Social Security Advisory Board

September 2005

SOCIAL SECURITY:

Why Action Should be Taken Soon

AUTHENTICATED
U.S. GOVERNMENT
INFORMATION

SOCIAL SECURITY FACTS

What Do Your Social Security Taxes Pay For?

Workers and their employers each pay 6.2 percent on earnings of up to $90,000 into Social Security. These taxes pay for retirement, disability, family benefits, and survivors benefits. Currently about 159 million workers (96 percent of all jobs) are covered by Social Security, and about 48 million people (one out of every 6 Americans) are receiving benefits.

Social Security Provides:

- Retirement benefits to more than 30 million retired workers. Reduced benefits are payable at age 62; for workers reaching 62 in 2005, full benefits are payable at 66. (The age at which full benefits are payable will increase gradually to age 67 for those reaching age 62 in and after 2022.)

- Disability benefits to more than 6 million disabled workers with a severe physical or mental impairment that is expected to prevent them from doing "substantial" work for a year or more or who have a condition that is expected to result in death.

- Family benefits to about 3 million spouses and 2 million children of retired and disabled workers.

- Survivors benefits to about 7 million survivors of deceased workers, including nearly 2 million children.

Since 1972, all Social Security benefits have been indexed to increase automatically with increases in the Consumer Price Index, thus providing protection against inflation.

What Is Social Security's Current Budget Situation?

- In calendar year 2005, income to the Social Security Trust Funds is projected to be about $690 billion, and outlays $527 billion, leaving a surplus in 2005 of over $163 billion. The total amount of the Trust Funds at the end of 2005 is expected to be approximately $1.9 trillion, which equals about 38 months of Social Security benefits (including disability benefits).

- Social Security will account for about 28 percent of total Federal government outlays in fiscal year 2005, and 21 percent of total Federal government receipts.

- Fiscal year 2005 projected administrative costs for the Social Security programs are $5.3 billion — or 1 percent of total Trust Fund outlays.

Social Security Advisory Board

Hal Daub, Chairman
Dorcas R. Hardy
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An independent, bipartisan Board created by Congress and appointed by the President and the Congress to advise the President, the Congress, and the Commissioner of Social Security on matters related to the Social Security and Supplemental Security Income programs.

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I. INTRODUCTION

Since its establishment in the mid-1990s the Social Security Advisory Board has devoted much of its attention to meeting its statutory responsibility for addressing the short-term and long-term solvency of the Social Security program. Among other things we have twice previously (in 1998 and 2001) issued a report describing the scope of the problem and the importance of acting promptly to address it.

The Board is aware and gratified that the issue of Social Security solvency has recently received increased attention on the part of academic experts, policymakers, and the public at large. The Board is, of course, also aware that among our Nation's policymakers there are strongly held differences of opinion as to what changes should be made to strengthen the program and restore its soundness. The Board continues to believe that Social Security is a foundational element in the Nation's system of retirement security and that the Board can most usefully assist the process, not by recommending any specific change or set of changes, but by providing its bi-partisan conviction that the solvency issue can and should be addressed promptly. We are therefore re-issuing our original report with modifications primarily to update it to reflect the current financial situation of the Social Security program and to broaden the scope of the report to include some issues which are now being more prominently discussed.

The Board, however, notes with concern that it has been 7 years since we first issued a report urging prompt action. While Trust Fund interest and assets will allow full benefits to be paid until 2041, the year in which Trust Fund outlays are projected to exceed tax revenues is rapidly approaching and is, in fact, just a dozen years away. In the interim, there has been, as noted above, much useful discussion. The Board cannot stress too strongly that the passage of those 7 years only increases the need for prompt action. The policy options, many of which are discussed in this report, are known to all. We urge the President and the Congress to reach a consensus. The time for bold action is upon us.

Social Security is a social insurance program to which nearly all workers, along with their employers, are required to contribute in order to provide protection against the risk of loss of wages due to retirement, disability, or death of a worker. Retired workers make up 63 percent of all beneficiaries. But the program's income protection extends beyond retired workers. About 3 out of 10 people who are now age 20 will die or become disabled before reaching age 67. Today, 13 percent of all Social Security beneficiaries are workers who are disabled and have not reached retirement age; 10 percent are spouses and children of retired and disabled workers; and 14 percent are spouses and children of deceased workers. Whatever changes are enacted, Social Security must continue to protect these vulnerable individuals.

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Some think that Social Security should become more of a retirement savings program. They propose that a portion of a worker's earnings be placed in individual investment accounts, either on a mandatory or a voluntary basis. Others believe that the program should be maintained largely as it is now, and that solvency should be maintained without making structural changes. (See page 27 for a brief description of some of the proposals that have been made to address the long-range solvency problem.) All of the proposed changes require tradeoffs. Evaluating the merits will require careful assessment of their impact on the well-being of individuals and of society at large.

In considering changes to Social Security, it will also be necessary to take into account the Medicare program. Over the next few years, legislative changes will have to be made to Medicare. Because Social Security and Medicare serve many of the same individuals and both are financed largely from payroll taxes, they share the challenge of paying for benefits for an increasing number of older persons at the same time that growth in the workforce is slowing. It will be important for policymakers to consider the impact that changes in one program may have on their ability to assure the long-range solvency of the other.

Finally, it is important to recognize that Social Security is only one part of our multi-pillar retirement income system. Social Security has always been intended to provide a foundation for retirement income that needs to be supplemented by individual savings and employer pensions. All parts of this system are in need of review since Americans as a whole are not making adequate provision for their retirement.

Social Security reform should be meshed with a strengthening of the other parts of the retirement income system, including employer pensions, individual retirement accounts, 401(k) plans, and other savings mechanisms. Considering Social Security reform within this larger context is a vital aspect of the reform process.

While this report is addressed specifically to Social Security, the Board has also issued a report, *Retirement Security: The Unfolding of a Predictable Surprise*, that deals with the need to consider Social Security in the broader context of other public and private retirement income and health programs.

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II. SOCIAL SECURITY SOLVENCY

Background of Social Security Financing

Unlike most governmental programs that are funded through annual appropriations acts, Social Security is funded through earmarked taxes. The constitutional appropriation requirement is met through a permanent provision of law that appropriates those taxes into the Social Security Trust Funds, from which benefits can be paid without further action by Congress. Confidence in the ability of the program to meet its benefit obligations depends not on the ability of the program to compete in the annual appropriations process but rather on whether those earmarked revenues will be adequate to meet the benefits promised.

From its enactment in 1935 and up to the present, the Social Security program has provided for benefits that are related to the previous earnings of the insured worker and that vary the benefit computation in such a way that workers with lower earnings receive a greater relative replacement of prior earnings than workers with higher earnings. Also from the beginnings of the program, the Social Security law has required an annual report on the ability of the program to meet its obligations in the near term and also addressing its actuarial status.

Until 1972, the Social Security law did not include provisions designed to keep the benefits and financing up-to-date with economic changes. Instead, Congress periodically adopted legislation on an ad-hoc basis that recognized the impact of price inflation by increasing the benefit levels payable for any given level of prior wages. These ad-hoc changes also recognized wage growth through adjustments in the benefit tables or formulas and by increasing the maximum amount of earnings subject to Social Security taxes and creditable toward benefits. When it made these ad-hoc changes in the Social Security provisions, Congress also tended to make changes in the maximum taxable earnings, the tax rates, or both that were designed to provide adequate revenues to meet the projected benefit costs of the modified program on both a short-range and a long-range basis.

In 1972, Congress modified the Social Security law in ways that were intended to keep benefits and financing up to date with wage and price inflation through automatic annual changes to the benefit table and to the maximum earnings level for benefit and tax purposes. The new, automatic system turned out to be highly sensitive to economic changes, and the high inflation of the early 1970s soon left the system with serious financing shortfalls both in the near term and in the long range. In 1977, Congress changed the law, adopting a new system for automatically adjusting benefits and financing in a way that was expected to be less dependent on accurate projections of the

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absolute level of wages and prices. However, even the new system depended on wage growth exceeding inflation by about 2 percentage points in the short run (and 1.75 percentage points in the long run) in order to generate financing to meet benefit costs. The economy did not cooperate. Instead of that assumed real wage growth, the late 1970s and early 1980s saw extremely high price inflation levels and negative real wage growth. This again drove the program into serious financial difficulty. By late 1981, it was clear that inadequate funds would be available to pay benefits in 1982. Congress adopted temporary legislation allowing Social Security to borrow funds from the Hospital Insurance program. It then enacted the 1983 Social Security Amendments, which included changes to benefits and revenues that enabled the program to continue paying benefits in the short term and that restored actuarial balance over the 75-year valuation period.

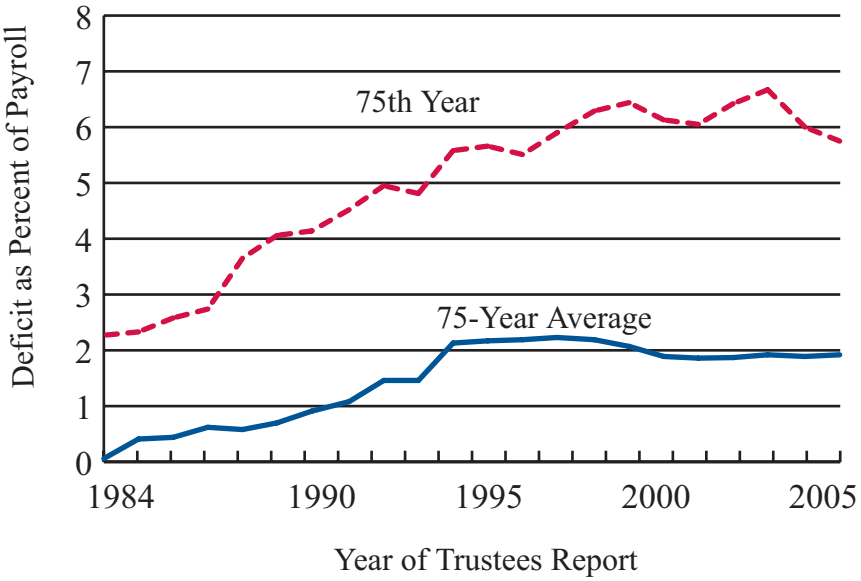
The focus of the 1977 and 1983 legislative activity was primarily on the short-term damage to the system caused by the poorly designed automatic increase mechanism adopted in 1972 and by the unusual combination of high inflation and negative real wage growth in the 1970s and early 1980s. At the same time, however, major demographic changes were taking place. Mortality at older ages was declining so that beneficiaries would be receiving benefits for more years. Fertility rates dropped to levels that would produce a stable rather than growing future workforce. The result of these trends would be a decline over coming decades in the number of workers per beneficiary.

Although the 1983 amendments restored 75-year actuarial balance on average, the financing provided for in the 1983 amendments interacted with the demographic workforce and beneficiary shifts in a manner that would accumulate Trust Fund surpluses over the first part of that period and then run deficits that would draw down those surpluses over the last part of that period. Although this financing met the traditional test of "close actuarial balance" over the entire 75-year period, it left the program with significant and growing annual deficits at the end of the 75-year period. As a result, the Trustees' Reports for each year's new 75-year valuation period would include one more year with a large deficit, continually worsening the long-range actuarial balance. Worse than expected disability experience and an unfavorable net change in assumptions and projection methods aggravated this actuarial situation. Changes in the economic outlook, in other assumptions, and methodology have, in some years, resulted in increases in actuarial balances. As shown in Chart 1, over the last dozen years, the end-of-period deficit has trended mostly upwards, but the average long-range deficit has been roughly stable at around 2 percent of taxable payroll. The demographic realities and the large end of period deficits, however, will result in a return to a deteriorating long-range outlook.

Although [the 1983 amendments'] financing met the traditional test of "close actuarial balance" over the entire 75-year period, it left the program with significant and growing annual deficits at the end of the 75-year period.

Chart 1

Social Security Deficit Projections
75-Year Average and 75th Year
1984 - 2005



The 1994-1996 Advisory Council and the Technical Panel appointed in 1999 by the Social Security Advisory Board both urged that future legislation should seek to achieve not just actuarial balance over the valuation period but also sustainable solvency. For the past several years, the Trustees' Reports have also noted that importance of "sustainable solvency" under which the Trust Fund ratios would be constant or growing over the last several years of the projection period.

Benefit Levels Under Current Law

In the early years of the Social Security program, benefits were payable only if a worker had reached age 65 and was fully retired or had only minimal earnings. Over the years, the Congress has amended these provisions of law. Individuals can begin to draw actuarially reduced benefits as early as age 62. Those who have reached the normal retirement age may receive full benefits regardless of the amount of earnings they receive from employment. The reduced benefits of individuals between age 62 and the normal retirement age who have earnings may be subject to further reduction, depending upon the amount of their earnings.

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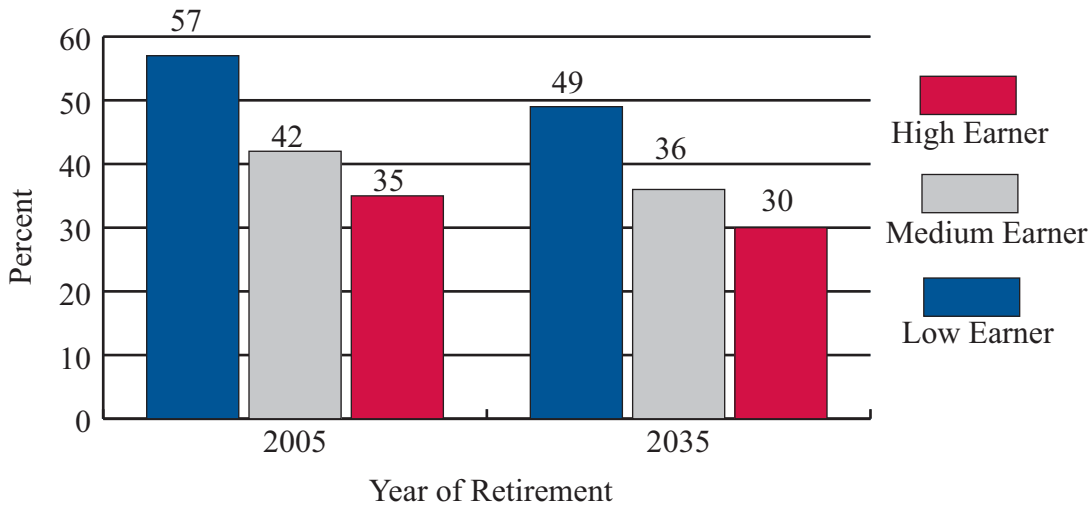
What Retired Workers Receive Now

The portion of a worker's earnings that is replaced by Social Security varies according to the worker's wage level. Low wage workers have a higher portion of their wages replaced than do higher wage workers. Chart 2 shows the portion of wages replaced ("replacement rates") for workers with different earnings levels who retire at age 65 in 2005 and in 2035.

As shown in the chart, the replacement rate for a low-wage earner retiring at age 65 in the year 2005 is about 57 percent, and for a relatively high-wage worker the replacement rate is about 35 percent.

Chart 2

Replacement Rates for Workers Retiring at Age 65 Under Current Law



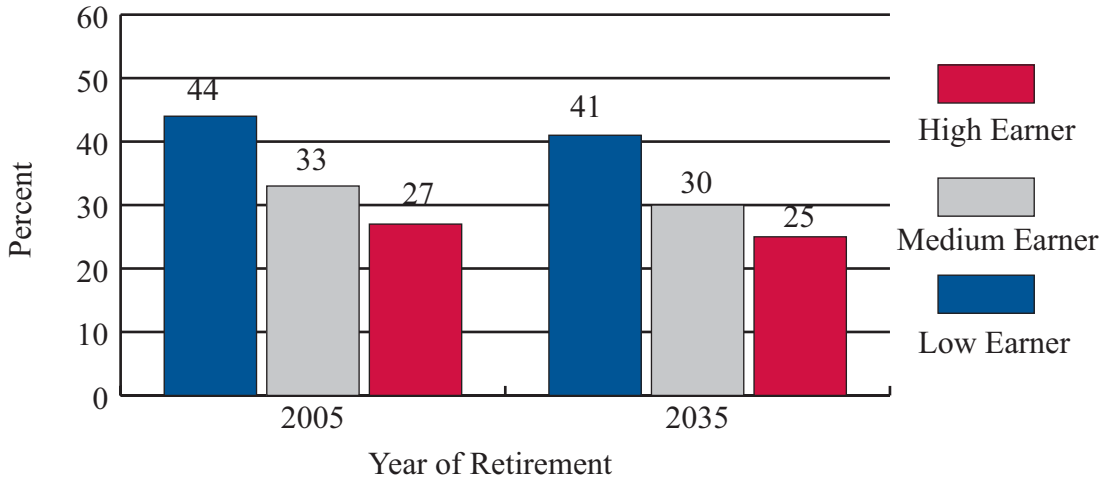
The Effect of the Scheduled Increase in the Retirement Age

As Charts 2 and 3 show, replacement rates for the retirees are dropping. This drop is occurring as a result of a change in the law in 1983, that provided for a gradual increase in the normal retirement age from age 65 to 67. The increase in the normal retirement age began for those reaching age 62 in 2000 and will be age 67 for those who will reach age 62 in 2022 or later.

Although individuals will continue to be eligible for early retirement benefits at age 62, those who elect to receive benefits at that age in the future will have their benefits actuarially reduced by more than early retirees now do. Social Security benefits for early retirees are reduced on what is termed "an actuarial equivalent" basis, so that total lifetime benefits paid to people over a longer period are made roughly equal to what would have been paid to them had they waited until normal retirement age to receive benefits.

Chart 3

Replacement Rates for Workers Retiring at Age 62 Under Current Law



For example, when the increase in the retirement age is fully phased in, people will receive 70 percent of full retirement benefits at age 62, instead of 80 percent, as was the case prior to the 1983 amendments. At age 65, people will receive 86.7 percent, rather than 100 percent. The net effect of increasing the normal retirement age for those who retire before that age is that their monthly benefits will represent a smaller percentage of their prior earnings compared to those who retired at the same age in earlier years. However, because life expectancy is increasing, they will get these benefits over what is, on average, a longer lifetime than is typical today.

Although retirement benefits for people retiring before normal retirement age will decline as a percentage of their prior wages, the actual dollar amount of benefits and their purchasing power are expected to continue to rise. (See Table 1.) The reason is that, on average, "real" wage growth (the amount by which wages are expected to grow relative to prices) is more than enough to offset the reductions in benefits caused by the increase in the retirement age. Future benefits will be based on those higher wages.

Table 1

Estimated Future Annual Benefits Payable to Workers Who Retire at Age 65 at Various Earning Levels (in 2005 dollars)

Year	Low Earner	Medium Earner	High Earner
2005	$9,003	$14,833	$19,568
2035	$10,911	$17,977	$23,840

What Will Happen When the Baby Boomers Retire?

Although the above replacement rates and benefit levels are what present law calls for, current projections of income and spending for Social Security indicate that there will not be enough money coming into the program to meet future obligations. This is because most of the money used to pay benefits for current retirees comes from the payroll taxes paid by current workers and their employers. The demographic changes that are occurring in the United States mean that in future years there will be more retirees but relatively fewer workers to pay for their benefits.

It is important to note that future deficits facing the Social Security program are largely the result of these significant and unavoidable changes occurring in the age structure of the population and not the result of expanding program coverage, increasing benefit generosity or unexpected economic conditions that have challenged the program's solvency in the past. Because there will be more beneficiaries per worker, continuing to meet the cost of currently scheduled benefits under the traditional pay-as-you-go financing arrangement would require a substantial increase in the percentage of wages used to support the program. Under the projections in the 2005 Trustees Report, the cost of the program as a percentage of earnings would grow by 70 percent between now and 2080 (from 11.13 percent of taxable earnings to 19.12 percent of taxable earnings).

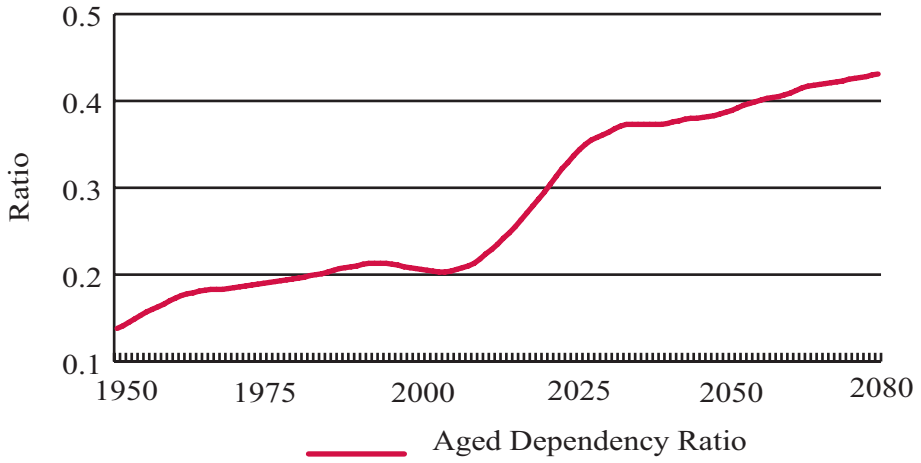
More Retirees

A major shift in the relative size of the working age and elderly populations will take place over the next 25 years. (See Chart 4.) The large numbers of people born during the post-World War II "baby boom" currently make up most of the workforce paying Social Security taxes. But they are nearing retirement age, and the oldest of the baby boomers (those born in 1946) will reach age 62 in the year 2008. By 2030, about 20 percent of the population is expected to be 65 or over as compared to about 12 percent in 2005. When the baby boomers move from being taxpayers to being beneficiaries, the cost of the Social Security program will rise quickly.

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Chart 4

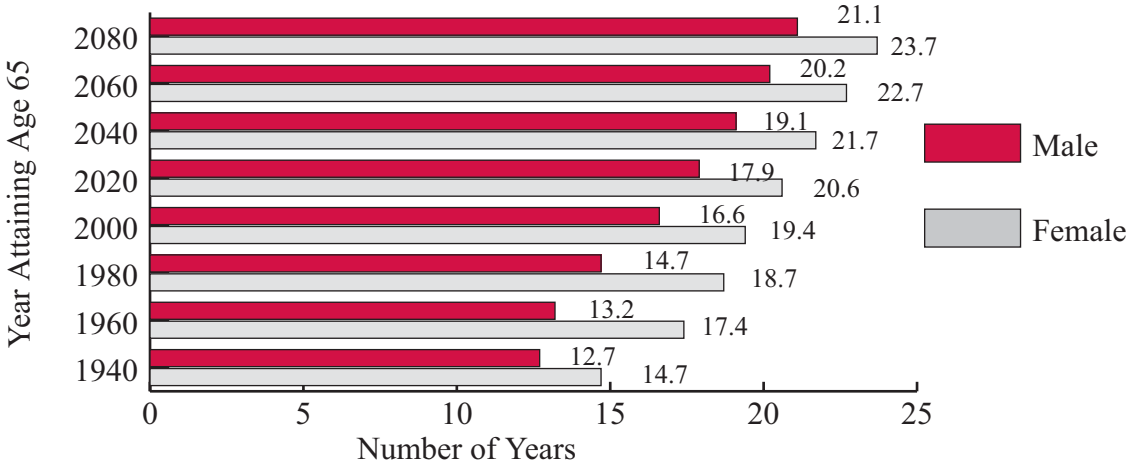
Ratio of Population Age 65 and Over to Population Age 20 to 64 1950-2080



Another factor contributing to increasing retirement costs is that people are living longer. In 1940, when the first Social Security benefits were paid, a man who reached age 65 could look forward to fewer than 13 years of life, and a woman had a life expectancy of fewer than 15 years. By 2030, when nearly all the boomers will have reached the Social Security normal retirement age, life expectancy at age 65 is projected to be over 18 years for men and more than 21 years for women. Longer lives for retirees mean more years receiving Social Security benefits. (See Chart 5.)

Chart 5

Life Expectancy at Age 65



Longer lives for retirees mean more years receiving Social Security benefits.

Relatively Fewer Workers

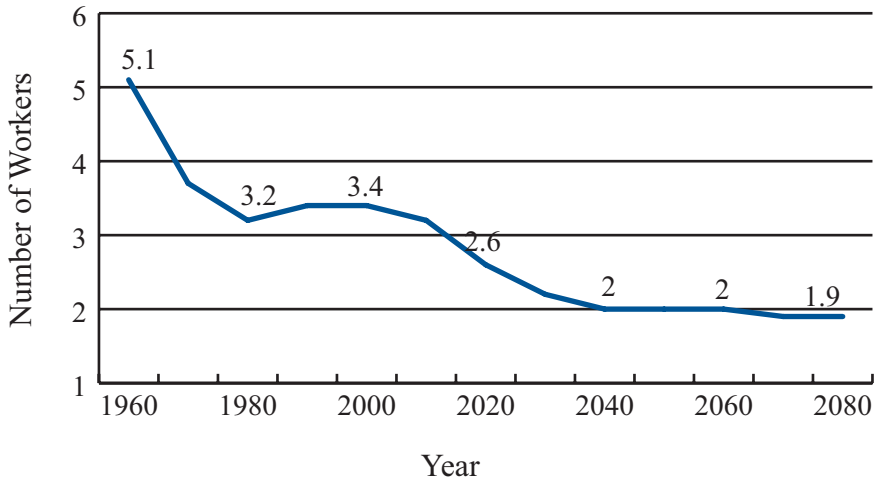
While the growing number of retirees and the increasing duration of retirement will cause spending for Social Security to grow, other factors will cause a slowdown in the growth of the labor force. The average rate of growth of the labor force slowed from the 2 percent a year it achieved from 1960 through 1989, to 1.2 percent annually over 1990-2003. Projections show this slowdown continuing to 0.9 percent from 2004-2014, 0.3 percent from 2015-2045, and 0.2 percent from 2045-2080.

The major reason for this slowdown is the decline in the birth rate that began in the 1960s. During the mid- to late-1960s, fertility began to decline dramatically, shrinking from above 3 children per woman from 1947 to 1964 to a low of just 1.74 by 1976. Since then, it has increased somewhat and has been roughly level at 2.02 to 2.03 in each of the last 4 years. Over the long run, the Social Security actuaries project a total fertility rate of about 1.95. Because of lower birth rates, there will be fewer workers to replace the baby boomers as they retire.

Another reason for the slower growth in the number of workers is that the rapid growth in labor force participation by women is expected to level off. The female labor force participation rate increased from 34 percent in 1950 to 60 percent in 2000, but has slightly declined since then to about 59 percent in 2004. Greater labor force participation among women has offset some of the costs of the growing number of Social Security retirees, but this trend appears to have leveled off.

Chart 6

Number of Workers Per Social Security Beneficiary



With more retirees and little growth in the number of workers, the ratio of workers to beneficiaries will decline substantially for several decades.

Decline in Number of Workers Per Beneficiary

Since most of the money used to pay benefits under the Social Security program comes from the payroll taxes paid by current workers and their employers, the number of workers relative to the number of beneficiaries affects the ability of society to meet obligations to retirees. With more retirees and little growth in the number of workers, the ratio of workers to beneficiaries will decline substantially for several decades. In 2004 there were 3.3 workers for every beneficiary. This ratio will decline to about 2.1 workers per beneficiary in 2035. After the year 2035, this ratio will continue to decline slowly, reflecting the increasing numbers of beneficiaries due to assumed increases in life expectancy.

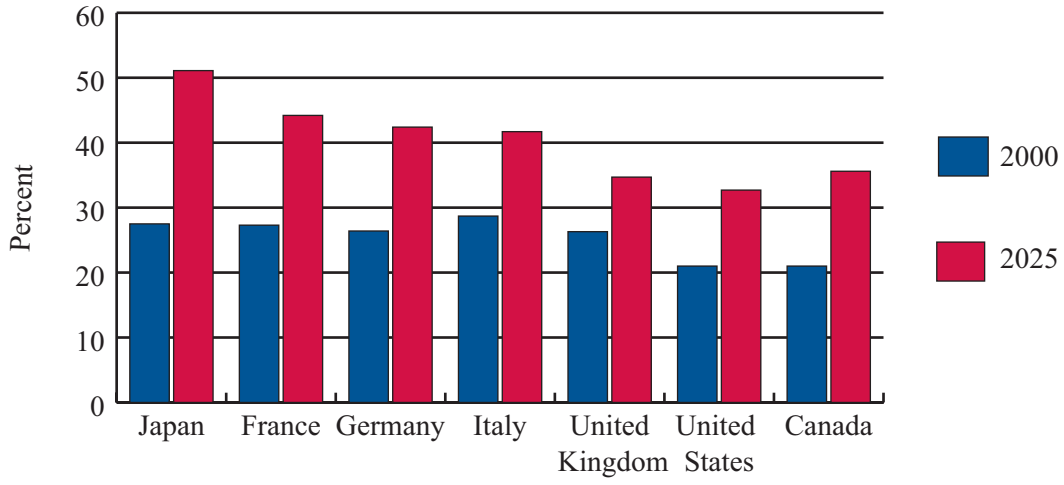
One of the principal uncertainties for the 21st century is whether the demand for labor in the economy will increase the number of jobs available for older workers and, if so, whether these workers will be willing to postpone retirement and continue to work, on either a full- or part-time basis. To the extent that older workers remain in the labor force and continue to pay into Social Security, some of the anticipated decline in the ratio of workers to beneficiaries that is reflected in Chart 6 would be reduced, and the magnitude of the financing problem would also be reduced.

Experience in Other Countries

The rapid aging of the population over the next few decades is not confined to the United States, but is manifested in countries the world over. In fact, the United States is somewhat better off than other developed countries in this regard. In 2000, in most industrialized countries, the ratio of individuals ages 65 and over to the population ages 20 to 64 ranged from about 21 percent in Canada to 29 percent in Italy. By 2025, according to projections of the U.S. Census Bureau, these ratios will have grown to amounts ranging from nearly 36 percent in Canada to more than 50 percent in Japan. For the U.S. in 2025, the ratio of older individuals to those of working age is expected to be under 33 percent, lower than in any other major industrialized country. (See Chart 7.)

Chart 7

Ratio of Population Age 65 and Over to Population Age 20 to 64



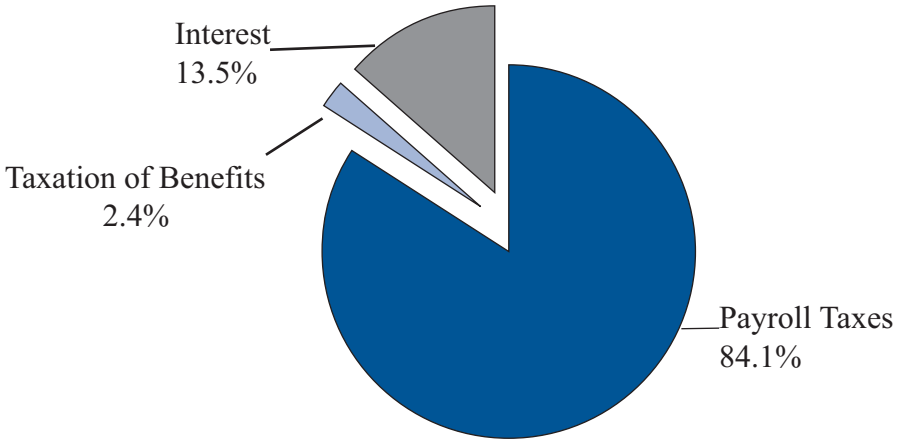
The Status of the Social Security Trust Funds

The Current Situation

In 2005, total income to the Social Security Old-Age, Survivors, and Disability Insurance Trust Funds will exceed spending by more than $163 billion. The amount of this excess income is expected to increase over the next 9 years, after which it will decline until 2027 when expenditures will exceed income. At the end of 2004, the Trust Funds had assets of about $1.7 trillion. Assets are expected to grow to $6 trillion in current dollars by 2026. By law, Social Security income that is not needed to pay benefits is invested in U.S. Treasury bonds.

In 2004, payroll taxes accounted for 84 percent of income to Social Security, interest on Trust Fund investments accounted for about 14 percent, and income from taxes on Social Security benefits accounted for about 2 percent. (See Chart 8.)

Chart 8
Sources of Income to Social Security Trust Funds in 2004
(Total income - $657.7 Billion)



Income from payroll taxes and taxes on benefits is expected to be higher than spending for benefits and administrative expenses until the year 2017. Thus, until 2017 the Social Security program will be a net plus for the Federal budget. This Social Security surplus helps to reduce the projected deficit in the so-called "unified Federal budget," which includes the operations of both the general fund of the government and a number of trust funds designated for special purposes, such as the Social Security, Medicare, and Highway Trust Funds. The U.S. Treasury borrows Social Security's surplus income, uses it for other government purposes, and issues bonds to the Social Security Trust Funds.

Spending Will Exceed Taxes in 2017

Beginning in 2017, Social Security expenditures will be higher than tax income. At that time, an amount equal to all of the tax income and a part of the interest due to the Trust Funds on outstanding bonds will be needed to pay the benefits that are due. To the extent that program costs exceed Social Security tax income, the Federal government will have to find additional funds elsewhere to meet its obligations to Social Security beneficiaries.

Spending Will Exceed Taxes Plus Interest in 2027

Beginning in 2027, Social Security spending will exceed total Social Security income (taxes plus interest on the bonds). At this point, in order to pay benefits that are due, the government will have to begin paying back the principal of the funds it has borrowed from Social Security by redeeming the bonds held by the Trust Funds.

Program Funding Will Become Insufficient to Pay Full Benefits

By cashing in the Treasury bonds in the Trust Funds, Social Security will be able to pay the full amount of promised benefits for several years after the point at which annual program costs begin to exceed annual program revenues. The exact year in which the currently large Trust Fund will be drawn down to zero depends heavily on prevailing interest rates and other short-range economic and program developments. In 1985, the exhaustion year was projected to be 2049. In 1995 the exhaustion year was projected to be 2030. In 2005, the exhaustion year is projected to be somewhere between 2041 (Trustees' projection) and 2052 (CBO projection). While projections of the exact year of exhaustion differ, the various projections agree that revenues will begin to fall short of costs, that this will draw down the Trust Funds to the point of exhaustion, and that, from that point, the program will have income that is insufficient, by a large margin, to pay benefits in full. (See Table 2.) In the analysis that follows, we will use the 2005 Trustees Report intermediate projections, but the overall outlook would be the same under the CBO projections.

Table 2

Projections of Social Security Deficit

	75-year deficit*	Year of exhaustion	Year costs first exceed revenues	Revenues as percent of costs	
				in 2040	in 2060
2005 Trustees Report	-1.92	2041	2017	76%	74%
2005 CBO (with Trustees' long-range economic assumptions)	-1.69	2044	2019	75%	74%
2005 CBO (with CBO assumptions)	-1.05	2052	2020	78%	76%
1995 Trustees Report	-2.17	2030	2013	75%	72%

* 75-year deficit as percent of taxable payroll

Key Dates For Social Security

2017 - First year expenditures exceed **tax** income; interest on Trust Funds will be needed to pay benefits

2027 - First year expenditures exceed **tax plus interest** income; Trust Fund assets will be needed to pay benefits.

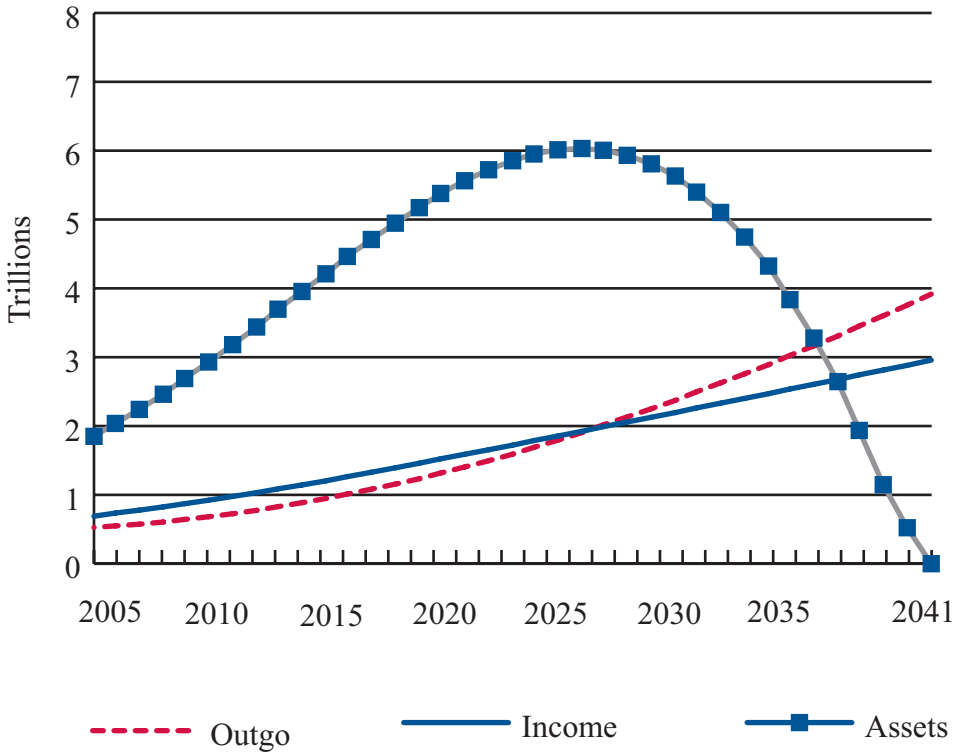
2041 - Year program Trust Fund assets are exhausted; Trust Fund income will be sufficient to pay 74 percent of benefits.

The Situation in 2041

By 2041, income to Social Security will be equal to about three-fourths of the promised benefits. However, the rate of growth in benefit obligations will increase faster than the rate of growth in tax income, so the percentage of the benefits that can be paid with current income will continue to decline, dropping to about 70 percent by the end of the 75-year estimating period. It is expected to continue to fall, but more gradually, after that. (See Chart 9.)

Chart 9

Social Security Income, Outgo, and Assets (in current dollars)



What Could Happen If No Action Is Taken Before 2041?

The Congress has never allowed the finances of the Social Security program to reach the point where benefits could not be paid, and it is not unreasonable to expect Congress to act similarly in the future. In addressing the future solvency of the Social Security program, the Congress will have many different proposals to consider.

However, as a way of gauging the significance of the projected financing shortfall, it is useful to look at what could happen in the unlikely event that no action is taken to modify Social Security by 2041 when the Trust Funds are now projected to fall to zero. At that point, there would be two basic alternatives — **large benefit cuts or large tax increases (or some combination of the two).**

A Hypothetical Illustration of the Impact of Cutting Benefits

As described above, the Social Security Trustees project that in 2041 current income to the system from taxes will be sufficient to pay about three-fourths of the Social Security benefits that beneficiaries are entitled to receive under current law. If this situation were met by cutting benefits across the board, there would have to be about a 25 percent reduction in 2041 and even larger reductions in later years (reaching about 30 percent in 2080). These reductions would have to affect not only those becoming entitled to Social Security benefits in 2041 and later but also those already receiving benefits at that time. To illustrate what it would mean if benefits were cut in this way:

- In 2041, for a medium-wage worker retiring at age-65, the projected monthly Social Security benefit of about $1,595 (in 2005 dollars) would fall to $1,180. Benefits for a low-wage earner would drop from $968 to $716.

- Initial Social Security benefits awarded to workers who retired in 2041 and after would replace significantly less of these workers' pre-retirement wages compared to the benefits awarded to those who retired in prior years. As illustrated in Chart 10, this "replacement rate" for workers who retire at age 65 would immediately fall

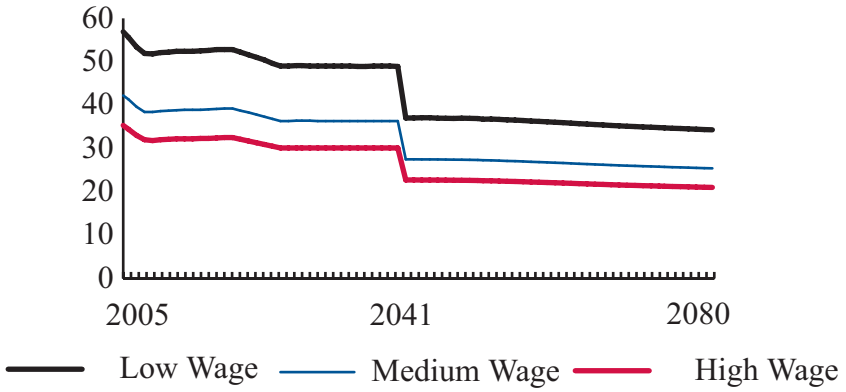
  — from 49 percent to 36 percent for low earners;
  — from 36 percent to 27 percent for medium earners; and
  — from 30 percent to 22 percent for high earners.

- Benefit cuts could mean that, in 2041 and later years, the percentage of aged people living in poverty would rise and there would be greater reliance on welfare programs, such as the Supplemental Security Income program.

The Congress has never allowed the finances of the Social Security program to reach the point where benefits could not be paid, and it is not unreasonable to expect Congress to act similarly in the future.

Chart 10

Illustration of Decline in Replacement Rates for Workers Retiring at Age 65 if No Change is Made Until 2041



A Hypothetical Illustration of the Impact of Raising Taxes

In order to continue paying full benefits in 2041 and for another 38 years thereafter, the law would have to be changed to increase Social Security taxes by almost one-half, from the current 12.4 percent (6.2 percent each for employers and employees) to about 17.5 percent (8.75 percent each for employers and employees). (See Chart 11B.)

In 2041, for a worker earning the estimated average wage of $54,949 (in 2005 dollars), this would mean an increase in Social Security taxes of $1,401 a year (from $3,407 to $4,808), levied on both the worker and the worker's employer. For a worker earning the estimated maximum taxable amount of $134,547 (in 2005 dollars), the increase would be $3,431 a year (from $8,342 to $11,773).

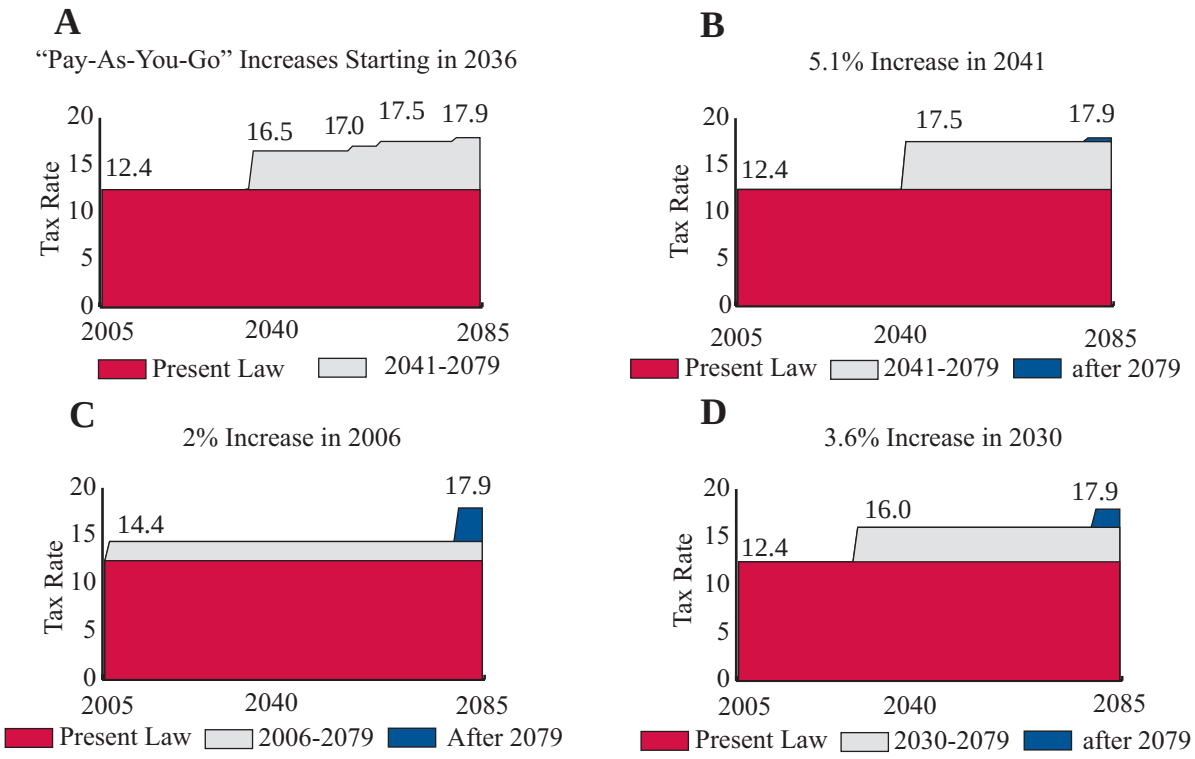
Enacting this higher tax rate around 2041 would not be sufficient to assure that Social Security benefits could be paid for an indefinite period. For 2080, the tax rate would need to be increased by an additional 0.4 percentage points (to 17.9 percent) to ensure that scheduled benefits could be paid for several years. Further small increases would be needed thereafter to maintain this ability to pay scheduled benefits assuming continued increases in longevity. (See Chart 11B.)

- A tax increase enacted close to the point of Trust Fund exhaustion would have little or no effect on people who have already retired. They would not be subject to the tax for the most part, and their benefits and replacement rates would remain at levels provided in present law.

- However, a tax increase would significantly affect people in the labor force (a group about twice as large as the retired population in 2041). And the younger the worker when the tax increase takes effect, the larger the impact, as the increased taxes accumulate over a working lifetime.

Chart 11

Tax Rates to Meet 75-Year Deficit and Continue Paying Benefits After 2079



These four charts illustrate different ways that tax rates could be structured if rate increases were used to generate sufficient revenues to pay all scheduled benefits over the next 75 years and to continue paying full benefits for a number of years at the end of that period.

Chart A assumes that the current tax rate is maintained until the Trust Fund declines to about a one-year reserve level (around 2036). Rates would then be increased on a pay-as-you-go basis sufficient to pay benefits and keep the fund at a one-year reserve (to 12.5% in 2036, 16.5% in 2037, 17% in 2058, 17.5% in 2064 and finally to 17.9% in 2080).

Chart B illustrates the scenario described on page 18 in which no action is taken until trust fund exhaustion is imminent in 2041 when the tax rate would be increased by about 5 percentage points to meet the remainder of the 75-year period with a further 0.4 of a point increase at the end of the period to a level of 17.9%.

Charts C and D illustrate the alternatives (as described on page 23) of raising the rate by about 2 percentage points in 2006 or postponing action until 2030 and then raising the rate 3.6 percentage points, with further increases to 17.9% at the end of the period in each case.

Each alternative has the same impact on the 75-year deficit, and in all scenarios the tax rate would have to be raised to 17.9% at the end of the period to continue paying full benefits.

III. THE ADVANTAGES OF ACTING SOONER RATHER THAN LATER

The Reasons for Prompt Action

As time goes by, the size of the Social Security problem grows, and the choices available to fix it become more limited. Thus, there are important reasons for making changes earlier.

- **There are more choices available earlier.** For example, the sooner you change the way Social Security benefits are calculated or the age at which people can receive benefits, the more choices you have about how to make the changes.

- **Changes can be phased in more gradually.** By acting sooner, you can avoid making extreme changes at a future crisis point, and can instead reduce benefits or increase taxes in a more gradual way. Making gradual changes avoids creation of the large differences in benefit or tax levels between successive generations of retirees and workers that result when modifications are made precipitously.

- **The cost of repairing Social Security can be spread more evenly over more generations of workers and beneficiaries.** The possibilities for distributing this cost across generations will diminish as time passes. The net effect of delaying action is to reduce or eliminate the burden of repairing Social Security on earlier generations and to place an even heavier burden on later generations.

- **The longer change is delayed, the heavier the impact will be on each individual who is affected.** Larger increases in tax rates or more severe cuts in benefits greatly increase the magnitude of the loss in well-being experienced by each individual. Conversely, making smaller changes in Social Security benefits or taxes soon, so that they could apply over several decades, would affect more people — but by less per person.

- **There will be more advance notice for those who will be affected, so they can plan for their retirement.** If, for example, there is to be a cut in benefits, workers need to know soon in order to be able to make career and investment choices that will make up for the loss of Social Security, and avoid the possibility that they could face a substantial reduction in benefits after they were at or near retirement and unable to make other arrangements.

- **Confidence in the ability of Social Security to continue to pay benefits to future generations of retirees will be strengthened.** According to a survey completed earlier this year, only 31 percent of workers polled were very or somewhat confident in the future financial viability of Social Security. Fixing the program quickly would eliminate the uncertainty that is currently eroding confidence in the program.

As time goes by, the size of the Social Security problem grows, and the choices available to fix it become more limited.

- **There will be less disruption in labor market participation.** Changes in either Social Security benefit levels or tax rates affect the work and retirement decisions of individuals and the hiring decisions of employers. Benefit cuts, for example, would likely induce some people to stay in the labor force longer, while on the other hand, payroll tax increases may in the short run cause employers to hire fewer workers and thus limit employment opportunities for older workers. The sooner that both employees and employers know about future changes in Social Security, the more time they have to alter their choices gradually and to avoid creating precipitous shifts in the availability of workers or jobs.

- **There will be less disruption in decisions about consumption and saving.** The Social Security system can affect household decisions about how much to consume and how much to save. Raising tax rates reduces the take-home pay of households and forces people to either consume less, save less, or work more. Reducing expected benefits during retirement years causes people to either save more during their working years or work more to make up for the loss, or to have a reduced standard of living in retirement. The sooner that households become aware of the changes so that they can plan ahead, the smaller would be the disruptions to consumption and saving.

Illustrating the Effects of Acting Sooner Rather Than Later

There are many ways to fix Social Security, and their impact depends on timing. The examples in the following sections illustrate how the effects on both individuals and generations would differ if certain **basic** changes were effective in **2006** or if they were delayed until **2030**.

The total deficit that needs to be closed over the 75-year estimating period is the same regardless of whether the benefit reductions or revenue increases are implemented early in the period or only as they are needed to maintain year-by-year solvency during that 75-years. However, earlier action would spread these changes over more years and a larger population within the 75-year period so that the size of the changes, in each of the years they are effective within the period, would be lower than if changes were concentrated in fewer years. Earlier action would tend to build Trust Fund surpluses temporarily. There are differences of opinion as to whether and how much this buildup would contribute to national savings and economic growth, but, to the extent it did, the faster growth in average earnings levels could help to reduce the deficit. It also is important to remember that because of the growing imbalance between the size of the beneficiary population and the size of the covered workforce, significantly larger changes will still be needed in order to achieve on-going (sustainable) solvency than are needed to meet the current 75-year deficit.

Reduce the Social Security Cost-of-Living Adjustment (COLA)

Each year, Social Security benefits are raised to reflect increases in the Consumer Price Index (CPI). Many experts believe that the CPI currently overstates the rate of inflation and suggest changes that will make it more accurate.

...earlier action would spread these changes over more years and a larger population within the 75-year period....

If the annual COLA were permanently reduced in 2006, Social Security benefits would be lower for everyone getting benefits at that time and for all future beneficiaries. Thus, the many beneficiaries born throughout the 20th century and now in their 60s, 70s, and beyond would share in bearing the cost of fixing Social Security.

If a COLA cut were put off until 2030, however, only people still alive in and after that year and receiving benefits would be affected. This means that most people born before about 1940 would not bear any cost of fixing Social Security and that people born in 1968 and later, who could retire beginning in 2030, would bear the heaviest costs throughout retirement.

In 2030, an annual COLA cut would have to be nearly twice as large, about 1.9 percentage points, in order to solve the same proportion of Social Security's long-range (75-year) financing problem that a 1 percentage point cut would solve in 2006. A larger cut is needed in 2030 because it applies for fewer years. However, the total savings to the program over the 75-year period would be the same, no matter when a cut is made.

Because COLA cuts are compounded over time, they have a cumulative effect on benefit levels, which means that they have greater impact on those individuals who live longer and receive benefits over many years. Thus, a 1 percent annual COLA reduction would reduce a retired worker's benefits below levels provided in current law by about 13 percent when the worker is age 75, and by about 21 percent at age 85.

Reduce the Benefit Formula

The formula used for calculating Social Security benefits in 2005 is 90 percent of the first $627 of average monthly earnings, 32 percent of the amount above $627 through $3,779 of earnings, and 15 percent of additional creditable earnings. The earnings amounts used in the formula are adjusted annually as average earnings in the U.S. economy increase. (The graduated structure of the formula results in more favorable treatment of workers with lower earnings because it replaces a greater percentage of pre-retirement earnings for them than it does for workers with higher earnings.)

One way to reduce program costs is to adjust the Social Security benefit formula for future beneficiaries by lowering the percentage of earnings that is replaced by benefits. A reduction in the current benefit formula beginning in 2006 would lower the percentage of earnings replaced by benefits for everyone eligible to get benefits in that year or later, that is, people born in 1944 and after. It would not affect people born earlier and already eligible for benefits.

In 2030, an annual COLA cut would have to be nearly twice as large, about 1.9 percentage points, in order to solve the same proportion of Social Security's long-range (75-year) financing problem that a 1 percentage point cut would solve in 2006. A larger cut is needed in 2030 because it applies for fewer years.

A reduction in replacement rates of about 5 percent beginning with individuals newly eligible in 2006 would solve 32 percent of the average shortfall over the next 75 years and close about 16 percent of the 75th year gap between income and outgo. If a benefit formula change is delayed until 2030, the ultimate reduction in replacement rates would have to be larger, about 10 percent, to have the same impact on the long-range (75-year) actuarial deficit. By waiting until 2030, a larger reduction is needed because it applies for fewer years. However, in either case the total savings to the program would be the same for the 75-year period.

A cut for individuals newly eligible in 2030 would reduce retirement benefits for people born in 1968 and later, and would cause them to have substantially lower replacement rates than earlier generations. Changes could be made in the benefit formula in ways that reduce benefits by the same percentage at all income levels or in ways that are not uniform across income levels. If the benefit formula is reduced uniformly across income levels, lower income beneficiaries would tend to be impacted more heavily because they have fewer alternative sources of retirement income to make up for the reduction in Social Security benefits.

Increase the Payroll Tax

As with benefit cuts, the size of the tax increases needed to fix the system would vary depending upon when they became effective. An increase in 2006 of 2 percentage points in the current Social Security tax rate, from 12.4 to 14.4 percent (7.2 percent each for employees and employers), would resolve the Social Security funding shortfall until about 2079, after which an additional tax rate increase would be needed. (See Chart 11C.) If the tax change is not put in place until 2030, the rate needed to resolve the financing problem until 2079 would be an increase of 3.6 percentage points, from 12.4 to 16.0 percent (8 percent each for employees and employers). (See Chart 11D.) By waiting until 2030, a larger increase is needed because it applies for fewer years. However, in either case, the total income to the system needed would be the same for the 75-year period, and at the end of the 75-year-period (in the absence of other program changes) the total tax needed to meet benefit costs in 2080 and several years thereafter would have to be increased again to nearly 18 percent.

Increasing Social Security tax rates in 2006 would allow the additional costs to be spread over many generations — in rough terms, people born as far back as the late 1940s would pay more. On the other hand, postponing a Social Security tax increase until 2030 would mean that most of the people born before 1968, who would be at or near retirement in that year, would avoid paying any of the additional taxes necessary to pay full benefits to them in retirement.

Social Security tax increases reduce take-home pay for everyone who is required to pay them at the time they become effective. However, because payroll taxes apply only to earnings below a

Increasing Social Security tax rates in 2006 would allow the additional costs to be spread over many generations — in rough terms, people born as far back as the late 1940s would pay more.

certain annual limit ($90,000 in 2005), tax increases have a relatively greater impact on those workers whose earnings are at or below this limit than on those with higher earnings or with income from sources other than earnings from work.

Establish Individual Investment Accounts

Establishing a system of individual investment accounts to replace part of the current Social Security system would involve a significant shift away from the current Social Security structure to a form of defined contribution system. Currently, Social Security is a defined benefit system under which individuals and their employers contribute a portion of earnings. Benefit levels are based on an individual's earnings using a formula that is specified in law. The various risks insured against are shared by all workers covered by the system. Changing circumstances, such as the demographic shifts that will be occurring in the coming decades pose a particular level of risk and uncertainty. In a situation, such as now exists, where the system is significantly out of balance with scheduled benefits that can not be paid in full with the revenue stream projected under current laws, there is a risk that the law will be changed with benefits reduced and/or taxes increased in unpredictable and unforeseen ways.

Defined contribution systems are essentially savings programs. Workers and their employers contribute to accounts for individual workers. Eventual returns under defined contribution systems are difficult to predict in advance because they depend upon the amounts invested, the length of time the funds are invested, the rate of return for individual investments over this period, and the disposition of the funds upon withdrawal. Workers may benefit from high returns on their investments, thereby enhancing their retirement income. In addition, proponents of individual accounts argue that because individual accounts would be pre-funded they could raise national saving, leading to higher national income in the future. However, under a defined contribution system, individuals also bear risks related to their personal circumstances, their personal choices on how their account is invested, and to more general economic conditions, which may or may not turn out favorably in their own particular case. The way accounts would be paid out to individuals upon retirement also matters — for example, whether they receive payments in a single lump sum or annuitized over their remaining lifetime after retirement.

In general, under a system of individual investment accounts, workers who have higher earnings and longer-term attachment to the workforce would fare better than workers who have lower earnings or whose working years are briefer. Establishing an individual account plan sooner rather than later would provide more of today's workers with a longer time period over which to build up their investments.

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Various approaches to establishing individual investment accounts have been proposed. Some propose an approach that would substitute individual accounts for some of the retirement portion of Social Security, but would retain other portions of the program, such as survivors and disability insurance. Others propose that the current Social Security system be maintained essentially as it is, but that it be supplemented by a system of mandatory or voluntary individual investment accounts.

Any plan that establishes individual accounts and increases pre-funding would involve additional costs to workers during the decades when the plan was being phased in. These costs would be incurred because workers would have to pay for two retirement systems at the same time, both the system that is making payments to current beneficiaries, and the new individual account system that would pay for some of their own retirement. Adopting an individual account plan sooner rather than later would also help in addressing transition costs if the accounts resulted in increased savings and faster economic growth. But the annual cost of the two systems would increase if the transition start date is delayed, particularly if it were to be delayed to the time when most of the baby boomers had already entered retirement.

The total contribution for workers during the transition will depend on when the new system starts. For example, if nothing is done until 2041 when the Trust Funds are exhausted, it would require a payroll tax of about 16.6 percent (8.3 percent each for employees and employers) just to pay the following year's Social Security benefits. This would be in addition to any amounts that would be needed to pay for the new system. If changes were made as early as 2006, a payroll tax of about 11 percent (5.5 percent each for employees and employers) would initially be sufficient to pay the next year's benefits. This would be in addition to any amounts needed to pay for the new system.

The impact on individuals during the transition would also vary depending upon their age at the time the new system began. Under most methods of financing the transition, current workers, particularly those ages 25 to 55, would likely bear the highest transition costs until the new system was fully phased in. Younger workers would pay higher costs for some years, followed by lower costs after the new system was fully phased in.

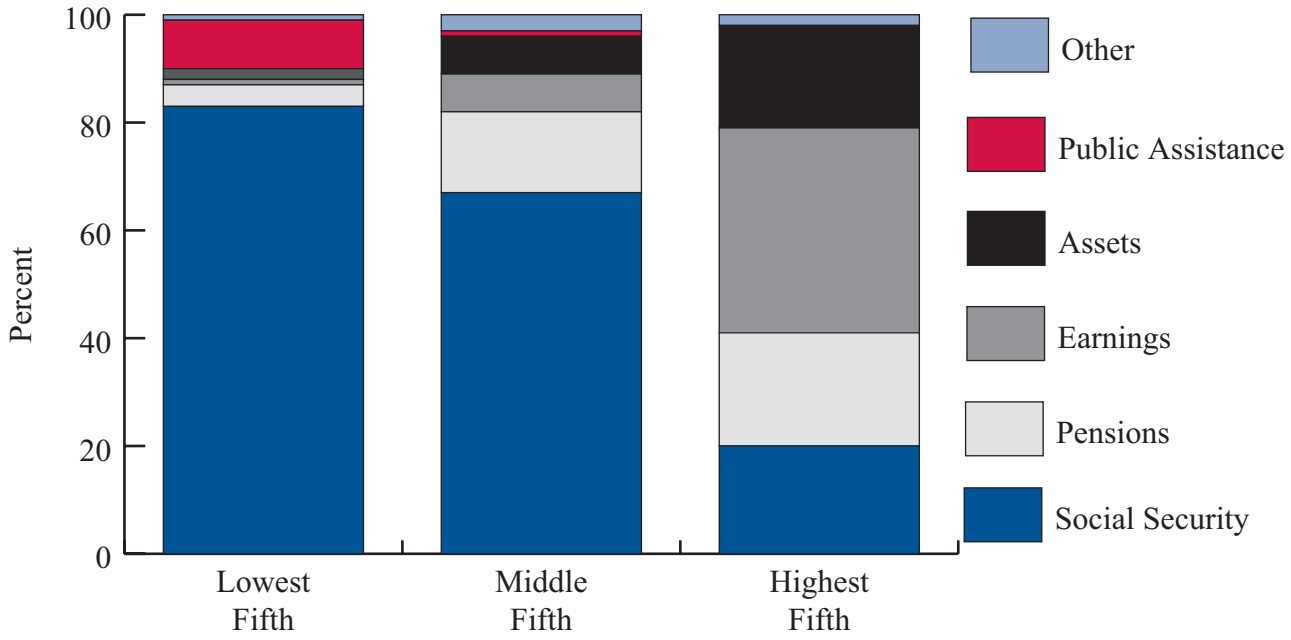
The Importance of Being Able to Plan for Retirement

Social Security is the major source of income for most of today's retirees, providing 39 percent of the total income of those age 65 and over and making up more than half of the income of about two-thirds of those in that age group. The importance of Social Security and other sources of income differs greatly across income groups. For example, Social Security provides over 83 percent of the total income of the lowest-income persons 65 and over (those in the bottom fifth of the income distribution), with public assistance accounting for the next highest portion (9 percent). For 22 percent of beneficiaries, Social Security is their only income.

For the highest-income aged (those in the top fifth), earnings are the most important source, amounting to almost 40 percent of total income. Social Security, pensions, and asset income each account for about 20 percent of income for the highest-income aged.

Chart 12

Shares of Income from Major Sources for Those 65 and Older by Level of Income, 2002



For those still in the workforce, who need to build reliable pension and investment strategies for retirement, knowing what they can expect from Social Security in future decades is a critical factor. Some changes in program benefits are already occurring. As discussed above, scheduled changes in the Social Security normal retirement age will result in a decline in Social Security replacement rates for all who retire in 2000 or later. And it is clear that other changes need to be made to remedy the funding problems created by the aging of the population. The effect of delaying change is to deprive workers unnecessarily of important information upon which they can reasonably base their lifetime plans for retirement security.

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IV. BACKGROUND INFORMATION FOR DISCUSSING THE FUTURE OF SOCIAL SECURITY

Proposals to Address the Long-Range Solvency Problem and Their Impact

Many ways have been suggested for addressing the future financing needs of Social Security. They include changes in revenues as well as in benefits. Most of the comprehensive proposals that have been made have included a combination of the two. In addition, there have been a number of different proposals to restructure the Social Security system by creating either mandatory or voluntary individual investment accounts. These accounts would supplement or replace part of the present Social Security system.

According to the actuarial estimates in the 2005 report of Social Security's Board of Trustees, the program faces a long-range shortfall in funding of 1.92 percent of payroll over the 75-year estimating period, equivalent to about $4.0 trillion in 2005 (present value). In other words, if the shortfall were to be met only by raising taxes, workers and their employers would each have to contribute about 1.0 percent of taxable wages throughout the period. This would be in addition to the 6.2 percent that each is currently paying. Future additional increases in taxes would be required to assure the program's solvency beyond the 75-year time frame. (See Chart 11.)

Whatever changes are ultimately agreed upon, over the long term, projected revenues will have to match projected spending if solvency is to be assured. Examples of ways to address the solvency issue are described below. The estimates of the impact of the changes were provided by the Social Security actuaries and show the impact of each change as a percentage reduction in the estimated shortfall in funding that exists under current law (current law tax rates and benefit levels).

The proposals described below differ not only in the extent to which they would reduce the deficit over the 75-year estimating period but also in the extent to which they would contribute to the on-going solvency of the program thereafter. The table on pages 34-37 shows both the impact on the 2005-2079 deficit and the extent to which each proposal would help to narrow the currently projected 5.7 percent of payroll gap between income and outgo at the end of the projection period.

Effects of individual changes are not necessarily additive — if adopted as part of a reform package, they could have interactive effects. The proposals described below and in the table which follows are, by no means, an exhaustive list of possibilities. Both variants of these specific proposals and completely different proposals are possible.

- **Reduce the Social Security cost-of-living adjustment (COLA).** Each year Social Security benefits are increased to reflect increases in the Consumer Price Index (CPI). Many experts believe that the CPI overstates inflation. The total size of the overstatement is a subject of dispute.

  In order to address one source of overstatement the Bureau of Labor Statistics (BLS) has developed a "superlative" CPI which will be retroactively updated

on the basis of more complete survey data and will measure substitution of consumption items. It has tended to produce a somewhat lower measure of price increases than the measure that is currently used to adjust Social Security benefits.

A reduction in the cost-of-living increase of 1 percentage point below the CPI beginning in 2006 would eliminate about 78 percent of the average 75-year deficit and about 40 percent of the final year (2079) deficit. A reduction of 0.5 percentage point would eliminate 40 percent over 75 years and 21 percent in the final year. The use of the superlative CPI (also referred to as the "chained" CPI) would eliminate about 18 percent of the 75-year deficit and 9 percent of the 75th year deficit.

These changes in the COLA would reduce cost-of-living increases for all individuals who receive benefits after the changes are effective, including both current and future beneficiaries. Because the changes would be cumulative, their effect would grow over time. The impact would increase as people live longer. For example, a 1 percentage point COLA reduction would reduce a future retired worker's benefits below levels provided in current law by about 13 percent when the worker is age 75 and by about 21 percent at age 85.

- **Increase the number of years used in calculating Social Security retirement and survivors benefits.** At the present time benefits are calculated based on a worker's highest 35 years of earnings. A gradual increase of 3 years (from 35 to 38) would eliminate 15 percent of the 75-year deficit and 8 percent of the 2079 deficit. An increase to 40 years would eliminate 24 percent of the 75-year deficit and 13 percent of the 2079 deficit.

  The effect on benefits of an increase to 38 years would depend on the worker's earnings history. For some workers it would have no effect, for others it could be close to an 8 percent reduction. On average, it would likely reduce benefits about 3 percent. Workers with fewer years of earnings than the average (including women who may have care-giving years outside of the paid workforce) would tend to have a greater reduction. This proposal would affect workers who become eligible for benefits after the change is effective.

- **Modify the formula used to calculate initial benefits to reduce benefits across the board.** An immediate across-the-board benefit reduction of 3 percent would eliminate 19 percent of the 75-year deficit and 9 percent of the 75th year deficit. A reduction of 5 percent would eliminate 32 percent of the 75 year deficit and 16 percent of the deficit for 2079. This proposal would reduce benefits for individuals who become eligible for benefits after the change becomes effective.

- **Gradually modify the middle and upper elements of the benefit formula.** The current benefit formula has 3 percentages applied to average indexed career earnings. The monthly benefit equals 90% of the lowest portion of earnings, 32% of a middle portion of earnings, and 15% of earnings at the highest end.

(The dollar amounts to which each percentage applies change every year to reflect changes in average wage levels. In 2005 the formula is 90% of the first $627 of average indexed monthly earnings, 32% of earnings from $628 to $3779, and 15% of any additional creditable earnings.) If the 32% and 15% factors that apply to the middle and upper ranges of earnings were gradually reduced over a 31-year period to 21% and 10% (for workers first eligible after 2035), 83 percent of the 75-year deficit would be eliminated and the deficit in 2079 would be reduced by 58 percent.

- **Change the rules for indexing initial benefits.** Initial benefit levels for those reaching eligibility each year are automatically modified by a set of "wage-indexing" rules that have the effect of maintaining an approximately constant percentage replacement of career pre-retirement earnings for workers at various levels (low-earner, medium-earner, etc.). These rules could be modified in any number of ways to provide lesser increases in initial benefit levels. If no automatic increases were provided (as was the case prior to 1972), both replacement rates and the purchasing power of benefits would deteriorate over time and the system would become over-financed as earnings levels rise except to the extent that Congress took action to raise benefit levels on an ad-hoc basis. One alternative to the present system would be indexing initial benefits to price inflation rather than to wage growth. This would freeze the purchasing power of benefits at the level in effect at the time of the change and would result in a continual decline in the percentage of pre-retirement earnings that benefits replace. Price indexing would more than eliminate the present 75-year deficit, accumulating to 124 percent of the deficit over 75 years, and would reach 138 percent of the 75th year deficit in 2079. By itself, it thus would result in an over-financed system. Other alternatives would be to provide financing somewhere between price and wage indexing or to use a hybrid approach with wage indexing for individuals in the lower part of the earnings distribution, price indexing for those at the highest income level, and a sliding scale between wage and price indexing at intermediate income levels. This latter approach has been referred to as "progressive" price indexing. These approaches would affect the deficit by somewhat less than full price indexing depending on how they were constructed. The impact of some alternatives are shown on pages 34 and 35.

- **Speed up the increase in the "normal retirement age" that will occur under present law; increase it beyond age 67.** Present law provides for phasing in an increase in the normal retirement age from the age of 65 that was in effect for those born prior to 1938 to age 67 for those born in or after 1960. Speeding up this increase so that it is fully in effect for those who turn age 62 in 2011 (born in 1949 or later) would eliminate 7 percent of the 75-year deficit. It would have no impact on the deficit in 2079. Further increasing the age to 68 at a rate of 1 month every 2 years, reaching 68 for those who turn 62 age in 2035 (in addition to speeding up the increase to age 67) would eliminate 27 percent of the 75-year deficit (13 percent of the 2079 deficit). A further increase to age 70 would eliminate 36 percent of the 75-year deficit (28 percent of the 2079 deficit). Increasing the normal retirement age has the effect of reducing the level of benefits for future beneficiaries.

- **Index the benefits eligibility rules to life expectancy**. Under present law, full retirement benefits are payable if taken at or after the normal retirement age which is now scheduled to increase to age 67. Benefits prior to the normal retirement age may now be taken as early as age 62 but such benefits are permanently reduced on an actuarial basis so that, on average, the same total lifetime benefits are payable regardless of whether benefits are taken at 62, at the normal retirement age, or somewhere in between. Because life expectancy is increasing, the lifetime benefits payable for any given normal retirement age will continue to increase thus raising the cost of the program. One way to offset that additional cost would be to gradually and automatically increase the normal retirement age. That would, however, require increasingly greater reductions in benefits taken at earlier ages in order to maintain the actuarial relationship. The currently scheduled increase in the normal retirement age to 67 will lower the benefit payable at age 62 to 70 percent of the full benefit from the 80 percent that was payable when full benefits were payable at age 65. One possibility to prevent a continuing decline in benefit levels taken prior to normal retirement age would be to increase the earliest eligibility age along with increases in the normal retirement age.

  Indexing the normal retirement age and the initial eligibility age could make it necessary for workers to continue in employment until older ages or to accumulate additional resources to cover their income needs in the years prior to Social Security eligibility. It would also have an impact on many employment-based plans that have built in incentives to retire at specific ages or that integrate pension and Social Security benefits. Such a change would also have implications for individuals with disabilities who might have difficulty working to older ages. Some of the savings could be offset by expenditures resulting from increased disability benefits.

  Within the 75-year estimating period, indexing the normal retirement age for longevity would be equivalent to the previously described alternative of increasing the normal retirement age to age 70 and thus would, like that provision, be expected to eliminate 36 percent of the 75-year deficit and 28 percent of the deficit for 2079. Also increasing the early eligibility age would further reduce the deficit to some extent. However, the exact amount of deficit reduction would depend on what conforming changes were made to the benefit computation rules and, because benefits are reduced if received prior to normal retirement age, the net reduction in the deficit from raising the early eligibility age would, in any case, be very small.

- **Reduce or eliminate benefits for workers with higher incomes.** The amount of savings from this change would depend on the level at which the income restrictions are applied. For example, reducing benefits by 10 percent beginning at a family income of $40,000 annually and an additional 10 percent for each $10,000 of income up to a maximum of 85 percent was estimated in 2001 to eliminate 89 percent of the deficit.[1]

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[1] Because the Social Security actuaries do not maintain data on family incomes, it was not feasible to obtain an updated estimate of an income test. However, it seems likely that the 2001 estimate would still be approximately valid if the $40,000 cut off were increased to reflect current family income levels.

Another alternative would be to limit future cost-of-living increases for individuals with higher income. These kinds of changes would introduce a "means test" for Social Security beneficiaries. It would apply to all benefits payable after the effective date of the change, including both current and future beneficiaries. It would reduce the rate of return that higher income beneficiaries receive on their Social Security taxes. It could also significantly increase the administrative burdens both on the government and on individuals to the extent that it would involve ongoing reporting and verification of family income levels.

- **Raise Social Security payroll tax rates.** An increase from the current 12.4 percent of taxable earnings (6.2 percent each for workers and their employers) to 14.4 percent in 2006 would eliminate the 75-year actuarial deficit and close 35 percent of the 2079 gap between income and outgo. An increase in the tax rate of 2.1 percentage points to 14.5 percent in 2020 with an additional increase of 2.1 percentage points to 16.6 percent in 2050 would also eliminate the 75-year deficit and close 74 percent of the 2079 income-outgo differential. Increasing payroll tax rates would not affect those already retired and receiving benefits and would have a limited effect on those close to retirement. It would have the greatest effect on young workers and those not yet in the workforce who would pay increased taxes over most or all of their working lifetime. All employers of covered workers would also contribute.

- **Increase the portion of Social Security benefits that is subject to the income tax.** Under present law, Social Security benefits are taxable only if income is above specified thresholds. One alternative would be to phase out the thresholds and tax benefits in a manner similar to that for contributory private pension income, that is, tax benefits to the extent they are expected to exceed what the worker paid in taxes. Phasing out the lower thresholds during 2006-2015, taxing benefits similar to private pensions, and putting all additional revenue raised into the Social Security Trust Funds would eliminate 17 percent of the 75-year deficit and it would remove 5 percent of the 2079 deficit.

  Most beneficiaries would pay increased income taxes. However, because the income tax is structured to protect low income people from being required to pay taxes, beneficiaries with low income would still not pay any income tax on their benefits.

- **Increase the amount of earnings subject to the Social Security tax.** In 2005, earnings in employment covered by Social Security that exceed $90,000 are neither subject to payroll tax nor considered for calculating benefits. This "contribution and benefit base" increases automatically each year with increases in the average wage. Currently, about 85 percent of all covered earnings are below the base, but this percentage has been falling from about 90 percent in 1983 and is projected to continue to fall to about 83 percent in 2014.

Making all earnings covered by Social Security subject to the payroll tax beginning in 2006, but retaining the current law limit for benefit computations (in effect removing the link between earnings and benefits at higher earnings levels), would eliminate 115 percent of the 75-year deficit and 51 percent of the deficit in 2079. If benefits were to be paid on the additional earnings, 95 percent of the 75-year deficit would be eliminated (36 percent of the 2079 deficit).

Making 90 percent of earnings covered by Social Security subject to the payroll tax and paying benefits on the additional earnings (phasing in these increases in 2006-2015) would eliminate 43 percent of the 75-year deficit (17 percent of the 2079 deficit). This would increase the estimated maximum amount of earnings subject to Social Security taxes in 2015 to $275,100, compared to the projected level of $133,500 under present law (in current dollars). These changes would cause higher-paid workers and their employers to pay higher taxes. And they would mean that higher-paid workers (those above the current taxable maximum) would receive a lower average rate of return on their Social Security taxes than they do today.

- **Extend Social Security coverage to all new employees of State and local governments.** Social Security coverage is virtually universal, with the largest excluded group being employees of a number of State and local governments (those employees who are covered by their own pension system). About 30 percent of State and local government employees are not now covered by Social Security. A proposal to cover non-student State and local employees hired after January 1, 2006, would eliminate 11 percent of the 75-year deficit. Because the newly covered workers would ultimately qualify for benefits, the proposal has minimal effect on the 2079 deficit. The impact of this change would fall on those State and local governments whose employees are currently outside the Social Security system and on all individuals hired by these entities after the effective date of the change.

- **Invest Social Security reserves in the stock market**. The impact on the long-range deficit would depend on the rate of return on stocks relative to Treasury bonds. The real interest rate on long-term bonds is projected by the actuaries to be about 3.0 percent. By comparison, over the period 1900 to 2000, the real return on investments in stocks has been about 7 percent. In estimating proposals, the standard assumption made by the Social Security actuaries is that investment in stocks would yield a 6.5 percent real rate of return. If in the future the return on stocks were 3.5 percentage points higher than the rate of return for Treasury bonds, then a 40 percent investment in stocks phased in between 2006 and 2020 would eliminate 46 percent of the 75-year deficit. If the return on stocks averages 2.5 percentage points higher than for bonds, then a 40 percent investment in stocks would eliminate 33 percent of the 75-year deficit. This would reduce the need for future benefit cuts or tax increases to maintain the solvency of the program. Questions about the government's role in managing investments in the stock market would have to be addressed. Since this proposal does not fully eliminate the deficit, it would, by itself, have no impact on the deficit in the 75th year (by which time the Trust Funds would have been exhausted).

- **Use the general revenues of the Treasury to make up the long-range deficit.** A contribution from the general fund of the Treasury to the Social Security Trust Funds could be used to make up all or a portion of the long-term deficit. The use of general revenues would be a departure from the approach historically used in the United States to finance Social Security. Unless there is a surplus in the operating budget of the Federal government, it would require increases in other taxes, tradeoffs with other government expenditures, or increased government borrowing from the public.

  The impact of using money from general revenues (which are ultimately derived largely from individual income taxes) to help pay Social Security benefits would fall on both beneficiaries and workers. Because of the progressive nature of the income tax, those with higher incomes would be affected more than those with lower incomes.

- **Require or allow workers to invest a portion of their wages in individually owned private investment accounts.** Moving to a system of individual investment accounts would enable individuals to control how their contributions are invested. The return that each worker realizes would depend on future market trends and the investment choices made by the individual.

  Replacing a part of Social Security with individual accounts would reduce the accumulation of additional benefit obligations under the Social Security program and would provide for pre-funding part of retirement benefits for account holders. However, because Social Security must continue to pay benefits to individuals who have already contributed to the current pay-as-you-go system, any transfer of taxes into individual accounts from the Social Security Trust Funds would increase Social Security's operating deficit during a transition period. Benefit cuts or additional sources of revenue would have to be found to offset the payroll tax revenue diverted to the individual accounts. These changes would be in addition to the benefit cuts or additional sources of revenue necessary to eliminate the previously existing deficit. An alternative would be to establish voluntary or mandatory individual accounts funded by an increase in the payroll tax as a supplement to the existing Social Security system, rather than as a partial replacement.

- **Return to pay-as-you-go financing.** Setting payroll tax rates at a level sufficient to pay benefits on a current-cost basis (without accumulating more than a minimal reserve) would eliminate the long-range deficit. In the short run, it could result in a payroll tax reduction of about 2 percentage points (1 percent each for employees and employers). One alternative would be to allow workers to invest the amount by which their taxes are reduced in voluntary individual accounts. After the initial lowering of rates, unless there were offsetting reductions in benefit costs, rates on a pay-as-you-go basis would rise gradually reaching current levels in approximately 10 to 15 years with increases by 2080 to about 5.5 percentage points (about 2.75 percentage points each for employees and employers) above the present 12.4 percent rate.

Options	Impact of Proposal On			
	75-Year Deficit (1.92% of Taxable Payroll)		Deficit in 2079 (5.7% of Taxable Payroll)	
	As Percent of taxable payroll	As Percent of 1.92% deficit	As Percent of taxable payroll	As Percent of 5.7% deficit
Reduce the COLA beginning in December 2006:				
By 1.0 percentage points below CPI	1.49	78	2.30	40
By 0.5 percentage points below CPI.	0.76	40	1.20	21
Use the "superlative" (or "chained") CPI for COLA beginning in 2006.	0.34	18	0.54	9
Increase number of years used to calculate benefits for retirees and survivors (phased in over 2006-2010) from 35 years to:				
38 years	0.28	15	0.43	8
40 years.	0.46	24	0.73	13
Reduce benefits across the board for those newly eligible for benefits, beginning in 2006:				
By 3 percent	0.37	19	0.54	9
By 5 percent.	0.61	32	0.90	16
Starting in 2006, gradually reduce the middle and upper benefit formula factors (32% and 15%) so that they would be reduced to 21% and 10% for workers first eligible for benefits after 2035.	1.60	83	3.29	58
Starting with benefits for workers first eligible in 2012, modify the rules for indexing so that initial benefit levels are indexed for price inflation rather than wage growth.	2.38	124	7.85	138

Options	Impact of Proposal On			
	75-Year Deficit (1.92% of Taxable Payroll)		Deficit in 2079 (5.7% of Taxable Payroll)	
	As Percent of taxable payroll	As Percent of 1.92% deficit	As Percent of taxable payroll	As Percent of 5.7% deficit
Starting with benefits for workers first eligible in 2012, modify the rules for indexing so that initial benefits are updated for price inflation for earners at the maximum level; updated for wage growth for earners below a specified thrershold; and updated on a sliding scale between price and wage growth for other earners above the threshold of earnings set at the:				
30th Percentile	1.43	74	4.62	81
40th Percentile	1.21	63	3.89	68
50th Percentile	0.97	51	2.92	51
60th Percentile.	0.68	35	1.82	32
Phase in the currently scheduled increase in the normal retirement age to 67 for those reaching age 62 in 2011 rather than 2022.	0.14	7	0	0
In addition to speeding up the increase to age 67, continue to increase the normal retirement age by 1 month every 2 years after 2011:				
to age 68	0.52	27	0.76	13
to age 70.	0.69	36	1.61	28
Index the normal retirement age for longevity. (In addition to speeding up the increase to age 67, continue to increase the normal retirement age by 1 month every 2 years after 2011 continuing indefinitely.)	0.69	36	1.61	28
Reduce benefits by 10% beginning at family income of $40,000 annually and an additional 10% for each additional $10,000 with a (maximum reduction of 85%).	NA	NA	NA	NA

Options	Impact of Proposal On			
	75-Year Deficit (1.92% of Taxable Payroll)		Deficit in 2079 (5.7% of Taxable Payroll)	
	As Percent of taxable payroll	As Percent of 1.92% deficit	As Percent of taxable payroll	As Percent of 5.7% deficit
Raise payroll tax rates by 2 percentage points for employers and employees combined starting in 2006.	1.96	102	2.00	35
Raise payroll tax rates by 2.1 percentage points in 2020-2049 and by an additional 2.1 percentage points in 2050.	1.98	103	4.21	74
Tax Social Security benefits in a manner similar to private pension income beginning in 2006. Phase out the lower income thresholds during 2006-2015.	0.33	17	0.27	5
Beginning in 2006, make all earnings subject to the payroll tax:				
-but retain the cap for benefit calculations	2.21	115	2.89	51
-and credit all earnings for benefit calculations.	1.82	95	2.06	36
Make 90 percent of earnings subject to the payroll tax and credit them for benefit purposes. (Phased in 2006-2015).	0.83	43	0.96	17
Cover newly hired state and local government employees beginning in 2006.	0.22	11	0.01	0
Invest 40% of the Trust Fund (phased in 2006-2020) and assume a real rate of return on the stocks of:				
6.5 % (standard assumption)	0.88	46	0	0
5.5 %	0.64	33	0	0
3.0% (T-bond assumption).	0	0	0	0
Transfer money from general revenues to offset the Trust Fund deficit.	Impact on Trust Fund deficit would depend on amount transferred.			

Options	Impact of Proposal On			
	75-Year Deficit (1.92% of Taxable Payroll)		Deficit in 2079 (5.7% of Taxable Payroll)	
	As Percent of taxable payroll	As Percent of 1.92% deficit	As Percent of taxable payroll	As Percent of 5.7% deficit
Use a portion of the payroll tax (e.g. 2 or 5 percent) to provide individual investment accounts.	Trust Fund deficit would be increased unless revenue loss is offset by benefit cuts.			
Allow or require workers to contribute to individual investment accounts funded by additional amounts withheld from wages.	No direct effect on the Trust Fund deficit. Benefits from these accounts would enhance retirement income.			
Return to pay-as-you-go financing and allow workers to put money saved from temporary payroll tax reduction into individual investment accounts.	Trust Fund deficit would be eliminated by raising payroll taxes as needed to meet future benefit obligations.			

Source: Estimates in this table were provided by the Office of the Chief Actuary, Social Security Administration, using the Intermediate assumptions in the 2005 Annual Report of the Board of Trustees.

Issues Raised by Proposals to Address the Long-Range Solvency Problem

The many alternatives for changing Social Security will affect beneficiaries, workers and their families, and the economy in different ways, and individuals will have different views as to the relative importance of these effects. Below are some of the questions that are likely to be raised in the ongoing discussion around the future of Social Security.

Questions relating to such basic issues as the adequacy and fairness of benefits are subjective. How they are answered and how the answers are interpreted will vary, depending on individual points of view. In addition, there will be disagreement among experts on the answers to questions relating to such matters as how specific changes will affect the economy. However, the discussion that will take place in response to these questions will help to inform the decisions that policymakers and the public must make if the future solvency of Social Security is to be assured.

Will benefits be adequate?

- Do the benefits, combined with private savings and employer pensions, provide adequate retirement income protection for workers and their families?
- Is there adequate benefit protection for workers who become disabled?
- What benefits are provided for dependents and survivors when a worker retires, dies, or becomes disabled?
- Are beneficiaries adequately protected against inflation?
- Will there be more or fewer people living in poverty?

Will costs and benefits be fair?

- Are individuals in equal circumstances treated equally?
- How will the burden of program changes be shared by current and future workers and beneficiaries?

What are the risks?

- What are the economic and political risks for workers and beneficiaries? Who will bear them?

The many alternatives for changing Social Security will affect beneficiaries, workers and their families, and the economy in different ways, and individuals will have different views as to the relative importance of these effects.

Are benefits progressive?

- Will lower wage workers receive proportionally higher benefits relative to their contributions than higher wage workers?

How will the economy be affected?

- What will happen to national savings? Will we save more or less than we do now?
- What will happen to economic growth? Will the economy grow faster or slower than it does now?

What will be the effect on the Federal budget?

- Does the proposal contribute to a budget surplus or a budget deficit? In the short term? In the long term?

What is the effect on the long-term obligations of the Federal government?

- What is the impact on total obligations?
- What is the impact on Medicare?
- Does the proposal contribute to the financial solvency and stability of Social Security for future generations?

What will be the effect on program efficiency and integrity?

- How will the proposal affect administrative efficiency?
- How will it affect the accuracy of benefit payments?

What will be the effect on public confidence, understanding, and acceptance?

- Will the proposal enhance or diminish public confidence in Social Security?
- How will the changes affect public understanding of the program?
- Are the changes consistent with maintaining broad public acceptance of the program?

Appendix I
Indexing Options

Many basic elements of Social Security are sensitive to economic and demographic changes. In the early years of the program, adjustment to the program to recognize those changes was entirely a matter of ad-hoc legislation. In the 1970s, Congress made changes to build into the program automatic mechanisms to keep the program in sync with changes in the levels of price inflation and wage growth. The first attempt to do this in 1972 turned out to be badly flawed and was replaced in 1977 with the current system that is designed to be less sensitive to variations in projected wage and price levels. Even the 1977 design, however, was overwhelmed by the high inflation and negative real wage growth of the 1970s and early 1980s.

The indexing methodology adopted in 1972 and the revised method adopted in 1977 (and still in effect) were intended to have roughly the same effect as the ad-hoc methodology previously used (except that the outcomes would be tied more closely to the exact levels of wage and price inflation). Benefit amounts for new retirees would increase from year to year in a way that reflected rising wage levels. Once that initial benefit level was determined (as of the second year prior to eligibility) it would be increased from year to year according to a price index so as to maintain a constant purchasing power. A shorthand way of referring to this is "wage indexing" of initial benefit levels and "price indexing" of ongoing benefit levels. The cost of both kinds of increases is met by rising wage levels in the economy, which bring in additional tax revenue. However, that revenue increase is constrained by the upper limit that the law places on the amount of earnings that are subject to Social Security taxes (and the growth of initial benefit levels would also ultimately be constrained by that limit). To overcome these constraints, the automatic indexing provisions also provide for an annual increase in the maximum taxable and creditable earnings to reflect rising wages.

The wage indexing of initial benefit levels results in benefits that replace approximately the same percentage of career pre-retirement earnings for each year's new group of eligible retirees. Because the benefit formula is weighted in favor of lower earners, replacement rates will vary between higher and lower earners in any given year. However, replacement rates for low earners should stay approximately the same from year to year, and the same is true for medium earners and high earners and throughout the earnings spectrum. Because wage levels tend to increase faster than price levels, keeping initial benefits indexed to wages to maintain constant replacement rates means that the purchasing power of initial benefits will rise from year to year. This is sometimes described as keeping initial benefits up to date with standards of living so that each year's new group of eligibles will have Social Security maintain the same portion of their pre-retirement standard of living as was true for past retirees with similar earnings histories.

Although wage indexing, by itself, maintains constant replacement rates over time, other changes to the program can affect (and have affected) what those replacement rates are. Replacement rates were increased by large ad-hoc benefit increases in the early 1970s and by the flawed operation of the automatic provisions adopted in 1972. In adopting the revised automatic provisions in 1977, Congress explicitly modified the benefit formula to roll back replacement rates by about 5 percent. The increases in the normal retirement age from 65 to 67, which are taking place under the 1983 amendments are also having the effect of reducing replacement rates at all levels.

Proposals have been made to modify the current indexing provisions by indexing initial benefit levels to price inflation rather than wage inflation. Such a change would maintain initial benefit levels where they are now in terms of purchasing power. It would also be possible to modify the indexing rules to provide increases that fell somewhere in between price indexing and wage indexing. That would produce initial benefit levels that increased from year to year in terms of purchasing power but not by as much as wage increases. One proposal, a hybrid approach that has been referred to as "progressive price indexing," would maintain the existing wage indexing for those with wages that fall below the 30th percentile of the earnings spectrum. For those above that level, indexing would be somewhere between wage and price indexing on a scale that would be mostly wage indexing at lower levels gradually changing to mostly price indexing at higher levels and full price indexing for maximum earners. The choice of the 30th percentile as the lower bound below which there would be full wage indexing is somewhat arbitrary and is not the only choice that could be made. Increasing the threshold below which there would be full wage indexing reduces the savings from the proposal but would also limit the extent to which the proposal would reduce replacement rates for middle and higher earners below the maximum.

Changing initial benefit indexing to something less than full wage indexing could be used to reduce benefit levels gradually to some target replacement rate or target solvency level after which wage indexing would resume. Or the change could be made a permanent part of the program. If the change were made permanent, replacement rates under Social Security would continually decline. (Under a hybrid approach, replacement rates attributable to that part of the benefit that is not fully wage indexed would decline.) To the extent that the goal of national retirement income policy is to enable individuals to maintain in retirement the standard of living that they had attained in their working years, this would mean that Social Security would play a smaller role in achieving that policy and that other forms of retirement income would have to play a greater role. Such a change on a permanent basis would also mean that the increased income to the program from rising wage levels would ultimately create Trust Fund surpluses. Congress could use those surpluses by raising benefits or reducing taxes either on an ad-hoc basis or by adding some additional automatic features.

Table 3

Benefits As Percent of Present-Law Scheduled Benefits (For Age 65 Retiree)

Year attain age 65	Present-law "payable" benefits*	Price Indexing	Price-Wage Hybrid Plans Full Wage Indexing to Percentile			
Scaled Low Earner			**30**	**40**	**50**	**60**
2016	100%	98%	100%	100%	100%	100%
2026	100%	88%	100%	100%	100%	100%
2036	100%	79%	100%	100%	100%	100%
2046	74%	71%	100%	100%	100%	100%
2056	73%	64%	100%	100%	100%	100%
2075	69%	52%	100%	100%	100%	100%
Scaled Medium Earner						
2016	100%	98%	99%	99%	100%	100%
2026	100%	88%	93%	95%	98%	100%
2036	100%	79%	88%	92%	97%	100%
2046	74%	71%	84%	88%	95%	100%
2056	73%	64%	79%	85%	94%	100%
2075	69%	52%	73%	81%	93%	100%
Scaled High Earner						
2016	100%	98%	98%	98%	98%	99%
2026	100%	88%	90%	90%	91%	93%
2036	100%	79%	82%	83%	85%	88%
2046	74%	71%	75%	77%	79%	83%
2056	73%	64%	69%	71%	74%	80%
2075	69%	52%	59%	62%	70%	80%
Steady Maximum Earner						
2016	100%	98%	98%	98%	98%	98%
2026	100%	88%	88%	88%	88%	88%
2036	100%	79%	79%	79%	79%	79%
2046	74%	71%	71%	71%	71%	71%
2056	73%	64%	64%	64%	64%	66%
2075	69%	52%	52%	52%	57%	66%

* Benefit levels that could be financed from revenues provided by current law.

Source: Estimates in this Table were provided by the Office of the Chief Actuary, Social Security Administration, using the Intermediate assumptions in the 2005 Annual Report of the Board of Trustees.

Appendix II
Recent Proposals for Which Detailed Estimates Have Been Published by the Social Security Office of the Chief Actuary or by the Congressional Budget Office

This appendix categorizes the main policy provisions of 25 specific Social Security reform plans for which the Office of the Chief Actuary has prepared a complete actuarial analysis estimating the plan's effect on the long-range financial status of the OASDI program as of July 15, 2005.[2] In this report, the plans are grouped by very general descriptions of their provisions, but much more detailed descriptions can be found in the SSA and CBO estimation memoranda. The plans detailed below all contain some combination of proposals to [1] decrease net benefits, [2] increase net revenues, [3] increase the retirement age, and/or [4] create individual accounts (IA). Under each of the 4 categories, the list shows somewhat more specific categories of provisions and the plans which include them.

NOTES:

- Included among the methods to reduce benefits are listed plans that also include some provisions to *increase* benefits for certain categories of beneficiaries such as surviving spouses, low wage earners, beneficiaries over age 85+, and recipients of non-covered government pensions.

- Although proposals to increase the retirement age and create disincentives for early retirement effectively reduce the benefit obligations of the Trust Fund in actuarial terms, they are listed separately from proposals which alter the benefit calculation formula.

- Individual accounts proposals below are differentiated only by their source of funding (almost all rely on payroll taxes re-directed to individual accounts) although they may also vary in details such as eligibility criteria, amount of funding, investment rules and disbursement of returns. A feature of many of the proposals for individual accounts is an offset provision reducing participants' future Social Security benefits so as to allow the Trust Funds to recapture the accrued value of payroll taxes diverted to the individual accounts. In the typical provision, the offset is calculated by assuming the participant's contributions had been invested at a specified rate of return and then converted to an annuity at retirement. The participant's current law benefits are then reduced by the value of the hypothetical annuity. The overall net benefit (or loss) to the participant, then, would be the excess (or shortfall) of the participant's actual account earnings compared with the statutorily assumed earnings. Financial projections and actual costs of the offset depend critically on the method of

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[2] See http://www.ssa.gov/OACT/solvency/index.html
Estimates from the Congressional Budget Office for three of the plans (Diamond/Orzag, Kolbe/Stenholm, and President's Commission Model II) can be found at http://www.cbo.gov/SocialSecurity.cfm

calculating the hypothetical account returns, specifically on the choice of an assumed rate of return. Many of the plans also attempt to protect participants against a net reduction in benefits by providing for a guaranteed minimum benefit level equal to either the poverty line (or some fraction thereof) or current law benefits. The minimums are guaranteed either by General Revenues or mandatory purchases of equivalent annuities at retirement. In the table below, neither offset provisions nor guaranteed minimum provisions are listed separately among the policy mechanisms shown.

- In the table below, multiple plans by the same author(s) are distinguished by the year in which the Office of the Chief Actuary completed their estimates of the plan's financial effects. Some plans introduced at different times by the same author(s) contain different proposals. Some contain the same proposals but were submitted for cost estimates at different dates. Readers who wish to examine the estimates by the Chief Actuary should note that the technical assumptions and methods used to make estimates can and do change in each year's Trustee's Report. Consequently, actuarial estimates of identical or very similar plans (or provisions within plans) evaluated in different years may not be the same. In addition, estimates of the same plan by the Chief Actuary and the Congressional Budget Office, where available, may differ because of methodologies and assumptions unique to each agency.

I. Plans with provisions that reduce OASI benefits

A. Reduce Cost of Living Adjustment (4 plans)
Ball (2005); Kolbe/Stenholm (2004); Ball (2003); Kolbe/Stenholm (2001)

B. Increase number of years used to compute average earnings (3 plans)
Kolbe/Stenholm (2004); DeFazio (2001); Kolbe/Stenholm (2001)

C. Index benefits to estimated longevity (6 plans)
Hagel (2005); Kolbe/Stenholm (2004); Diamond/Orzag (2003); Pozen (2002); President's Commission Model III (2002); Kolbe/Stenholm (2001)

D. Change benefit formula—disproportionate reductions for higher wage earners (7 plans)
(Note: includes indexing, and redefinition of "bend points" and replacement factors)
Pozen (2005); Kolbe/Stenholm (2004); Diamond/Orzag (2003); Smith (2003); Pozen (2002); President's Commission Model III (2002); Kolbe/Stenholm (2001)

E. Index initial benefits by price inflation rather than wage growth (3 plans)
Johnson, for those not participating in IA (2005); Graham (2003);
President's Commission Model II (2002)

F. Increase benefits for selected groups of beneficiaries (11 plans)
(Note: may include surviving spouses, low wage earners, ages 85+, credit for years of child care)
Shaw (2005); Kolbe/Stenholm (2004); Diamond/Orzag (2003); Graham (2003); Smith (2003); Shaw (2003); Pozen (2002); President's Commission Model II (2002); President's Commission Model III (2002); Shaw (2001); DeFazio (2001)

II. Plans that increase revenues available to the OASDI Trust Funds

A. Increase payroll tax rate (3 plans)
Ball (2005); Diamond/Orzag (2003); Graham option 3 (2003)

B. Increase amount of earnings subject to payroll tax (7 plans)
(Note: some plans specify a target limit as a percentage of OASDI covered earnings, some propose a surcharge on earnings above the taxable earnings limit)
Ball (2005); Kolbe/Stenholm (2004); Diamond/Orzag (2003); Ball (2003); Pozen (2002); DeFazio (2001); Kolbe/Stenholm (2001)

C. Cover all new State and local government employees (3 plans)
Ball (2005); Diamond/Orzag (2003); Smith (2003)

D. Apply estate tax revenue to Trust Funds (1 plan)
Ball (2005)

E. Transfer General Fund revenues to Trust Funds (15 plans)
DeMint (2005); Ryan/Sununu (2005); Hagel (2005); Johnson (2005); Pozen (2005); Ryan (2004); Kolbe/Stenholm (2004; Ferrara (2003); Graham (2003); Smith (2003); Pozen (2002); President's Commission Model II (2002); President's Commission Model III (2002); DeMint/Armey (2001); Kolbe/Stenholm (2001)

F. Partial investment of Trust Funds in equities (2 plans)
(Note: this constitutes an addition to the Trust Funds if invested funds earn a positive return)
Ball (2005); DeFazio (2001)

III. Plans that increase retirement age:

A. Raise retirement age 1 year to 68 (1 plan)
Hagel (2005)

B. Accelerate current law increase in retirement age (3 plans)
Kolbe/Stenholm (2004); Smith (2003); Kolbe/Stenholm (2001)

C. Incentives in benefit formula to work past minimum retirement age (3 plans)
Hagel (2005); Kolbe/Stenholm (2004); Kolbe/Stenholm (2001)

IV. Plans that create individual accounts

A. Create Individual Accounts financed by General Revenues (3 plans)
Shaw (2005); Shaw (2003); Shaw (2001)

B. Create Individual Accounts financed by payroll tax re-direction (17 plans)
DeMint (2005); Ryan/Sununu (2005); Hagel (2005); Johnson (2005); Pozen (2005); Ryan (2004); Kolbe/Stenholm (2004) ; Ferrara (2003); Graham (2003); DeMint (2003); Smith (2003); Pozen (2002) ; President's Commission Model I (2002); President's Commission Model II (2002); President's Commission Model III (2002); DeMint/Armey (2001); Kolbe/Stenholm (2001)

C. Create Individual Accounts financed by General Fund Transfers Equal to Trust Fund Surpluses (1 plan)
McCrery/Shaw/Johnson/Ryan/Shadegg (2005)

List of Long-Range Solvency Plans with Completed Estimates of Long-Range Financial Effects by the Office of the Chief Actuary, SSA

Ordered from most recent by date of estimate (as of 7/15/05)
(See http://www.ssa.gov/OACT/solvency/index.html for full text of estimates)

Author(s): Representative Jim **McCrery**, Representative E. Clay **Shaw**, Jr., Representative Sam **Johnson**, Representative Paul **Ryan**, Representative John **Shadegg**, *et al.*
Title: *Growing Real Ownership for Workers Act of 2005*
H.R. 3304 (109th Congress)
Date estimated: July 15, 2005 (using 2005 Trustees Report intermediate assumptions)

Author(s): Senator Jim **DeMint**
Title: *Stop the Raid on Social Security Act of 2005*
S.1302 (109th Congress)
Date estimated: June 23, 2005 (using 2005 Trustees Report intermediate assumptions)

Author(s): Representative E. Clay **Shaw**, Jr.
Title: *Social Security Guarantee Plus Act of 2005*
H.R. 750 (109th Congress)
Date estimated: May 12, 2005 (using 2004 Trustees Report intermediate assumptions)

Author(s): Representative Paul **Ryan** and Senator John **Sununu**
Title: *Social Security Personal Savings Guarantee and Prosperity Act of 2005*
H.R. 1776, S. 857 (109th Congress)
Date estimated: April 20, 2005 (using 2004 Trustees Report intermediate assumptions)

Author(s): Robert M. **Ball**
Title: *Proposal with Six Provisions That Would Improve Social Security Financing*
Date estimated: April 14, 2005 (using 2004 Trustees Report intermediate assumptions)

Author(s): Senator Chuck **Hagel**
Title: *The Saving Social Security Act of 2005*
S. 540 (109th Congress)
Date estimated: March 10, 2005 (using 2004 Trustees Report intermediate assumptions)

Author(s): Representative Sam **Johnson**
Title: *Individual Social Security Investment Program Act of 2005*
H.R. 530 (109th Congress)
Date estimated: February 15, 2005 (using 2004 Trustees Report intermediate assumptions)

Author(s): Robert **Pozen**
Title: *A Comprehensive Social Security Reform Proposal Including Progressive Price Indexing*
Date estimated: February 10, 2005 (using 2004 Trustees Report intermediate assumptions)

Author(s): Representative Paul **Ryan**
Title: *Social Security Personal Savings and Prosperity Act of 2004*
H.R. 4851 (108th Congress)
Date estimated: July 19, 2004 (using 2003 Trustees Report intermediate assumptions)

Author(s): Representative Jim **Kolbe** and Representative Charles **Stenholm**
Title: *Bipartisan Retirement Security Act*
H.R. 3821 (108th Congress)
Date estimated: February 11, 2004, adjusted February 25, 2004 (using 2003 Trustees Report intermediate assumptions) (Note: CBO estimation of effects completed July 21, 2004 (using CBO assumptions))

Author(s): Peter **Diamond** and Peter **Orszag**
Title: *A Proposal to Restore Solvency to the Social Security Program*
Date estimated: October 8, 2003 (using 2003 Trustees Report intermediate assumptions)
Note: CBO estimation of effects completed December 12, 2004 (using CBO assumptions)

Author(s): Peter **Ferrara**
Title: *The Progressive Personal Account Plan*
Date estimated: December 1, 2003, April 6, 2004 (using 2003 Trustees Report intermediate assumptions)

Author(s): Senator Lindsey **Graham**
Title: *Social Security Solvency and Modernization Act of 2003*
S. 1878 (108th Congress)
Date estimated: November 18, 2003 (using 2003 Trustees Report intermediate assumptions)

Author(s): Robert M. **Ball**
Title: *Two Provisions that Would Improve Social Security Financing Plus a Balancing Tax-Rate Increase*
Date estimated: October 10, 2003 (using 2003 Trustees Report intermediate assumptions)

Author(s): Representative Jim **DeMint**
Title: *Social Security Savings Act of 2003*
H.R. 3177 (108th Congress)
Date estimated: September 26, 2003 (using 2003 Trustees Report intermediate assumptions)

Author(s): Representative Nick **Smith**
Title: *Retirement Security Act*
H.R. 3055 (108th Congress)
Date estimated: September 10, 2003 (using 2003 Trustees Report intermediate assumptions)

Author(s): Representative E. Clay **Shaw**, Jr.
Title: *Social Security Guarantee Plus Act of 2003*
H.R. 75 (108th Congress)
Date estimated: January 7, 2003 (using 2002 Trustees Report intermediate assumptions)

Author(s): Robert **Pozen**
Title: *A Three-Part Proposal to Reform the Social Security Program*
Date estimated: November 4, 2002 (using 2002 Trustees Report intermediate assumptions)

Author(s): **President's Commission** to Strengthen Social Security
Title: *Model 1*
Date estimated: January 31, 2002 (using 2001 Trustees Report intermediate assumptions)

Author(s): **President's Commission** to Strengthen Social Security
Title: *Model 2*
Date estimated: January 31, 2002 (using 2001 Trustees Report intermediate assumptions)
Note: CBO estimation of effects completed July 21, 2004 (using CBO assumptions)

Author(s): **President's Commission** to Strengthen Social Security
Title: *Model 3*
Date estimated: January 31, 2002 (using 2001 Trustees Report intermediate assumptions)

Author(s): Representative Jim **DeMint** and Representative Richard **Armey**
Title: *Social Security Ownership and Guarantee Act of 2001*
H.R. 3535 (107th Congress)
Date estimated: December 19, 2001 (using 2001 Trustees Report intermediate assumptions)

Author(s): Representative E. Clay **Shaw**, Jr.
Title: *Social Security Guarantee Plus Plan*
H.R. 3497 (107th Congress)
Date estimated: December 13, 2001 (using 2001 Trustees Report intermediate assumptions)

Author(s): Representative Peter **DeFazio**
Title: *Social Security Stabilization and Enhancement Act of 2001*
H.R.3315 (107th Congress)
Date estimated: November 30, 2001 (using 2001 Trustees Report intermediate assumptions)

Author(s): Representative Jim **Kolbe** and Representative Charles **Stenholm**
Title: *21st Century Retirement Act*
H.R. 2771 (107th Congress)
Date estimated: August 24, 2001, October 2, 2001 (using 2001 Trustees Report intermediate assumptions)

GLOSSARY

Actuarial reduction. Downward adjustment of monthly benefit levels for early retirees so that total expected lifetime benefits paid to them over their longer periods of retirement will be roughly equal to what would have been paid to them had they waited until normal retirement age to receive benefits.

Disability. For Social Security purposes, the inability to engage in substantial gainful activity by reason of any medically determinable physical or mental impairment that can be expected to result in death or to last for a continuous period of not less than 12 months. Special rules apply for workers whose disability is based on blindness.

Earnings. Wages and salaries from employment and net earnings from self-employment. Data in this report referring to low, medium, or high earners are based on estimates from the Social Security Actuaries using their "scaled earner" methodology.

- **Low—**Earnings that equal 45 percent of the average wage.
- **Medium—**Earnings that are equal to 100 percent of the average of all wages in the economy ($36,600 in 2005).
- **High—**Earnings that equal 160 percent of the average wage.

Intermediate assumptions. The "best estimates" of the Trustees of the Social Security Trust Funds of likely future demographic and economic conditions.

Normal retirement age. The age at which a person can first become entitled to unreduced retirement benefits. For persons who reached age 62 before 2000, the normal retirement age is 65. It will increase gradually to 67 for persons reaching age 62 in 2022 or later, beginning with an increase to 65 years and 2 months for persons who reached age 62 in 2000.

Pay-as-you-go financing. A financing scheme where taxes are scheduled to produce just as much income as required to pay current benefits, with Trust Fund assets built up only to the extent needed to prevent exhaustion of the fund by short-term economic fluctuations.

Payroll taxes. A tax levied on the gross wages of workers and on net earnings from self-employment up to a taxable maximum ($90,000 in 2005).

Present value. The equivalent value, at the present time, of a future stream of payments (either income or expenditures). The present value of a future stream of payments may be thought of as the lump sum amount that, if invested today, together with interest earnings would be just enough to meet each of the payments as they fell due. At the time of the last payment, the invested fund would be exactly zero.

Replacement rates. The percentage of earnings replaced by Social Security benefits at retirement or disability.

Taxation of benefits. Amendments in 1983 required beneficiaries with income of more than $25,000 if single, and $32,000 if married, to include up to 50 percent of their benefits in their taxable income, beginning in 1984. Revenues from this provision are credited to the Social Security Trust Funds. Amendments in 1993 required beneficiaries with incomes of more than $34,000 if single, and $44,000 if married, to include up to 85 percent of their benefits in their taxable income, beginning in 1994. The additional revenues from this provision are credited to the Medicare Hospital Insurance Trust Fund.

Trust Funds. Separate accounts in the United States Treasury into which Social Security income from payroll taxes and other sources is deposited, and from which benefits and other expenses are paid. Funds not used for current expenses are invested in Government securities, as required by law, and the interest earned is also deposited in the Trust Funds.

SOCIAL SECURITY ADVISORY BOARD

Hal Daub, Chairman

Hal Daub is currently a partner in the law firm of Blackwell Sanders Peper Martin in Omaha, Nebraska and Washington, D.C. Previously, he was President and Chief Executive Officer of the American Health Care Association and the National Center for Assisted Living. He served as Mayor of Omaha, Nebraska from 1995 to 2001, and was an attorney, principal, and international trade specialist with the accounting firm of Deloitte & Touche from 1989 to 1994. Mr. Daub was elected to the U.S. Congress in 1980, and reelected in 1982, 1984, and 1986. While there he served on the House Ways and Means Committee, the Public Works and Transportation Committee, and the Small Business Committee. In 1992, Mr. Daub was appointed by President George H.W. Bush to the National Advisory Council on the Public Service. From 1997 to 1999, he served on the Board of Directors of the National League of Cities, and from 1999 to 2001, he served on the League's Advisory Council. He was also elected to serve on the Advisory Board of the U.S. Conference of Mayors, serving a term from 1999 to 2001. From 1971 to 1980, Mr. Daub was vice president and general counsel of Standard Chemical Manufacturing Company, an Omaha-based livestock feed and supply firm. A former U.S. Army Infantry Captain, he is a Distinguished Eagle Scout, 33rd Degree Mason, is active in the Salvation Army, Optimists International and many other charitable and philanthropic organizations. He is the current chairman-elect of the Community Health Charities of America. Mr. Daub is a graduate of Washington University in St. Louis, Missouri, and received his law degree from the University of Nebraska. Term of office: January 2002 to September 2006.

Dorcas R. Hardy

Dorcas R. Hardy is President of DRHardy & Associates, a government relations and public policy firm serving a diverse portfolio of clients. After her appointment as Assistant Secretary of Human Development Services, Ms. Hardy served as Commissioner of Social Security from 1986 to 1989 and was recently appointed by President Bush to chair the Policy Committee for the 2005 White House Conference on Aging. Ms. Hardy has launched and hosted her own primetime, weekly television program, "Financing Your Future," on Financial News Network and UPI Broadcasting and "The Senior American," an NET political program for older Americans. She speaks and writes widely about domestic and international retirement financing issues and entitlement program reforms and is the author of *Social Insecurity: The Crisis in America's Social Security System and How to Plan Now for Your Own Financial Survival*, Random House, 1992. Ms. Hardy consults with seniors' organizations, public policy groups and businesses to promote redesign and modernization of the Social Security, Medicare and disability insurance systems. Additionally, she has chaired a Task Force to rebuild vocational rehabilitation services for disabled veterans for the Department of Veterans Affairs. She received her B.A. from Connecticut College, her M.B.A. from Pepperdine University and completed the Executive Program in Health Policy and Financial Management at Harvard University. She is a Certified Senior Advisor and serves on the Board of Directors of The Options Clearing Corporation, Wright Investors Service Managed Funds, and First Coast Service Options. First term of office: April 2002 to September 2004. Current term of office: October 2004 to September 2010.

Martha Keys

Martha Keys served as a U.S. Representative in the 94th and 95th Congresses. She was a member of the House Ways and Means Committee and its Subcommittees on Health and Public Assistance and Unemployment Compensation. Ms. Keys also served on the Select Committee on Welfare Reform. She served in the executive branch as Special Advisor to the Secretary of Health, Education, and Welfare and as Assistant Secretary of Education. She was a member of the 1983 National Commission (Greenspan) on Social Security Reform. Martha Keys is currently consulting on public policy issues. She has held executive positions in the non-profit sector, lectured widely on public policy in universities, and served on the National Council on Aging and other Boards. Ms. Keys is the author of *Planning for Retirement: Everywoman's Legal Guide*. First term of office: November 1994 to September 1999. Current term of office: October 1999 to September 2005.

David Podoff

David Podoff was a senior advisor to the late Senator Daniel Patrick Moynihan on Social Security and other issues while serving as Minority Staff Director and Chief Economist for the Senate Committee on Finance. While on the Committee staff he was involved in major legislative debates with respect to the long-term solvency of Social Security, health care reform, the constitutional amendment to balance the budget, the debt ceiling, plans to balance the budget, and the accuracy of inflation measures and other government statistics. Prior to serving with the Finance Committee he was a Senior Economist with the Joint Economic Committee and directed various research units in the Social Security Administration's Office of Research and Statistics. He has taught economics at the Baruch College of the City University of New York, the University of Massachusetts and the University of California in Santa Barbara. He received his Ph.D. in economics from the Massachusetts Institute of Technology and a B.B.A. from the City University of New York. Term of office: October 2000 to September 2006.

Sylvester J. Schieber

Sylvester J. Schieber is Vice President/U.S. Director of Benefits Consulting at Watson Wyatt Worldwide, where he specializes in analysis of public and private retirement policy issues and the development of special surveys and data files. From 1981 to 1983, Mr. Schieber was the Director of Research at the Employee Benefit Research Institute. Earlier, he worked for the Social Security Administration as an economic analyst and as Deputy Director at the Office of Policy Analysis. Mr. Schieber is the author of numerous journal articles, policy analysis papers, and several books including: *Retirement Income Opportunities in An Aging America: Coverage and Benefit Entitlement*, *Social Security: Perspectives on Preserving the System* and *The Real Deal: The History and Future of Social Security*. He served on the 1994 - 1996 Advisory Council on Social Security. He received his Ph.D. from the University of Notre Dame. First term of office: January 1998 to September 2003. Current term of office: October 2003 to September 2009.

MAKING ASSUMPTIONS ABOUT THE FUTURE

Projections about the financial status of the Social Security programs are based in part on things already known and in part on things about which assumptions have to be made regarding what will happen in the future.

With respect to demographic factors, all of those who will be retiring and most of those who will be in the workforce over the next few decades have already been born, so the sizes of the working and retired populations over that period are fairly well known. But there are some uncertainties concerning the population; for example, the rate at which life expectancy will increase and the number of immigrants who will join the workforce.

Economic factors are also critical in making projections about the future of Social Security, and they are far less certain than the key demographic factors. Perhaps most important is how fast wages will rise relative to increases in prices; that is, the increase in "real wages." If real wage increases (wage increases relative to price increases) are greater than currently anticipated, then the Social Security program will be in a position to meet more of its future benefit obligations. But if they are not as high as now projected, Social Security's ability to pay benefits will be reduced.

Unemployment and labor force assumptions are also important. If more people are working in the future than are now expected (including possibly a greater portion of the elderly), there will be more workers paying taxes to support beneficiaries, and the financing picture will be improved. However, if there are fewer workers the financing picture will be worse than expected.

Actuaries in the Social Security Administration analyze these and other data in order to project the future of the Social Security programs. Their projections help the Congress, the President, and the public evaluate the financial condition of the programs and the impact of any changes.

The numbers used in this document are derived primarily from information provided by the Office of the Chief Actuary of the Social Security Administration and reflect the intermediate assumptions of the *2005 Report of the Trustees of the Old-Age, Survivors, and Disability Insurance Trust Funds*. Information on income of the aged comes from SSA's Office of Research, Evaluation, and Statistics, and data on foreign populations is based on projections by the U.S. Census Bureau. Information on the budget comes from the fiscal year 2006 President's Budget and supporting materials.

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