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LEGISLATIVE OPTIONS TO CHANGE THE U.S. SOCIAL SECURITY PROGRAM IN ORDER TO MAKE THE PROGRAM SUSTAINABLE

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Editor's note: A summary of the provisions and financial effects discussed in this article can be found on the U.S. Social Security Administration's Office of the Chief Actuary website at ***bit.ly/SSPChanges****.*

The most recent actuarial valuation of the U.S. Social Security program shows that it faces financial shortfalls over the next 75 years. The program's trust fund reserves are projected to begin declining in nominal dollars in 2020 and become depleted in 2034. Congress must make changes to the program before trust fund reserves are depleted in order to avoid sharp and immediate cuts in benefits to millions of Americans. Making adjustments sooner rather than later would allow necessary changes to be phased in gradually, and would give workers and beneficiaries time to adjust to them.

The last time major legislative changes were made to the Social Security program was in 1983. At that time, a combination of revenue increases and benefit adjustments was used to close the projected financing gap. Most notably, the 1983 law:

- Expanded Social Security coverage to new federal employees, employees of tax-exempt non-profit organizations and certain other groups;
- Advanced scheduled increases in payroll tax rates and increased tax rates for self-employment income;
- Subjected the Social Security benefits of beneficiaries with income above specified levels to federal income tax; and
- Raised the normal retirement age (NRA) beginning with workers reaching age 62 in 2000.

Many policymakers have developed proposals and options to address the current long-range shortfall. These proposals cover a broad range of policy options that focus on both trust fund solvency and benefit adequacy. Each year, the U.S. Social Security Administration's Office of the Chief Actuary (OCACT) publishes a summary of these provisions and their financial effects on its website. Visit **bit.ly/SSPChanges** to view the summary.

CONGRESS MUST MAKE CHANGES TO THE SOCIAL SECURITY PROGRAM BEFORE TRUST FUND RESERVES ARE DEPLETED TO AVOID SHARP AND IMMEDIATE CUTS IN BENEFITS TO MILLIONS OF AMERICANS.

action

DIG DEEPER ONLINE

The 2015 Old-Age, Survivor and Disability Insurance (OASDI) Trustees Report, officially called "The 2015 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds," presents the current and projected financial status of the trust funds. Visit **bit.ly/2015OASDIReport** to download a PDF of the report.

Visit **bit.ly/SSPChanges** for the U.S. Social Security Administration's Office of the Chief Actuary (OCACT) summary of the provisions and financial effects discussed in this article.

Provisions fall into several broad categories. This article sets out to describe and show the financial effects of selected sample provisions. For each provision, we provide the change in two key financial indicators:

1. The *long-range actuarial balance* measures the financial status of the program over the entire long-range (75-year) period. Based on the intermediate assumptions of the 2015 OASDI Trustees Report, the current-law shortfall in the long-range actuarial balance is *2.68 percent of payroll*.

2. The *annual balance in the 75th year* gives an indication of the yearly net cash flow at the end of the 75-year period. The current-law shortfall in the annual balance in the 75th year is *4.65 percent of payroll*.

FIGURE 1 on page 31 includes numerical results for all of the examples described in this article.

A. PROVISIONS AFFECTING COST-OF-LIVING ADJUSTMENT

These provisions modify the annual cost-of-living adjustment (COLA). Each year, Social Security benefits are increased based on the change in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W), calculated by the Bureau of Labor Statistics. There has been some debate in policy circles about the appropriate measure of CPI to use in calculating the COLA, as illustrated by the examples below.

Provision A3

Starting in December 2016, compute the COLA using a chained version of the CPI-W. We estimate this change would reduce the annual COLA by about 0.3 of a percentage point, on average. This provision is projected to decrease the shortfall in the long-range actuarial balance by 21 percent. (See the details for this and the other example provisions in **FIGURE 1** on page 31.)

Provision A6

Starting in December 2017, compute the COLA using the Consumer Price Index for the Elderly (CPI-E). We estimate this change would increase the annual COLA by about 0.2 of a percentage point, on average. This provision is projected to *increase* the shortfall in the long-range actuarial balance by 14 percent. Note that this provision would not help to close the funding shortfall; instead, it addresses concerns about the adequacy of benefits for older Americans.

B. PROVISIONS AFFECTING LEVEL OF MONTHLY BENEFITS

These provisions modify the formula used for calculating the basic Social Security monthly benefit, called the Primary Insurance Amount (PIA), including provisions that:

- Change PIA bend points and factors, or their indexing
- Change computation years, which are the number of years of earnings used in determining benefits
- Increase minimum benefits for targeted individuals, generally those with low earnings and long work careers
- Provide additional benefit increases for older beneficiaries

Provision B2.1

Beginning with those newly eligible for Old-Age and Survivors (OASI) benefits in 2025, multiply the PIA factors by the ratio of life expectancy at age 67 for 2020 to the life expectancy at age 67 for the fourth year prior to the year of benefit eligibility. Unisex period life expectancies computed by OCACT would be used to determine the ratio. Disabled workers are: (a) not affected prior to NRA; and (b) subject to a proportional reduction in benefits, based on the worker's years of disability, upon conversion to retired-worker beneficiary status. This provision is projected to decrease the shortfall in the long-range actuarial balance by 19 percent.

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Provision B6.1

Provide an additional 5 percent increase to the monthly benefit amount of any beneficiary who is 85 or older at the beginning of 2016, or who reaches his or her 85th birthday after the beginning of 2016. This provision is projected to increase the shortfall in the long-range actuarial balance by 4 percent.

C. PROVISIONS AFFECTING RETIREMENT AGE

These provisions modify:

1. The NRA, the age at which individuals can retire and receive their full PIA;
2. The earliest eligibility age (EEA), the age at which individuals can first begin receiving retirement benefits; or
3. Both of the above.

Note that under current law, the NRA is age 66 for those born between 1943 and 1954 and is scheduled to increase gradually to age 67 for those born in 1960 and later. The EEA is age 62.

Provision C1.4

After the NRA reaches age 67, increase the NRA two months per year until it reaches age 69 for individuals attaining age 62 in 2034. Thereafter, increase the NRA one month every two years. This provision is projected to decrease the shortfall in the long-range actuarial balance by 38 percent.

D. PROVISIONS AFFECTING FAMILY MEMBER BENEFITS

These provisions modify the benefit amounts received by widows, widowers, spouses or children based on a worker's Social Security account.

E. PROVISIONS AFFECTING PAYROLL TAXES

Some of these provisions modify the current-law payroll tax rate of 12.4 percent (6.2 percent each for employees and employers). Others modify the contribution and benefit base (CBB), or taxable maximum, which limits the amount of earnings subject to payroll tax and credited for benefit computation.

Provision E1.1

Increase the payroll tax rate (currently 12.4 percent) to 15.3 percent in 2016 and later. This provision is projected to decrease the shortfall in the long-range actuarial balance by 103 percent (i.e., it will lead to a surplus).

Provision E3.1

Increase the taxable maximum so that 90 percent of earnings would be subject to the payroll tax (phased in 2016–2025). Provide benefit credit for earnings up to the revised taxable maximum. This provision is projected to decrease the shortfall in the long-range actuarial balance by 29 percent.

F. PROVISIONS AFFECTING COVERAGE OF EMPLOYMENT OR EARNINGS

These provisions extend or reduce the categories of workers or the amount of earnings covered under the Social Security system.

Provision F1

Starting in 2016, cover newly hired state and local government employees. This provision is projected to decrease the shortfall in the long-range actuarial balance by 6 percent.

G. PROVISIONS AFFECTING TRUST FUND INVESTMENT IN MARKETABLE SECURITIES

These provisions allow for the investing of a portion of the Social Security trust funds in marketable securities (e.g., equities or corporate bonds), rather than in special-issue government bonds, as required under current law.

H. PROVISIONS AFFECTING TAXATION OF BENEFITS

These provisions change the current rules for subjecting Social Security benefits to personal income tax. Under current law, beneficiaries with income above specified levels pay income taxes on their benefits. These taxes are credited to the Social Security and Medicare trust funds.

Provision H2

Starting in 2016, tax Social Security benefits in a manner similar to private pension income. Phase out the lower-income thresholds from 2016–2035. This provision is projected to decrease the shortfall in the long-range actuarial balance by 7 percent.

CONCLUSION

FIGURE 1 summarizes the financial effects of these selected example provisions on a stand-alone basis. These provisions, and the others listed at **bit.ly/SSPChanges**, may be combined to form a comprehensive proposal to restore trust fund solvency. However, it is important to note that individual provisions may interact with each other. Therefore, the sum of the shortfalls restored under the

FIGURE 1 ESTIMATED FINANCIAL EFFECTS OF SELECTED PROPOSED CHANGES TO THE SOCIAL SECURITY PROGRAM

Proposed Provision	Provision Description	Change from Current Law as a Percentage of Payroll		Percentage of Shortfall Eliminated	
		Long-Range Actuarial Balance	Annual Balance in 75th Year	Long-Range Actuarial Balance	Annual Balance in 75th Year
A3	Compute the COLA using a chained version of the CPI-W.	0.55%	0.76%	21%	16%
A6	Compute the COLA using the CPI-E.	−0.38%	−0.53%	−14%	−11%
B2.1	For OASI benefits, index the PIA factors by life expectancy.	0.51%	1.69%	19%	36%
B6.1	Provide a 5 percent increase to the monthly benefit amount for those 85 or older.	−0.11%	−0.16%	−4%	−3%
C1.4	After the NRA reaches 67, increase the NRA two months per year until it reaches 69 and by one month every two years thereafter.	1.04%	2.21%	38%	48%
E1.1	Increase the payroll tax rate (currently 12.4 percent) to 15.3 percent.	2.76%	2.87%	103%	62%
E3.1	Increase the taxable maximum so that 90 percent of earnings would be subject to the payroll tax. Provide benefit credit for earnings up to the revised taxable maximum.	0.77%	0.63%	29%	14%
F1	Cover newly hired state and local government employees.	0.15%	−0.16%	6%	−4%
H2	Tax Social Security benefits in a manner similar to private pension income.	0.19%	0.15%	7%	3%

Current-law shortfall in *long-range actuarial balance* is 2.68 percent of payroll and in *annual balance in 75th year* is 4.65 percent of payroll. Estimates are based on the intermediate assumptions of the 2015 OASDI Trustees Report.

individual provisions may be different than the shortfall restored when the provisions are taken together as a whole proposal. As a result, further analysis is required in order to determine whether a proposal combining more than one provision is expected to achieve solvency throughout the 75-year period or beyond. ■

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background

A FIVE-MINUTE GUIDE TO SOCIAL SECURITY BENEFITS

If you are unfamiliar with how benefits are calculated under the U.S. Social Security system, you may not understand the potential changes to the scheduled benefits. Here's a quick tutorial. For more detailed information, please visit **ssa.gov/retire**.

FUNDING OF THE SYSTEM

System benefits are funded primarily by payroll taxes. Employers and employees each pay 6.2 percent of earnings up to the contribution and benefit base (CBB). The CBB for 2016 is US$118,500.

A smaller portion of the system's financing comes from taxes on Social Security benefits assessed to certain higher-income individuals.

WHO IS COVERED?

Almost all U.S. workers are covered by Social Security. Certain federal, state and local government employees are not covered.

CALCULATION OF BENEFITS

The official name for the system is Old-Age, Survivors and Disability Insurance (OASDI). This summary describes the calculation of the Old-Age benefit only. Rounding of actual benefits may be different than shown in the examples.

Normal Retirement Age (NRA) and Earliest Eligibility Age (EEA)

The NRA is the age at which unreduced retirement benefits are available. For those born before 1938, it is age 65. The NRA increases for those born after 1937, ultimately reaching age 67 for those born after 1959. If you start receiving benefits before NRA, the benefit is reduced for the rest of your life: by 6.67 percent per year for each of the first three years before NRA, and 5 percent per year thereafter. If you delay starting benefits beyond NRA, benefits are increased by 8 percent per year up to age 70 to reflect the shorter expected payment period.

The EEA is the age at which individuals can begin receiving retirement benefits, currently age 62.

Average Indexed Monthly Earnings (AIME)

Earnings up to age 60 (limited by the CBB) are indexed to changes in the national average wage index (AWI). Earnings after age 60 are not indexed. The AIME is the sum of the 35 highest indexed years of earnings divided by 420. For those with fewer than 35 years of earnings, the AIME still is calculated using a denominator of 420.

Primary Insurance Amount (PIA)

The PIA is the basic monthly benefit that is payable when benefits begin at NRA. PIA is calculated using a three-segment formula. Under this formula a participant receives:

- 90 percent of AIME up to the first "bend point," which is $856 for those reaching age 62 in 2016;
- 32 percent of AIME in excess of $856 and up to the second bend point, which is $5,157 in 2016; and
- 15 percent of AIME in excess of $5,157.

The formula is designed to be progressive—that is, more favorable to lower earners. Here is an example.

Year of birth: 1954
NRA: Age 66
AIME: $6,300
PIA = 90% x $856 + 32% x ($5,157 − $856) + 15% x ($6,300 − $5,157)
= $770.40 + $1,376.32 + $171.45
= $2,318

The PIA would be payable for benefits starting at age 66. If the participant elected to begin payment four years earlier at age 62, the PIA would be reduced by 25 percent and the monthly payment would be 75 percent of $2,318, or $1,739.

Indexing

The CBB, AIME and bend points are indexed based on the growth in the AWI. Benefits are indexed after retirement by an annual cost-of-living adjustment (COLA), based on changes in the Consumer Price Index.