DEPARTMENT OF HEALTH & HUMAN SERVICES

Social Security Administration

Refer to S3NL

Memorandum

Date: May 3, 1995

From: Stephen C. Goss
Supervisory Actuary

Subject: Estimated Long-Range OASDI Financial Effect of Draft Proposals for Kerrey-Simpson Staff-INFORMATION

To: Harry Ballantyne
Chief Actuary

The attached table presents estimates of the change in the long-range OASDI actuarial balance that would result from enactment of a package of proposals, as requested by Linda Kotschwar of Senator Kerrey's staff.

The package would include (1) transfer of 1.5 percentage points of the OASDI payroll tax to individual accounts, (2) increasing the NRA to 70, (3) introducing a third bend point with an additional PIA factor of 10 percent beginning 2030, with slower indexing of the second and third bend points for 25 years, (4) computation of the COLA as the increase in the CPI-W minus 0.5 percentage point, (5) capping the COLA at the 20th percentile of PIAs for retired and disabled workers, (6) covering all State and local government employees hired after 1997, (7) reducing the percentage of PIA payable to spouse beneficiaries from 50 to 33 percent, and (8) investing a portion of the OASI and DI Trust Funds in equities.

Estimates are provided for each individual provision as a change from present law. For the package as a whole, the total combined effects of the provisions are estimated to be an increase (improvement) in the long-range OASDI actuarial balance of 2.26 percent of taxable payroll, which would eliminate the long-range deficit of 2.17 percent under present law. This total differ from the sum of the individual effects due to interaction among provisions.

Because the long-range actuarial deficit would be eliminated, the OASDI programs would be able to pay benefits on a timely basis under this package. The OASDI combined Trust Funds expressed as a percentage of annual outgo (i.e., the trust fund ratio, or TFR) would rise gradually to a level of 305 percent in 2020, then decline slowly to a fairly stable level around 230 percent by 2040 (and through the end of the 75-year long range period, which ends with 2069).

The balance of this memorandum describes the provisions of this package as they have been modified to date, and their estimated effects on the OASDI long-range actuarial balance. All estimates are based on the intermediate alternative II assumptions of the 1995 Trustees Report.

Proposal 1. Transfer 1.5 Percentage Points of the OASDI Payroll Tax to Individual Accounts Beginning 1998

This provision would reduce the amount of payroll tax credited to the OASDI Trust Funds by 1.5 percentage points beginning 1998 for all workers under age 55 at the beginning of 1998. This amount would be redirected to individual accounts. The exact nature of these accounts and the conditions under which individuals would have access to the balances are yet to be determined. Enactment of this proposal alone, i.e., not in conjunction with any other provision, would reduce (worsen) the long-range OASDI actuarial balance by about 1.38 percent of taxable payroll.

Proposal 2. Gradually Increase Retirement Age to 70

This provision would raise the normal retirement age (NRA) from age 65 for persons who reach age 62 before the year 2000, by 2 months for each year after 1999 that a person reaches age 62, with an ultimate NRA of 70 for those who reach age 62 in 2029 or later. "Actuarially equivalent" extensions of present law reduction factors would ultimately reduce benefits payable to retired workers to 57 percent of PIA at age 62, and to 70 percent of PIA at age 65. The 28.5-percent reduction (to a level of 71.5 percent of PIA) would be retained for widow(er) beneficiaries entitled at age 60.

Enactment of these provisions alone, i.e., not in conjunction with any other provision, would increase (improve) the OASDI long-range actuarial balance by an estimated 0.97 percent of taxable payroll.

Proposal 3. Introduce a Third PIA Bend Point in 2030 and Reduced Indexing for 25 Years

This proposal would modify the PIA formula by introducing a third bend point in 2030 so that in addition to the 90, 32, and 15 percent factors in the current formula, an additional factor of 10 percent would be added for AIME amounts in excess of the new third bend point. The second bend point would be indexed by the increase in the SSA average wage indexing series (AWI) and by a factor of 0.98, for each year 2030 through 2054 (for 25 years) with indexing by the AWI only thereafter. The third bend point for 2030 and later would be set equal to the second bend point divided by 0.6035 (0.98 raised to the 25th power). As a result, the new third bend point would be the same as the "present-law" second bend point after 2053, and the second bend point under the proposal would be roughly half way between the first and second bend points.

Enactment of this proposal alone, i.e., not in conjunction with any other provision, would increase (improve) the long-range OASDI actuarial balance by about 0.37 percent of taxable payroll.

Proposal 4. Compute the OASDI COLA as the Increase in the CPI-W Minus 0.5 Percentage Point

This provision would reduce the size of the automatic cost of living increase (COLA) under the OASDI program from the full increase in the Consumer Price Index for All Urban Wage and Clerical Workers (CPI-W) to 0.5 percentage points less than such increase, for COLAs on December 1998 and later. Enactment of this proposal alone, i.e., not in conjunction with any other provision, would increase (improve) the long-range OASDI actuarial balance by about 0.70 percent of taxable payroll.

Proposal 5. Cap the COLA at the 20th Percentile

This provision would limit the size of the COLA beginning December 1998 to no more than would be payable to each beneficiary if their benefit were based on the PIA payable to worker beneficiaries at the 20th percentile. The 20th percentile would be determined by distributing all retired and disabled worker beneficiaries currently receiving benefits by the level of their PIA. The COLA payable at the 20th percentile (from the bottom) would be the maximum COLA payable. The maximum would be applied for each beneficiary based on his or her PIA, and would thus be adjusted by the level of any actuarial reduction or delayed retirement increment applicable based on their age at benefit entitlement. The PIA at the 20th percentile for the year 1995 is estimated at about $420. Enactment of this proposal alone, i.e., not in conjunction with any other provision, would increase (improve) the long-range OASDI actuarial balance by about 1.66 percent of taxable payroll.

Proposal 6. Cover Newly Hired State and Local Employees

This provision would cover, under OASDI, earnings of State and local government employees hired after 1997. Enactment of this proposal alone, i.e., not in conjunction with any other provision, would increase (improve) the long-range OASDI actuarial balance by about 0.21 percent of taxable payroll.

Proposal 7. Reduce Spouse Benefits

This provision would reduce the percentage of PIA payable to a wife or husband of a retired worker or disabled worker from 50 percent to 33 percent for those newly eligible after 2015. The percentage would be reduced beginning in the year 2000, by one percent each year through 2016 for those becoming newly eligible in each year. Enactment of this proposal alone, i.e., not in conjunction with any other provision, would increase (improve) the long-range OASDI actuarial balance by about 0.17 percent of taxable payroll.

Proposal 8. Invest a Portion of the Trust Funds in Equities

This provision would specify that a portion of the amounts to be invested by the OASI and DI programs after 1997 be placed in a broad-based indexed fund of equities (stocks) so that about one fourth of the funds would be in equities within 15 years (in 2012 and later). Investments after 2012 would be made to maintain a distribution of about one-fourth of assets in equities and three fourths of assets in special public debt obligations issued by the U.S. Government. The precise effect of this proposal on the long-range financial status of the OASDI program is highly dependent on the nature and timing of other proposals of the overall package. For example, is other proposals are developed to put the OASDI program on a purely pay-as-you-go basis throughout the long-range period (i.e., to maintain the TFR at about 100 percent), then this provision will have little effect. However, if trust fund assets are maintained significantly in excess of one year's outgo, then this proposal will have a substantial effect on the financing of the program. Enactment of this proposal alone, i.e., not in conjunction with any other provision, would increase (improve) the long-range OASDI actuarial balance by about 0.56 percent of taxable payroll. However, assuming the enactment of provisions 1 through 7, the incremental effect of this provision would be to increase (improve) the long-range OASDI actuarial balance by about 0.19 percent of taxable payroll.

Stephen C. Goss
Supervisory Actuary

Attachment

cc:
Linda Kotschwar

Estimated Long-Range OASDI Financial Effect of Draft Proposals for Kerrey-Simpson Staff, May 1995

Proposal	Estimated Change in Long-Range OASDI Actuarial Balance 1/ (percent of payroll)
1. Transfer 1.5 percentage points of the OASDI payroll tax to individual accounts beginning 1998, for those under 55 in 1998.	-1.38
2. Raise the NRA by 2 months per year beginning with those attaining 62 in 2000, reaching an NRA of 70 for those attaining 62 in 2029 and later.	0.97
3. Introduce a third bend point in the PIA formula in 2030, adding a fourth factor of 10 percent (in addition to the 90, 32, 15 factors in the current formula). Index the second and third bend points by the increase in average wages less two percent for 25 years (2030-2054).	0.37
4. Compute the OASDI COLA as the increase in the CPI-W minus 0.5 percentage point for December 1998 and later.	0.70
5. Cap the COLA to the amount payable if PIA were equal to the 20th percentile of PIAs for all worker beneficiaries (retired and disabled) for December 1998 and later.	1.66
6. Cover State and local hired in 1998 and later.	0.21
7. Lower spouse benefits to 33 percent of PIA.	0.17

Subtotal for Proposals 1 through 7	2.07
8. Invest a portion of the OASDI Trust Funds in equities beginning in 1998.	0.19

Total for Proposals 1 through 8	2.26

1/ Estimates for individual proposals do not reflect interaction, except for proposal 8, which would be 0.56 without interaction..

Based on the intermediate alternative II assumptions of the 1995 Annual Trustees Report.

Office of the Actuary/Social Security Administration
May 3, 1995