Social Security

Memorandum

Date: August 24, 2001

To: Representative Jim Kolbe
Representative Charles Stenholm

From: Stephen C. Goss, Chief Actuary
Alice H. Wade, Deputy Chief Actuary

Subject: Estimated Long-Range OASDI Financial Effects of the ***21st Century Retirement Act*** -- INFORMATION

This memorandum provides long-range estimates of the financial status of the OASDI program assuming enactment of the ***21st Century Retirement Act (H.R. 2771, introduced on August 2, 2001)*** with modifications noted below. The principal staff contacts are Jen Olsen from Representatives Kolbe's staff and Ed Lorenzen from Representatives Stenholm's staff. The comprehensive proposal described in ***H.R. 2771*** (with modifications) would:

- Modify the computation of OASDI benefit levels in several ways,
- Transfer specified amounts from the General Fund of the Treasury to the OASDI Trust Funds,
- Credit all revenue from taxation of OASDI benefits (including disbursements from individual accounts) to the OASDI Trust Funds,
- Change the indexing of the benefit and contribution base, and
- Establish individual accounts for workers who are under age 55 in 2003 by redirecting a portion of their payroll tax.

The estimates provided in this memorandum (below and in table 1) reflect the intent of the legislation as stated by Representative Kolbe's and Representative Stenholm's staff. All estimates are based on the intermediate assumptions of the 2001 Trustees Report plus additional assumptions described below.

The stated intent of several provisions differs from the language of ***H.R. 2771***, as initially introduced. These discrepancies are indicated in table 2. It is anticipated that technical amendments to the bill that will conform to the stated intent will be forthcoming.

Enactment of the comprehensive proposal described in this memorandum would improve the long-range OASDI actuarial balance by an estimated 1.92 percent of taxable payroll, changing the present-law actuarial deficit of 1.86 percent to an actuarial balance of +0.06 percent of taxable payroll. The OASDI annual balance for the year 2070 would improve by 6.42 percent of payroll, to an estimated level of +0.64 percent of payroll. The trust fund ratio for the combined OASDI program would increase to a peak of 375 percent in 2014, then decline to 57 percent in 2053. After 2054, the trust fund ratio would begin to rise, reaching 179 percent at the end of the long-range period, at which time the ratio would be rising by about 8 percentage points per year. OASDI trust fund levels under this proposal are thus projected to be (1) positive throughout the long-range (75-year) period and (2) stable or rising as a percentage of the annual cost of the program at the end of the period. On this basis we conclude that enactment of this proposal would be expected to provide for the full payment of benefits (as modified) throughout the period, and beyond.

The remainder of this memorandum provides the following:

- Description of the equity yield assumption used in estimating the income taxes payable on individual account disbursements (which are transferred to the trust funds),
- Sensitivity analysis with regard to the equity yield assumption,
- Description of the provisions of this bill (with modifications to reflect intent) as they would affect the Social Security program,
- Brief listing of the individual provisions of the proposal, including the effect of each provision, separately, on the long-range OASDI actuarial balance (shown in table 1), and
- Listing of discrepancies between bill language and intent (shown in table 2).

Description of the equity yield assumption used in estimating income taxes payable on individual account disbursements

As indicated above, estimates provided in this memorandum are based on the intermediate assumptions of the 2001 Trustees Report. In addition, the long-term ultimate average annual real yield assumed for equities is assumed to be 6.5 percent. This is slightly lower than the expected real equity yield used for estimates produced by the Office of the Chief Actuary over the last several years.

A consensus is forming among economists that equity pricing as indicated by price-to-earnings ratios may average somewhat higher in the long-term future than in the long-term past. This is consistent with broader access to equity markets and the belief that equities may be viewed as somewhat less “risky” in the future than in the past. Equity pricing will vary in the future as in the past. Price-to-earnings ratios were very high in the recent past, and are now lower. The ultimate average real equity yield assumed for estimates in this memorandum is consistent with an average ultimate level of equity pricing somewhat above the average level of the past. The extent of this ultimate change is unknown, but it is consistent with assuming a real equity yield somewhat below the long-range past average of about 7 percent.

The assumption for an ultimate real equity yield of 7 percent that was used until this year was developed in 1995 with the 1994-6 Advisory Council. At the time, the Trustees assumption for the ultimate average real yield on long-term Treasury bonds was 2.3 percent. Real yields on corporate bonds are believed to bear a close relationship to Treasury bond yields of similar duration. The 2001 Trustees Report includes the assumption that the ultimate real yield on long-term Treasury bonds will average 3 percent, or 0.7 percentage point higher than in 1995. This increase in the assumed bond yield is consistent with a reduction in the perceived risk associated with equity investments.

Sensitivity analysis with regard to the equity yield assumption

If actual real yields on equities held in individual accounts over the next 75 years were to average only 3 percent, the same level as assumed for long-term Treasury bonds, this comprehensive proposal would still provide for adequate financing for the OASDI program through the provisions described above. The long-range OASDI actuarial balance would improve by an estimated 1.87 percent of taxable payroll, changing the present-law actuarial deficit of 1.86 percent to an actuarial balance of +0.01 percent of taxable payroll.

It must be noted that the uncertainties associated with equity investments, bond yields, and mortality improvement, as well as with a number of additional variables means that actual experience could vary substantially from the estimates provided in memorandum. In particular, there is a potential that long-range ultimate equity yields could average less than the 3 percent, although this is not very likely.

Description of the provisions of this bill (modified to reflect stated intent) as they would affect the Social Security program

Provision 1: Reduce the COLA by 0.33 percentage point

This provision is intended to reduce the present-law OASDI annual cost-of-living adjustment (COLA) for monthly OASDI benefits by an average 0.33 percentage point from the level currently anticipated under the assumptions of the 2001 Trustees Report. The reduction would start with the COLA scheduled for December 2001 and continue indefinitely thereafter. The proposal would require a reduction in the computed percentage increase in the CPI-W upon which the COLA is based, before rounding to the nearest one-hundredth of a percentage point. The reduction would be equal to 0.33 percentage point less the sum of the following:

(a) Starting with the first year for which the COLA is based on a CPI that eliminates upper level substitution bias (should such a change be enacted in the future), the average size of the bias that has been eliminated, as estimated by the Bureau of Labor Statistics (BLS) and

(b) The average size of the change in the annual growth rate in the CPI used to compute the COLA based on other modifications (than described in (a) above) to remove bias in the CPI that are implemented after January 31, 2001, as estimated by the BLS.

However, the 0.33-percentage-point reduction would in no case be diminished to less than zero by (a) and (b) above.

Provision 2: Eliminate the hiatus in the currently scheduled increase in normal retirement age (NRA); Modify actuarial reduction and increment factors

Eliminate the hiatus in the currently scheduled increase in NRA

Under current law, the NRA increases from age 65 by two months a year beginning with individuals attaining age 62 in the year 2000, until it reaches 66 for individuals attaining age 62 in the year 2005. While current law then leaves the NRA at 66 for several years, this provision would continue to phase the NRA upwards by two months a year until it reaches 67 for individuals reaching age 62 in 2011. The NRA would remain at age 67 for all individuals reaching age 62 after 2011.

Modify actuarial reduction and increment factors

In addition, the early retirement reduction factors and delayed retirement credits would be changed in an attempt to reflect the fact that the marginal increase in the full benefit level (i.e., the PIA) for earnings after reaching retirement eligibility age is, generally, relatively small. (Reduction and increment factors provided under current law are intended to provide actuarially equivalent lifetime benefits for a fixed earnings history regardless of the age at which retirement benefits start.) This relatively small marginal increase results from both the AIME formula, which uses 35 years of earnings, and the weighted PIA benefit formula. Together, these provide a larger marginal amount of benefit per dollar of additional earnings for low earners and for earnings earned early in a worker's career. This provision is intended to provide a greater marginal incentive to work past the retirement earliest eligibility age (EEA). Because the degree of this marginal effect depends upon the extent and level of earnings a worker has had in earlier years, no absolute adjustment can be provided that would be appropriate for all workers. Rough estimates of adjustments to the reduction and increment factors have thus been developed.

The chart below displays the proposed monthly early retirement reductions that would be applicable for retired worker beneficiaries for the first 36 months for which benefits are received prior to NRA under both current law and the provision. (Different factors apply to aged spouse beneficiaries and aged widow beneficiaries.)

Monthly Reduction in Benefits for Each of First 36 Months of Retirement Before NRA

Age 62 in:	2001	2002	2003	2004	2005	2006+
Present Law	20/36%	20/36%	20/36%	20/36%	20/36%	20/36%
Proposal	20/36%	21/36%	22/36%	23/36%	24/36%	25/36%

Similar increases for aged spouse beneficiaries would be applied, increasing the monthly reduction for the first 36 months of entitlement before NRA from 25/36 percent under present law to 30/36 percent under the provision.

The reductions that are proposed for the fourth and fifth year of benefit entitlement before NRA are 12/24% per month (current law reductions are 10/24% per month) for both retired worker and aged spouse beneficiaries. The reductions for the fourth and fifth year of entitlement before NRA are applicable to all new eligibles who reach age 62 after 2005 and are phased in for those newly eligible in 2002 through 2005.

The ultimate percentages of PIA payable for retired workers by age at initial benefit entitlement are shown in the table below.

Ultimate Percent of PIA Payable for Retired Worker Beneficiaries by Age at Initial Entitlement to Benefits

Age at Initial Entitlement:	NRA-5	NRA-4	NRA-3	NRA-2	NRA-1	NRA
Present Law	70%	75%	80%	86.7%	93.3%	100%
Proposal	63%	69%	75%	83.3%	91.7%	100%

The percentage of PIA payable for non-disabled aged widow beneficiaries newly eligible at age 60 would remain at 71.5 percent. The percentages payable for those newly eligible at ages between 60 and the NRA would scale linearly between 71.5 and 100 percent, as under present law.

The delayed retirement credit (DRC) under present law is scheduled to increase to 8% per year for workers attaining age 65 after 2007. Under ***H.R. 2771,*** the DRC would continue to increase at the rate of 0.5 percentage point every two years, with the first new increase applied to those attaining age 65 in 2010. An ultimate factor of 10 percentage points per year would be reached for workers reaching 65 after 2015. The delayed retirement credit applies for those months between NRA and age 70 in which no retired worker benefit is received.

The legislative language in ***H.R. 2771*** does not mention the intended increases (described above) for aged spouse beneficiaries.

Provision 3: Adjust the PIA levels to reflect changes in life expectancy for persons newly eligible after 2011

Adjust the PIA levels of retired worker beneficiaries newly eligible after 2011 to reflect changes in life expectancy at age 62, based on period life tables produced by the Office of the Chief Actuary in the Social Security Administration. This provision does not apply to disabled worker beneficiaries. In addition, only a portion of the amount of reduction due to this provision would apply to the benefits of retired worker beneficiaries who convert from disabled worker beneficiary status.

Adjustment to benefits of retired workers with no disability periods

The intent of this provision is to adjust benefit levels to reflect actual measured changes in longevity. The adjustment would be applied beginning with workers turning age 62 in 2012, the first year after the year in which the NRA under this proposal reaches its maximum of 67 years. The adjustment would be a ratio of:

- The life expectancy at age 62 from the period life table for the calendar year 2008 *to*
- The life expectancy at age 62 from the period life table for the calendar year that is three years prior to the year in which the retiree turns age 62.

For example, the benefit of a worker reaching EEA, age 62, in 2012 would be reduced based on the increase in period life expectancy at age 62 between 2008 and 2009. The two years would generally be the two most recent years of complete data. If the life expectancy at age 62 increased from 20.02 to 20.05 between 2008 and 2009, then the benefit level of the worker would be multiplied by 0.9985 (=20.02/20.05), for a reduction of 0.15 percent. For a worker retiring at age 62 in 2013, the reduction in benefit level would be based on the increase in life expectancy at age 62 between 2008 and 2010. The chart below provides the expected life-expectancy adjustment factors and the benefit reduction percents that would apply to selected retired-worker beneficiaries using the intermediate assumptions of the 2001 Trustees Report.

Life-Expectancy Adjustment Factors Projected to Apply* to PIA of Retired Workers With no Disability

(1)	(2)	(3)	(4)
Year retired worker turns age 62	**Life expectancy at age 62***	**Life-Expectancy Adjustment Factor**	**Percent Reduction in Benefit**
2011	20.02	NA	NA
2012	20.05	0.9985	0.15%
2015	20.15	0.9935	0.65
2020	20.38	0.9823	1.77
2030	20.98	0.9542	4.58
2050	22.14	0.9042	9.58
2070	23.19	0.8633	13.67

* The life expectancies used for this table are based on projections and are for the year 3 years prior to the year the worker turns age 62. Reductions applied would be based on actual data.

Adjustment to benefits for disabled workers or retired workers with disability periods

The intent of this provision is to limit in two ways the amount of benefit reductions that would apply to workers who have had periods of disability. First, because the annuity derived from a disabled worker's individual account is first payable at disability conversion age, no reduction due to this provision would apply to benefits received as a disabled worker. Second, once the disabled worker reaches disability conversion age, the reduction due to this provision would be limited, reflecting only the portion of potential working years (years from age 22 through age 61) that the individual was not entitled to a disabled-worker benefit.

For example, a worker who becomes disabled at age 32 and is thereafter continuously receiving disability benefits would receive no reduction in his/her benefit level due to this provision until disability conversion age (age 67). At conversion, monthly benefits would be paid from the individual account, and a portion of the reduction due to the life-expectancy adjustment would begin to apply to the PIA. Of the 40 potential working years, 10 years (ages 22 though 31) were years that the worker did not receive a disability-worker benefit. Thus, for this worker, one-fourth of the reduction due to the life-expectancy adjustment would apply to his/her PIA level.

The legislative language in ***H.R. 2771*** with regards to this provision differs from the stated intent described above. The legislative language stipulates that the benefits for disabled worker beneficiaries would be fully reduced for this life expectancy adjustment. In addition, the numerator of the life expectancy adjustment ratio is specified as using data for the calendar year 2010, rather than 2008.

Provision 4: Change in calculation of AIME

This provision would apply in determining benefits for retired workers and their dependents and for survivors of deceased workers. This provision does not apply in determining benefits for disabled workers and their dependents.

In calculating the AIME for a retired worker under present law, the highest 35 years of indexed earnings are used in determining the numerator of the AIME and a benefit computation period of 35 years is used in determining the denominator. Under this provision, the following changes would be made in the calculation of the AIME for someone newly eligible for retirement benefits after 2001.

- The number of years of earnings used in calculating the numerator of the AIME is gradually increased, reaching all years for individuals becoming newly eligible in 2010.
- The benefit computation period, used in determining the denominator of the AIME, is gradually increased, reaching 40 years (5 additional years), except for the "lower earner" of a married couple. Specifically, in the case of a two-earner couple, the benefit computation period used in the denominator for the earner with the lower PIA is retained at 35 years.

The chart below indicates the phase-in schedule of the above changes.

Change in Calculation of AIME for Retired Worker
(assumes the retired worker is not the *lower earner of a married couple*)

Newly Eligible in Years:	2002 – 2003	2004 - 2005	2006 – 2007	2008 – 2009	2010+
Present Law					
Years in Numerator[1]	35	35	35	35	35
Denominator (in years)[2]	35	35	35	35	35
Proposal					
Years in Numerator[1]	37	39	41	43	all
Denominator (in years)[2]	36	37	38	39	40

[1] Years in Numerator: Refers to the number of years of earnings used in calculating the numerator of the AIME.
[2] Denominator (in years): Refers to the benefit computation period (in years) used in calculating the denominator of the AIME.

Under this provision alone, the number of benefit computation years used for the denominator of the AIME for a retired worker turning age 62 after 2009 would be 40. Under current law, the number of benefit computation years is determined by subtracting 5 *dropout* years from the number of *elapsed* years (years age 22 through the year prior to reaching EEA). Under this proposed provision, the increase in the number of benefit computation years would be accomplished by reducing the number of *dropout* years, ultimately to zero.

The legislative language in ***H.R. 2771*** with regard to this provision differs from the stated intent described above. The language attempting to include all years of earnings is flawed, and no mention is made of *gradually* including all years of earnings in the numerator of the AIME calculation. Also, in determining the lower earner of a two-earner couple, the legislative language assigns the earner with the smaller amount of wages paid and self-employment income credited to the preceding calendar year, rather than the earner with the lower PIA.

Provision 5: Credit all revenue from taxation of OASDI benefits to OASDI by 2019

This provision would redirect revenue collected by the IRS from Federal income taxes payable on OASDI benefits, in excess of the tax on 50 percent of such benefits, from the Medicare HI trust fund to the OASDI trust funds. The provision would redirect 10 percent of this revenue for 2010, 20 percent for 2011, ... , and 100 percent for 2019 and later. It should be noted that disbursements from individual accounts established under this bill would be included as OASDI benefits for the purpose of income taxation.

Provision 6: Establish a minimum PIA level

For beneficiaries newly eligible in 2012 and later, establish a minimum PIA amount as described below:

For Retired Workers: The minimum PIA would apply to such retired workers who have at least 80 quarters of coverage (reduced by 2 for each year of disabled-worker entitlement). It would equal 60% of the *Monthly Applicable Poverty Level* (see below for definition) for workers with 80 quarters of coverage (reduced by 2 for each year of disabled-worker entitlement) and 100% of the *Monthly Applicable Poverty Level* for workers with at least 160 quarters of coverage (reduced by 4 for each year of disabled-worker entitlement). The percentage of the *Monthly Applicable Poverty Level* defining the minimum PIA for an individual with more than 80 quarters and less than 160 quarters of coverage would be prorated between 60% and 100%, based on their number of quarters of coverage. These criteria would also apply in determining PIA levels used for auxiliary benefits for survivors of workers who died after reaching age 62.

For Disabled Workers and Survivors of Workers Who Die Before Age 62: A minimum PIA for disabled worker beneficiaries and for auxiliary benefits for survivors of workers who die before age 62 would be similar, equaling 60% of the *Monthly*

> *Applicable Poverty Level* for individuals whose quarters of coverage equal to twice the number of their elapsed years (reduced by 2 for each year of disabled-worker entitlement) and 100% of the *Monthly Applicable Poverty Level* for individuals whose quarters of coverage equal four times their number of such elapsed years (reduced by 4 for each year of disabled-worker entitlement). Elapsed years are defined as years between attaining age 22 and the earliest of disability benefit entitlement, death, or age 61.

The minimum PIA is phased in during the years 2008 through 2011. For new eligibles in 2008, the percentage of the *Monthly Applicable Poverty Level* is one-fifth of the fully phased in percentage in 2012. This fraction increases by an additional one-fifth for each year during the phase in period, reaching four-fifths for 2011.

The *Annual Applicable Poverty Level* for 2000 is $8,259 (*Monthly Applicable Poverty Level* would equal 1/12 of this amount). The *Annual Applicable Poverty Level* that applies to an individual in their year of initial eligibility is determined by increasing the 2000 level by:

1. the *COLA* for 2000 through the earlier of (1) the year prior to the year of initial benefit eligibility and (2) 2011; and
2. increases in the *average wage index* between 2010 and the second year prior to initial benefit eligibility.

Minimum PIA levels would increase by the COLA after benefit eligibility in all cases.

The legislative language in ***H.R. 2771*** with regard to this provision differs from the stated intent described above. According to the legislation, the quarters-of-coverage requirement is the same for all types of beneficiaries. Also, the rules that are described above for retired workers with no period of receiving disability benefits would apply to all beneficiaries, with no exceptions. In addition, the legislative language for this provision specifies different effective dates. Lastly, the future adjustments in the *Annual Applicable Poverty Level* specified in the legislation do not match those described above.

Provision 7: Modification of PIA Formula during 2012-2030

Provision 7 would reduce the upper two factors of the PIA benefit formula (32 and 15) by 2.5 percent per year (multiply by 0.975) for 2012 through 2030. The upper two PIA benefit factors applicable for beneficiaries newly eligible in 2030 and later would be 19.8 and 9.3 percent, respectively.

This provision would not apply to disabled worker beneficiaries. In addition, only a proportion of the amount of reduction due to this provision would apply to the benefits of retired worker beneficiaries who convert from disabled worker beneficiary status. The application of this provision to the benefits of disabled worker beneficiaries and beneficiaries who convert from disabled worker beneficiary status is the same as described under *provision 3* in the section *adjustment to benefits of disabled workers or retired workers with disability* *periods.*

The legislative language in ***H.R. 2771*** with regard to this provision differs from the stated intent described above. The legislative language stipulates that the PIA formula factors would be fully reduced for disabled worker beneficiaries.

Provision 8: Modification of PIA formula during 2031-2060

Provision 8 reduces the primary insurance amount (PIA) of those who become eligible for benefits after 2030 by multiplying the PIA successively by a factor of 0.985. The number of times the PIA is multiplied by the factor of 0.985 is equal to the number of years beginning with 2031 through the earlier of the year in which the beneficiary reaches initial benefit eligibility (or death) and 2060. The ultimate reduction due to this provision for those newly eligible for benefits after 2060 is 36 percent.

This provision does not apply to disabled worker beneficiaries. In addition, only a proportion of the amount of reduction due to this provision would apply to the benefits of retired worker beneficiaries who convert from disabled worker beneficiary status. The application of this provision to the benefits of disabled worker beneficiaries and beneficiaries who convert from disabled worker beneficiary status is the same as described under *provision 3* in the section *adjustment to benefits of disabled workers or retired workers with disability periods.*

The legislative language in ***H.R. 2771*** with regard to this provision differs from the stated intent described above. The legislative language *subjects* disabled worker beneficiaries to the full adjustments in the PIA.

Provision 9: Redirect 3 percent of the first $10,000 of taxable earnings and 2 percent of their remaining taxable earnings to individual accounts

Beginning in 2003, for each worker who is under age 55 at the beginning of 2003, redirect 3 percent of his/her first $10,000 of taxable earnings and 2 percent of taxable earnings in excess of $10,000 to individual accounts. This amount redirected to fund individual accounts is taken from the employee's share of the FICA payroll tax. A similar redirection would occur for taxable self-employment earnings, with 3 percentage points of the first $10,000 of taxable self-employment income and 2 percent of taxable self-employment income in excess of $10,000 redirected to individual accounts. The $10,000 threshold is increased after 2003 by the increase in the Average Wage Index. The Federal Government would collect all redirected amounts in the same manner that payroll taxes are collected currently. Accounts would be managed and invested, under the direction of the worker, in a federally administered individual security account, similar to the government employee Thrift Savings Plan. However, when the balance of an individual's federally administered individual security account is at least equal to the minimum deposit amount ($7,500 for 2003 and increase by COLA adjustments thereafter), he/she would be eligible to designate a privately administered individual security account.

Disbursements to individuals after retirement or to their estates at death from the portion of the individual accounts arising from the redirection of the payroll taxes would be considered Social Security benefits when determining income taxes. Thus, the revenue from taxing these disbursements would be transferred to the OASI Trust Fund. In order to estimate the income to the OASDI Trust Fund from taxing the disbursements from individual accounts, the following assumptions were made:

- During the accumulation period, individual accounts would be, on average, invested 50% in equities and 50% in long-term Treasury bonds.
- During the disbursement period (after retirement), the net real yield is assumed to be 3 percent annually, consistent with a life annuity.
- The real yield on equities is assumed to average 6.5 percent annually (see earlier discussion of equity yield assumption).
- The real yield on long-term Treasury bonds is assumed to average 3.0 percent annually.
- The charge for annual administrative expenses would average 90 basis points during the accumulation period.

The legislative language in ***H.R. 2771*** with regard to this provision differs from the stated intent described above. The legislative language increases the $10,000 threshold in determining the level of contributions to individual accounts by the increase in the COLA, rather than the increase in the Average Wage Index. In addition, the legislative language extends this provision to workers born after 1946 rather than those born after 1947 (under age 55 in 2003).

Provision 10: Transfer revenue from the General Fund to the OASI Trust Fund

This provision provides a transfer to the OASI Trust Fund from the General Fund of the Treasury. The amounts would be transferred beginning in 2002 and are specified as an increasing percentage of OASDI taxable payroll. These amounts are as follows:

Calendar Year	Percent of Taxable Payroll		Calendar Year	Percent of Taxable Payroll		Calendar Years	Percent of Taxable Payroll
2002	0.13		2006	0.28		2010-2015	0.47
2003	0.15		2007	0.32		2016-2039	0.55
2004	0.20		2008	0.35		2040-2059	0.66
2005	0.24		2009	0.38		2066+	0.80

Provision 11: Gradually increase the benefit and contribution base so that 86 percent of all covered earnings is taxable

Under current law the *contribution and benefit base* ($80,400 in 2001) is automatically increased each year based on increases in the SSA average wage index. The ratio of OASDI effective taxable payroll to covered earnings was 86 percent in 1996 and has been dropping since that time. It is currently about 83.7 percent and is projected to be about 83.1 percent in

2011.

This provision would gradually increase the *contribution and benefit base* over the period 2002-2004, so that by the end of this period 86 percent of all covered earnings would be taxable. After 2004, the *contribution and benefit base* would be determined so that this level of 86 percent is maintained. The actual levels of the base for each year would need to be set based on the estimated level and distribution of earnings for the upcoming year, as computed by the Office of the Chief Actuary based on the intermediate assumptions in the latest published Trustees Report.

The legislative language in ***H.R. 2771*** with regard to this provision differs from the stated intent described above. After 2004, the legislative language sets the benefit and contribution base equal to 86% of the average wage rather than as described above.

Provision 12: Redesign the PIA formula

Establish a new bend point in the PIA formula equal to 196% of the present-law first bend point. PIA formula factors would be initially set at 90, 32, 32, and 15 percent (yielding the same benefit as current law). Beginning with new eligibles in 2006, the four PIA formula factors would be adjusted until reaching factors of 90, 70, 20, and 10 for newly eligible beneficiaries in 2015 and later. The yearly adjustments to the formula factors over the 10-year period (2006 through 2015) are:

- The second formula factor would be increased each year by 3.8 percentage points,
- The third formula factor would be decreased each year by 1.2 percentage points, and
- The fourth formula factor would be decreased each year by 0.5 percentage points.

This provision alone is intended to have no effect on the long-range cost of the OASDI program.

The legislative language in ***H.R. 2771*** with regard to this provision differs from the stated intent described above. The legislative language sets the ultimate value of the last formula factor at 15, rather than 10. In addition, the legislative language makes this provision fully effective for anyone who is newly eligible for benefits after 2008 (no phase-in of this provision is included).

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Table 1. Estimated Long-Range OASDI Financial Effect of a Proposal by Representatives Kolbe and Stenholm

	Provision	Estimated Change in Long-range OASDI Actuarial Balance (percent of taxable payroll)
1	Reduce the COLA for OASDI benefits by 0.33 percentage point beginning Dec. 2001.	0.51
2	Eliminate the hiatus in the currently scheduled increase in NRA. Increase early retirement reduction factors and delayed retirement credits.	0.48
3	Adjust the PIA levels of retired worker beneficiaries newly eligible after 2011 to reflect changes in life expectancy (based on period life expectancies at age 62). This provision does not apply to disabled worker beneficiaries. In addition, only a proportion of the amount of reduction due to this provision would apply to the benefits of retired worker beneficiaries who convert from disabled worker beneficiary status.	0.44
4	Increase the benefit computation period by up to 5 additional years for new eligibles (by one additional year for new eligibles in each year 2002, 2004, 2006, 2008, and 2010). For two-earner couples, however, cap the benefit computation period for the earner with the lower PIA at 35 years. In conjunction with increasing the benefit period, phase in including earnings for all years in calculating the AIME. This provision does not apply to disabled worker beneficiaries.	0.25
5	Credit all revenue from taxation of OASDI benefits to the OASDI trust funds by 2019 (phase revenue from HI to OASDI during the period 2010-2019).	0.33
6	Beginning in 2008, establish a minimum PIA level for newly eligible beneficiaries with quarters of coverage equal to twice their number of elapsed years (reduced for any years of disabled worker entitlement). The minimum PIA level will be fully phased in by 2012, and would equal 100% of the *applicable poverty level* for newly eligible beneficiaries with quarters of coverage equal to four times their number of elapsed years (reduced for any years of disabled worker entitlement).	-0.02
7	Reduce the 32 and 15 PIA-formula factors by 2.5 percent (multiply by 0.975) for each year 2012-2030. Factors for those newly eligible after 2029 are 19.8 and 9.3, respectively. This provision does not apply to disabled worker beneficiaries. Only a proportion of the amount of reduction due to this provision would apply to the benefits of retired worker beneficiaries who convert from disabled worker beneficiary status.	1.40
8	Reduce PIA levels 1.5 percent (multiply by 0.985) each year for those newly eligible in years 2031-2060. This provision does not apply to disabled worker beneficiaries. Only a proportion of the amount of reduction due to this provision would apply to the benefits of retired worker beneficiaries who convert from disabled worker beneficiary status.	0.85
9a	Beginning in 2003, for each worker who is under age 55 in 2003, redirect 3 percent of their first $10,000 of OASDI taxable earnings and 2 percent of their taxable earnings above $10,000 to individual accounts. The $10,000 threshold is increased after 2003 by the increase in the Average Wage Index.	-2.13
9b	Disbursements from individual accounts are considered OASDI benefits for income tax.	0.15
10	Transfer amounts (specified as percentages of taxable payroll) to the OASI Trust Fund from the General Fund of the Treasury for years after 2001.	0.53
11	Over the period 2002-2004, gradually increase the benefit and contribution base so by the end of this period 86 percent of all OASDI covered earnings is taxable. After 2004, maintain this level of 86 percent.	0.32
12	Establish a new bend point in the PIA formula equal to 196% of the present-law first bend point. PIA formula factors would be initially set at 90, 32, 32, and 15 (yielding the same benefit as current law). Beginning with new eligibles in 2006, the second formula factor would be increased each year by 3.8, the third formula factor would be decreased each year by 1.2, and the fourth formula factor would be decreased each year by 0.5, until reaching factors of 90, 70, 20, and 10 for newly eligible beneficiaries in 2015 and later.	1/
Total for Provisions 1 through 12 (including interaction among provisions)		**1.92**

Based on the intermediate assumptions of the 2001 Trustees Report under present law, the long-range actuarial balance for the 75-year period (2001-2075) is –1.86 percent of taxable payroll.

[1]Negligible (between -0.005 and .005 percent of payroll) change in the OASDI long-range actuarial balance.

Office of the Chief Actuary, Social Security Administration August 24, 2001

Table 2. Differences between the stated intent of provisions and the legislative language of ***H.R. 2771 (introduced August 2, 2001).***

Provision Number	H.R. 2771 language	Stated Intent
2	Early retirement factors applied to aged spouse benefits are **unchanged**.	Early retirement reduction factors are **increased** for aged spouse benefits.
3	This provision applies to individuals who become eligible for old-age or **disability** benefits or who die. The life expectancy ratio is the ratio of: • The life expectancy at age 62 from the period life table for the calendar year **2010** to • The life expectancy at age 62 from the period life table for the calendar year that is three years prior to the year in which the retiree turns age 62.	This provision applies to individuals who become eligible for old-age benefits or who die. **(Disabled worker beneficiaries are excluded from this adjustment to the benefit formula factors.)** The life expectancy ratio is the ratio of: • The life expectancy at age 62 from the period life table for the calendar year **2008** to • The life expectancy at age 62 from the period life table for the calendar year that is three years prior to the year in which the retiree turns age 62.
4	In the case of a two-earner couple, the benefit computation period is retained at 35 years for the **earner with the smaller amount of wages paid and self-employment income credited to the preceding calendar year**.	In the case of a two-earner couple, the benefit computation period used in the denominator for the **earner with the lower PIA (or estimated PIA)** is retained at 35 years.
4	No mention is made of **gradually** including all years of earnings in the numerator of the AIME calculation. In addition, the **language attempting to include all earnings is flawed**. The bill does include all earnings in the numerator. However, it also assigns the number of years used in calculating the **denominator** of the AIME years to years after 1950. Thus, a beneficiary entitled at age 62 and born in 1985 would have 97 years (1951-2047) used in the denominator of the AIME.	In conjunction with increasing the benefit period, **phase in** including earnings for all years in the **numerator** of the AIME calculation.
6	The Annual Applicable Poverty Level for 2000 is $8,259 (Monthly Applicable Poverty Level would equal 1/12 of this amount). The Annual Applicable Poverty Level that applies to an individual in their year of initial eligibility is determined by increasing the 2000 level by: 1. COLAs for **1996** through the earlier of (1) the year prior to the year of initial benefit eligibility and (2) **2009**; and 2. Increases in the *average wage index* between **2009** and the second year prior to initial	The Annual Applicable Poverty Level for 2000 is $8,259 (Monthly Applicable Poverty Level would equal 1/12 of this amount). The Annual Applicable Poverty Level that applies to an individual in their year of initial eligibility is determined by increasing the 2000 level by: 1. COLAs for **2000** through the earlier of (1) the year prior to the year of initial benefit eligibility and (2) **2011**; and 2. Increases in the *average wage index* between **2010** and the second year prior to

	benefit eligibility.	initial benefit eligibility.
6	This provision would apply to those who initially become eligible for benefits after **December 31, 2009.**	This provision would be **phased in** for those who initially become eligible for benefits after **December 31, 2007 and** would be **fully** effective for those who become eligible for benefits after **December 31, 2011.**
6	In determining the minimum PIA under this provision, the minimum quarters of coverage is equal to **80**, with no exceptions for type of beneficiaries.	In determining the minimum PIA under this provision for a **disabled worker beneficiary** or **young survivor** the minimum quarters of coverage would be **twice his/her number of elapsed years.** For retired workers, the minimum quarters of coverage is equal to **80, reduced by 2 for each year of disabled-worker entitlement**.
7 and 8	These provisions apply to individuals who become eligible for old-age or **disability** benefits or who die, in any calendar year after 2008.	These provisions apply to individuals who become eligible for old-age benefits or who die, in any calendar year after 2011. **Disabled worker beneficiaries are excluded from these adjustments to the benefit formula factors.**
9a	Beginning in 2003, workers who are born after **December 31, 1946** would begin contributing to individual accounts.	Beginning in 2003, workers who are born after **December 31, 1947** would begin contributing to individual accounts.
9a	The $10,000 threshold in determining the level of contributions to individual accounts is increased after 2003 by the increase in the **COLA**.	The $10,000 threshold in determining the level of contributions to individual accounts is increased after 2003 by the increase in the **Average Wage Index**.
11	After 2004, the benefit and contribution would be set equal to 86% of **the average wage.**	After 2004, the benefit and contribution base would be maintained at a level so that 86% of **covered earnings would be subject to the OASDI payroll tax**.
12	A new bend point equal to 196% of the first bend point would be established and formula factors would become 90, 70, 20, and **15. These changes apply to those newly eligible for benefits after 2008.**	A new bend point equal to 196% of the first bend point would be established and formula factors would become 90, 70, 20, and **10. These changes apply to those newly eligible for benefits after 2014 and are phased on for those newly eligible for benefits over the period 2006-2014.**

In addition to the above, sections 8 and 9 appear to need a conforming section. Section 9 inserts (iv) after clause (iii) of Section 215(a)(1)(A) in order to establish a fourth formula factor. However, the reductions to the formula factors in Section 8 do not apply to this new fourth formula factor.