beneficiaries. The government does not 'owe' any worker or beneficiary the amount they have paid into the program.

However, studies have shown that regardless of Social Security benefits' status as an asset, individuals behave as if they do possess a legal claim to the benefits. Families reduce their private wealth growth in light of the expected payments from the programs. In targeting a desired retirement income replacement rate, workers often begin with their expected replacement rate from Social Security and adjust their lifetime savings to fill in the remainder.

While Social Security benefits are often not included in the analysis of wealth inequality, the federal government does include the accrued pension and post-employment benefits of federal workers as liabilities in its financial statements. The

> "...the role played by Social Security in providing resources for current retirees significantly reduces conventional measures of inequality."

federal government reports the combined present value of Social Security and Medicare benefits payable to current retirees was equal to $23.5 trillion in 2018. The sheer size of benefits cannot be left off the table when considering the government's present and future obligations.

In this paper, the author estimates the degree to which Social Security wealth reduces wealth inequality in the U.S. Accrued Social Security benefits are used to estimate Social Security wealth, which are conceptually similar to accrued pension benefits from a defined benefit plan and provide an approximate level of wealth from the worker's vantage point. Accrued Social Security benefits are based on past participation in the program, not on the expectation of continued participation. These accrued benefits are calculated by estimating the monthly benefits one would receive at the normal retirement age using past earnings. These estimates are then paired to households' other assets from the 2016 Survey of Consumer Finances.

Findings show that accrued Social Security benefits are much more equally distributed than are conventional wealth measures that exclude them. The top 10% of households based on their net worth held 18% of accrued Social Security benefits. In contrast, these households held 75% of the total net worth in 2016. When accrued Social Security benefits are included in a comprehensive wealth measure, the share of total wealth held by the top 10% declines to 64%. Among households headed by respondents 65 years of age and above, the top 10% held about 14% of accrued Social Security benefits and about 70% of the total net worth. When Social Security is included, the share of total wealth held by these households declines to 58%.

Accrued Social Security wealth should not be ignored when studying wealth inequality. When included, accrued benefits substantially reduce total wealth inequality relative to inequality based on conventional wealth measures. While accrued Social Security benefits are not assets in the legal sense, it is critical that policy interventions recognize the role this program has in reducing wealth inequality.

PUBLIC PENSION REFORMS AND FISCAL FORESIGHT: NARRATIVE EVIDENCE AND AGGREGATE IMPLICATIONS

OECD countries have significantly increased public spending on old-age pensions over the last fifty years. This is due, in part, to the increasing share of residents who are, or are quickly approaching, retirement age compared to younger residents. As more retirees begin to draw benefits, policymakers have increasingly focused on pension retrenchment reforms in order to keep their pension systems financially afloat. In working paper 2008, PERC Professor Sarah Zubairy and co-author Huixin Bi study the role that government policies have played in the rise of pension spending since the 1960s. The paper also studies the impact long-term structural reforms have had on retirement decisions and pension spending.

In order to study these long-term policy reforms, the authors construct a new data set that documents the changes by year in public pension policy for ten OECD countries between 1962 and 2017. Policy changes are sourced from the OECD Economic Surveys and legislative documents for each country in four main areas: whether pension changes made pension programs more or less generous to beneficiaries, policy tools used during pension changes, the motivation behind the changes, and implementation lags. At the time of publication, this data set is the first of its kind to provide comprehensive documentation across a broad number of countries spanning six decades, as well as the motivation behind pension policy changes and information about implementation plans.

This new data set reveals that the expansion in pension programs between the 1960s and 1980s played an important role in the rapid rise in pension spending across the set of countries studied. At that time, changes were implemented so that more generous payments were offered by pension programs to the elderly population. Also, benefits were extended to a broader segment of the population. Results show that that changes in pension policy come in waves, with periods of rapid expansions of pension systems being followed by

> "People close to retirement have distinctly different responses to pension retrenchments with implementation delays from those without."

retrenchment efforts, or the reduction of costs or spending due to economic concerns.

The motivation behind this expansion is multifaceted. Cyclical reasons play a part, one example being the adoption of early retirement programs during the 1970s and 1980s in response to periods of high unemployment rates, especially among the youth. The aim was to encourage older workers to retire early, stimulating promotions for middle-aged workers and providing opportunities for the young to enter the workforce. Part of the expansion was carried out to raise the living standards for the elderly in order to keep up with economic growth. However, these expansions led to much higher, unsustainable levels of pension liability and a wave of pension retrenchments in the late 1980s and 1990s.

The authors document the motivations behind pension policy changes and policies are divided into two categories - policies that are driven by short-run cyclical or purchasing power concerns and those that are driven by long-run forces, or structural pension reforms, such as fiscal responsibility. They then analyze the impact of these structural pension policy changes on the labor market and pension spending.

Although not uniform across countries, many pension reforms include long phase-in periods in order to provide time to workers who are close to retirement to adjust their retirement plans. In addition, implementation lags make pension retrenchments more satiable for the public, as they are politically challenging to enact. Pension policy reforms are separated into those that include phase-in periods and those that are implemented immediately following announcements to better study the labor market.

Although phase-in periods ease the impact of pension reforms on retirees, they also have significant drawbacks. Phase-in periods slow the progress of scaling back government pension spending and raise long-run financial risks. Understanding these effects are important to the success of future pension reforms.

These findings show that structural pension reforms, depending on whether they include phase-in periods or not, can have significant impacts on government budgets. Structural reforms can also affect the labor decisions of people who are close to retirement. If structural pension retrenchments are implemented immediately, people close to retirement stay in the work force longer in order to compensate for the decline in their pensions, as labor force participation rates groups between the age of 55 and 64 years rise. Less generous pension benefits, in combination with higher labor force participation for older workers, leads to a decline in old-age pension spending. However, news about structural pension retrenchment in the future can have unintended consequences, and workers nearing retirement are more likely to leave the labor market before the reform takes place. The modification of retirement decisions based on news of future pension changes also provides an example of the fiscal foresight information channel.

Due to these changes in worker's retirement decisions, public spending on old age pensions actually increases, rather than decreases, in the first few years following the announced change. This was found to be more common for pension reforms that come with significant phase-in periods of 10 to 15 years and for reforms that stripped away other pension options that would have otherwise been available to retirees. As pension options and benefits decline over the phase-in period, older workers may be incentivized to retire earlier and lock in current benefits, which leads to a rise in overall spending.

Policy tools were found to play an important, though varied, role in the fiscal foresight channel. Within structural pension reforms, 30 percent of policy tools were found to be related to changing benefit formulas or indexation rules, while 70 percent were associated with changes in retirement age or contribution years. Although the responses to pension reforms with no phase-in period remain unchanged, the responses to age- and contribution-based structural reforms with phase-in periods had the most pronounced effects on labor force participation rates, although only in the first 3 years of the phase-in period. These findings can help policymakers design future pension reforms that more realistically meet their reform goals.

PRIVATE ENTERPRISE RESEARCH CENTER
TEXAS A&M UNIVERSITY
Texas A&M University
4231 TAMU
College Station, TX 77843-4231

PERCSPECTIVES ON RESEARCH WINTER 2021

Founded in 1977 through the generosity of former students, corporations and foundations, the Private Enterprise Research Center pursues a dual mission of supporting academic research at Texas A&M University and developing market-oriented solutions to public policy problems.

CONTACT

Private Enterprise Research Center
Texas A&M University
4231 TAMU
College Station, TX 77843-4231
(979) 845-7559
perc@tamu.edu

PRIVATE ENTERPRISE RESEARCH CENTER
TEXAS A&M UNIVERSITY

For archived newsletters, visit

perc.tamu.edu