



AMERICAN ACADEMY *of* ACTUARIES

Social Security Reform Options

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**Thursday, January 18, 2007
Noon – 1:00 pm
The Monocle Restaurant
107 D Street, NE Washington DC**

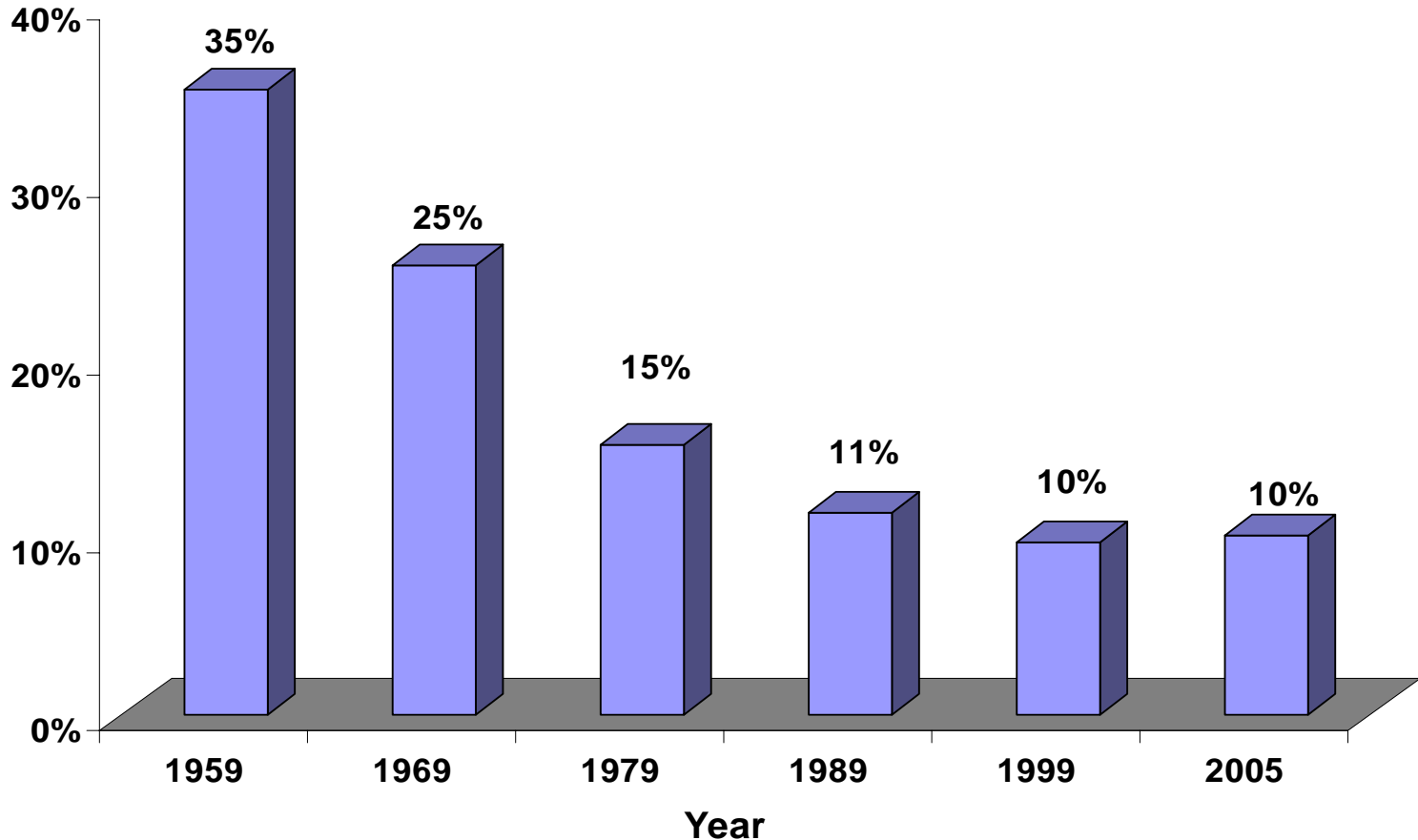


Social Security Topics

- Background
- Social Security's Financial Status
- Options for Reform
- Recent Ideas



Poverty Rates For People Age 65 and Older

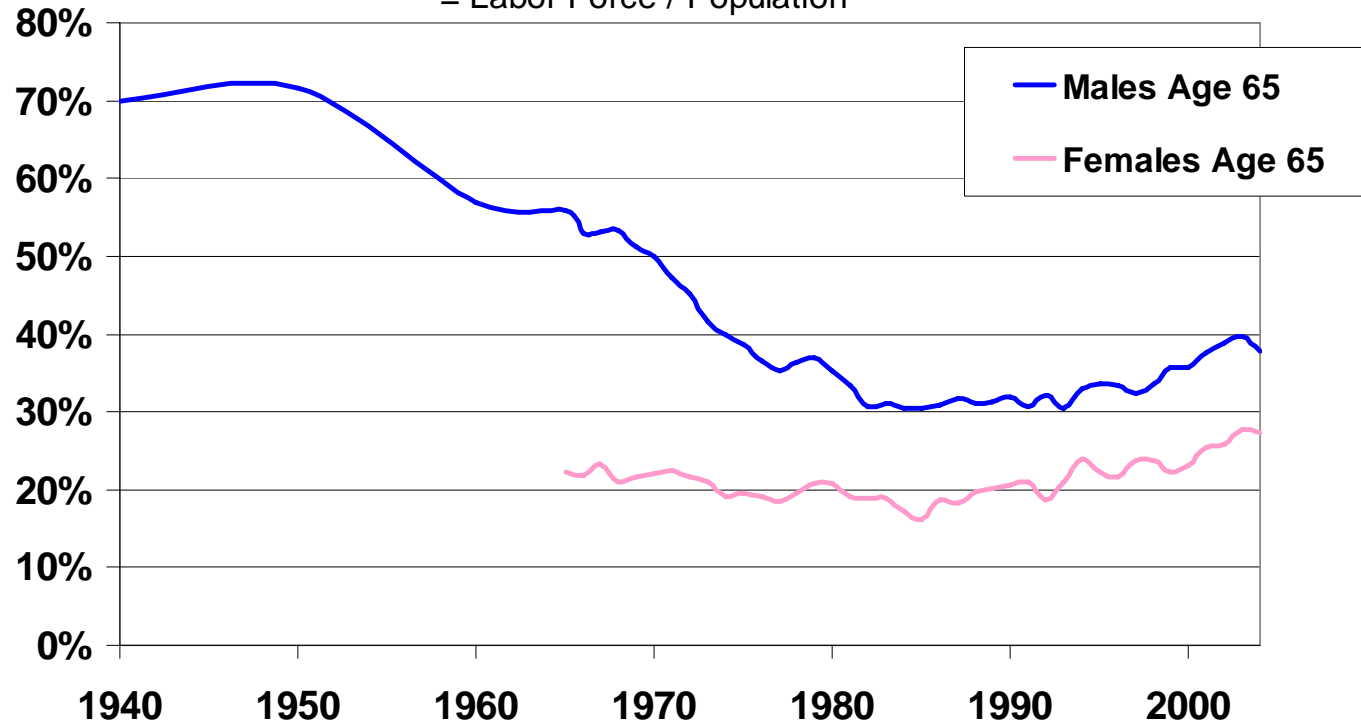


Social Security (along with SSI & Pensions) decreased the % of elderly below the poverty level to the same % as for people of working age. The poverty threshold (for people over 65) is about \$9,000 per person (~ \$12,000 for a couple). The thresholds increase with CPI (which is subject to criticism).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



Labor Force Participation Rates

= Labor Force / Population



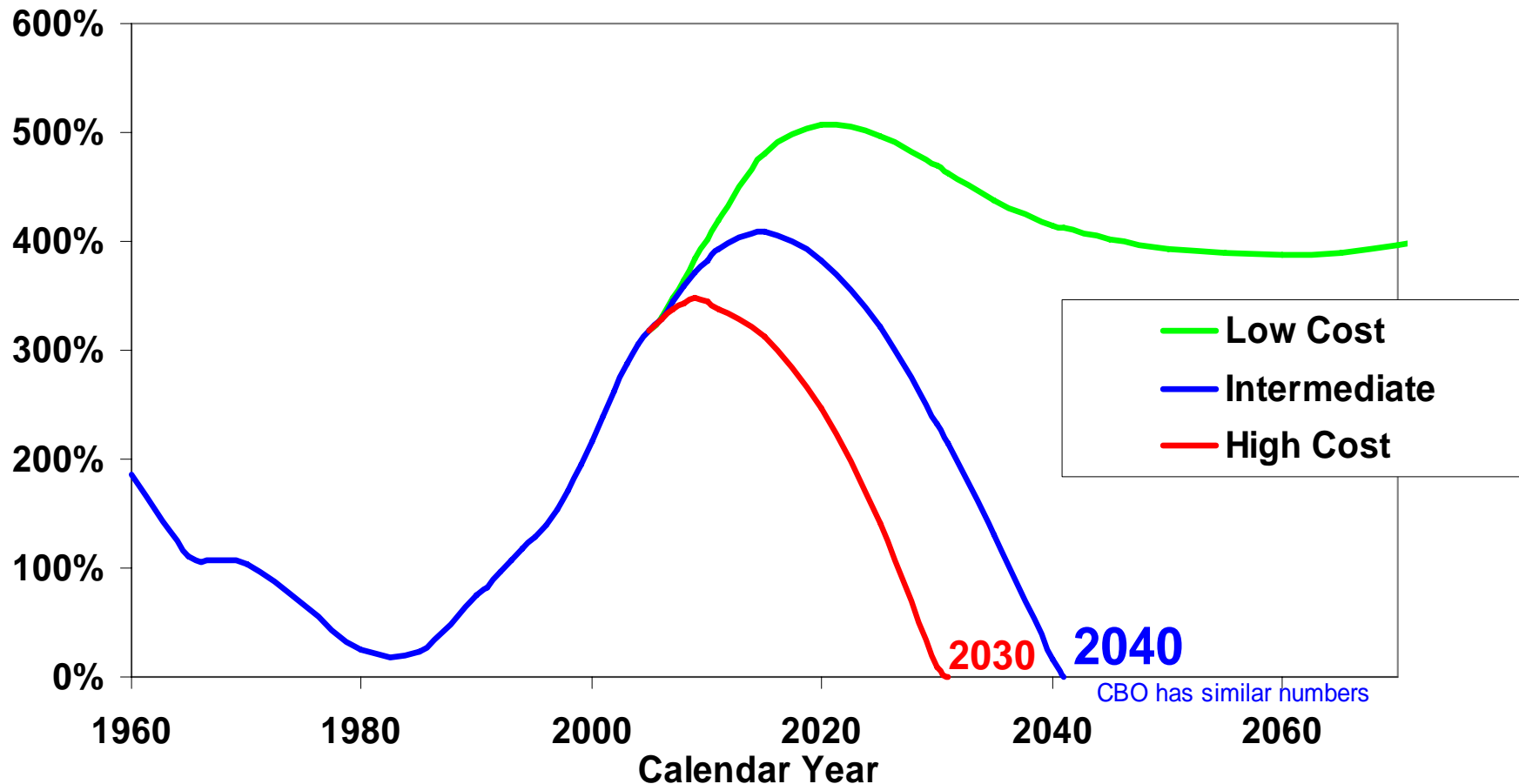
Sources: Labor Force Statistics from the BLS Consumer Population Survey (CPS). For 1940 to 1960, data is from US Census: Historical Statistics of the United States pg. 132, Statistical Abstract p. 411
Labor Force = Employed + Unemployed (those actively seeking and available)

Social Security, Medicare, and employer benefits encouraged people to retire earlier. Pro work policies since the 1980s and the recent stock crash may have caused the increases in past 20 years.



Social Security Trust Fund Ratios

(Beginning of Year Assets as a Percentage of Expenditures)

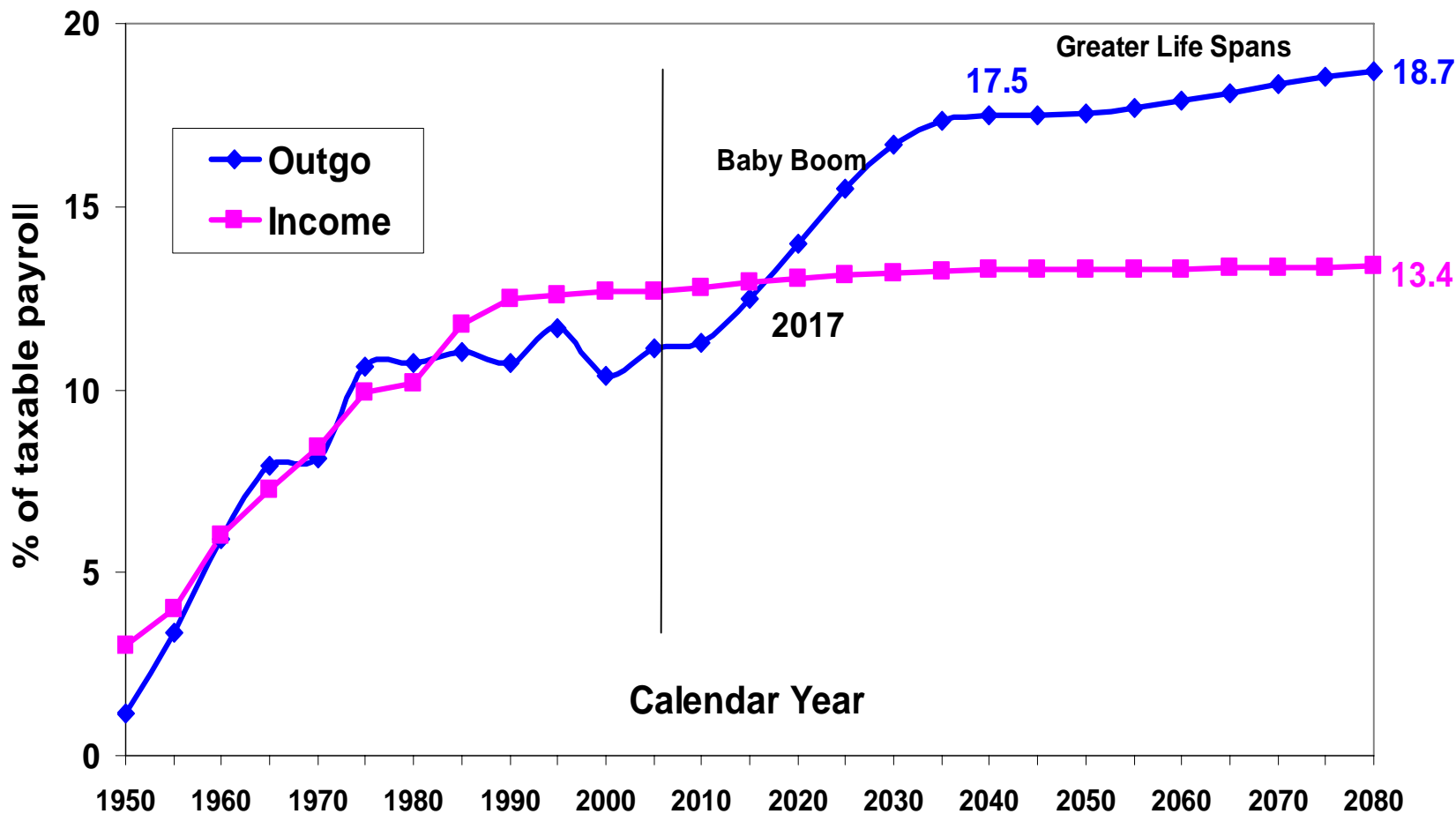


The Social Security Trust Funds are projected to be exhausted in 2040 using the Intermediate Assumptions. In 2040, tax income can pay around 74% of benefits, per Figure II.D2 (70% in 2080). The assumptions are reasonable in the aggregate per GAO/PWC report & individually reasonable per SS Chief Actuary. On low cost assumptions, Social Security could be solvent but may not meet the Sustainability Test (trust fund ratios stable or increasing around 75th year). 2006 Trustees Report Tables IV.B3 & VI.A4.



Social Security Income & Outgo

Intermediate Assumptions



2006 Report Table IV.B1. Using low (high) cost assumptions, the 2080 outgo is 13.5% (27%), and the 2017 date is 2022 (2013). The unfunded obligations over the next 75 years = \$4.6 trillion = -2.02%, -5.17 & 0.35% of taxable payroll for the intermediate, high, & low cost assumptions, per Table IV.B4.



Reasons to Reform Social Security Sooner Rather Than Later

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



Social Security Game

www.actuary.org

The screenshot shows the 'the Social Security game' interface by the American Academy of Actuaries. The main content area is titled 'Benefit reductions' and contains a question: '1. Gradually increase the retirement age for full benefits.' There are three radio button options: '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', and 'c. None of the above'. A 'Submit' button is located to the right of the options. Below the question, there are two columns of text: 'Supporters Say' and 'Opponents Say'. The 'Supporters Say' text reads: '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.' The 'Opponents Say' text reads: 'This isnt 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.' On the right side of the interface, there is a progress indicator showing 'You've solved 0% of the problem' and a vertical thermometer-style gauge with a scale from 0 to 100. On the left side, there are four buttons: 'Benefit reductions' (highlighted with an orange border), 'Revenue increases', 'Investing in the private sector', and 'How am I doing so far?'. At the bottom left, there is a 'Back' button and the version number 'v1.1.2'.

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.



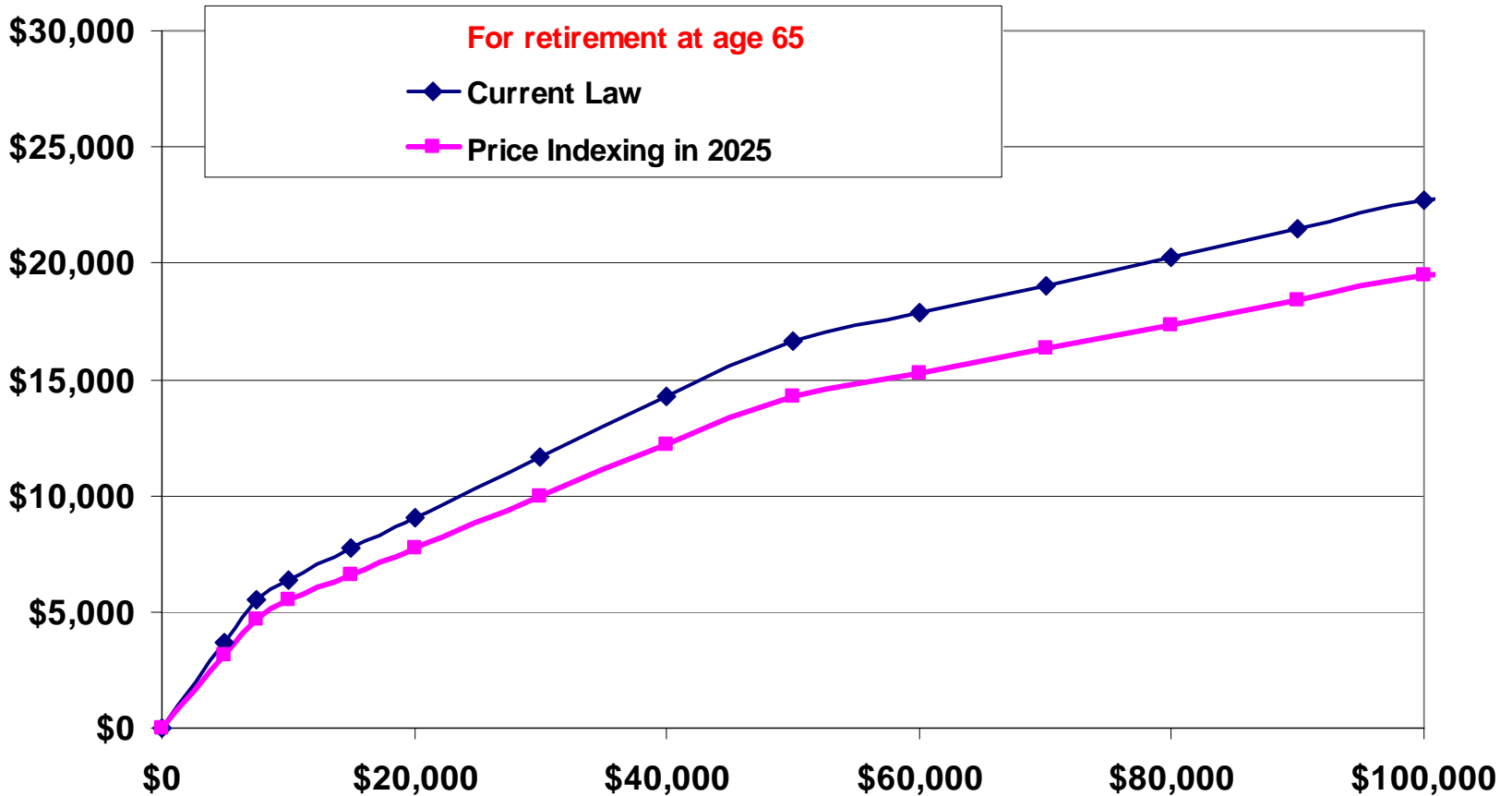
Options

- 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 would have reduced SS deficit)
- Funding sources: Additional Contributions, SS, General Revenue

% Fix
36%
42%
100%
70%
75%
21%
51%
26%
20%
11%
0%-50%
0%



Price Indexing Initial Social Security Benefit

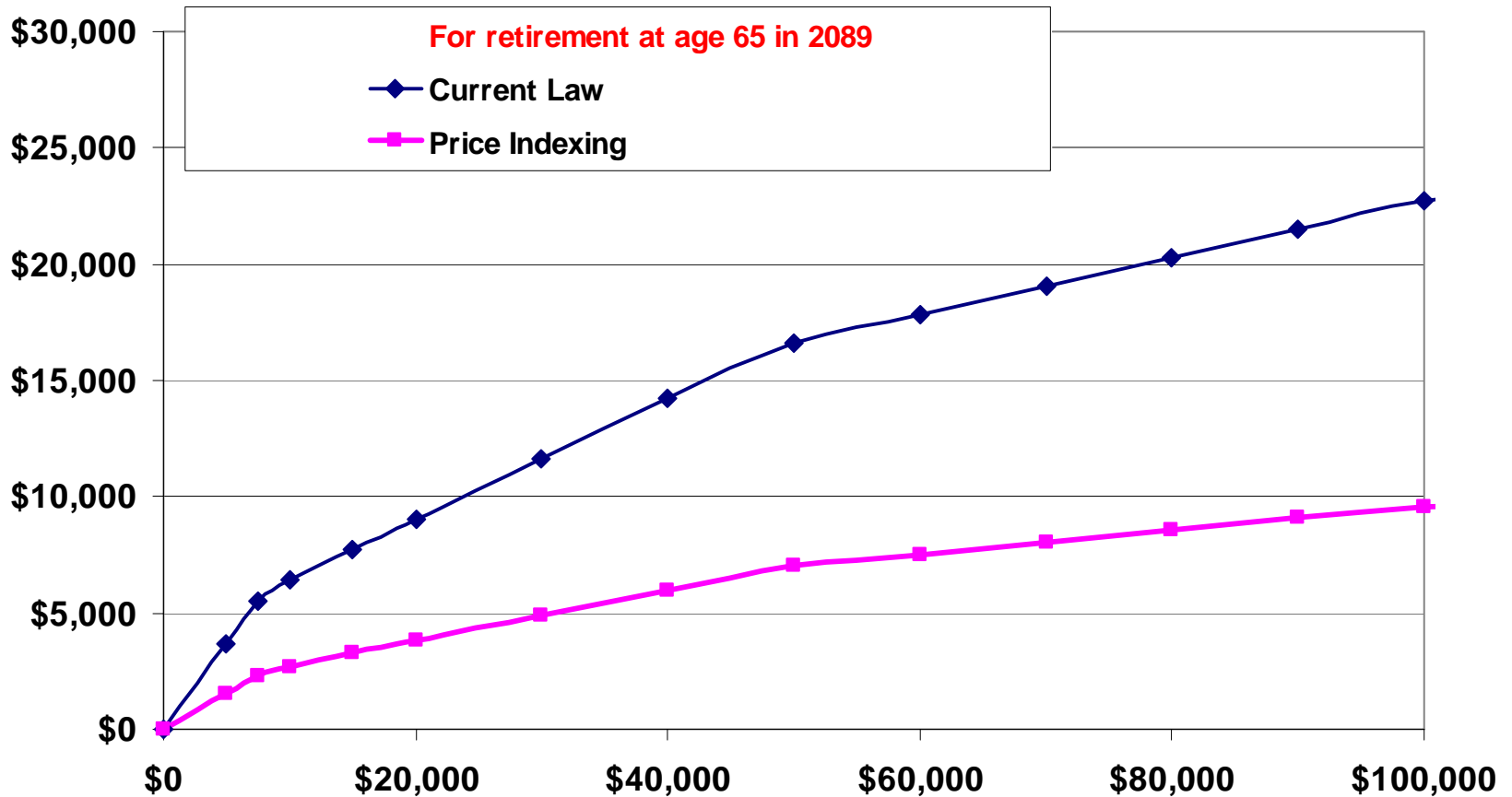


Earnings Just Before Retirement (using today's wage levels)

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

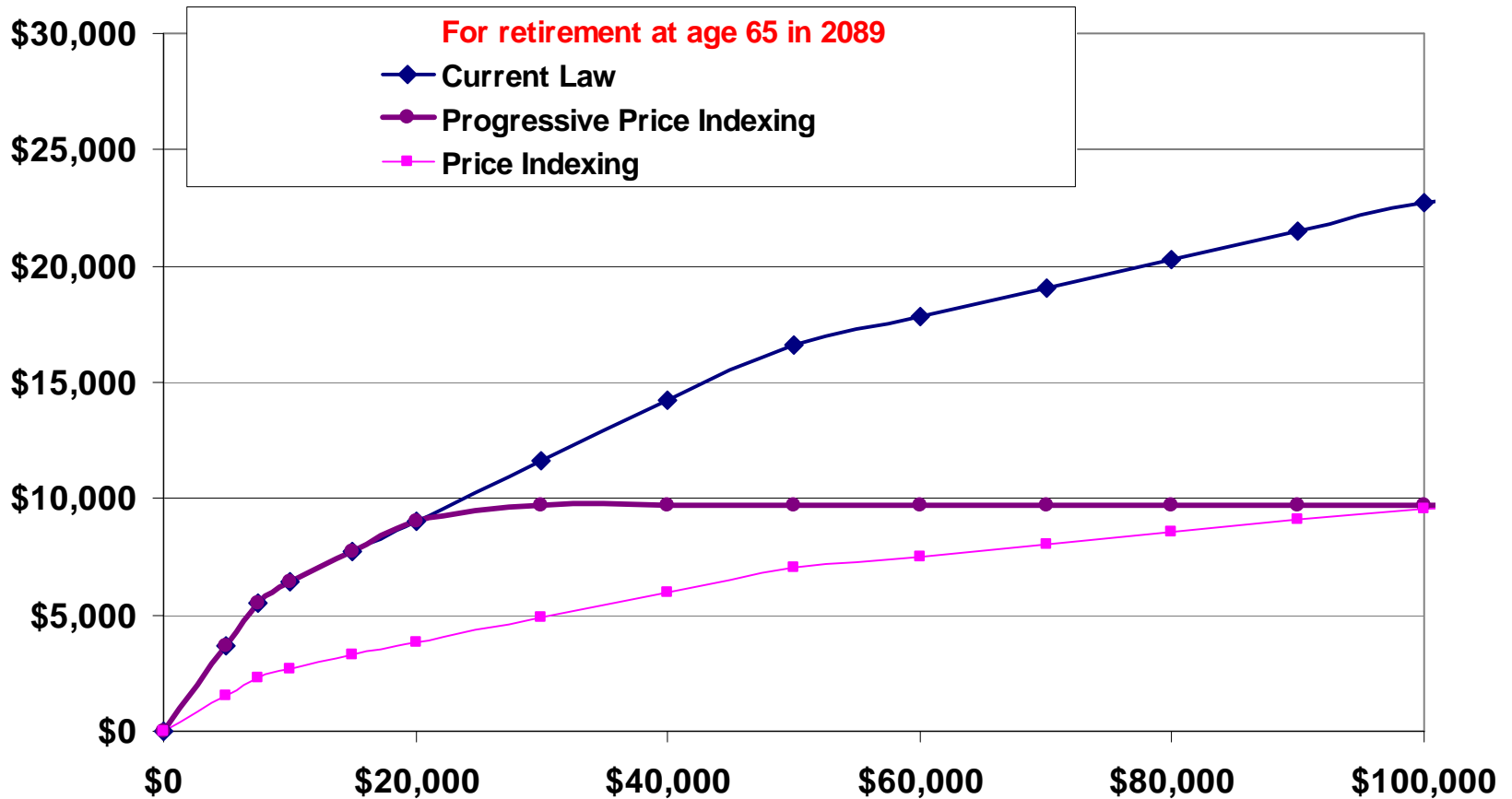


Earnings Just Before Retirement (using today's wage levels)

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



Progressive Price Indexing

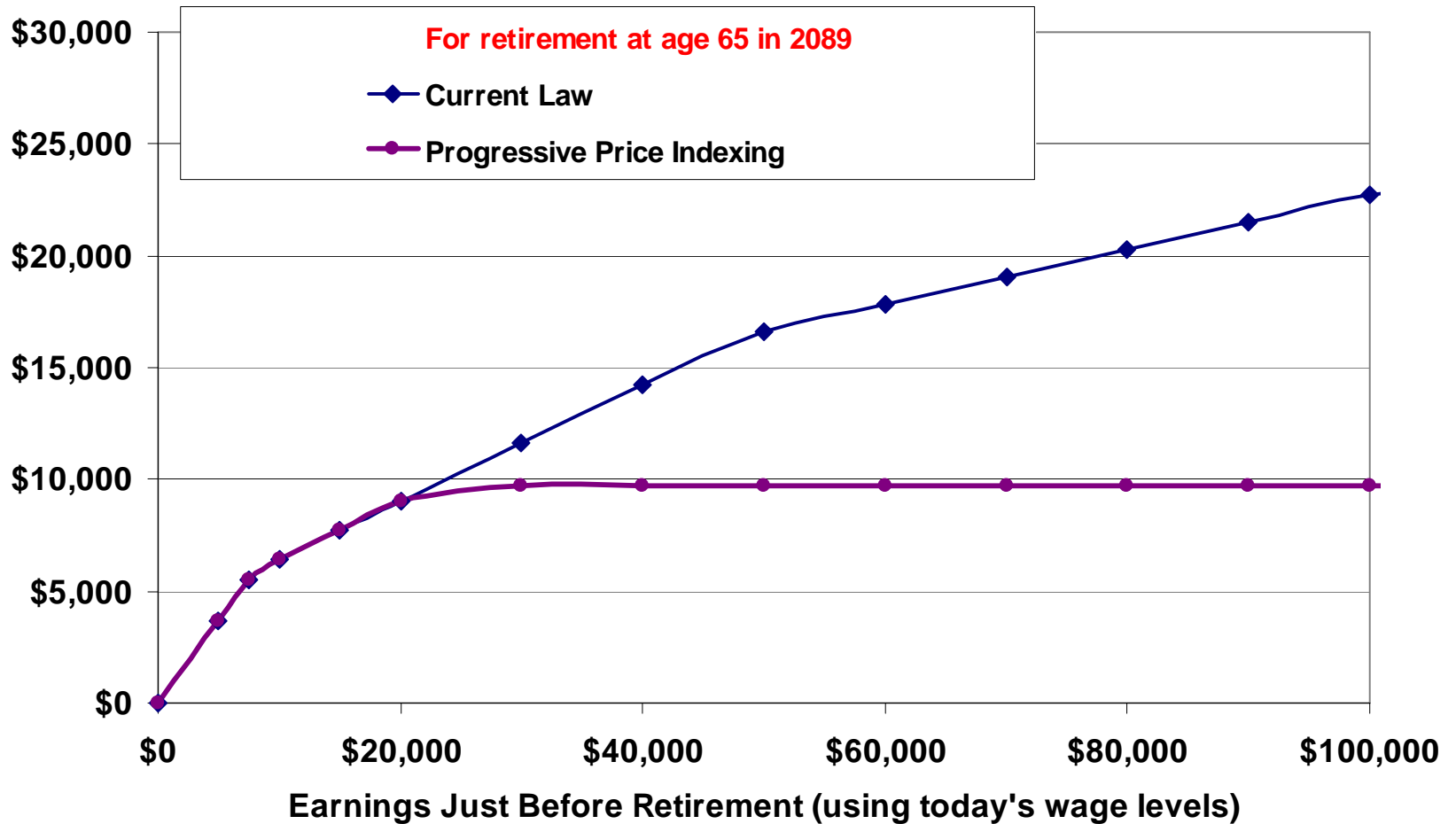


Earnings Just Before Retirement (using today's wage levels)

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
- 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 increase returns, but also risk
 - Good returns help worker, not Social Security
 - But do make it easier to reduce benefits
 - But voluntary, so risk averse will see reductions
 - Diverts money from SS, bringing key solvency dates sooner
 - Treasury has to borrow from somewhere else
 - Does PAYGO require offset?
- Recent proposal for add on:
 - \$1,000 at birth + 1% of pay from worker and employer

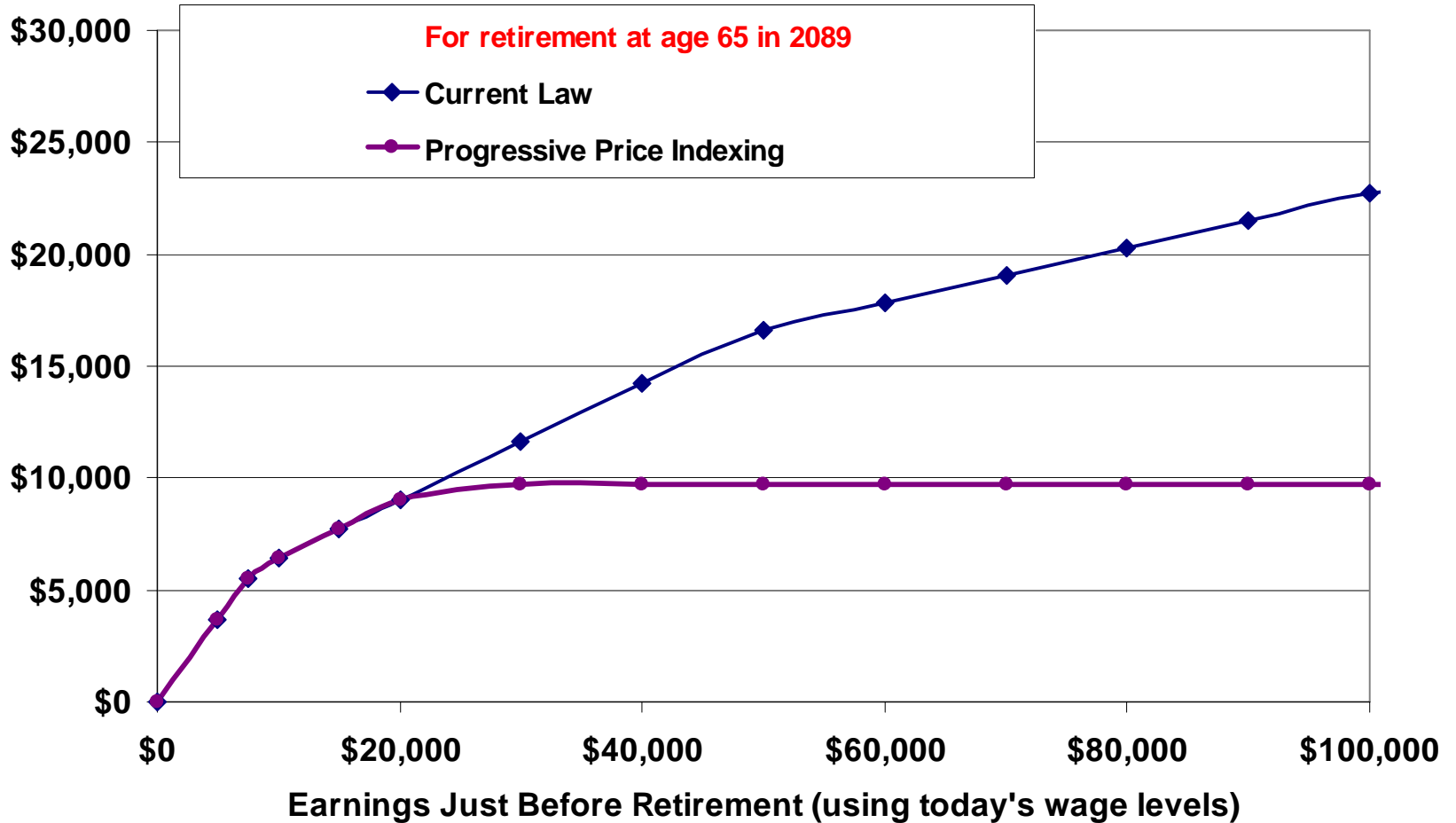


Individual Accounts

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



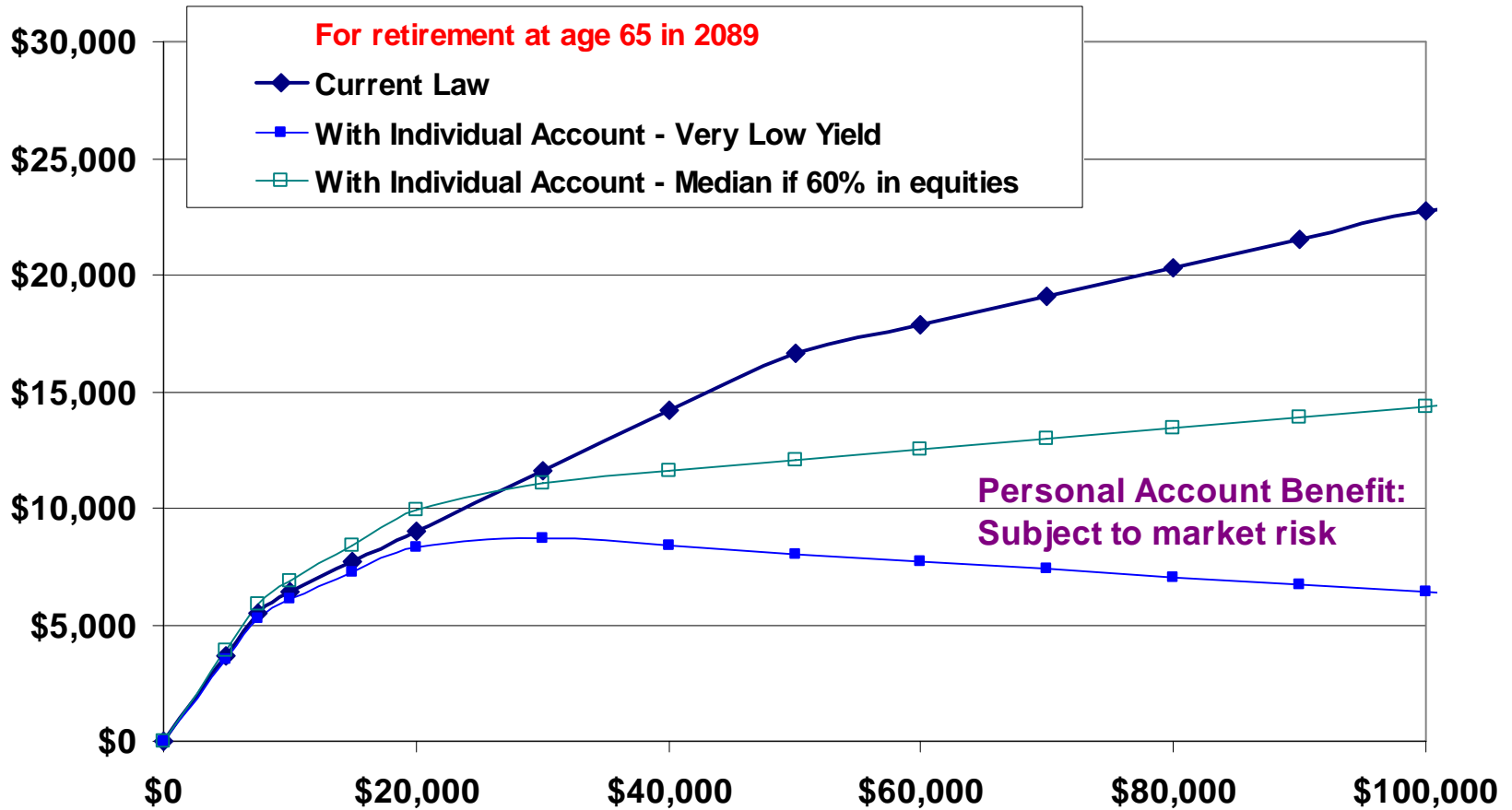
Progressive Price Indexing w/out Individual Accounts



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

- President Bush raised bar in early January
 - Solution should eliminate 75-year deficit
 - AND make Social Security “sustainable”
- Due to increasing longevity
 - Social Security will go out of balance slightly each year as we add on another deficit year
 - 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
 - (202) 785-7872
- Academy website: www.actuary.org

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