Social Security on Auto-Pilot; International Experience with Automatic Stabilizer Mechanisms

Bosworth and Weaver

Mauricio Soto
Fiscal Affairs Department – IMF
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Automatic Mechanisms—Why?

• Premise: **gradual** and **expected** changes are preferable
  – (public and) congress might be myopic
  – time to prepare
  – demographics + politics

But, frequent legislative action
• could be costly (congress would do it anyway)
• might be risky (reforms can always go wrong)
Benefit Adjustments Before 1973

Graph showing the SS Benefit Index and CPI-W Index from 1939 to 1972.
Benefit Indexation After 1973

- SS Benefit Index
- CPI-W Index
Automatic=Success?
No COLA Adjustments

Low U.S. inflation rate bites millions of retirees

- No cost of living adjustment for second year in row
- U.S. House to vote on $25B one-time payment

SS recipients brace for stagnant income

March 27, 2011 1:10 PM

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In Other Advanced Economies

- Index to life expectancy
  - ret. age (Denmark, Greece, Italy)
  - benefits (Brazil, Finland, Portugal)
  - years of service (France)

- Sustainability Factors (Austria, Germany, Japan)

- Actuarial Balance (Canada, Sweden)

- NDC (Italy, Latvia, Norway, Poland, Sweden)

- Triggers (Greece, Spain)
A Combination Could Work

• Automatic Adjustments with Triggers (Japan, and to an extent Germany)
  
  – Adjust up to a limit—say replacement rate 50 percent

  – Once that limit is reached, review all parameters of the system
Proposals for the U.S.

- **Index Retirement Age to Longevity (1/5 of imbalance)**
  - Coburn (2011); Graham, Paul, Lee (2011); Bowles, Simpson, Rivlin, Domenici (2010); Pomeroy (2010); Ryan (2010); NRC, NAPA; (2010); NASI (2009); AARP (2009); National Commission on Retirement Policy (2000)

- **Index PIA to Longevity (1/4 of imbalance)**
  - Bennet (2009); Bennet (2006); Kolbe, Boyd (2005); Kolbe, Stenholm (2003); Kolbe, Stenholm (2001); Gregg, Breaux, Kerrey, and Grassley (2001)

- **Index Payroll Rates to Longevity (1/4 of imbalance)**
  - Diamond, Orszag (2003)
Proposals for the U.S.

• **Index Taxable Maximum to Wage Distribution**
  - Bowles, Simpson, Rivlin, Domenici (2010); Senate Special Committee on Aging (2010); AARP (2009); Kolbe, Boyd (2005); Kolbe, Stenholm (2003); Diamond, Orszag (2003); Kolbe, Stenholm (2001)

• **Explicit Mechanism to Respond to Shortfalls**
  - Gregg, Breaux, Kerrey, and Grassley (2001)

• **Constraining Future Legislation**
  - Deutch (2010)
Automatic Mechanisms = Success?

• Are they credible?
  – manipulation  – suspension
  – evasion  – erosion

• Do they really isolate adjustments from politics?

• Intra- and inter- generational equity
What are the Alternatives?

- **No Reform**: Wait and See
  - If systems are unsustainable and fiscal space is limited, not feasible

- **Sequential Reforms**: Congress Knows Best

- **Autopilot**: Better Now than Later

- **Triggers**: Better Later than Never
Number of Countries with Fiscal Rules, 1990-2009

Sources: IMF fiscal rules database; and staff calculations.