SOCIAL SECURITY

MEMORANDUM

Date: June 19, 2008 Refer To: TCA

To: John Gist and Sara Rix
AARP Public Policy Institute

From: Steve Goss, Chief Actuary
Alice Wade, Deputy Chief Actuary
Chris Chaplain, Supervisory Actuary

Subject: Estimated Financial Effects of Several Social Security Reform Options --INFORMATION

This memorandum provides estimates of the financial effects on the OASDI program of several individual provisions that you have identified as possible options for reforming Social Security. Estimates are provided for the effect on the long-range OASDI actuarial deficit, which is estimated at 1.70 percent of taxable payroll under current law. Estimates are also provided for the effect on the annual deficit (excess of program scheduled cost over scheduled tax revenue) in 2082, which is estimated at 4.20 percent of payroll under current law. It is critical to note that the estimates provided are for each provision individually as a single change to current law. The combined effects of two or more provisions cannot be simply added together due to the effects of interaction among provisions. These interactions can be very substantial. Thus, considering the effects on an additive basis should only be done with an understanding that the result will generally overstate the effect of the combination of provisions.

All estimates are based on the intermediate assumptions of the 2008 Trustees Report. The estimates should also be considered preliminary as time has not permitted full modeling of all aspects of some of these provisions. The estimates should, however, provide a very good indication of the effects of these provisions as further refinements are unlikely to have a substantial effect.

Social Security Reform Options:

1. Raise the taxable maximum amount (the contribution and benefit base) to include 90 percent of total OASDI covered earnings. Phase in this increase gradually between 2010 and 2015. Benefit computations would reflect all earnings up to the new taxable maximum.

   Enacting this change would reduce the long-range OASDI actuarial deficit by an estimated 0.84 percent of taxable payroll. The reduction in the annual deficit for the year 2082 is estimated at 0.93 percent of taxable payroll.

2. Impose a 3 percent payroll tax on OASDI covered earnings above the current taxable maximum starting in 2009. Benefit computations would not reflect any earnings above the taxable maximum amount.

   Enacting this change would reduce the long-range OASDI actuarial deficit by an estimated 0.64 percent of taxable payroll. The reduction in the annual deficit for the year 2082 is estimated at 0.78 percent of taxable payroll.

3. Cover all State and local government employees newly hired in 2009 and later.

   Enacting this change would reduce the long-range OASDI actuarial deficit by an estimated 0.22 percent of taxable payroll. The reduction in the annual deficit for the year 2082 is estimated to be negligible (i.e., less than 0.005 percent of taxable payroll).

4. Gradually invest 15 percent of OASDI trust fund assets in a broad index of equity market securities (such as the Wilshire 5000). Increase the portion in equities by 1.5 percent each year 2009 through 2018. Maintain the percentage at 15 percent thereafter.

   Enacting this change would reduce the long-range OASDI actuarial deficit by an estimated 0.29 percent of taxable payroll, assuming an average annual real yield on equities of 6.4 percent (3.5 percentage points over the expected average yield on long-term Treasury bonds.) From the perspective of a low yield or risk-adjusted perspective where equity yields are taken to be equal to the average real yield on Treasury bonds, this provision would have no effect on the estimated actuarial deficit of the OASDI program. The reduction in the annual deficit for the year 2082 is estimated to be negligible (i.e., less than 0.005 percent of taxable payroll).

5. Index benefits to longevity after the normal retirement age (NRA) reaches age 67 under current law. Under current law, the NRA reaches 67 for individuals who attain age 62 in 2022 and later. Under this provision, the NRA would be further increased by one month for those attaining age 62 in every other year after 2022.

   Enacting this change would reduce the long-range OASDI actuarial deficit by an estimated 0.37 percent of taxable payroll. The reduction in the annual deficit for the year 2082 is estimated at 1.09 percent of taxable payroll.

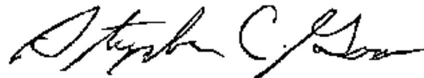
6. For all individuals becoming eligible for OASDI benefits in 2009 and later use a new, modified primary insurance amount (PIA) formula. The new formula would use an additional bend point placed between the current 2 bend points. The additional bend point would be equal to the current lower bend point plus 75 percent of the difference between the current bend points. (The new bend point would be at about the 58th percentile of average career earnings levels for new retired worker beneficiaries.) The PIA factor for dollars of average monthly indexed earnings (AIME) between the new bend point and the upper bend point would be lowered from 32 to 20 percent. The PIA factor applied for dollars of AIME above the upper bend point would be lowered from 15 to 10 percent.

Enacting this change would reduce the long-range OASDI actuarial deficit by an estimated 0.28 percent of taxable payroll. The reduction in the annual deficit for the year 2082 is estimated at 0.34 percent of taxable payroll.

7. Gradually raise the EEA for Social Security retirement benefits from 62 to 65. The EEA would be increased by 2 months for individuals reaching age 62 in every year, starting in 2010. The EEA of 65 would apply for those reaching age 62 in 2027 and later (those reaching age 65 in 2030 and later). As under current law, the PIA formula applicable for any individual would depend on the year in which eligibility age is attained. It should be noted that the elimination of retirement eligibility between ages 62 and 65 would increase the number of individuals who would apply for disabled worker benefits at those ages.

   Enacting this change would increase (worsen) the long-range OASDI actuarial deficit by an estimated 0.01 percent of taxable payroll. The increase (worsening) in the annual deficit for the year 2082 is estimated at 0.30 percent of taxable payroll.

You also asked for estimates for two additional provisions. One was a minimum benefit provision and the other provided for an aged spouse benefit of 33 percent of PIA and an aged widow(er) benefit option that would be set at 75 percent of the combined benefit if both spouses were still alive. We do not have estimates for these provisions as yet but will be providing these in the near future. We hope the estimates above will be helpful. Please let us know if you have any additional questions.



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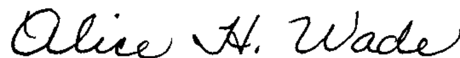

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