SOCIAL SECURITY
Office of the Chief Actuary

March 29, 2013

The Honorable Gwen Moore
United States House of Representatives
Washington, D.C. 20515

Dear Representative Moore:

I am writing in response to your request for estimates of the financial effects on Social Security of the "Social Security Enhancement and Protection Act of 2013", which you introduced on March 21, 2013. This Bill includes five provisions with direct effects on Social Security benefits and tax revenues. We have enjoyed working closely with Steffany Stern of your staff in developing this proposal to meet your goals.

The enclosed tables provide estimates of the effects of the five provisions on the cost, income, and trust fund reserves for the Old Age, Survivors, and Disability Insurance (OASDI) program, as well as the estimated effects on retired worker benefit levels for selected hypothetical workers. In addition, tables 1b and 1b.n reflect the Federal budget implications of the five provisions and tables B1, B2, and B3 provide illustrations of the effects on Social Security retired worker benefit levels. We estimate that enactment of these provisions would extend full solvency of the OASDI program for an additional 35 years, with the projected depletion of combined OASI and DI Trust Fund reserves moving from 2033 under current law to 2068 under the proposal. We base all estimates on the intermediate assumptions of the 2012 Trustees Report.

The estimates and analysis provided here reflect the combined effort of many in the Office of the Chief Actuary, but most particularly Alice Wade, Christopher Chaplain, Daniel Nickerson, Jason Schultz, Kyle Burkhalter, and Katie Sutton.

The Bill includes the following five provisions with direct effects on the OASDI program:

1) *Increase the special minimum PIA, beginning for workers who become newly eligible for retirement or disability benefits or die after 2014*. The minimum PIA for workers with 30 or more years of work (YOWs) is 100 percent of the annual HHS poverty level for the prior year prior, divided by 12. The percent is reduced by 3 and 1/3 percentage points for each YOW less than 30 years, with no minimum benefit for 10 or less years of coverage. A worker's number of YOWs is determined as the number of earned quarters of coverage divided by 4 (ignoring any fraction), plus up to 5 years with a child under age 6 living with the worker.

2) *Provide a 5-percent uniform PIA increase after 16 years of eligibility.* The full benefit increase is 5 percent of the PIA of a worker having career-average earnings equal to SSA's average wage index in years up through the year before initial eligibility. The benefit increase phases in at 1 percent per year beginning 16 years after initial benefit eligibility, and is fully phased in at 5 percent beginning 20 years after initial benefit eligibility. Early retirement factors continue to apply to the PIA increases for retired workers who claimed benefits before full retirement age. This provision is effective in 2015 and later years.

3) *Extend benefit eligibility for children of disabled or deceased workers until age 22, beginning in 2015.* This provision applies if the child is in high school, college, or vocational school.

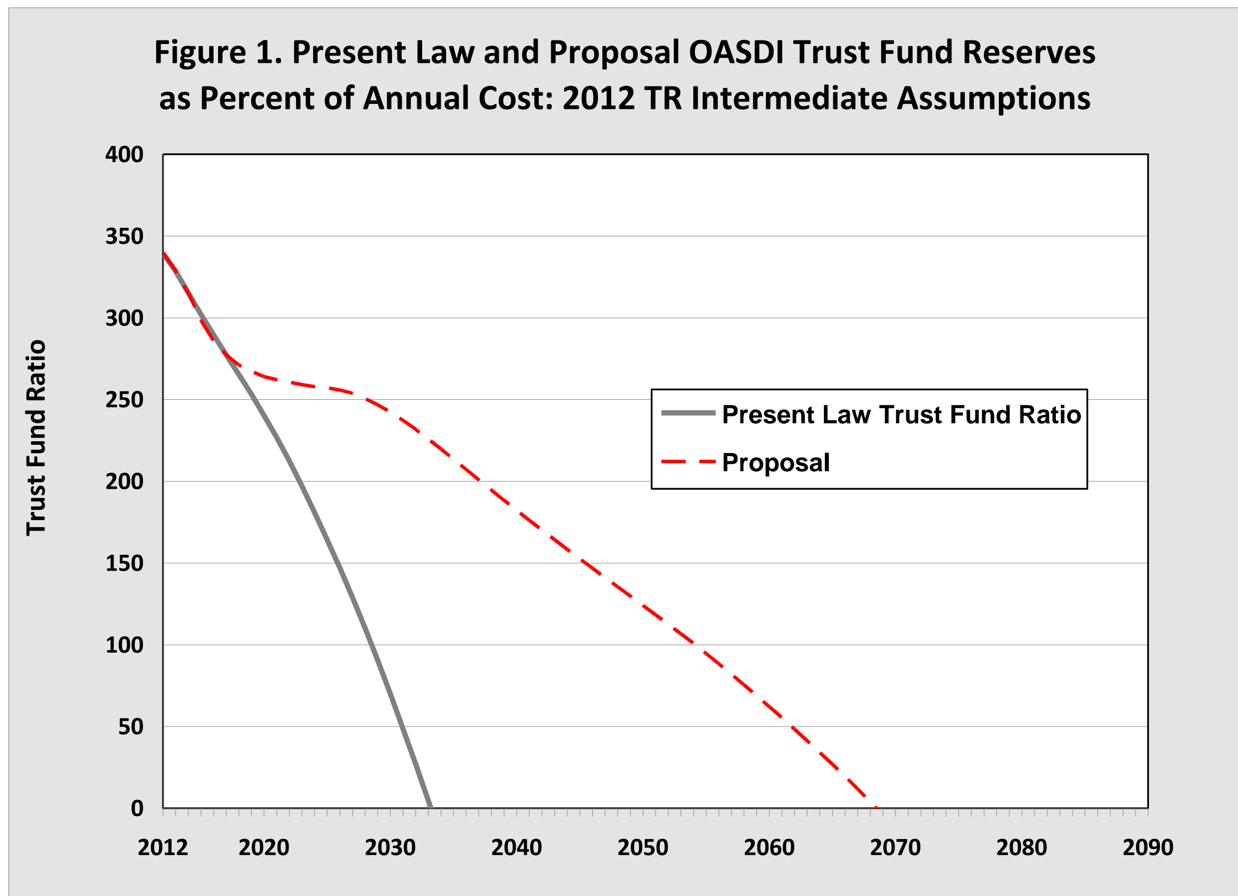
4) *Eliminate the taxable maximum, fully effective in 2024.* Phase in the elimination over 10 years by taxing all earnings above the current law taxable maximum at a rate of 1.24 percent in 2015, 2.48 percent in 2016, …, and 12.40 percent in 2024 and later. Additional earnings taxed are creditable for benefit purposes. The PIA formula is changed by: (1) adding a new bend point at the current law taxable maximum (without regard to this provision) for the second year prior to eligibility, divided by 12, and (2) applying a 3-percent PIA factor to AIME above the new bend point.

5) *Increase the payroll tax rate to 13.0 percent, fully effective in 2020.* The increase is phased in beginning in 2015, using 0.1 percentage point increments.

The balance of this letter provides a summary of the effects of the five provisions on the actuarial status of the OASDI program, our understanding of the specifications and intent of each provision, and descriptions of our detailed financial estimates for trust fund operations, benefit levels, and implications for the federal budget.

Summary of Effects of the Proposal on OASDI Actuarial Status

Figure 1 below illustrates the expected change in the combined Old-Age and Survivors Insurance (OASI) and Disability Insurance (DI) Trust Fund reserves, expressed as a percent of annual program cost, assuming enactment of the five provisions of this Bill. Assuming enactment, the OASDI program is expected to be fully solvent for an additional 35 years, under the intermediate assumptions of the 2012 Trustees Report.



Note: *Trust Fund Ratio* for a given year is the ratio of reserves in the combined OASI and DI Trust Funds at the beginning of the year to the cost of the program during the year.

Assuming enactment of the Bill, the level of reserves for the theoretical combined OASI and DI Trust Funds declines from 340 percent of annual program cost at the beginning of 2012 until these reserves are depleted in 2068 (35 years later than projected depletion under current law). At the time of reserve depletion in 2068, the program would be able to pay about 91 percent of then scheduled benefits with continuing taxes (under current law, 75 percent of scheduled benefits are projected to be payable in 2033 after depletion with this percentage rising slightly to 76 percent for 2068). By 2086, 89 percent of benefits scheduled under the proposal would be payable compared to 73 percent of scheduled benefits payable under present law.

Enactment of the five provisions of this Bill would eliminate almost 84 percent of the long-range OASDI actuarial deficit of 2.67 percent of taxable payroll under current law, lowering the OASDI actuarial deficit to 0.44 percent of payroll for the long-range period.

Figure 2 below illustrates annual projected levels of cost, expenditures, and non-interest income as a percent of the current-law taxable payroll. The projected levels of cost reflect the full cost of scheduled benefits under both present law and the proposal. After trust fund reserve depletion, projected expenditures under current law and under the proposal include only amounts payable from projected tax revenues (non-interest income), which are less than projected cost.

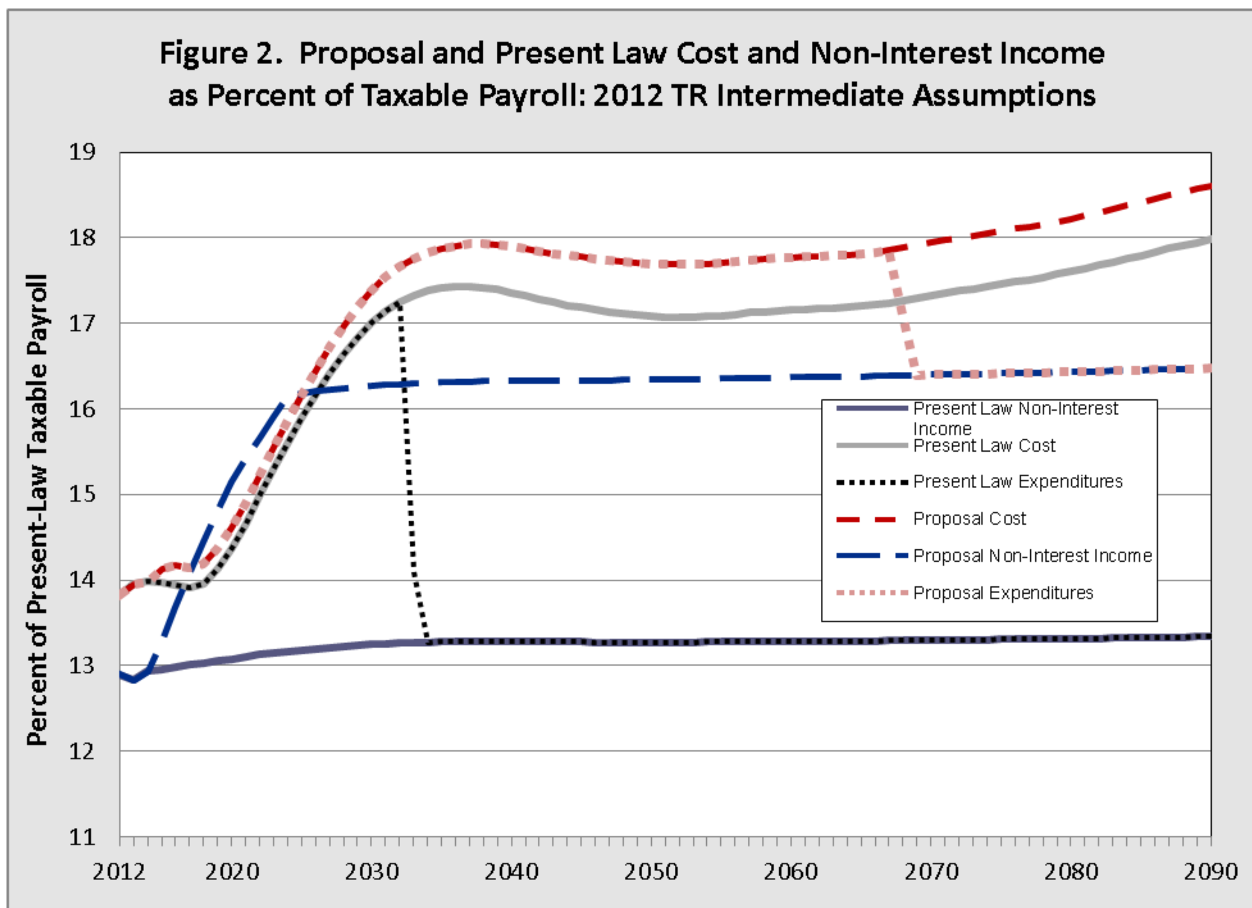
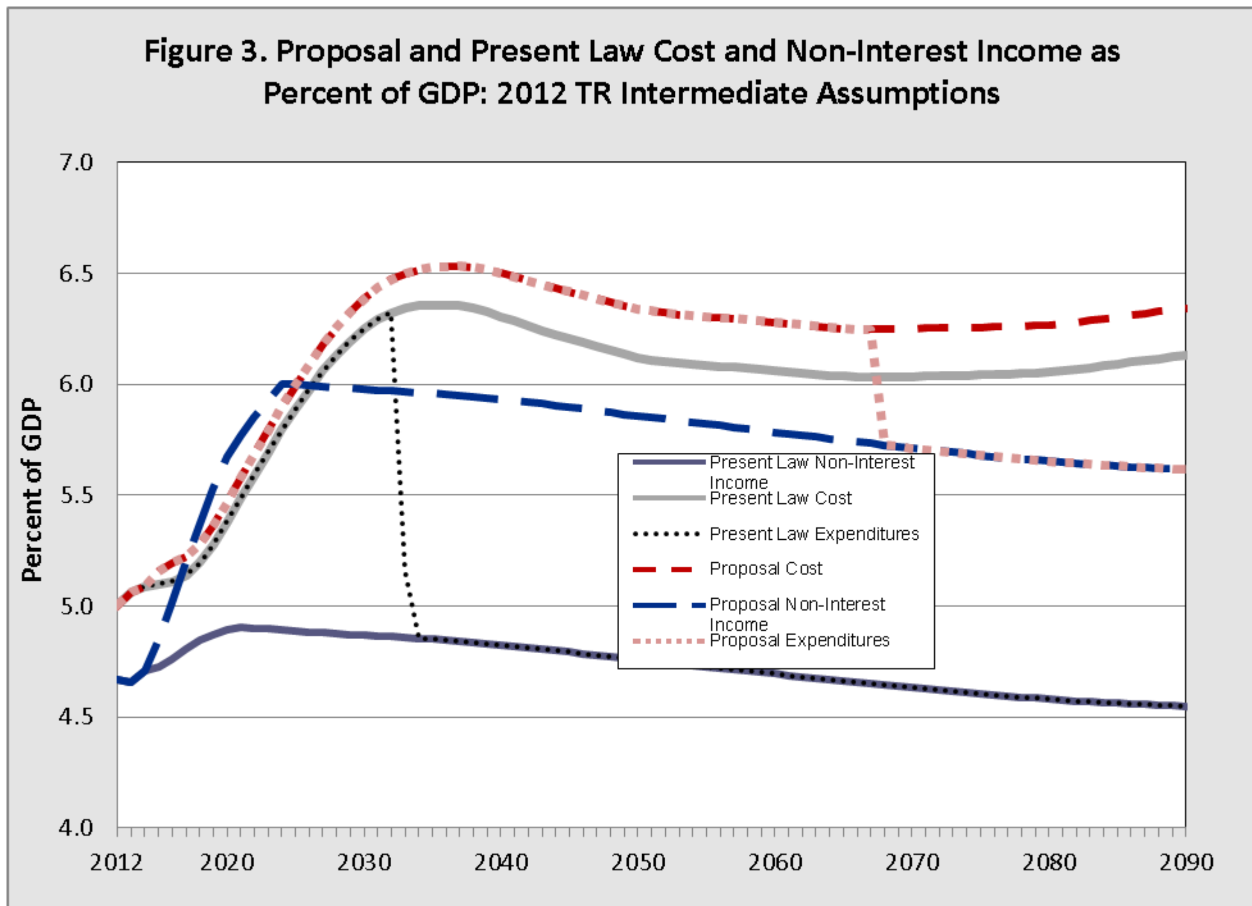


Figure 2. Proposal and Present Law Cost and Non-Interest Income as Percent of Taxable Payroll: 2012 TR Intermediate Assumptions

After 2014, OASDI program cost is higher under the proposal than under current law. This difference in program cost increases gradually over time to about 0.6 percent of current-law payroll by 2080. Non-interest income under the proposal is also higher than under current law, with the difference in non-interest income growing from 0.3 percent of payroll in 2015 to 3.0 percent of payroll by 2040. The proposal improves the annual cash-flow balance (non-interest income minus program cost) by 2.7 percent of payroll for 2025, with the improvement generally declining to 2.5 percent of payroll by 2086. Under the proposal, annual cash-flow balance is positive for 2018 through 2025, with annual deficits rising thereafter to 2.0 percent of payroll by 2086. As a comparison, the projected annual deficit under current law is 4.50 percent of payroll for 2086.

It is also useful to consider the projected cost, expenditures, and income for the OASDI program expressed as a percentage of Gross Domestic Product (GDP). The graph below illustrates these levels under both current law and the proposal.



Specification for Provisions of the Proposal

(1) Enhance the Special Minimum Benefit for Long-Career Low Earners

The present-law special minimum benefit has little effect currently because the level of benefit has been indexed from one generation of new beneficiaries to the next by increases in the CPI. This provision establishes a new minimum PIA under the OASDI program beginning with newly eligible beneficiaries in 2015.

For workers who become eligible for old-age or disability benefits or die in 2015 and later years, the full minimum PIA equals the Health and Human Services (HHS) annual individual poverty level for the year prior to eligibility divided by 12. For 2015, we project the full minimum PIA for eligible workers will be $950 (the estimated HHS poverty level for 2014 divided by 12). This amount equals the monthly poverty level for 2012 ($931), multiplied by the assumed

increase in the CPI-W from the third calendar quarter of 2011 to the third calendar quarter of 2013).

The percentage of the full minimum PIA that is applicable for a worker under this provision is determined by the number of years of work (YOWs) the worker has earned. YOWs are determined for a worker as the number of quarters of coverage divided by 4 (and truncating any fraction). A worker can be credited with up to five additional YOWs, reflecting years they are caring for and living with a child under age 6. However, any quarters of coverage earned in such childcare year would not be counted in determining YOWs based on earned quarter of coverage.

For workers with 30 or more years of work, the minimum PIA is equal to 100 percent of the poverty level described above. This percent is reduced by 3 and 1/3 percentage points from 100 for each year of work less than 30 years, with no minimum benefit for 10 or less years of work. For example, a worker with 28 YOWs would receive a PIA equal to 93 1/3 percent of the HHS poverty level in the prior year (if higher), and a worker with 11 YOWs would receive a PIA of 36 2/3 percent of the HHS poverty level in the prior year (if higher).

This provision alone is estimated to increase the long-range OASDI actuarial deficit by 0.02 percent of taxable payroll. The change in the annual deficit for the 75th projection year (2086) is negligible (between -0.005 and 0.005 percent of payroll).

(2) Increase Benefits Starting 16 Years after Initial Eligibility

This provision provides for a gradual increase in PIA for the 16th through 20th years after initially becoming eligible for benefits. The increase would apply for all OASDI beneficiaries in 2015 and later. The PIA upon which their benefit is based will be increased for the 16th year of eligibility by 1 percent of the PIA amount for a worker of the same age who has earnings equal to the average (AWI) starting at age 20, up through the year prior to initial benefit eligibility. The PIA will be further increased by an additional 1 percent of the AWI-earner’s PIA in the 17th through 20th years of eligibility. The total 5 percent increase will continue to apply in the 21st and later years of eligibility.

This provision alone is estimated to increase the long-range OASDI actuarial deficit by 0.23 percent of taxable payroll and to increase the annual deficit for the 75th projection year (2086) by 0.31 percent of payroll.

(3) Continue Benefits for Children of Disabled or Deceased Workers until age 22

Under current law, minor children under the age of 18, and high school students under age 19 are entitled to benefits if they are the child of a retired, disabled, or deceased worker. This provision extends benefits for children until the age of 22 if they are a child of a disabled or deceased worker.

This provision alone is estimated to increase the long-range OASDI actuarial deficit by 0.06 percent of taxable payroll and to increase the annual deficit for the 75th projection year (2086) by 0.06 percent of payroll.

(4) Eliminate the Taxable Maximum by 2024

Under current law, payroll taxes totaling 12.4 percent apply to covered earnings in a year up to the contribution and benefit base, or taxable maximum. This taxable maximum is $113,700 for 2013 and increases in the future in line with increases in the national average wage index (AWI). All covered earnings subject to the payroll tax are also creditable toward computation of potential benefits as well as attainment of insured status.

Under this provision, all covered earnings in excess of the present-law taxable maximum would be subject to some payroll tax starting in 2015. Covered earnings in excess of the maximum would be taxed at a 1.24 percent rate in 2014, at a 2.48 percent rate in 2015, at a 3.72 percent rate in 2016, …, and at a 12.4 percent rate in 2024 and later years. Therefore, all covered earnings above and below the present-law taxable maximum would be taxed at the full 12.4 percent payroll tax rate for 2024 and later.

Under this provision as modified, the primary insurance amount (PIA) would be determined by adding an additional bend point to the current law PIA formula. Under current law, the PIA is calculated as 90 percent of earnings under the first bend point, plus 32 percent of earnings above the first bend point and below the second bend point, plus 15 percent of earnings above the second bend point. The additional bend point would equal the monthly equivalent of the current law taxable maximum for the second year prior to initial eligibility (determined without regard to the changes made in this provision). A PIA factor of 3 percent would apply to earnings above the new bend point.

This provision alone is estimated to reduce the long-range OASDI actuarial deficit by 1.92 percent of taxable payroll and to reduce the annual deficit for the 75th projection year (2086) by 2.18 percent of payroll.

(5) Increase the Payroll Tax Rate by 2020

Currently the combined payroll tax rate for OASDI taxable earnings is 12.4 percent (6.2 percent each for employees and employers). This provision would increase the combined tax rate by 0.1 percentage point per year beginning in 2015 through 2020, bringing the combined rate to 12.5 percent in 2015, 12.6 percent in 2016 percent, …, and 13.0 percent in 2020 and later years.

This provision alone is estimated to reduce the long-range OASDI actuarial deficit by 0.53 percent of taxable payroll and to reduce the annual deficit for the 75th projection year (2086) by 0.60 percent of taxable payroll.

<u>Detailed Financial Results for the Provisions of the Proposal</u>

Summary Results by Provision

Table A provides estimates of the effects on the OASDI long-range actuarial balance for each of the five provisions of the proposal separately and on a combined basis. The table also includes summary estimates for the effect on the annual balance (the difference between income rate and the cost rate, expressed as a percent of present-law taxable payroll) for the 75th projection year, 2086.

Benefit Illustrations

Tables B1 and B2 provide illustrative examples of the projected change in benefit levels under the five provisions for beneficiaries retiring at age 65 in future years at five selected earnings levels, with selected numbers of years of work. The "Maximum-AIME Steady Earner" is assumed to have earnings at ages 22 through 64 that equal the present-law taxable maximum level (equivalent to $110,100 in 2012). As a result, the provision to increase the taxable maximum does not affect benefit levels illustrated in these tables. **Table B3** provides additional important information on characteristics of the illustrative retiring workers.

Table B1 compares the initial benefit levels assuming retirement at age 65 under the basic provisions of the proposal to both scheduled and payable present-law benefit levels. The proposed minimum benefit does not affect any of our hypothetical workers, because our very low hypothetical workers already receive a higher present law benefit in 2030, 2050, and 2080. The final two columns of this table show the level of scheduled benefits under the proposal as a percentage of present law scheduled and present law payable benefits, respectively. In the final column, no percentage is provided for years after 2068 because scheduled benefits under the proposal would not be fully payable.

Table B2 compares the change in scheduled benefit levels at ages 65, 75, 85, and 95 under the proposal to scheduled benefits under present law, assuming retirement at age 65. Table B2 shows that projected scheduled benefits under the provisions of this proposal increase in relation to present-law scheduled benefits between ages 65 and 95, because the increase in benefits for beneficiaries with 16 or more years of eligibility has a positive cumulative effect as beneficiaries age.

The hypothetical workers represented in these tables reflect average career-earnings patterns of workers who started receiving retirement benefits under the Social Security program in recent years. The tables subdivide workers with very low and low career-average earnings levels by their numbers of years of non-zero earnings.

Table B3 provides information helpful in interpreting the benefit illustrations in tables B1 and B2. Percentages in Table B3 are based on tabulations from a 10-percent sample of newly-entitled retired workers in 2007. Table B3 displays the percentages of these newly-entitled retired workers in 2007 that are closest to each of the illustrative examples and are:

1) "Dually Entitled", meaning they received a higher spouse or widow(er) benefit based on the career earnings of their husband or wife,
2) "WEP" (Windfall Elimination Provision), meaning that they received a reduced benefit due to having a pension based on earnings that were not covered under the OASDI program (primarily certain government workers), and they had less than 30 years of substantial earnings that were taxable under the OASDI program,
3) "Foreign Born", meaning that they entered the Social Security coverage area after birth (and generally after entering working ages), and
4) "All Others", meaning they had none of the three characteristics listed above.

The extent to which retired-worker beneficiaries represented by each of the illustrative examples has any of the characteristics listed above (dually entitled, WEP, foreign born) is important because such individuals are less dependent on the OASDI benefit that relates to their own career-average earnings level.

Trust Fund Operations

Table 1 shows the annual cost and income rates, annual balances, and trust fund ratios (reserves as percent of annual program cost) for OASDI assuming enactment of the five basic Social Security provisions of the proposal. This table also shows the change from present law in these cost rates, income rates, and balances. Included at the bottom of this table are summarized rates for the 75-year (long-range) period.

Table 1 indicates that the OASDI program is projected to be fully solvent for an additional 35 years assuming enactment of the five provisions. The year in which the combined reserves of the OASI and DI Trust Funds are projected to become depleted would change from 2033 under current law to 2068 under the proposal. Even after depletion of the trust fund reserves, however, the actuarial status of the program is improved as continuing income would be sufficient to pay a higher percentage of scheduled benefits than under current law. Under current law, 75 percent of benefits are projected to be payable at trust fund reserve depletion in 2033, declining to 73 percent payable by 2086. Under this proposal, 100 percent of the proposed (higher) scheduled benefits would be fully payable through 2067, and 91 percent would be payable at trust fund reserve depletion in 2068, declining to 89 percent payable by 2086.

The actuarial deficit for the OASDI program over the 75-year projection period is reduced by 2.23 percent of taxable payroll, from an actuarial deficit of 2.67 percent of payroll under current law to an actuarial deficit estimated at 0.44 percent of taxable payroll under the proposal.

We project annual balances (annual income rate minus annual cost rate) to become positive for years 2018 through 2025 under the proposal and to be negative thereafter. Annual deficits (negative annual balances) after 2025 are projected to be smaller than the deficits projected under current law by 2.45 percentage points or more through 2086.

Program Transfers and Trust Fund Reserves

Column 4 of **Table 1a** provides a projection of the level of reserves for the theoretical combined OASI and DI Trust Funds under the basic Social Security provisions of the proposal, expressed in present value dollars discounted to January 1, 2012. The table indicates that the basic provisions include no new specified transfers of general revenue to the trust funds. For purpose of comparison, the OASDI Trust Fund reserves, expressed in present value dollars, are also shown for the current-law Social Security program both without the added general fund transfers (if any) provided under the proposal (column 6) and with the proposal added transfers (column 7). Note that negative values in columns 4, 6, and 7 represent the "unfunded obligation" for the program through the year. The unfunded obligation is the present value of the shortfall of revenue needed to pay full scheduled benefits on a timely basis from the date of trust fund reserve depletion to the end of the indicated year. Gross Domestic Product (GDP), expressed in present value dollars, is shown in column 5 for comparison with other values in the table.

Effect of the Basic Social Security Provisions on the Federal Budget

Table 1b shows the projected effect, in present value discounted dollars, on the Federal budget (unified-budget and on-budget) cash flows and balances, assuming enactment of the five basic Social Security provisions of this proposal. Table **1b.n** provides the estimated nominal dollar effect of enactment of the five basic provisions of the proposal on the annual budget balances for years 2012 through 2022. All values in these tables represent the amount of the *change* from the level projected under current law.

The effect of the five basic Social Security provisions on unified budget cash flow (column 3) is expected to be positive starting for 2015, reflecting the gradual application of the payroll tax to earnings above the current-law taxable maximum amount.

Column 4 of Table 1b indicates that the projected effect of implementing the five basic Social Security provisions is a reduction, starting in 2015, of the Federal debt held by the public, reaching about $7.6 trillion in present value by 2086. Column 5 provides the projected effect of the basic Social Security provisions on the annual unified budget balances, including both the cash flow effect in column 3 and the additional interest on the accumulated debt indicated in column 4. Columns 6 and 7 indicate that the basic Social Security provisions of this proposal would have no expected direct effects on the on-budget cash flow, or on the total Federal debt, in the future.

It is important to note that these estimates are based on the intermediate assumptions of the 2012 Trustees Report and thus are not consistent with estimates made by the Office of Budget and Management or the Congressional Budget Office based on their assumptions.

Annual Trust Fund Operations as a Percent of GDP

Table 1c provides annual cost, annual expenditures (on a payable basis), and annual tax income for the OASDI program expressed as a percentage of GDP. These values are shown for both

present law and assuming enactment of the five basic Social Security provisions of the Bill. Showing the annual trust fund flows as a percent of GDP provides an additional perspective on these trust fund operations in relation to the total value of goods and services produced in the United States. The relationship between income and cost is similar when expressed as a percent of GDP to that when expressed as a percent of taxable payroll (see Table 1).

Effects on Trust Fund Reserves and Unfunded Obligations

Table 1d provides estimates of the changes due to enactment of the five basic Social Security provisions of this Bill in the level of projected trust fund reserves for years prior to trust fund reserve depletion and the level of unfunded obligations for years after trust fund reserve depletion. All values in the table are expressed in present-value discounted dollars. For the 75-year (long-range) period as a whole, the present-law unfunded obligation of $8.6 trillion in present value is reduced to an unfunded obligation of $1.0 trillion in present value. This $7.6 trillion change equals the following:

- A $9.2 trillion increase in revenue (column 2), primarily from additional payroll tax but also reflecting additional taxation of benefits revenues arising from increased aggregate benefit levels, *minus*
- A $1.6 trillion increase in cost (column 3), from additional benefits for worker beneficiaries on the rolls for 16 or more years, earnings above the present-law taxable maximum, and the enhanced special minimum benefit.

We hope these estimates will be helpful. Please let me know if we may provide further assistance.

Sincerely,

Stephen C. Goss
Chief Actuary

Enclosures