

Comment to the Paper

“Social Security’s Five OASI Inflation Indexing Problems” by Michael C. Lovell

This is a very interesting paper that examines a number of problems associated with the inflation indexing procedures used by the Social Security Administration in calculating Old Age and Survivors Insurance (OASI) Benefits in the United States. The aim of the paper is to analyze the issue of whether and to what extent the inflation indexing procedures affects (i) the incentives for delaying retirement, and (ii) the potential financial instability for the OASI trust fund if the economy faces periods of high inflation. Five problems associated with the inflation indexing procedures are analyzed using simulations for the income histories of four classes of workers (high, average, median, and minimum wage earners).

The main problem arises since the income history of a worker upon which the OASI benefit is calculated is adjusted for inflation only up through the 60th year. After that, the nominal wage is considered until the age of retirement what results in an “un-deflated earnings bonus”. This contributes to a distortion in the incentives towards postponing retirement, since each year worked after the 60th year is rewarded with an increased Primary Insurance Amount depending on inflation. The author argues that this could contribute to Social Security’s financial problems.

I have few conceptual comments on this paper. I agree in principle that partial indexation could potentially affect incentives when deciding upon the age of retirement. However, this result clearly depends on the income history of the worker. As we know, only the highest 35 years of earnings are selected in the computation of the PIA and, therefore, the greatest assumption made in the simulations is that, for instance, a worker that delays retirement until the age of 75 gets 14 out of his 35 best wage payments at the end of his career.

Another concern of empirical nature is related to the reward incentives on the age of retirement. Do retirement benefit rewards (for those who retire after the Normal Retirement Age) have increased the average retirement age? How large would be the contribution of partial indexing to this reward?

While I agree that increased social security payments, contribute to the Social Security’s financial problems, this can be hardly associated with partial indexation. Forman (2004) attributes the primary reason why the Social Security System is in financial trouble to people living longer and retiring earlier. As a matter of fact, social security benefits are primarily paid out of current-year social security payroll taxes. If, as mentioned above, partial indexation helps delay retirement, not only payroll taxes continuing being paid, but also less people are entitled retirement benefits for a longer period.

References:

Forman, J.B., 2004. Making Social Security Work. 65 Ohio State Law Journal 145.