

# Social Security Reform Options



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**Monday, June 11, 2007**  
**1:30 – 2:30 pm**  
**HC-7 Capitol Building**  
**Washington DC**



# Social Security Topics

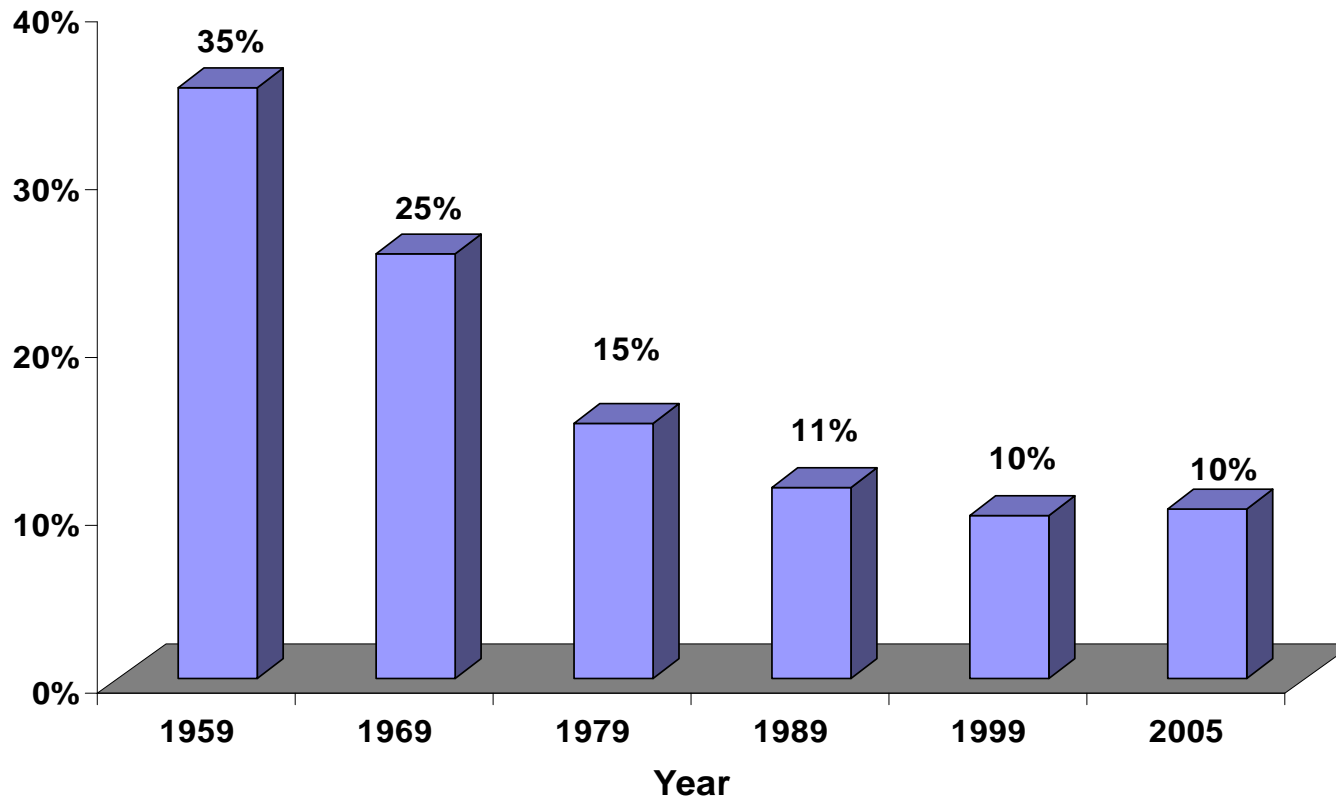


- Background on Social Security's Benefits
- Social Security's Financial Status
- Options for Reform
  - With Focus on Recent Options





## Poverty Rates For People Age 65 and Older



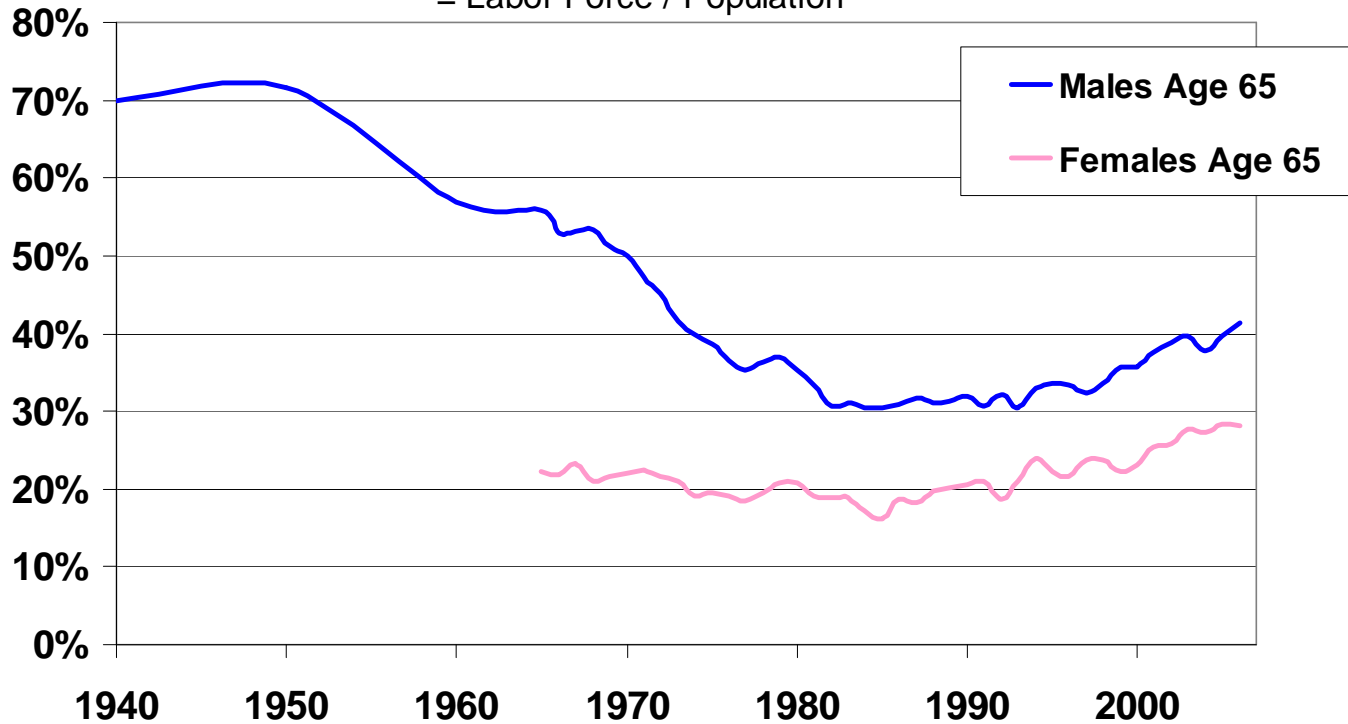
Social Security (along with SSI & Pensions) decreased the % of elderly below the poverty level to the same % as for people of working age. The poverty threshold (for people over 65) is about \$9,000 per person (~ \$12,000 for a couple). The thresholds increase with CPI (another reason why percents fell). Poverty rates for single women are much higher. Source: Census Bureau's CPS (Current Population Survey) at census.gov





# Labor Force Participation Rates

= Labor Force / Population



Sources: Labor Force Statistics from the BLS Consumer Population Survey (CPS). Prior to 1960, data is from US Census: Historical Statistics of the United States pg. 132, Statistical Abstract p. 411  
Labor Force = Employed + Unemployed (those actively seeking and available)

**Social Security, Medicare, and employee benefits encouraged people to retire earlier. Since 1985, however, pro-work policies (e.g., Age Discrimination in Employment Act, higher Social Security Normal Retirement Age (NRA), Earnings limit eliminated over NRA), better health, greater demands for labor, reduced employer benefits, and the recent stock crash may have encouraged more people to work longer.**



# Social Security Benefits

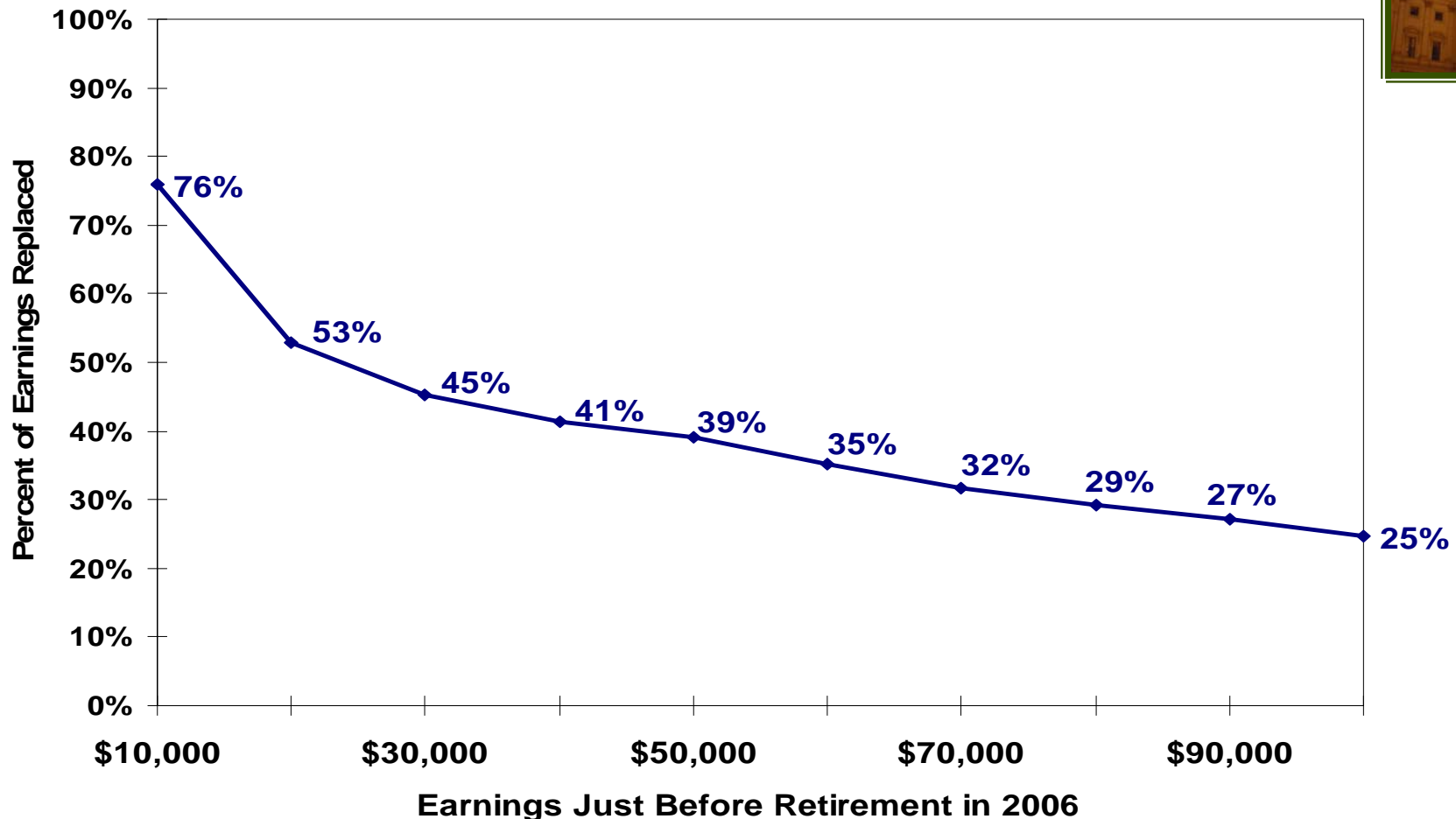


- Retirement benefits payable for life
  - No matter how long you live
  - No matter how bad the markets
- Benefits being paid increase by CPI each year
- Replacement rates maintained
  - Initial benefits increase by average wages each year
- Disability and Survivor benefits (1/3<sup>rd</sup> of total benefits)
- Spousal benefits
  - At least 50% of worker's benefit
  - Survivor: at least 100% of worker's benefit
    - Valuable for non-working spouses





## Social Security Replacement Ratios at Normal Retirement Age (and at Disability)

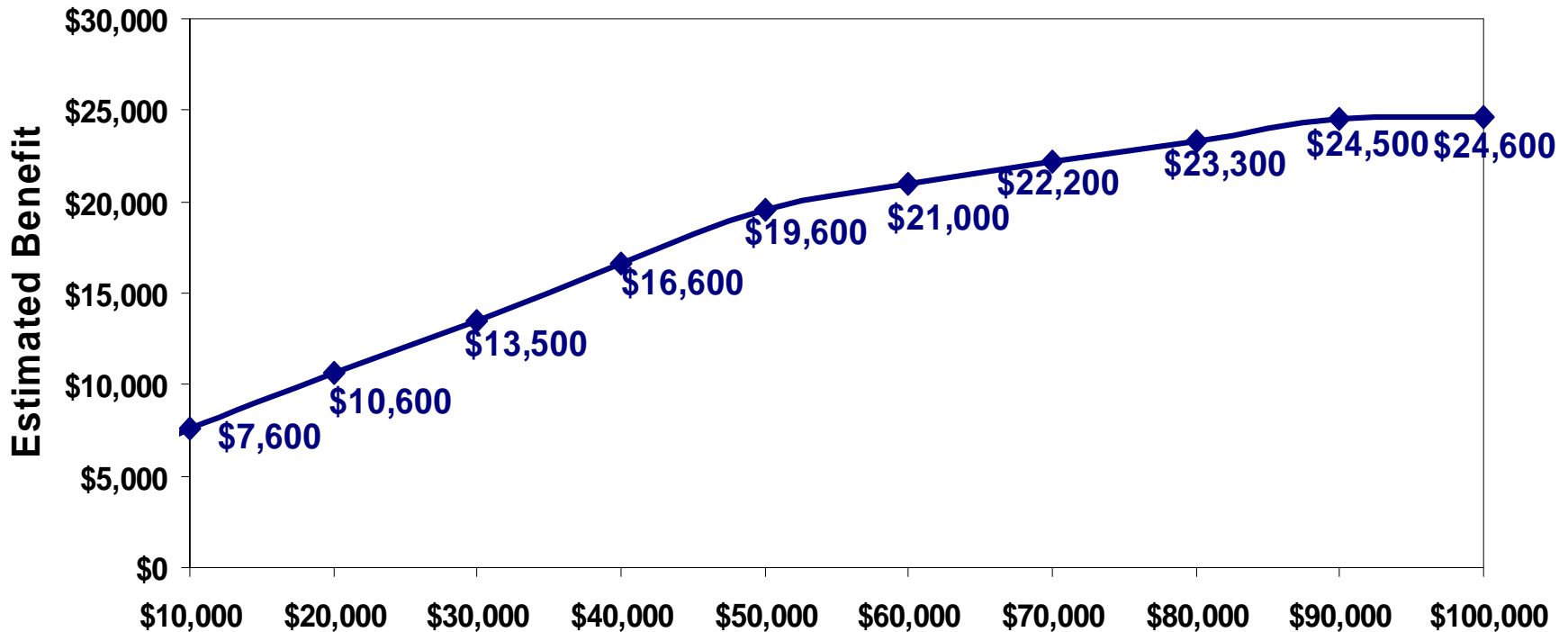


See History of Provisions at [www.ssa.gov/OACT/HOP](http://www.ssa.gov/OACT/HOP). Past wages based on National Average Wage Index. Percentages decrease by about 5 percentage points over the next 20 years, per Table VI.F10





# Social Security Benefits at Normal Retirement Age (and at Disability)



## Earnings Just Before Retirement in 2006

This and following graph show the primary goals of Social Security:

- (1) Individually equitable benefits (important to higher wage earners - the more contributed, the more received).
- (2) Socially adequate benefits (progressive benefits that are more important to lower wage earners)

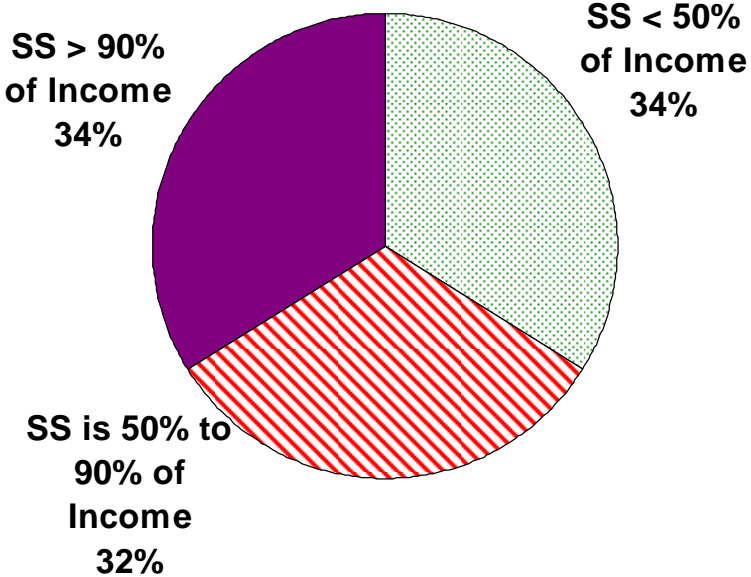


# Social Security as a Percent of Total Income

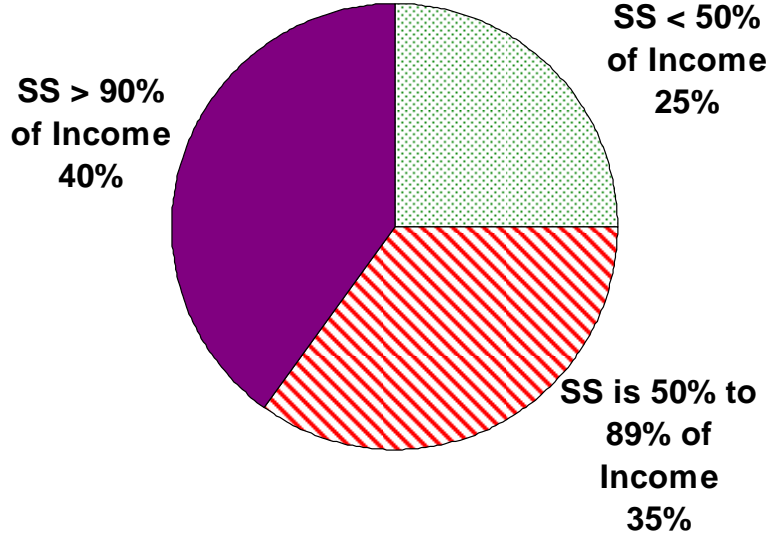
(For the 89% of People over 65 with Social Security Benefits)



**People Over Age 65**  
(24 million units)



**People Over Age 75**  
(12.5 million units)



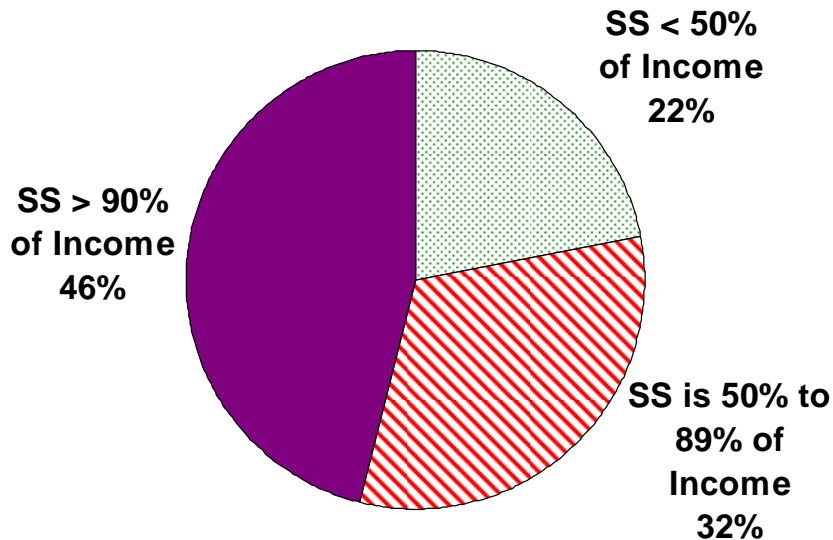
Source: Social Security: Income of the Population 55 or Older, 2004 Table 6.B  
 Many people over 65 depend on SS for a large portion of their income (i.e. about 1/3 depend on SS for most (>90%) of their income, and another 1/3 depend on it for over half of their income.) One unit = one married couple, or one non-married person.

# Social Security as a Percent of Total Income

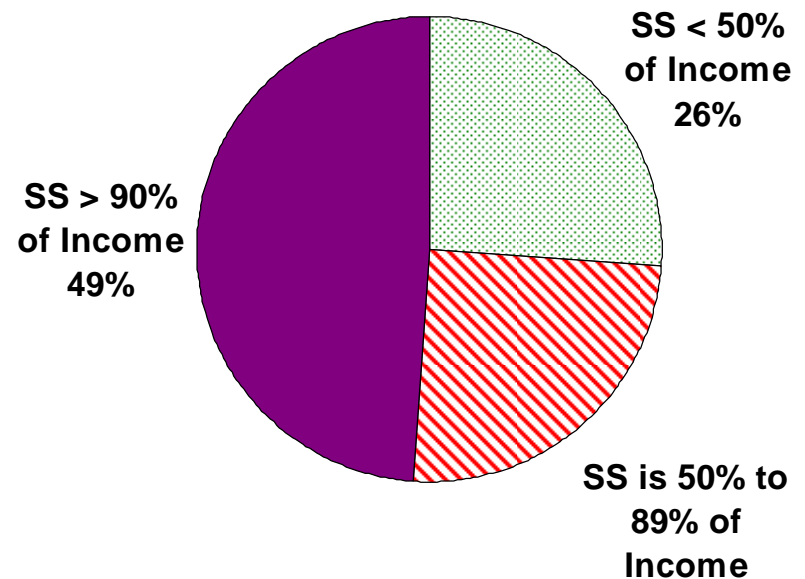
(For the 89% of People over 65 with Social Security Benefits)



**Non-Married Women Over Age 65**  
(10 million units)



**African Americans Over Age 65**  
(2 million units)



Source: Social Security: Income of the Population 55 or Older, 2004 Table 6.B

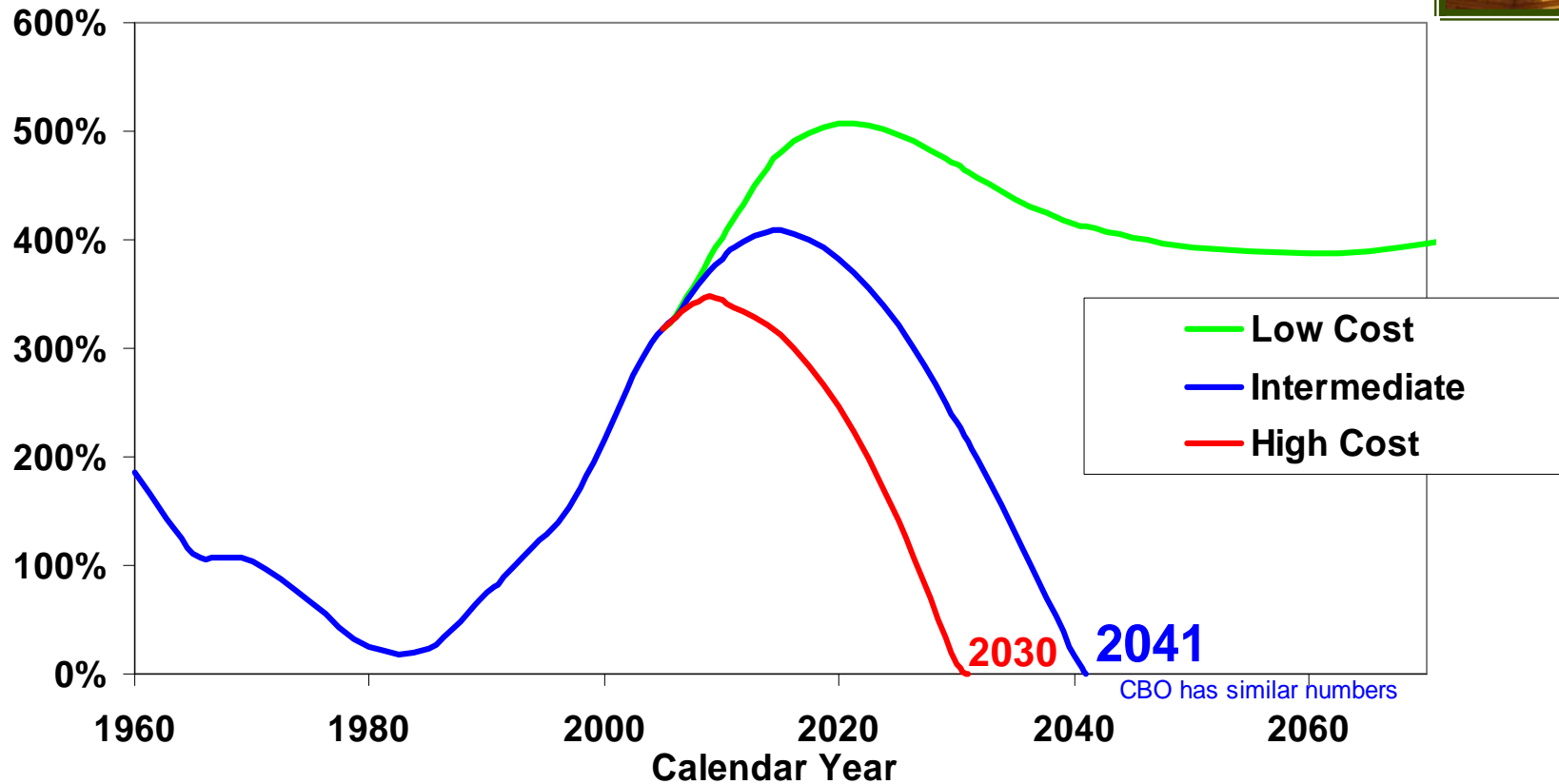
Certain demographic groups, like women, minorities, and low income people depend on Social Security even more. One unit = one married couple, or one non-married person.





# Social Security Trust Fund Ratios

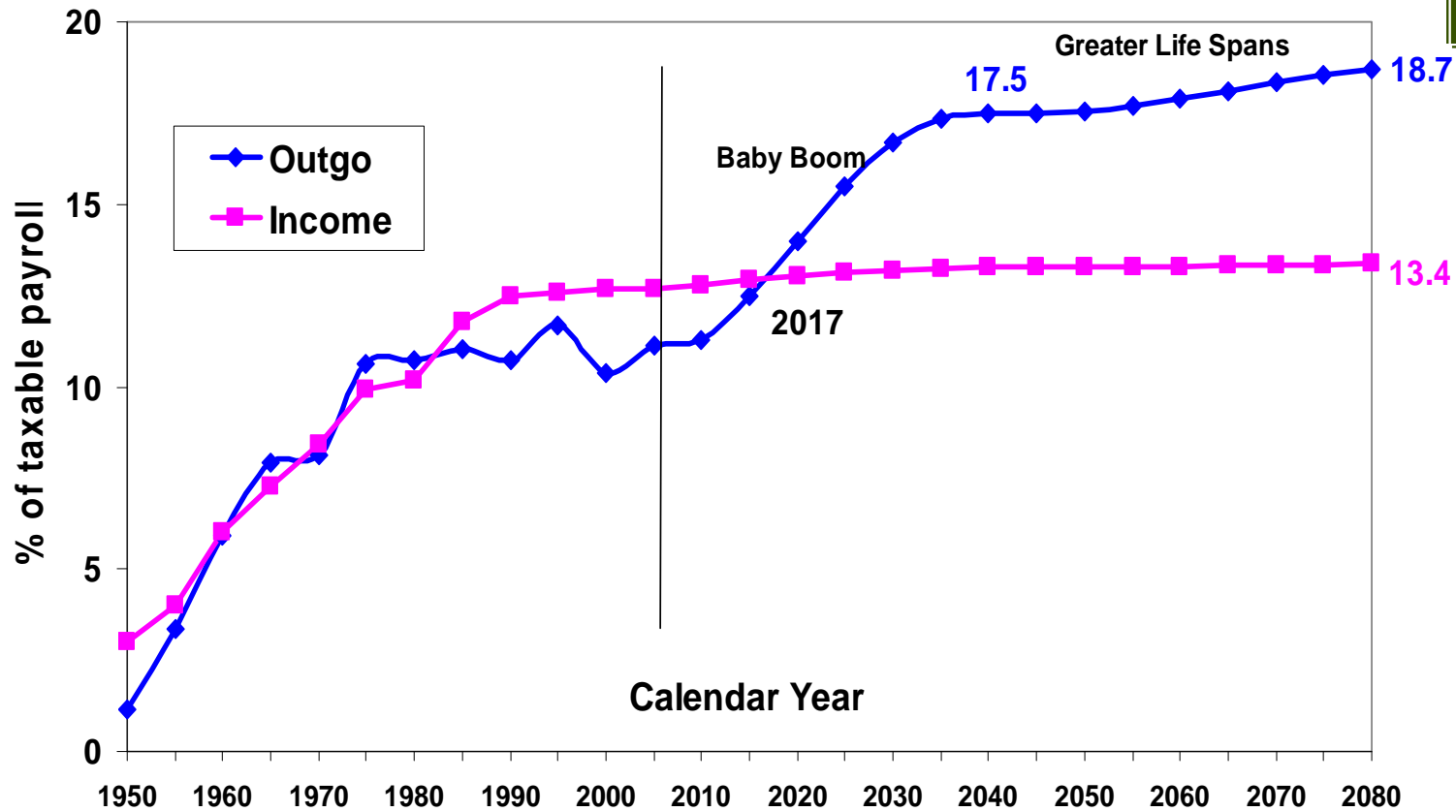
(Beginning of Year Assets as a Percentage of Expenditures)



The Trust Funds are projected to be exhausted in 2041 using the Intermediate Assumptions. In that year, tax income can pay about 75% of benefits, per Figure II.D2 (70% in 2081). The assumptions are reasonable in the aggregate per GAO/PWC report & individually reasonable per SS Chief Actuary. On low cost assumptions, Social Security could be solvent & sustainable (trust fund ratios stable or increasing around 75% year) but is unlikely to happen (< 5%). Source: 2007 Trustees Report Tables IV.B3 & VI.A4.



## Social Security Income & Outgo Intermediate Assumptions



2007 Report Table IV.B1. Using low (high) cost assumptions, the 2085 outgo is 13.4% (27%), and the 2017 date is 2022 (2014). The unfunded obligations over the next 75 years = \$5.1 trillion = -1.95%, -5.05 & 0.36% of taxable payroll for the intermediate, high, & low cost assumptions, per Table IV.B4.

# Long-Range Financing Issues



- Long-Range Actuarial Deficit (LRAD): 1.95% of taxable payroll. Trust fund assets projected to run out in 2041.
- Until 2017, Social Security projected to be a source of cash to Federal government. Drain on the Federal budget thereafter.
- Trust fund accumulation of government bonds represents a promise of future taxpayers (currently \$2 trillion and expected to reach \$6 trillion around 2025 under current law)
- LRAD can be solved with immediate 13% benefit cut (22% if everyone 55+ grandfathered), or immediate 16% increase in taxes.
- Immediate benefit cuts (tax increases) increase cash available to Federal government and promises of future taxpayers.
- Solving LRAD over 75 years may not produce long-range solvency if projected outgo for years after 75 not well matched to projected tax income.



# Reasons to Reform Social Security Sooner Rather Than Later



- More options available to policy-makers
- More people could be included in reform
- Benefit cuts & tax increases for future cohorts can be less
- Reforms may be phased-in
- Individuals can plan ahead for changes
- Instills confidence in the future of the program



# Social Security Game

[www.actuary.org](http://www.actuary.org)



the **Social Security** game

AMERICAN ACADEMY OF ACTUARIES

**Benefit reductions**

1. Gradually increase the retirement age for full benefits.

- a. Increase it to age 70 by 2030, then keep adjusting as needed
- b. Accelerate increase in retirement age to 67, then keep adjusting as needed
- c. None of the above

**Supporters Say**  
Since Social Security began, life expectancy has increased from 61 to 76 years, and Americans are healthier at older ages. It makes sense to ask people to work longer to claim full retirement benefits.

**Opponents Say**  
This isn't a realistic option for everybody who has a physically demanding job or has some kind of disability. And employers won't want the higher health costs they'd get with an older workforce.

Submit

You've solved **0%** of the problem

100  
90  
80  
70  
60  
50  
40  
30  
20  
10

Benefit reductions  
Revenue increases  
Investing in the private sector  
How am I doing so far?

Back

v.1.1.3

**Can you solve Social Security's financial problems?**

This game walks players through the major Social Security reform options, providing both the pro and con arguments, and tracks their progress towards achieving 100% success. The game is an ideal tool to teach people the complex trade offs required to save Social Security.



# Options

## Decrease Benefits

- Raise retirement age (to 67 faster & index by 1 month/2 years)
- Reduce COLA by ½%
- Cut initial benefits by 1%/yr for (Price Indexing)
  - Smaller cuts at lower incomes (Progressive Price Indexing)
- Affluence Test
- Increase number of yrs in wage average to 40

## Increase Taxes

- Increase tax rate by 1% total (0.5% on each)
- Increase wages subject to tax by 1/4
- Tax Social Security benefits like pensions
- Include rest of state & local government workers

## Increase Investment Returns

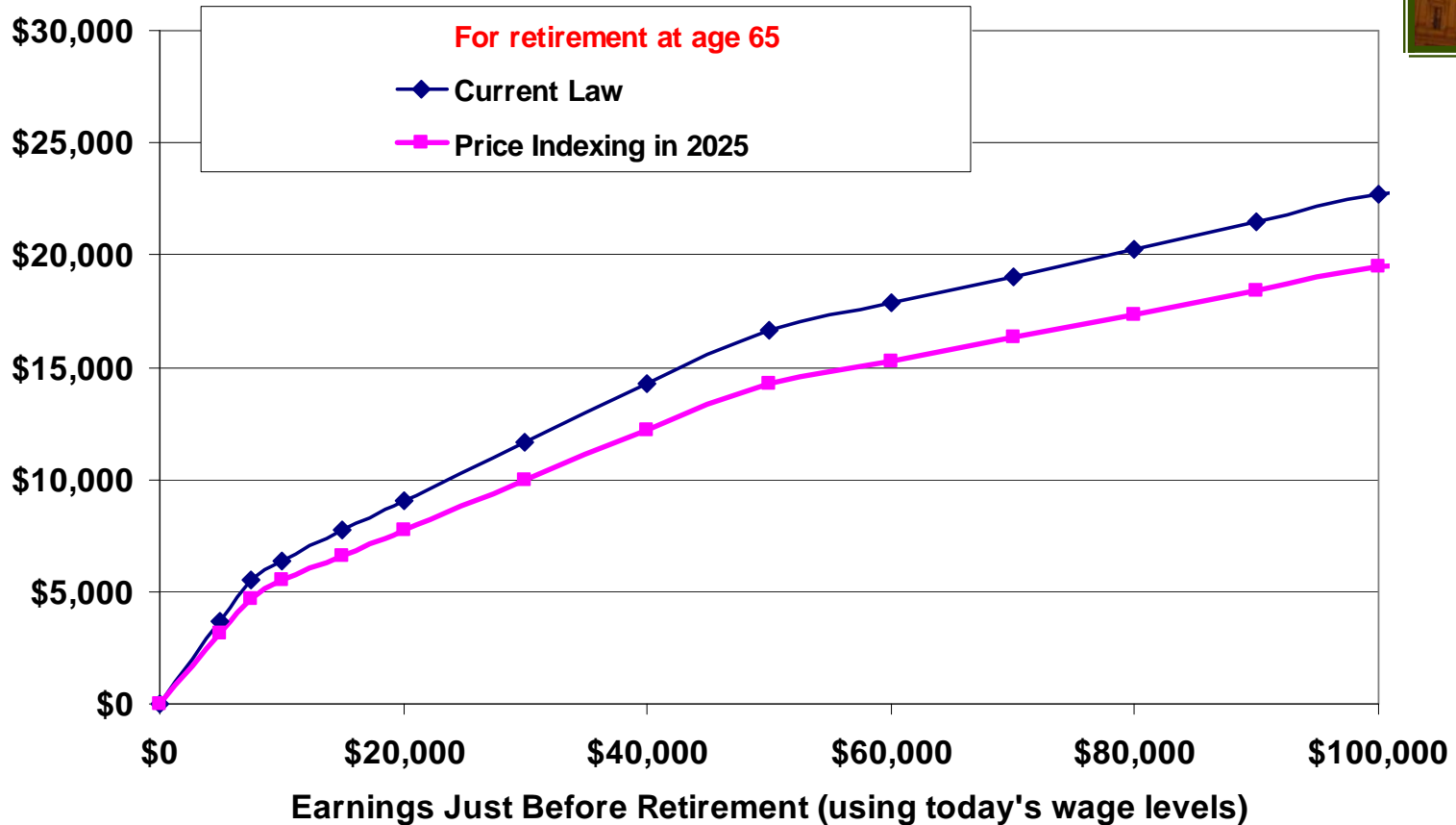
- Trust Funds
  - Individual Accounts (Archer-Shaw could reduce SS deficit)
- Funding sources: Additional Contributions, SS, General Revenue

% Fix	
75 yrs	75 <sup>th</sup> yr
36%	28%
40%	21%
124%	138%
74%	81%
75%	?
24%	13%
51%	18%
26%	10%
17%	5%
11%	<1%
0-50%	0%
0%	0%





## Price Indexing Initial Social Security Benefit

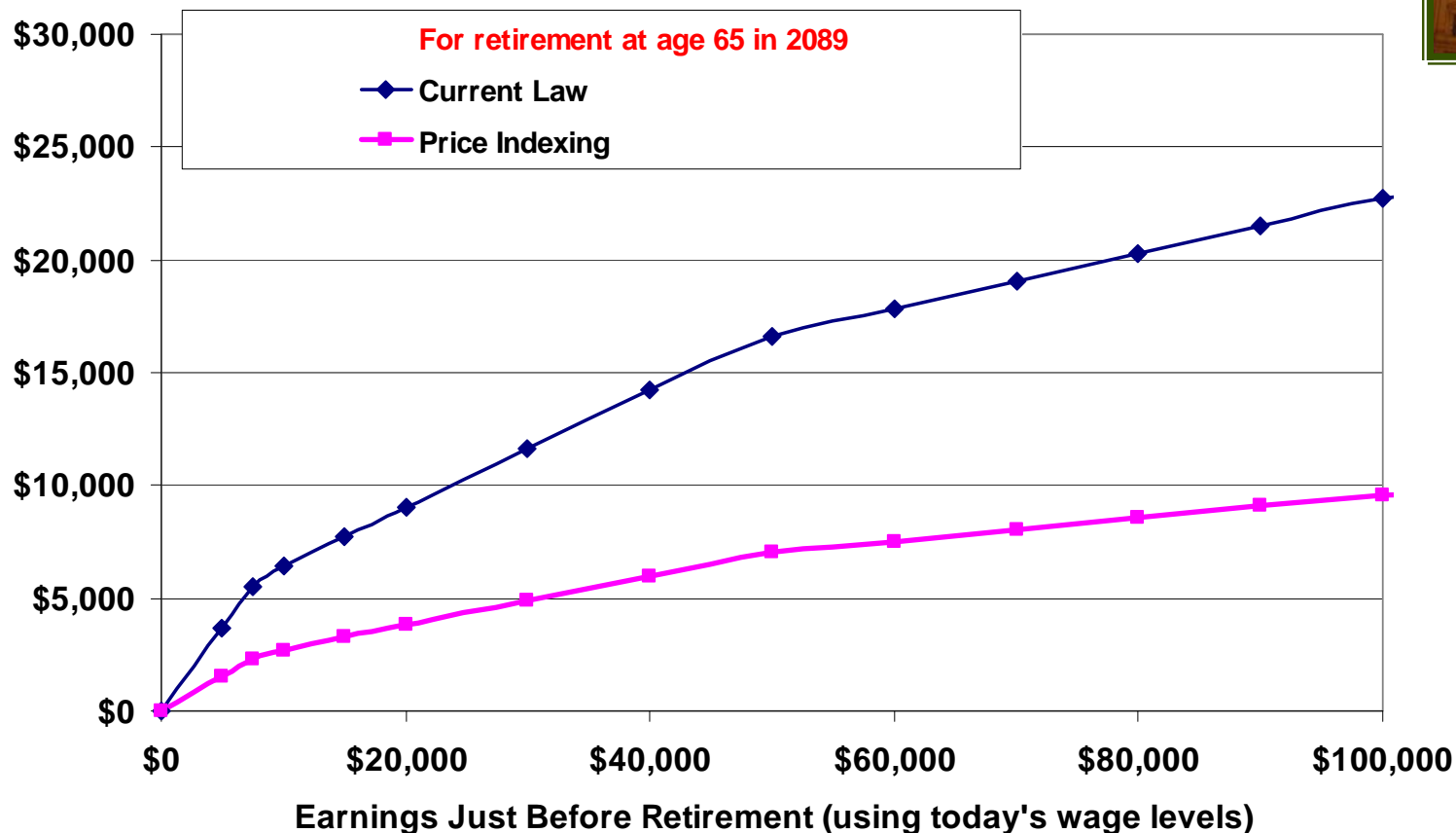


Price indexing reduces benefits by a small amount each year, but it is cumulative. Equivalent to raising the Normal Retirement Age fast (1 year in age every 6 years)





## Price Indexing Initial Social Security Benefit

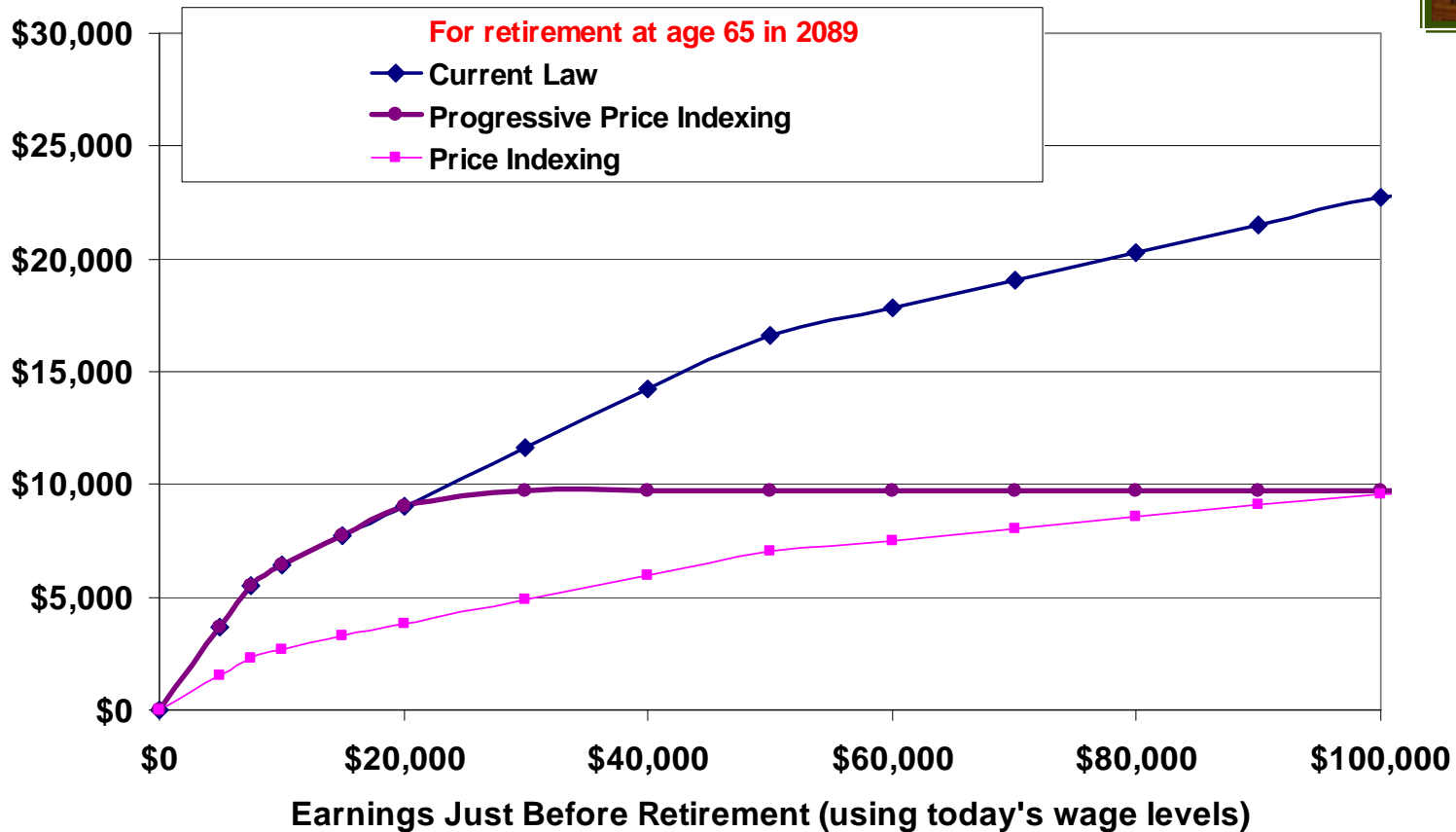


Price indexing cuts everyone's benefits in half every 62 years (assuming real wage growth of 1.1% per year). Calculations: Ron Gebhardt, American Academy of Actuaries





## Progressive Price Indexing

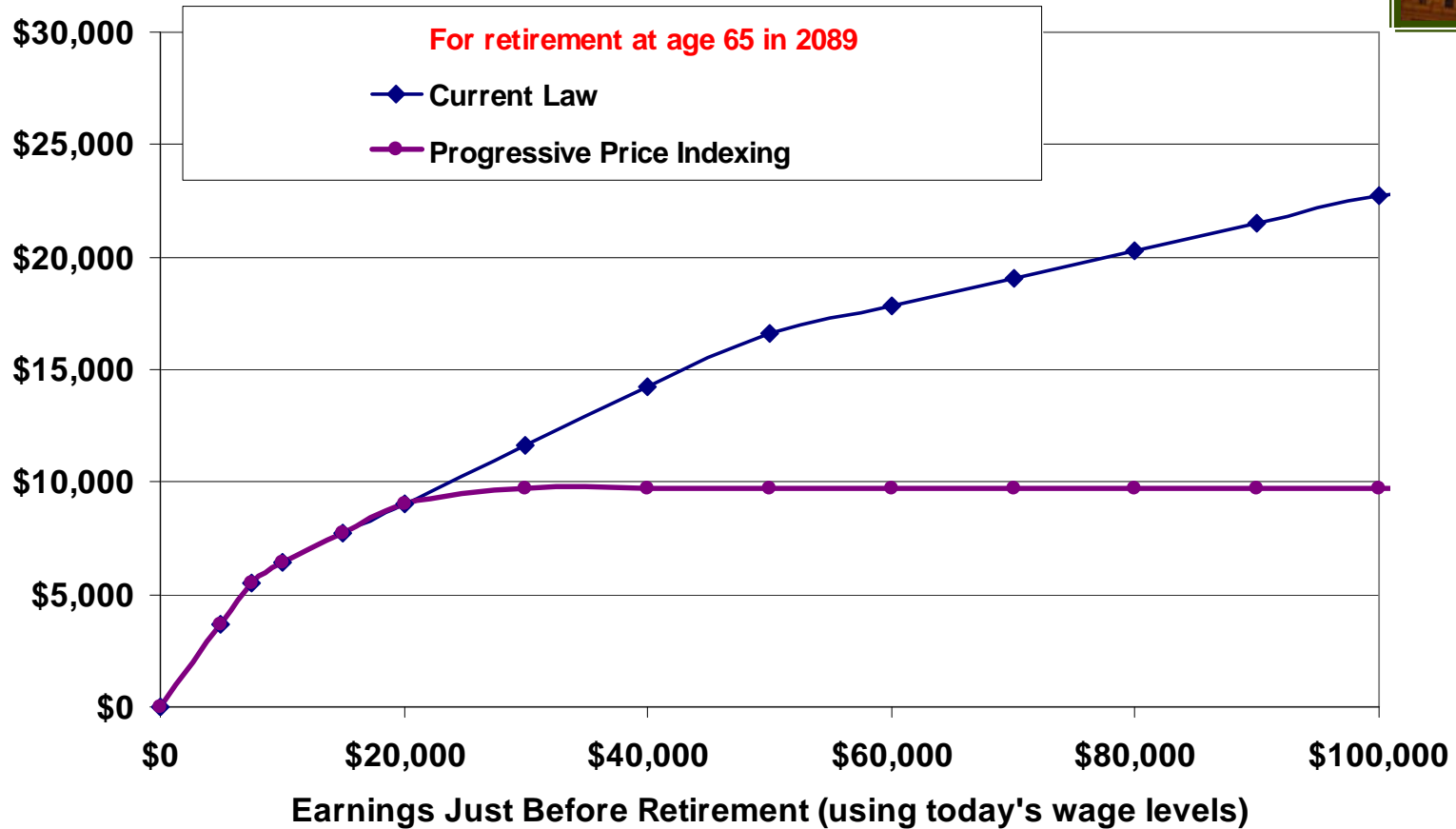


Under Progressive Price indexing, the bottom 30% are held harmless. Benefits for workers at maximum are still cut in half every 62 years, & around 2089 benefits become flat (changing the nature of SS) & could then decrease.





## Progressive Price Indexing



UK coming off price indexation after using it 25 yrs. Pozen suggested stopping in 75 years.



# Increase Earnings Subject to Tax



- President Bush: all options are on the table
  - Affects those > \$97,500 (and their employers)
  - Regressive?
    - People earning more have lower effective tax rate
    - But benefit is progressive and people at low incomes get EITC
  - Eliminate maximum taxable earnings base, or
  - Increase it about 25% over short period
  - Enough so that 90% of earnings are taxed
- Should benefits increase for these people?
  - Creates unnecessarily large benefits, or:
  - If they get no additional benefit for additional taxes
    - Social Security may lose universal appeal
    - High-income workers would seek non-taxable compensation



# Individual Accounts



- President's 2007 budget had individual accounts
  - Voluntary carve outs (2% from Social Security)
  - Investing in private sector increases returns, but also risk
  - Good returns help worker, not Social Security
    - But do make it easier to reduce benefits
    - Voluntary, so risk averse will see reductions
    - Diverts money from SSA, bringing key solvency dates sooner
    - Treasury has to borrow from somewhere else
    - PAYGO could require an offset
- Recent proposal recommending “add-on”
  - \$1,000 at birth + 1% of pay from worker and employer



# Individual Accounts

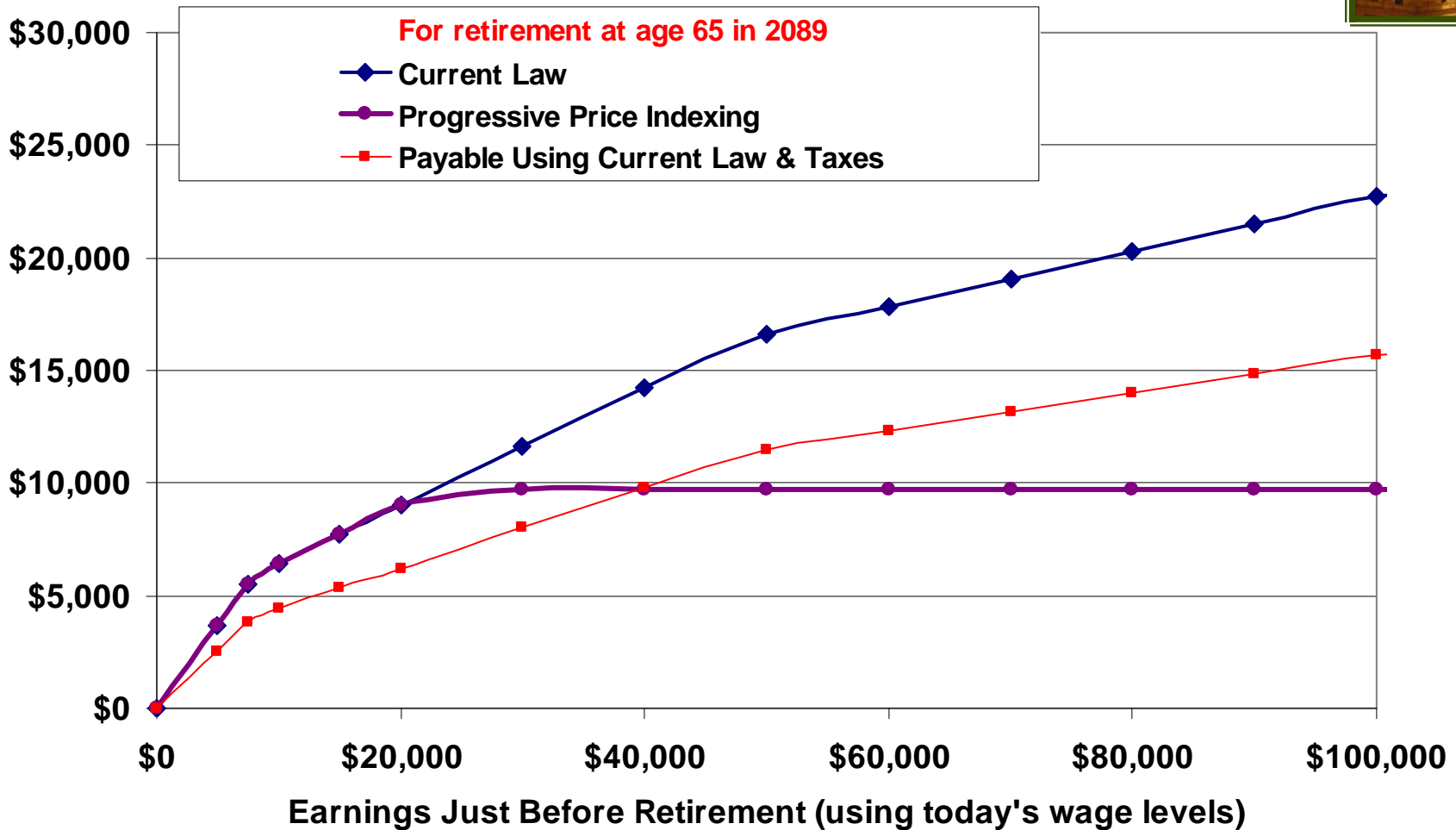


- Gives workers ownership and control
- High transition costs
- Many complex design issues
  - Payroll deduction to government not identified until next calendar year
  - Reduce disability and survivor benefits?
  - Require annuities? Spousal annuities? Gender neutral?
  - How much should Social Security benefits be cut for those diverting their contributions from Social Security?
  - Voluntary or mandatory accounts?
  - Should workers have access to accounts?
  - Should government specify investment choices?





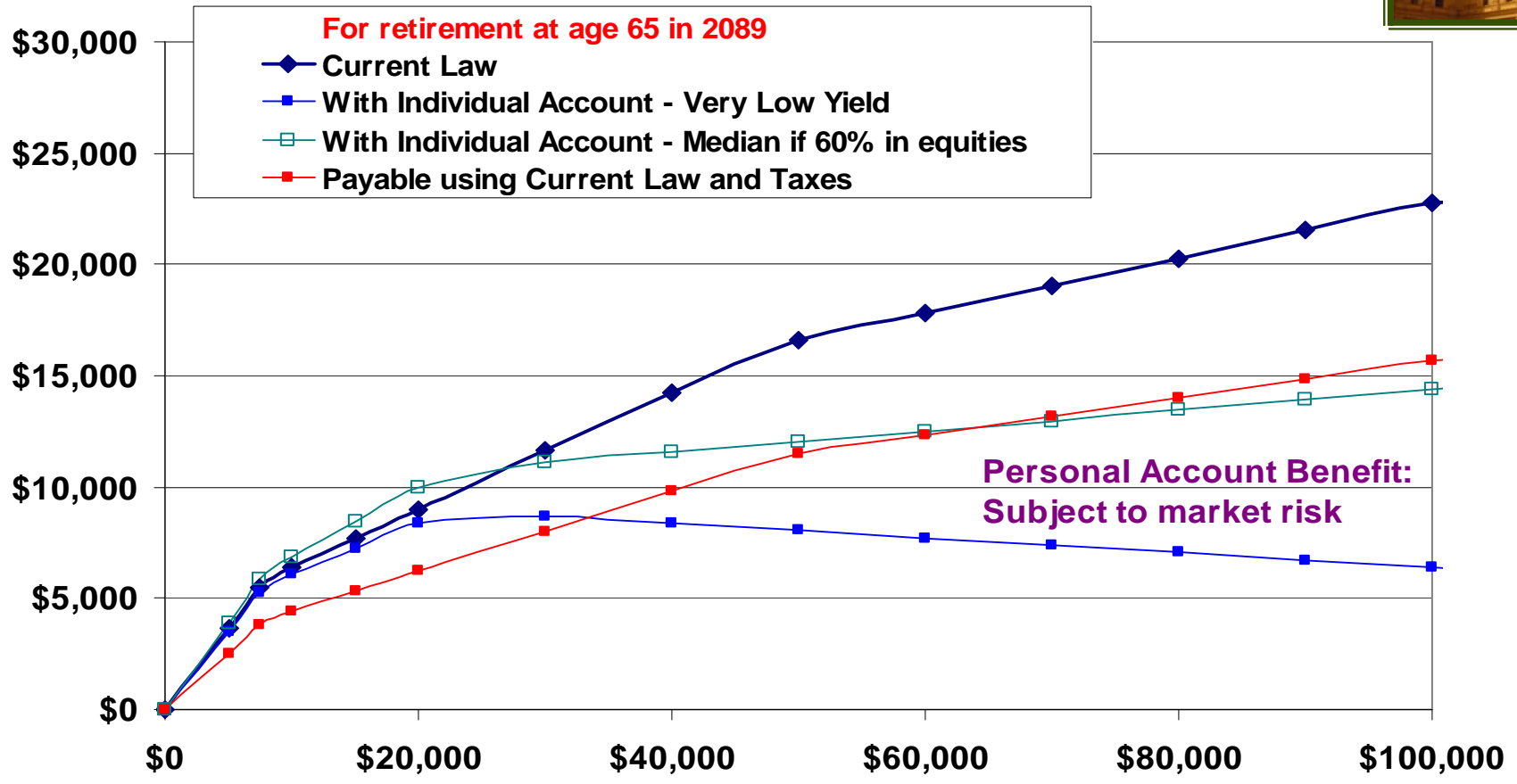
# Progressive Price Indexing w/out Individual Accounts



UK coming off price indexation after using it 25 yrs. Pozen suggested stopping in 75 years.



# Progressive Price Indexing with Individual Accounts



**Earnings Just Before Retirement (using today's wage levels)**

While the proposed benefit is less than the current benefit level, if workers elect to have a Personal Account and invest well, they could recoup some of the benefit cut. The median investor in 60% stocks might break even with what SS can afford now, using its current payroll tax. They might also do worse too, and they would experience that risk right up until retirement. They can reduce the risk by moving to bonds, but it also reduces the return.

# Sustainability



- In January 2007, President Bush suggested:
  - Solution should eliminate 75-year deficit
  - AND make Social Security “sustainable”
- Due to increasing longevity
  - Social Security goes out of balance slightly more each year as another deficit year is included in 75 years
  - Requires fixing Social Security every 20 years or so
- Unless we gradually index for longevity increases
  - Increase normal retirement age (age for full benefits)
    - Very slowly: increase NRA 1 year every 2 decades
  - Gradually index contributions up or benefits down
    - By 1 / 4 % each year





# Academy Products For You

- Issue Briefs & Monographs
- Social Security game on website
  - Featured frequently in media
- **Media Contact: Andrew Simonelli**
  - [Simonelli@actuary.org](mailto:Simonelli@actuary.org)
  - (202) 785-7872
- Academy website: [www.actuary.org](http://www.actuary.org)

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