

SOCIAL SECURITY: OVERVIEW AND REFORM



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IABA Conference, Boston

August 5-7, 2005

Agenda

- ◆ Three-Legged Stool
- ◆ Current System Overview
- ◆ Calculation of Monthly Social Security Benefit
- ◆ Demographic Trends
- ◆ Key Proposals
- ◆ Discussion Points

Three-legged Stool

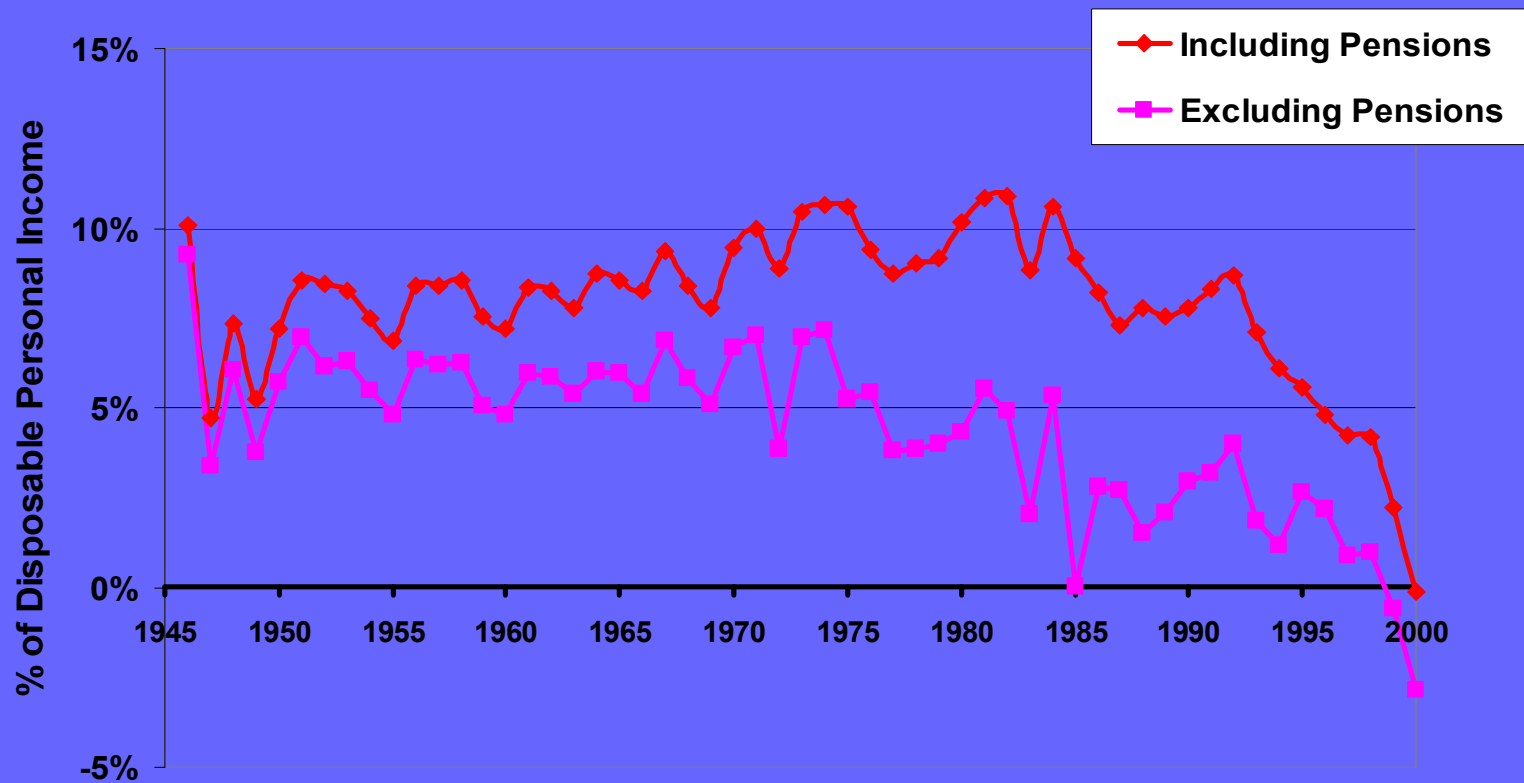
◆ Retirement Security Stool

- ◆ Social Security
- ◆ Private Pension
- ◆ Personal Savings

- ◆ Social Security is only source of retirement income for 40% of elderly African-Americans
- ◆ Only 54% have pension coverage
- ◆ More than half have no significant financial assets (wealth gap)

Three-legged Stool: Personal Savings

Personal Savings Rates are Down



Without pensions, personal savings would be very negative. Pensions are how we save now. Homes too, but they are heavily leveraged. Source: Bureau of Economic Analysis 3/01 Survey of Current Business Tables B.1 & B.2, and Federal Reserve 3/9/2001 Flow of Funds Table F.10. Note: this includes dissaving by retired.

Overview of Current System

- ◆ Old Age Survivors and Disability Insurance Program (OASDI)
- ◆ Political Father of our Social Security System – Franklin D. Roosevelt
 - ◆ “right to adequate protection from the economic fears of old age, sickness, accident, and unemployment.”
- ◆ Costs and Benefits spread among the entire workforce
- ◆ Benefits are non-inheritable

Overview of Current System (continued)

◆ Allocation of Social Security Funds

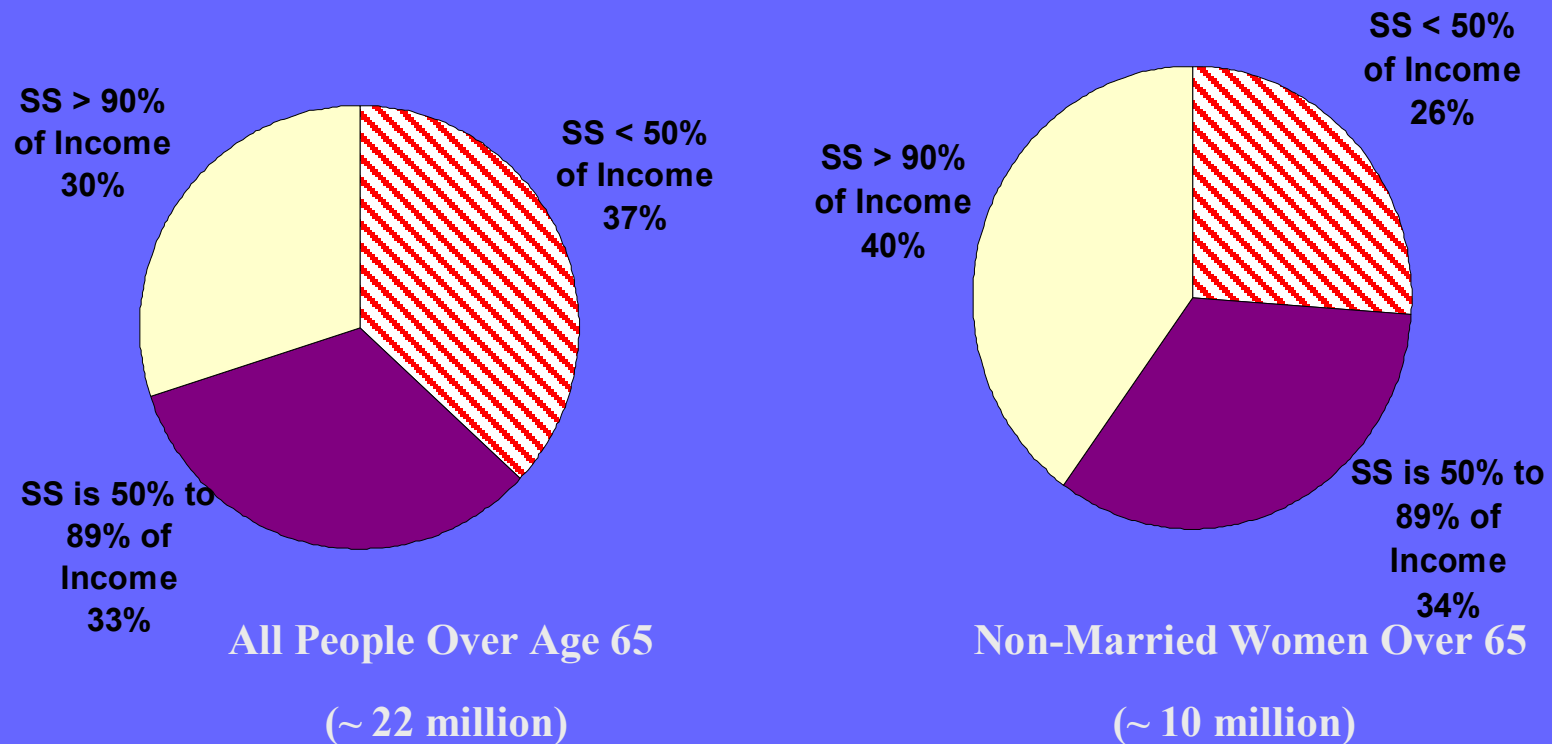
- ◆ 70% to retirees (“old age” benefit)
- ◆ 15% to disabled workers
- ◆ 15% to survivors (including children)

◆ African-American Population Benefits

- ◆ Receive less “old age” benefits over lifetime
- ◆ 17% of disabled workers receiving benefits
- ◆ 23% of all children receiving benefits in 2002

Discussion: Why do African-Americans receive less retiree payments over their lifetime?

Social Security as a Percent of Total Income



Source: Social Security: Income of the Population 55 or Older, 1998

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.)

Operations of a Pay-As-You-Go Program

- ◆ Financed by the Federal Insurance Contribution Act (FICA) payroll tax
- ◆ Tax paid by all working Americans on earnings up to about \$90,000
- ◆ Initially, large trust fund buildup controversial
- ◆ Payroll taxes paid by current workers almost immediately paid out in benefits
- ◆ FICA first collected in 1937 for benefits scheduled for 1940
- ◆ Current system is not pure pay-as-you-go program

Discussion: How is the payroll tax a regressive tax?

Important Amendments

- ◆ 1970s – PIA formula automatically adjusted to reflect change in CPI
 - ◆ Relates to the relationship between average benefits and average wages
- ◆ 1980s – Just in time to avoid partial default on benefits
 - ◆ Largely defines current structure
 - ◆ Raised retirement age

Trust Fund

◆ Real

- ◆ Holds special Treasury securities that will be paid back with interest
- ◆ Federal government will not default on obligations

◆ Fiction

- ◆ Government uses surplus to finance current expenditures and issues IOU to itself
- ◆ Eventually, future generations will have to pay IOU through higher taxes

Calculation of SS Benefit

◆ Progressive Formula

- ◆ Returns greater percentage of pre-retirement earnings to lower-wage worker
- ◆ Lowest years of earnings may be ignored

◆ Cost-of-Living Protection – Guarantees a benefit annually adjusted for inflation

◆ Calculated on the basis of the highest 35 years of earnings over worker's lifetime

Discussion: Why do African-Americans receive lower return on tax contributions?

Calculation of SS Benefit (continued)

Year of Birth	Normal Retirement Age	The benefit payable at NRA and at disability retirement
1937 & earlier	65	= the Primary Insurance Amount (PIA) = 90% x AIME up to \$627 + 32% x next \$3,779 of AIME (for 2005) + 15% x AIME over \$3,779
1938	65 2/12	Increase bend points by average wages each year Use formula in year eligible (age 62 for old age benefits).
1939	65 4/12	
1940	65 6/12	
1941	65 8/12	
1942	65 10/12	
1943 – 1954	66	AIME = Average Indexed Monthly Earnings Of your highest 35 years of covered earnings Indexed by average wages up to 2 years before eligibility (age 60 for old age benefits)
1955	66 2/12	
1956	66 4/12	
1957	66 6/12	
1958	66 8/12	
1959	66 10/12	Benefits are increased each year after eligibility by inflation using the Consumer Price Index (CPI-W)
1960 & later	67	Multiply PIA by age factors from below:

Normal Retirement Age (NRA) = Age for full benefits. 62 is earliest age for benefits

Reductions for retiring earlier than NRA are as follows:

6 2/3% for each year before NRA (up to 3 years), plus 5% for each year more than 2 years

If you work after NRA, your benefit is increased by up to 8% per year.

Social Security Replacement Ratios

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



See History of Provisions at www.ssa.gov/OACT/HOP. Past wages based on National Average Wage Index
These percentages increase by about 1 to 2 percentage points over the next 10 years, per Table VI.E11 in 2002 rpt.

Important Dates

◆ 2009

- ◆ Baby Boomers begin to retire
- ◆ Cash surpluses begin to decline
- ◆ Government must increase borrowing, raise taxes, or reduce government spending

◆ 2018

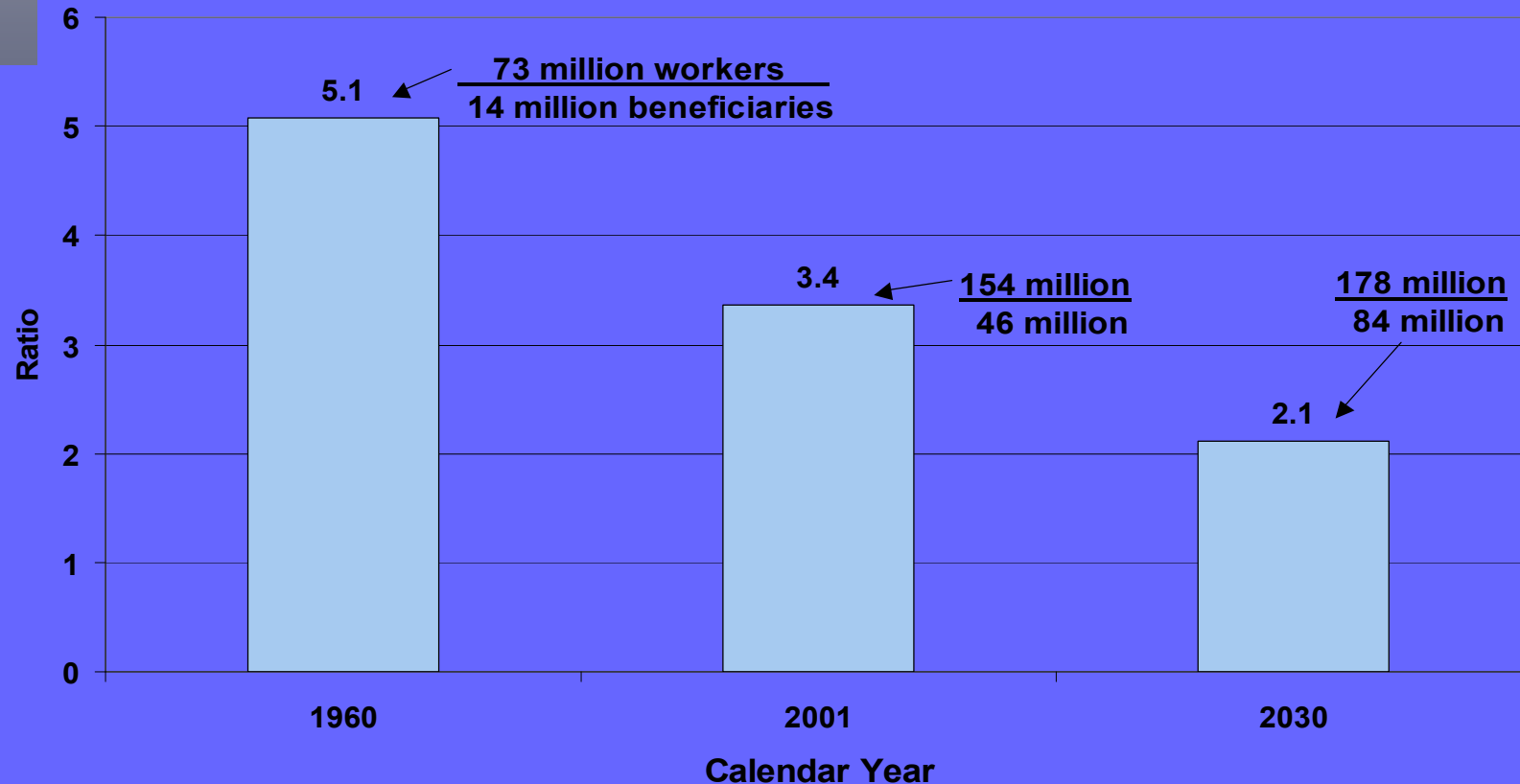
- ◆ Benefit payments exceeds payroll taxes
- ◆ System begins to draw on trust fund (reserve drawn)

◆ 2041

- ◆ Trust fund is exhausted
- ◆ Payroll tax revenue covers roughly 75% of benefits

Workers to Beneficiaries Ratios

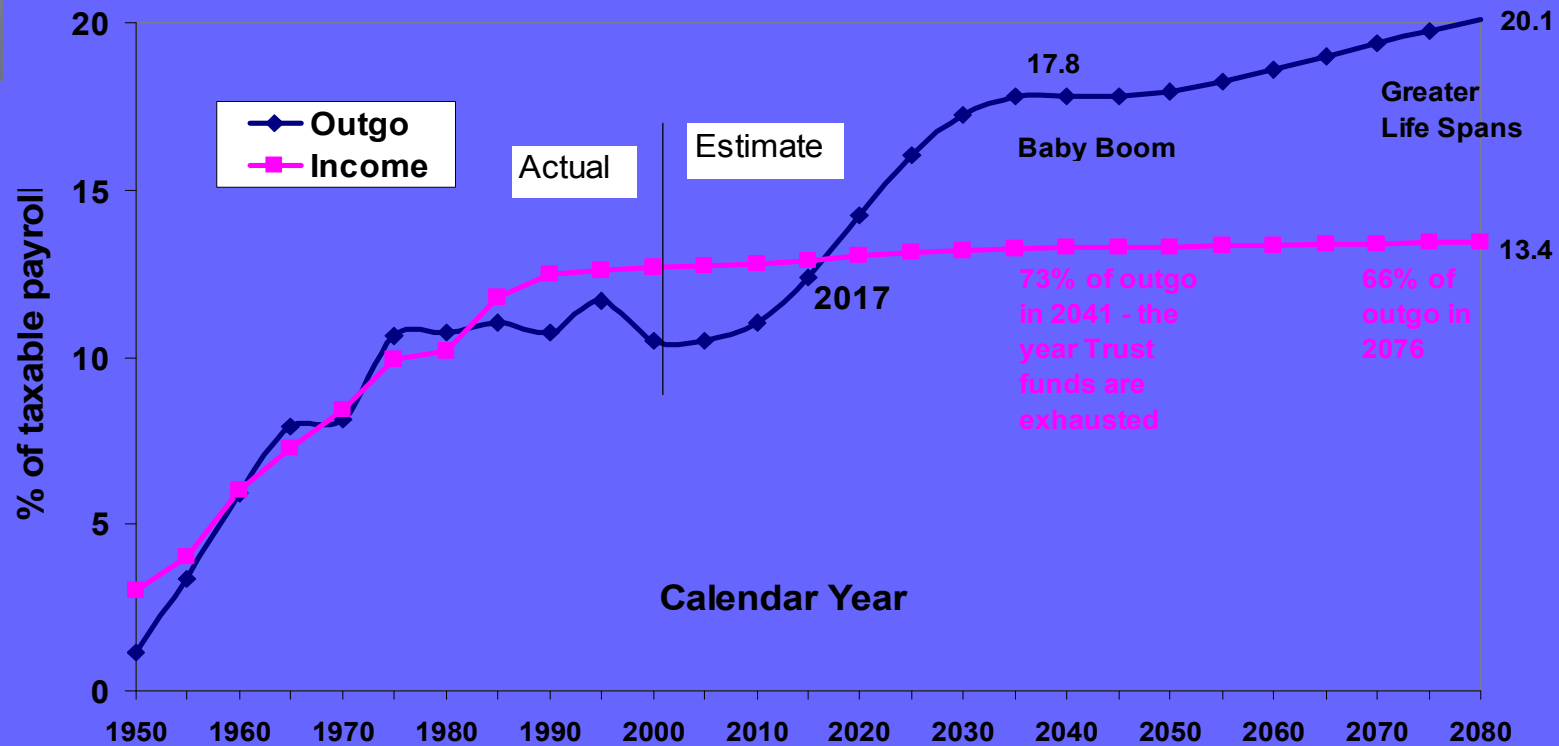
Workers per Beneficiary



The number of workers supporting beneficiaries decreases dramatically due to baby boomers & longer lifespans. Source: 2002 SSA Trustees' Report, Table IV.B2

Social Security Solvency

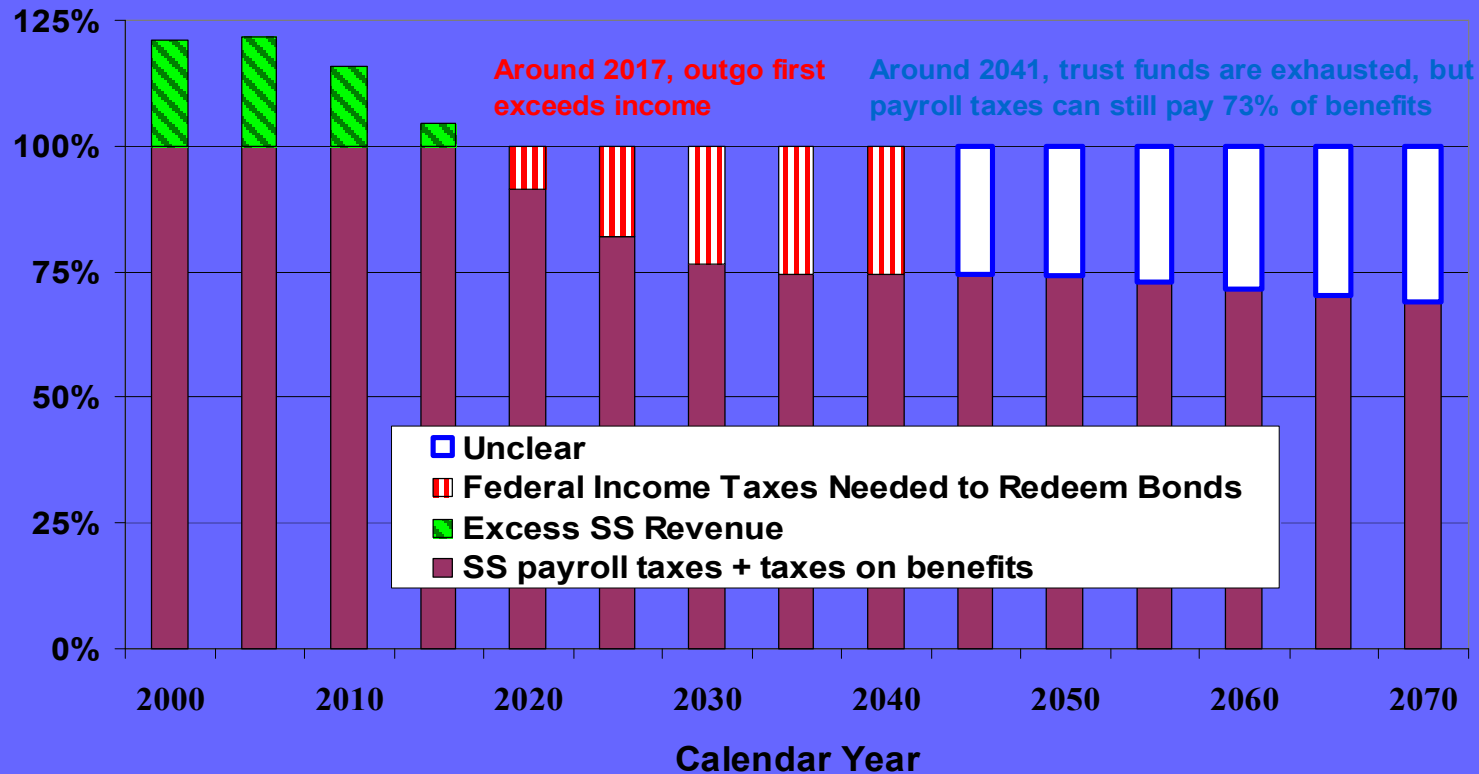
Social Security Income & Outgo Intermediate Assumptions



Source: 2002 SSA trustees report Table IV.B1 and Summary of 2002 trustees report (p. 7).
 The ultimate outgo under low and high cost assumptions are 14% & 29%.
 The 2017 date is 2013 and 2021 under the high and low cost assumptions. It's 2027, if interest is included.
 75 yr actuarial balance = -1.87, -5.00, & 0.44 for the intermediate, high, & low cost assumptions, Table IV.B5.
 1999 Tech Panel's assumptions increased intermediate 75 yr deficit by 0.5%, a 3% change in total costs.

Social Security Solvency (continued)

How Are Social Security Benefits Paid?



Source: 2002 SS Trustees Report Table IV. B1 Note: Redeeming SSA's Treasury Bonds requires General Revenue (surplus income taxes or more Deficits). Future surpluses depend on debt repayment, no tax cuts, no increased govt prgrams, good economy. Increased deficits (or stock redemption) increases borrowing costs.

Financing Choices

- ◆ Raise Revenue
- ◆ Lower Scheduled Benefits
- ◆ Increase Retirement Age

If no changes are made now, payroll tax rates would have to rise by more than 4% by 2041 and more than 6% by 2079.

Alternatively, benefits would need to be cut by 27% in 2041 and reach 32% by 2079.

Key Proposals

- ◆ House Ways & Means – GROW (Growing Real Ownership for Workers) Act
 - ◆ Dedicate trust fund surpluses to personal accounts for workers under 55 (voluntary)
 - ◆ Initially, accounts invested in Treasury securities (managed by independent board)
 - ◆ Balances used to help pay worker's SS benefit
 - ◆ Account balances are inheritable

Key Proposals (continued)

◆ Senator Sununu (R-NH) & Rep. Paul Ryan (R-WI)

- ◆ Voluntary personal accounts using the TSP as the investment structure
- ◆ No changes to current benefit formula or tax rates
- ◆ Carve out 1% of first \$10K; 5% of remainder
- ◆ Required to annuitize balance to at least 100% of current law benefit; could receive remainder in lump sum
- ◆ Fully inheritable
- ◆ Minimum benefit guaranteed at 100% current law
- ◆ -\$2.7 trillion cash flow (2004 – 2013)

Key Proposals (continued)

- ◆ Invest trust fund assets in stock market
 - ◆ President Clinton's 1999 State of the Union address

Discussion: Who should bear risk of investing in equities?
- ◆ Balance Present Paygo System
 - ◆ Raise taxes or cut benefits now
 - ◆ Look at FICA tax inequities
 - ◆ Review SSA and CBO assumptions

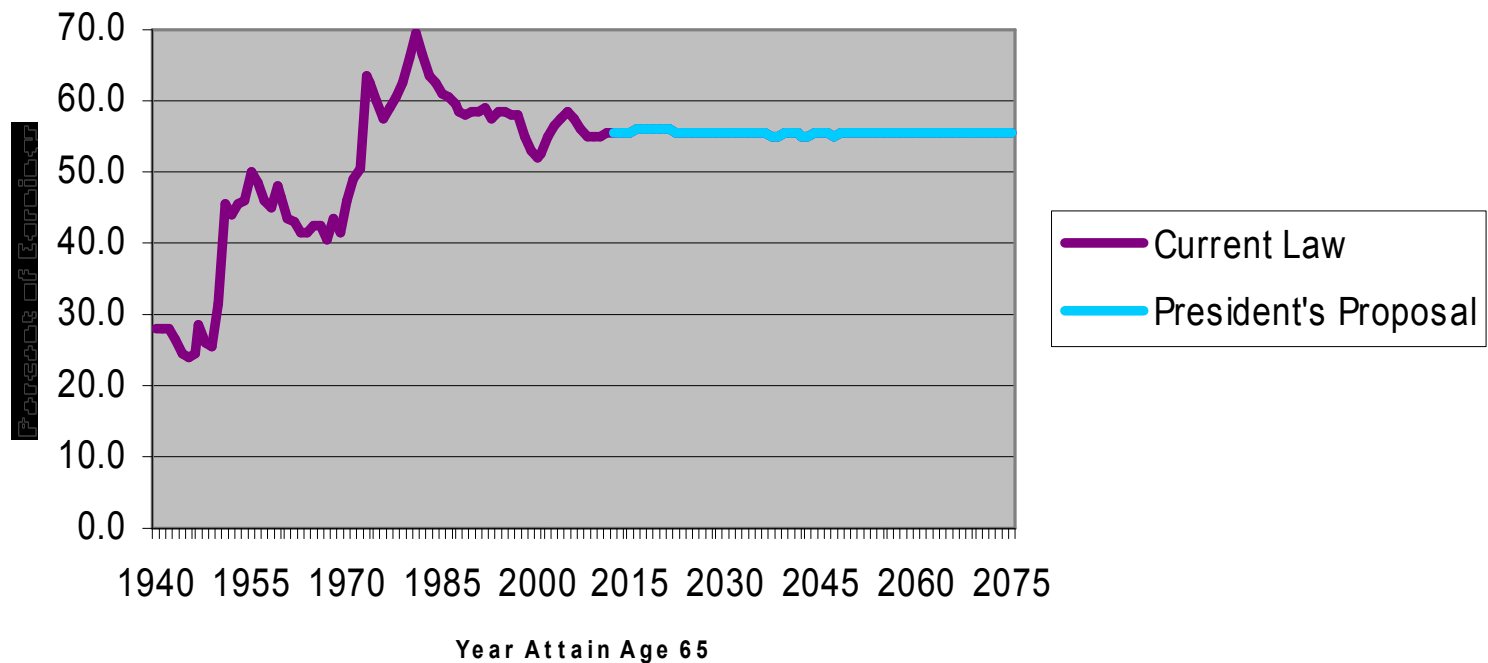
Key Proposals (continued)

◆ Bush Administration

- ◆ Voluntary personal accounts for workers under 50 using TSP as investment structure
- ◆ Carve out 4% of pay (maximum \$1,000)
- ◆ Required to annuitize balance to unspecified level; could receive remainder in lump sum
- ◆ Fully inheritable
- ◆ Benefit formula with progressive price indexing
- ◆ Increase survivor's benefit to 75%
- ◆ Minimum benefit of 120% of poverty level
- ◆ -\$712 billion cash flow (2004 – 2013)

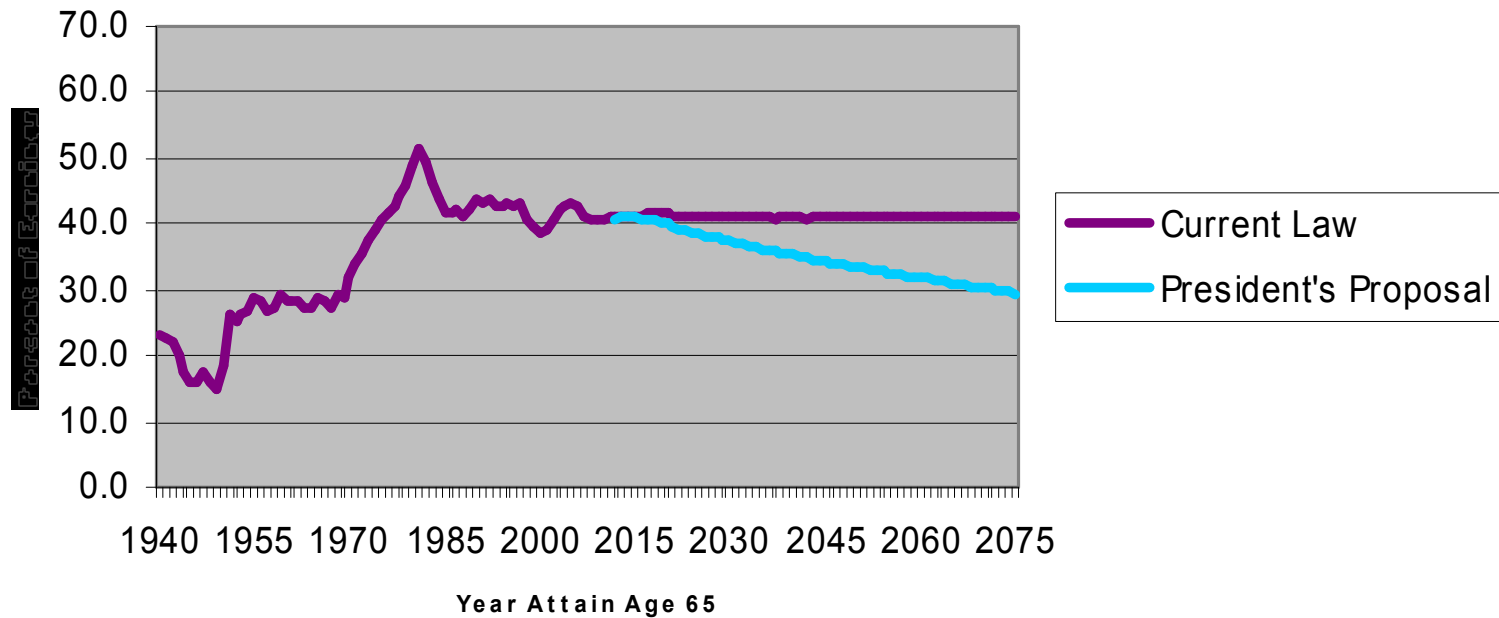
Progressive Price-Indexing

OASDI REPLACEMENT RATES
Low Pre-Retirement Earnings Pattern - Single Wage Earner
(For Years 1940 to 2075)



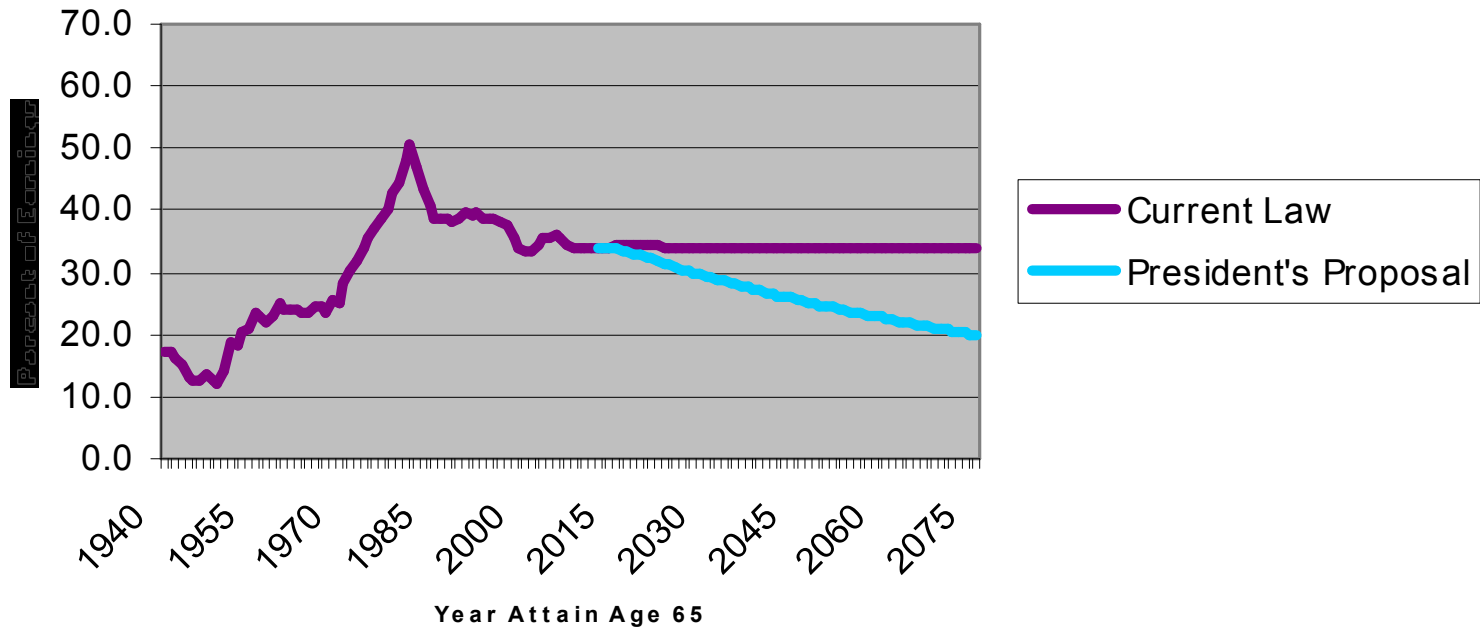
Progressive Price-Indexing (continued)

OASDI REPLACEMENT RATES
Medium Pre-Retirement Earnings Pattern - Single Wage Earner
(For Years 1940 to 2075)



Progressive Price-Indexing (continued)

OASDI REPLACEMENT RATES
High Pre-Retirement Earnings Pattern - Single Wage Earner
(For Years 1940 to 2075)



Talking Points

◆ Personal Retirement Accounts

- ◆ What are some arguments for?
- ◆ Arguments against?
- ◆ Voluntary or Mandatory

Talking Points

◆ Personal Retirement Accounts

- ◆ Financing
- ◆ Contributions
- ◆ Investment Structure
- ◆ Treatment at Death

Talking Points

◆ Personal Retirement Accounts

- ◆ Changes to Benefit Formula
- ◆ Changes to Survivor and Disability Benefits
- ◆ Minimum Benefits
- ◆ Administrative Costs

Talking Points (continued)

- ◆ Trust Fund
- ◆ Finance Projections
- ◆ Permanent Fix or Sustainable Solvency
- ◆ Tax Inequities

Legislative Watch

- ◆ Democrats maintain strong opposition to personal accounts
- ◆ Strong support from White House and key lawmakers
- ◆ Many opportunities to derail legislation
- ◆ Pressure to act this year; 2006 is election year

Conclusion

- ◆ Important issue to all Americans
- ◆ Social Security is a large source of retirement income
- ◆ Each solution has advantages and disadvantages
- ◆ Reform is needed sooner rather than later



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