SOCIAL SECURITY COVID NOTCH

- The unprecedented conditions of the COVID-19 economic crisis have unearthed a technical Social Security glitch. Without congressional action, a COVID notch will result:
  - Those turning 60 in 2020 – around 3 million workers – and their families will receive substantially lower Social Security benefits than workers (and their families) with identical earnings who turned 60 in 2019.
  - To take the most extreme example, if the glitch is uncorrected, an average worker born on January 1, 1960 will get around thousands of dollars$1,430 a year less in benefits than someone with the identical earnings but who was born December 31, 1959 – perhaps born just a few minutes earlier! It obviously makes no sense to get lower Social Security benefits for the rest of your life on the fortuity of being born in 1960.
  - The COVID notch will not only result in lower benefits for those born in 1960, but also their families, as well as for workers who become disabled in 2022 and their families, and the surviving families of workers who die in 2022.

- The glitch is being called a COVID notch, because the sudden drop in benefits for those turning 60 or becoming disabled or dying in a particular year – called a "notch" – is a direct result of the pandemic-caused economy.

- To understand the pandemic-caused notch, one must understand some basics about Social Security and how benefits are calculated.

- It Is important to understand what wage-indexing is and why it is used in the calculation of benefits. Social Security benefits are designed to replace final pay, as many private sector, employer-sponsored traditional pensions do. Replacing a percentage of final pay is the right approach because it allows beneficiaries to maintain their standards of living once wages are no longer being earned.

- Replacing a percentage of final pay is more complex, though, when the sponsor of the pension plan – that is, Social Security – is the federal government, not a worker's employer.
  - If Social Security were based on actual final earnings, a simple final pay replacement formula would inadvertently penalize those who were laid off late in life and could only find work at much lower wages.
  - In addition, final pay could be manipulated by employers and employees interested in gaming the system.

- To avoid those problems, Social Security benefits are based on workers' lifetime earnings over their careers.

    - Using nominal dollars, however, would produce unfair results because – for instance – $30,000 in 1980 was a top salary; today, it is below average.
    - Consequently, Social Security indexes the wages to have them approximate today's earnings and today's living standards.
    - To do that it uses what is called wage-indexing.

        - Wage indexing adjusts earning based on the growth in wages nationwide.
        - Because there is a lag in receiving the national economic data, each person's past earnings are wage-indexed forward to two years before the worker's eligibility for benefits. For retirees (who first become eligible for benefits at age 62), that means all of their past earnings are indexed forward to the equivalent wage levels in the year they turn 60.

- Wage indexing is the right method to use.

    - Not only does it do an excellent approximation of final pay, it replaces the same percentage of wages over time, regardless of when similarly situated working families experience an insured event (retirement, disability, or death leaving survivors).
    - This structure is ingenious, fair, and works extremely well in almost all economic times. But these are not normal times.

- Under wage-indexing, nominal wages are indexed by multiplying them by a fraction, the numerator of which is the average aggregate wages two years before a worker first becomes eligible for benefits, and the denominator of which is the average aggregate wages the year the wages were earned.

- Generally, nationwide average aggregate wages rise from year to year. However, the pandemic-induced recession hit harder and far more suddenly than other recessions. Due to this current crisis, aggregate wages are expected to be significantly lower in 2020 than they were in 2019 – an unprecedented drop in the aggregate wage index that Social Security uses.

    - Because this drastic and sudden decline in aggregate wage levels is so unusual, our Social Security system does not take that possibility into account.
    - Congress must fix that understandable oversight to avoid the COVID notch.

- Fortunately, the solution is easy and straightforward. But Congress must act. Congress should enact a simple correction that mirrors other parts of our Social Security system: preventing a drop from one year to the next in this aggregate wage index as used for specific benefit calculation purposes, so it cannot reduce benefit levels.

- As just one example, Social Security's automatic annual cost of living adjustment can never result in a decrease in benefits, notwithstanding what is happening with inflation. There may not be an inflation adjustment that results in larger benefits, but no one's benefits are ever reduced.
- Similarly, Congress should amend Social Security's indexing of earnings so that it does not result in lower benefits no matter what is happening with aggregate wages nationwide.

  - Essentially workers would all be held harmless. Technically, when workers are two years before their earliest age of eligibility, Social Security should use the higher of (1) average wage index for that year or (2) the highest index from past years.
    - When multiplying a number by a fraction, as is done when wage-indexing benefits, the product is larger when the numerator is larger and smaller when the numerator is smaller. (i.e., 12 x 1/3=4; 12x2/3=8; 12x3/3=12.)
    - A drop in aggregate wages produces a substantially lower benefit when it occurs two years before earliest eligibility, because it is used in every single numerator in the indexing process. In other words, people who turn 60 this year (and others who will first become eligible for benefits two years in the future) have all of their past wages indexed forward to a much lower level. This produces a significant and harmful benefit reduction, for the rest of their lives.

  - For indexing wages of all other workers, current law should not change. The current law measure of aggregate average wages should continue to be used.

    - When multiplying a number by a fraction, as is done when wage-indexing benefits, the product is larger when the denominator is smaller, and the product is smaller when the denominator is larger. When multiplying a number by a fraction, the product is smaller when the denominator increases (e.g., 12 x 1/2=6, 12 x 1/3=4, 12 x 1/4=3).
    - A drop in aggregate wages may produce a slightly higher benefit when it occurs in a year when wages are earned, because it will appear in the denominator for one year of wages – when indexing forward the wages earned in 2020, for future benefit calculations.
  - The only change in current law would be that the aggregate nationwide wage index used for the year two years before benefit eligibility – that is, the number used in the numerator – would never be lower than prior years.

- That simple fix – ensuring that a decline in overall wages doesn't produce lower benefits – solves the problem.
  - It should hold harmless those close to retirement age from earning lower benefits simply because their wages are indexed to a year of a severe economic downturn.
  - It should not cut the benefits of anyone else, but simply retain current law in all other situations.

- Congress should immediately enact this change in a carefully constructed way, so that no one's benefits are cut.

    - H.R. 7499, the Social Security COVID Correction and Equity Act, is drafted correctly and carefully to fix the notch problem while not creating an unintended benefit cut for workers and their families not affected by the notch but who have earnings in 2020.

        - It changes current law only for those who first become eligible for benefits two years after a drop in the national average wage index. For them, the numerator used to index benefits is never lower than it was in prior years.
        - For everyone else, benefits continue to be calculated as they are under current law.
    - S.4180, the Protecting Benefits for Retirees Act is overbroad and would result in benefit cuts.

        - Like H.R. 7499, it eliminates the notch.
        - Unlike H.R. 7499, it changes current law so that the "hold harmless" index is used to adjust wages earned in 2020 – resulting in benefits that would be lower than under current law.

- Although the exact level of 2020 aggregate wages will not be known until late in 2021, Congress should not delay action.

    - What is being corrected is a mistake in the law. There is no reason to delay to know whether the error in drafting actually results in problems.
    - The fix described above automatically adjusts to the size of the actual notch, whether that is large or small.
    - Americans should not have to worry about whether Congress will prevent a large unintended loss of Social Security benefits solely as the result of the arbitrary fact that they turned 60 during this unprecedented economic crisis.
    - There is absolutely no sound reason for Congress to wait to correct this inadvertent glitch, now that it is aware of it.

- If left unaddressed, the COVID notch is almost certain to generate intense, understandable anger and frustration by those affected towards their elected Senators and Representatives.

- Because this is an issue that, if not corrected, adversely affects millions of Americans living in every Congressional district and state, we hope that it can be expeditiously corrected on a bipartisan basis as quickly as possible.