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THE MEDIUM-TERM PLAN FOR SOCIAL SECURITY

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What lies ahead for Social Security? Let's examine the current condition of the Social Security Trust Fund and the options that can reasonably be used to extend the solvency of the fund, being mindful of Social Security's dual role of individual equity and social adequacy.

THE 2012 SOCIAL SECURITY TRUSTEES REPORT

The Trustees Report (<http://www.ssa.gov/oact/TR/2012/tr2012.pdf>) states that, under the intermediate assumptions, the expected date of exhaustion of the combined Old Age Survivors and Disability Insurance (OASDI) trust funds is 2033. Taxes payable at that time will still be sufficient to pay about 75 percent of scheduled benefits (declining to 73 percent of scheduled benefits by 2086, the end of the current 75-year projection period). Contrary to popular opinion, this projected exhaustion date is, by no means, a Social Security "bankruptcy" date, but it certainly provides clarity for our discussion.

The projected date of exhaustion has fluctuated between 2027 and 2042 over the last two decades, extending mightily during the Clinton years of economic boom, and contracting during the most recent severe recession. Social Security actuaries have done a great job with these projections, but no one knows how the economy, the big driver of the trust fund exhaustion date, will perform.

TRUST FUND DEPLETION

Based on that intermediate projection, we must ask, "What general pattern do the Social Security actuaries expect for trust fund depletion?" The answer lies with a heuristic device I call the Three-Four-Five Rule. Actuaries expect three years of minimal depletion, four years of intermediate spending down, and five years of severe spending down. What follows is, of course, a projection. In nominal dollars, when trust fund principal is used to pay benefits, we expect that the first three years will average less than \$50 billion annually (2021 – 23). This is followed by four years of larger spend-



ing down, from \$100 to \$200 billion annually (2024 – 27). The finale will be severe: five years of average annual budget drag of \$400 to \$500 billion (2028 – 32). Most of a \$3 trillion fund disappears in less than a decade and must be covered by borrowing or other means. How do we forestall a half trillion annual hit to the general budget for five years in a row?

BENEFIT REDUCTIONS

Let's consider the impact of legislated benefit reductions and other possible benefit reductions. Scheduled increases in normal retirement age (NRA), to age 67, will begin again in 2022 and will be completed in 2027. People who are age 55 this year will retire (at NRA) in the middle of that period. Historically, people over age 55 have been given a pass on any proposed Social Security benefit reductions, including normal retirement age increases. We are currently in an 11-year hiatus between an age 66 NRA and an age 66 years and two months' NRA. Certainly, accelerating the increase in



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NRAs is an option, but its potential effect on the trust fund over the next two decades is becoming increasingly limited.

After all, President Reagan chose to give citizens two decades to make plans for increased NRAs, with early 1980s legislation starting to be implemented in the 2000s. He was right to be cautious about cutting people's retirement income. Other than normal retirement age, any other type of benefit reduction is completely new to Social Security and should probably be handled the same way Reagan handled NRAs. Using this as a benchmark, benefit reductions, in general, will have minimal impact on trust fund depletion over the next two decades. Since we are no longer realizing budget surpluses from Social Security payroll taxes, investment of the trust fund in marketable securities could only be done with respect to past surpluses already invested in government bonds. The viability of that option can be debated elsewhere. The only other option is to increase revenue.



REVENUE INCREASES

Social Security tax rates rose between five and seven times per decade, from the '50s to the '80s. The payroll tax was 10.16 percent in 1980 and rose gradually over a 10-year period to 12.4 percent, where it stands today, unchanged since 1990. President Reagan also brought the taxable maximum high enough to cover 90 percent of wage income, with the intention of keeping it there, but it has slipped to nearly 83 percent of wage income because of faster wage growth in the top income tier. Via the 1983 Social Security Amendments, revenue enhancements were in place within seven years, and benefit cuts were planned over five decades. President Reagan's Social Security plan from the '80s should guide us today.

Revenue increases are nothing new. Social Security is now, once again, a developing system, because of the impact of the baby boomers over the next 40 years. Policymakers must realize that the baby boomers are an extraordinary shock to the system, not only because of their sheer size, but also because their presence has allowed lower tax rates for decades.

THE THREE-LEGGED RETIREMENT STOOL

Over the decades since Social Security became law, a certain balance on the three-legged stool of retirement income has been achieved and then lost. Now, the stool has pretty much been kicked out from under us. Here's what we've seen and what to expect as a result of recent decades: (1) fewer defined benefit plans in force, covering far fewer workers; (2) wage growth stagnation among the lower three to four quintiles of workers; (3) smaller investment returns; (4) more stock market investment risk and economic uncertainty risk, affecting both retirement investments and future job prospects; (5) reduced life spans among the least educated workers.

INCREASING NORMAL RETIREMENT AGES

Increased life expectancies form the basis for both past and present normal retirement age

proposals, and this merits special attention. To start with, most overall life expectancy increases have occurred because of decreases in death rates at lower ages rather than at higher ages (see 2012 Trustees Report). This means, simply, that more people (who have paid into Social Security much of their lives) can now expect to get at least a dollar of that money back, before dying, than did previous generations. This is a much bigger reason for increased Social Security spending than that of people living longer within retirement.

If this fact were widely known in the public sphere, people would say that it's only fair that more people benefit from a universal program. They would expect actuaries to use life expectancy within retirement (after NRA), not life expectancy at birth, in their arguments to raise the NRA. Consequently, the decision of some actuaries to use life expectancy at birth to bolster their calls for increased NRAs is questionable.

People also have a strong desire to know their exact retirement age well before retirement so they can plan. Using formulas involving life expectancy to determine NRAs, while appealing to many actuaries, doesn't help policymakers explain to their constituents what their retirement ages will be. Moreover, new studies have shown that increases in life expectancy are confined to the relatively well-educated and well-off. College graduates of all races enjoy about a decade more of expected life span, compared to the least-educated, who have seen declines in life expectancy of up to four years since 1990.

It is important to also note that increasing the normal retirement age is a regressive benefit change. Not only do lower benefit workers tend to be at a disadvantage in terms of life expectancy, but they have fallen even further behind recently, and their retirement income often consists only of Social Security.

OTHER SOLVENCY PROPOSALS

Much of this life span research has occurred

since 1983, so its effects would have been unknown during the last round of Social Security changes. What benefit reductions might be more progressive than normal retirement age increases? Here are some solvency proposals: Individual Changes Modifying Social Security (<http://www.ssa.gov/oact/solvency/provisions/index.html>). These options are not currently graded by progressiveness, but perhaps that is an option that will be pursued in the future. This much is clear. We absolutely need to focus our efforts on bolstering the trust fund in the near future and reducing the projected losses over the next two decades.

RECOMMENDATIONS

Based on the preceding information and ideas, here are my recommendations.

1. Require both the Trustees Report and Individual Changes Modifying Social Security (solvency proposals) to model proposed changes over the next 20 – 30 years and to include modeling of the trust fund impact over that time period.
2. Build consensus on the minimum length of time that policyholders should allow citizens to plan for their retirement, with advance notice of benefit cuts.
3. Focus on revenue changes to build up the trust fund prior to the full force of all the baby boomers reaching retirement.
4. Grade solvency proposals by progressiveness. Some are much more progressive than others. Both revenue and benefit change proposals should be graded.
5. Focus on revenue increases in the short term and benefit reductions over the long term, and realize that benefit changes cannot have a large impact over the next two decades.
6. Engage in the nuts and bolts of action. Despite our tendency as actuaries to say nothing, we must advocate for specific changes and support those changes with good reasons.

After we have placed the impact to the trust fund in the central role, there are three Social Security revenue changes that are quite simple

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and mimic the 1983 amendments. Following these are some more provisions that were not included in 1983, but which I recommend to counteract the regressive nature of raising the payroll tax percentage (Item 1).

- (1) Gradually raise the Social Security tax rate by 2.7 percentage points, to 15.1 percent, consistent with the 1980's percentage increase.
- (2) Raise the taxable maximum to 95 percent of all wage income, to account for its many years at 85 percent or below.
- (3) Include all new state and local workers in the Social Security system.
- (4) Rather than using average wage indexing to increase the taxable maximum, use wage indexing using only the top 5 percent of earners.

- (5) Expand covered earnings to cover employer and employee premiums for employer-sponsored health insurance.
- (6) Use a smaller tax above the revised taxable maximum for higher earners (say 3 percent for earnings above the maximum).
- (7) Reduce or eliminate the benefit credit for earnings above a certain point for higher earners.

Overall adequacy of retirement income is more important than ever. We must agree that we have waited too long to fix our Social Security problems with benefit cuts alone. We can fix them with a balance of revenue, weighted toward earlier years, and benefit cuts, weighted toward later years, in the 75-year projection period. 

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