Presentation to New York City Office of the Actuary

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Outline

1) Background and results from the 2017 Trustees Report
2) Challenges and selected issues
    - Aging
    - Mortality
    - Disability
    - Earnings dispersion
    - Adequacy of benefits
    - Budget scoring
3) Potential long-term solutions

Social Security Trust Funds

- Two legally distinct trust funds:
  - OASI = Old-Age and Survivors Insurance
  - DI = Disability Insurance
- Financial operations are overseen by the Social Security Board of Trustees
- The two funds are often looked at on a theoretical combined basis and referred to as OASDI
  - As of December 31, 2016, the OASDI trust funds hold about $2.85 trillion in asset reserves

How Is Social Security Financed (Income)?

- Payroll taxes
  - Employees and employers each pay 6.2% of covered earnings
  - The self-employed pay 12.4% of covered earnings
  - On earnings up to $127,200 in 2017
- Taxes on Social Security benefits
  - High-income beneficiaries pay federal income tax on their benefits
- Interest on trust fund reserves
  - Invested in interest-bearing securities of the US government

Where Does the Money Go (Outgo)?

- Benefit payments
  - About 61 million people getting benefits as of December 2016:
    - 44 million retired workers and dependents of retired workers
    - 6 million survivors of deceased workers
    - 11 million disabled workers and dependents of disabled workers
  - Benefits are:
    - Calculated using the highest 35 years of wage-indexed earnings
    - Calculated using a progressive benefit formula
    - Increased each year with COLA based on CPI-W
- Administrative expenses
  - Only about 0.7 percent of total expenditures in 2016

Social Security Financing

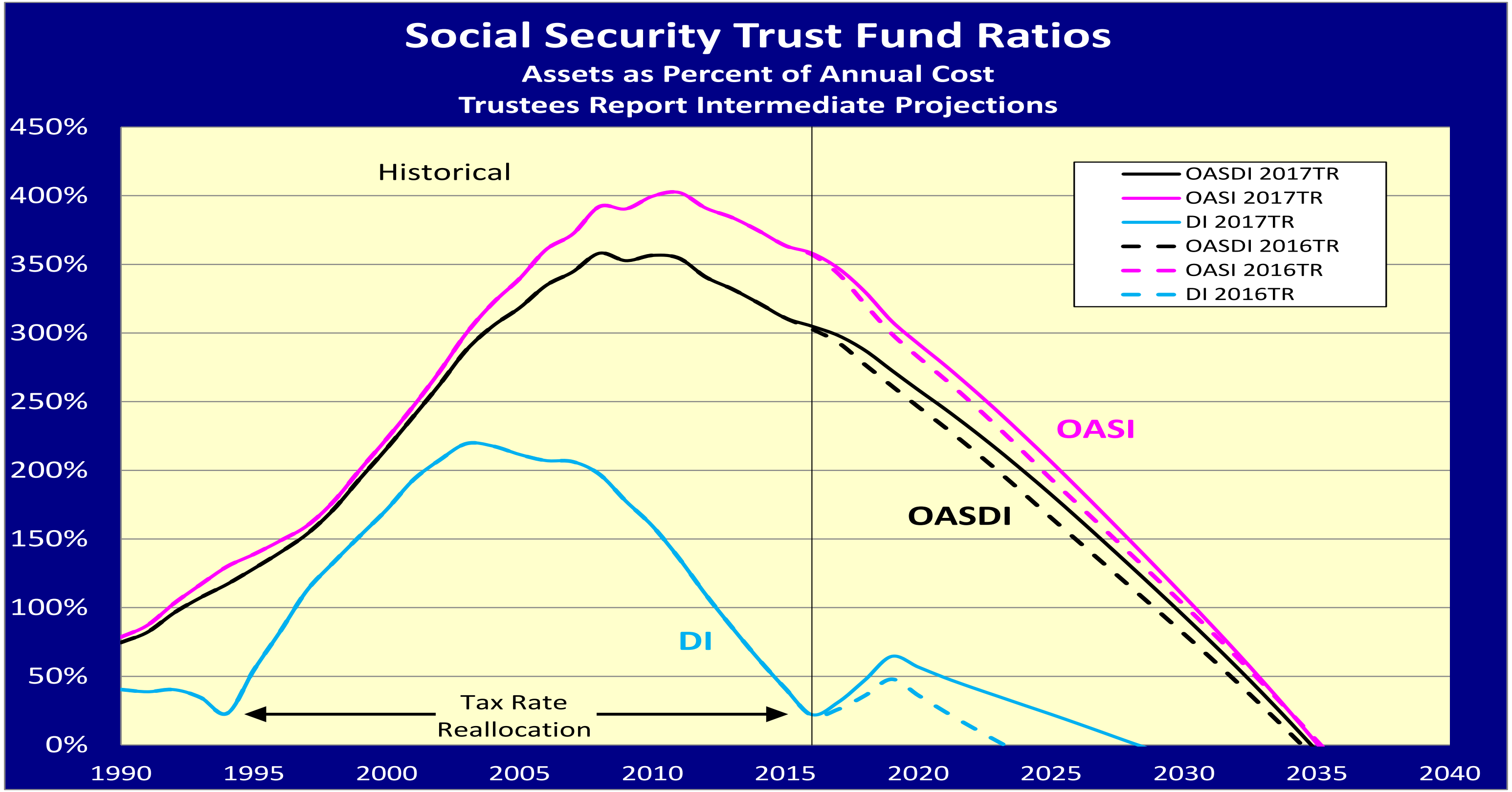
- Income invested in Trust Funds
- Pay-as-you-go financing
  - Maintain contingency reserve because no significant borrowing authority
  - Must warn Congress to act in time
- Annual Trustees Reports since 1941
  - Congress has always acted in time
  - Trust fund reserve depletion is the trigger

What Is the Legislative Mandate for the Annual Social Security Trustees Report?

1) Trust Fund operations of the past year and the next five years
2) Actuarial status of the trust funds
   - This means the ability to meet the cost of scheduled benefits with scheduled revenue and trust fund reserves
   - And the extent to which scheduled revenue will fall short, forcing cuts or delays in benefits in the absence of legislative change

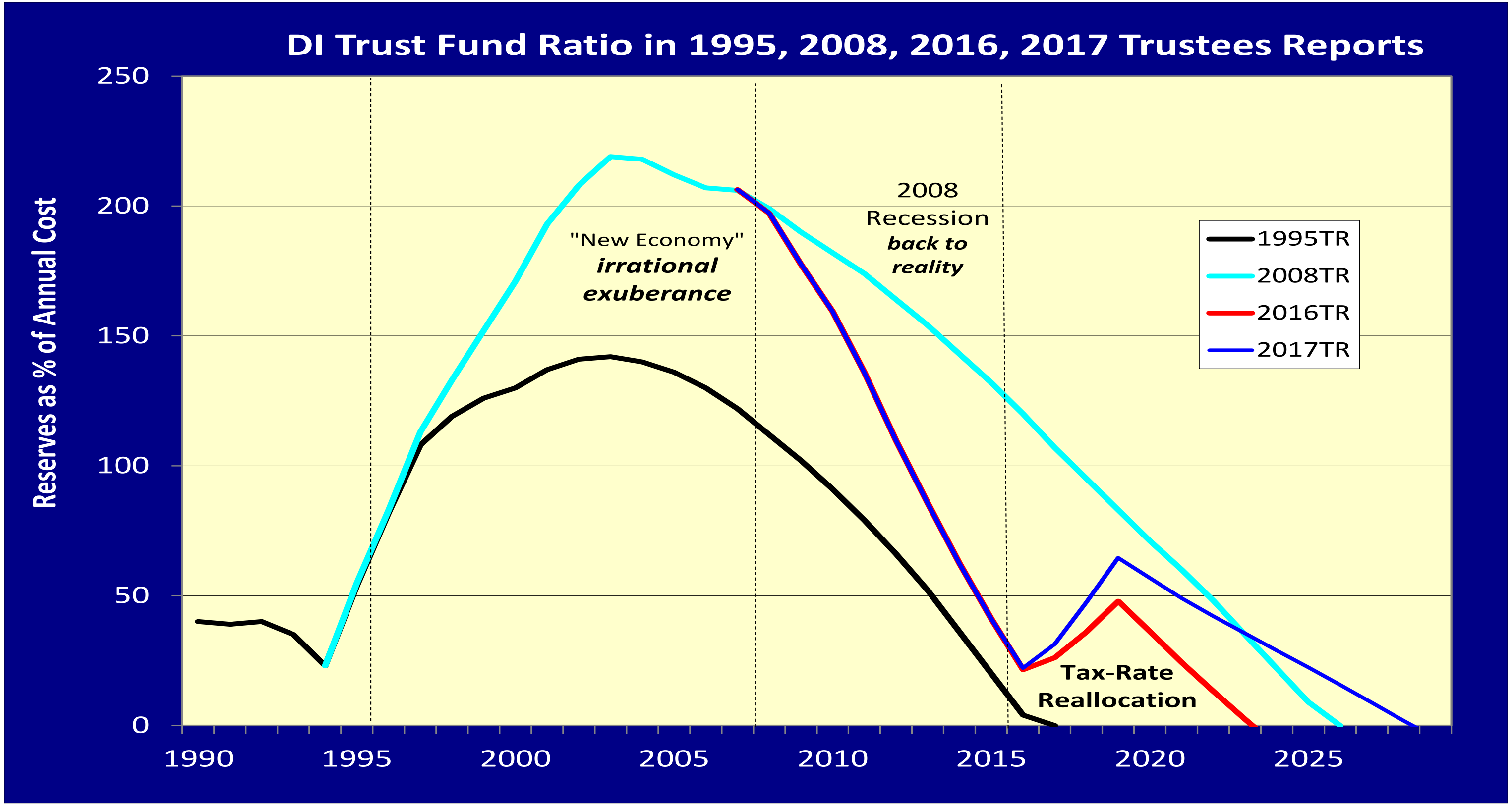
SOLVENCY: OASDI Trust Fund Reserve Depletion in 2034

(Same year as in last year's report)

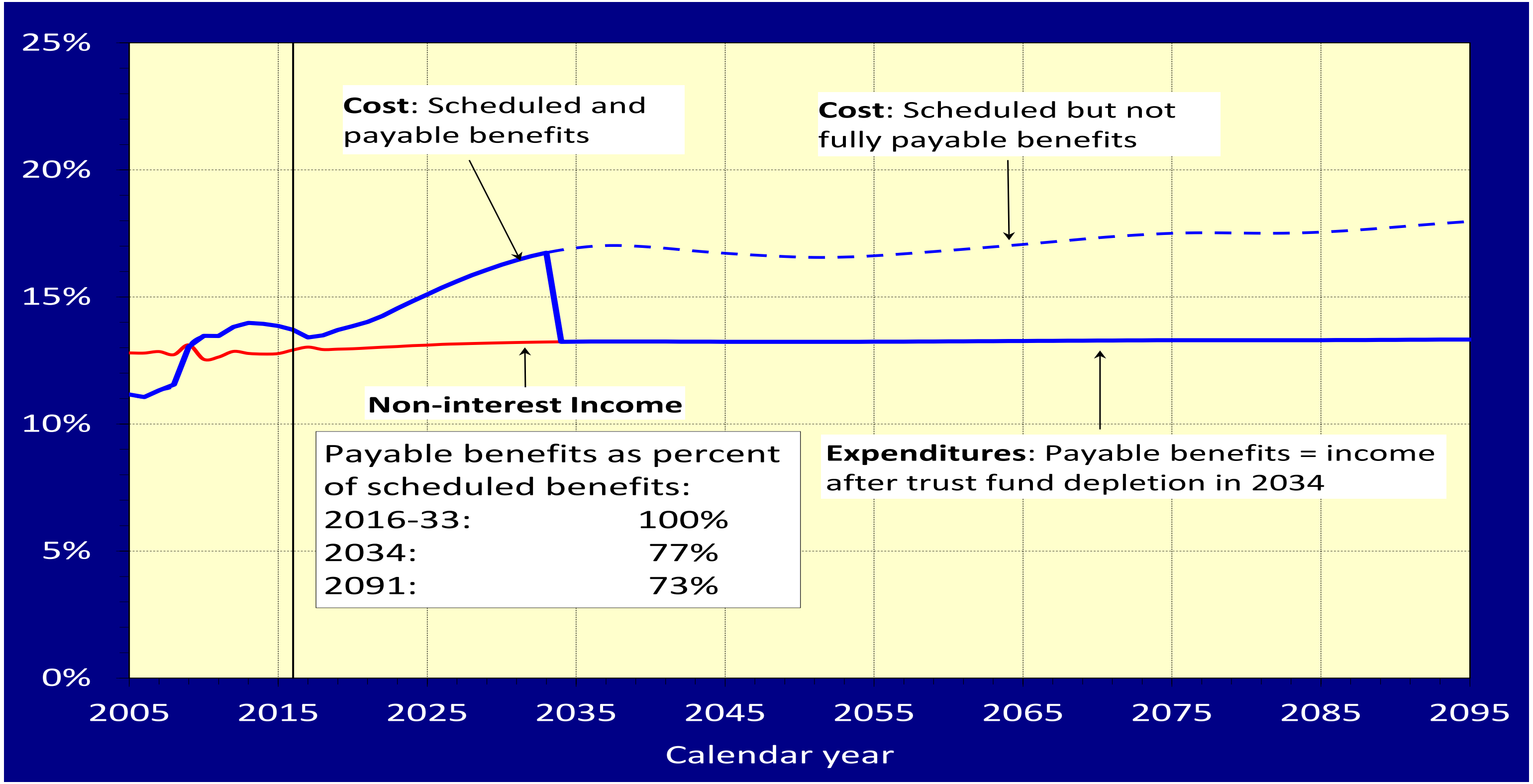


Changes in Solvency Projections for the DI Trust Fund

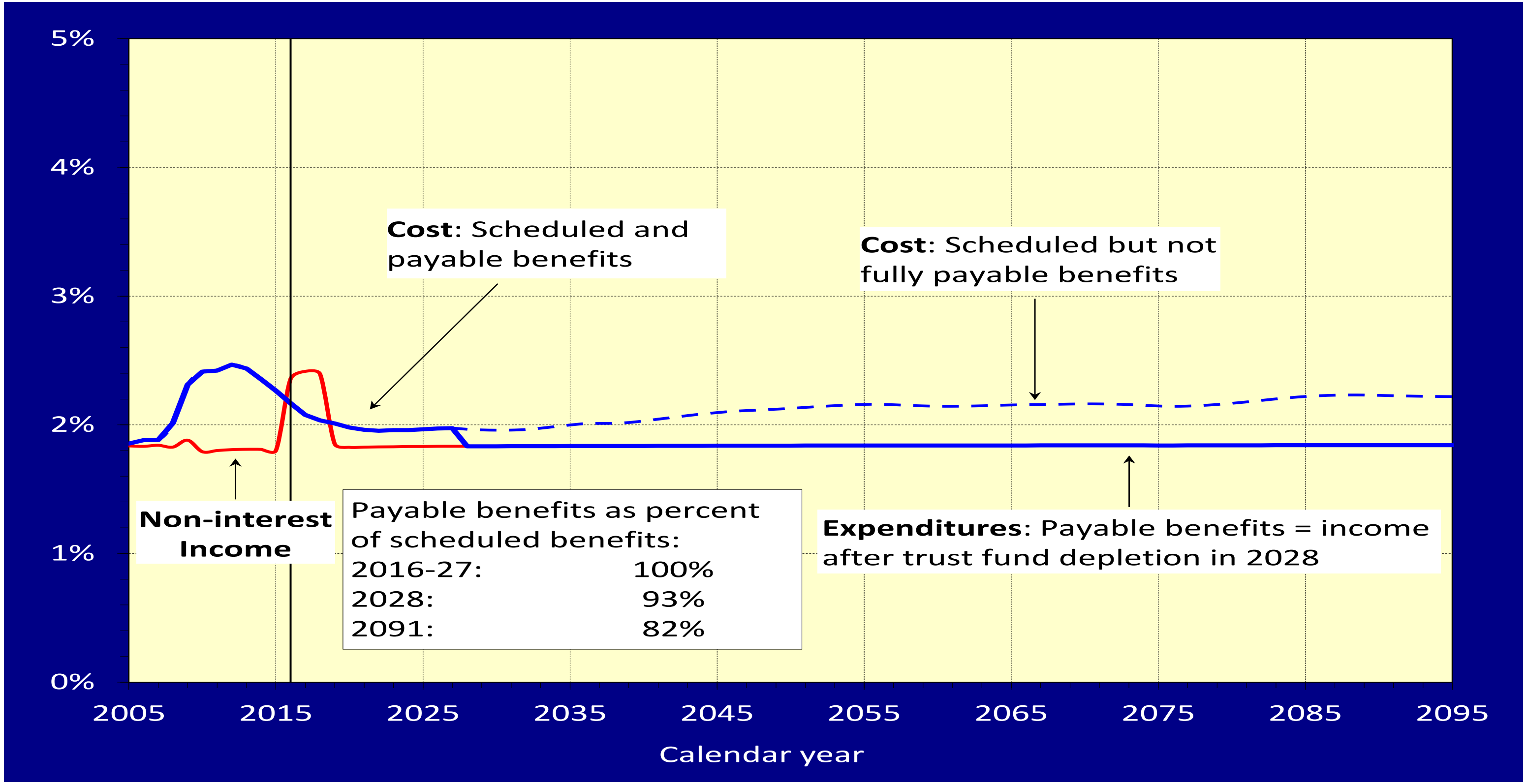
2008 recession offset the "new economy"; cycles still happen



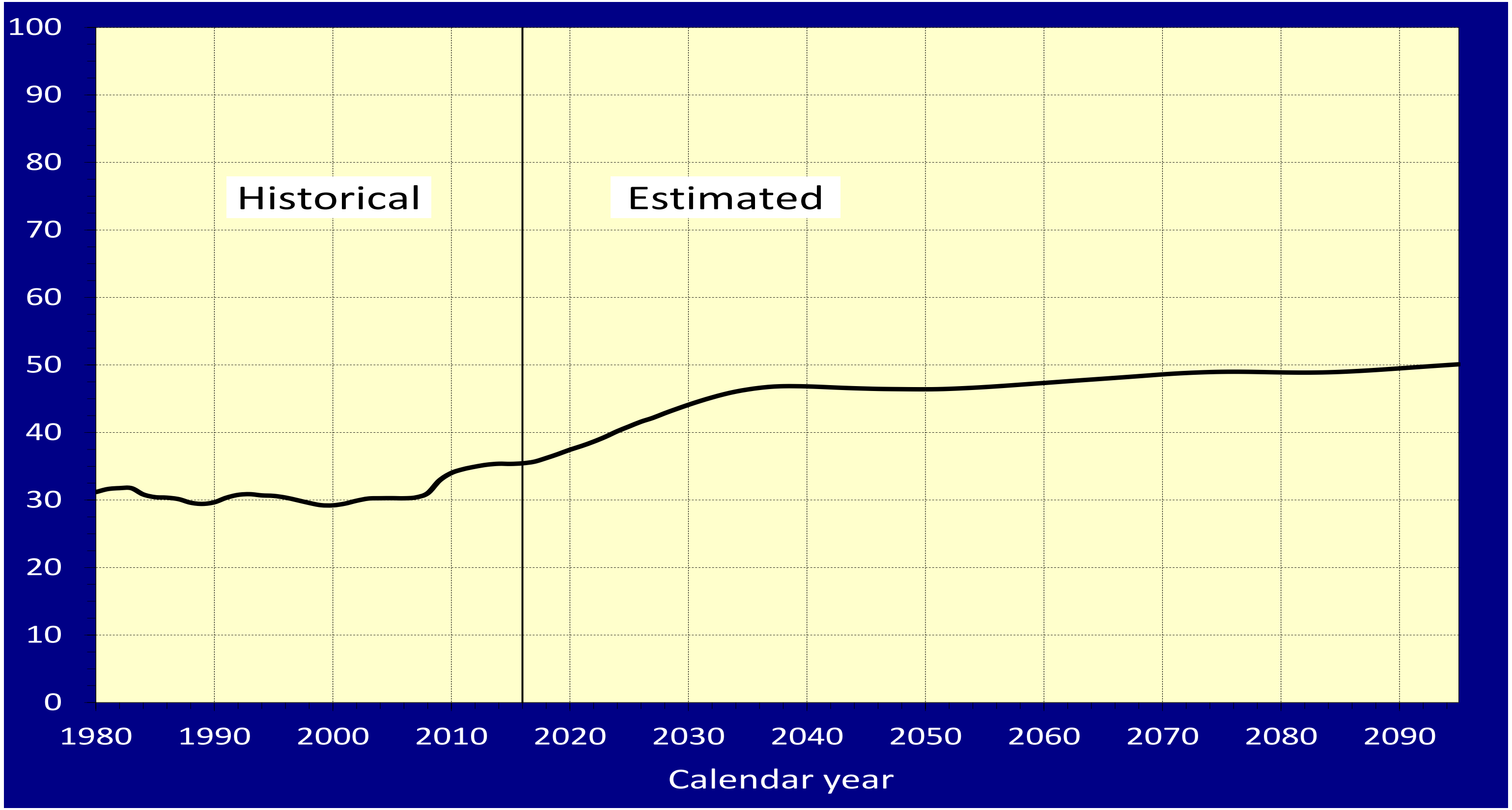
OASDI Annual Cost and Non-Interest Income as a Percent of Taxable Payroll *(77% payable at reserve depletion)*



DI Annual Cost and Non-Interest Income as a Percent of Taxable Payroll *(93% payable at reserve depletion)*



OASDI Beneficiaries per 100 Workers

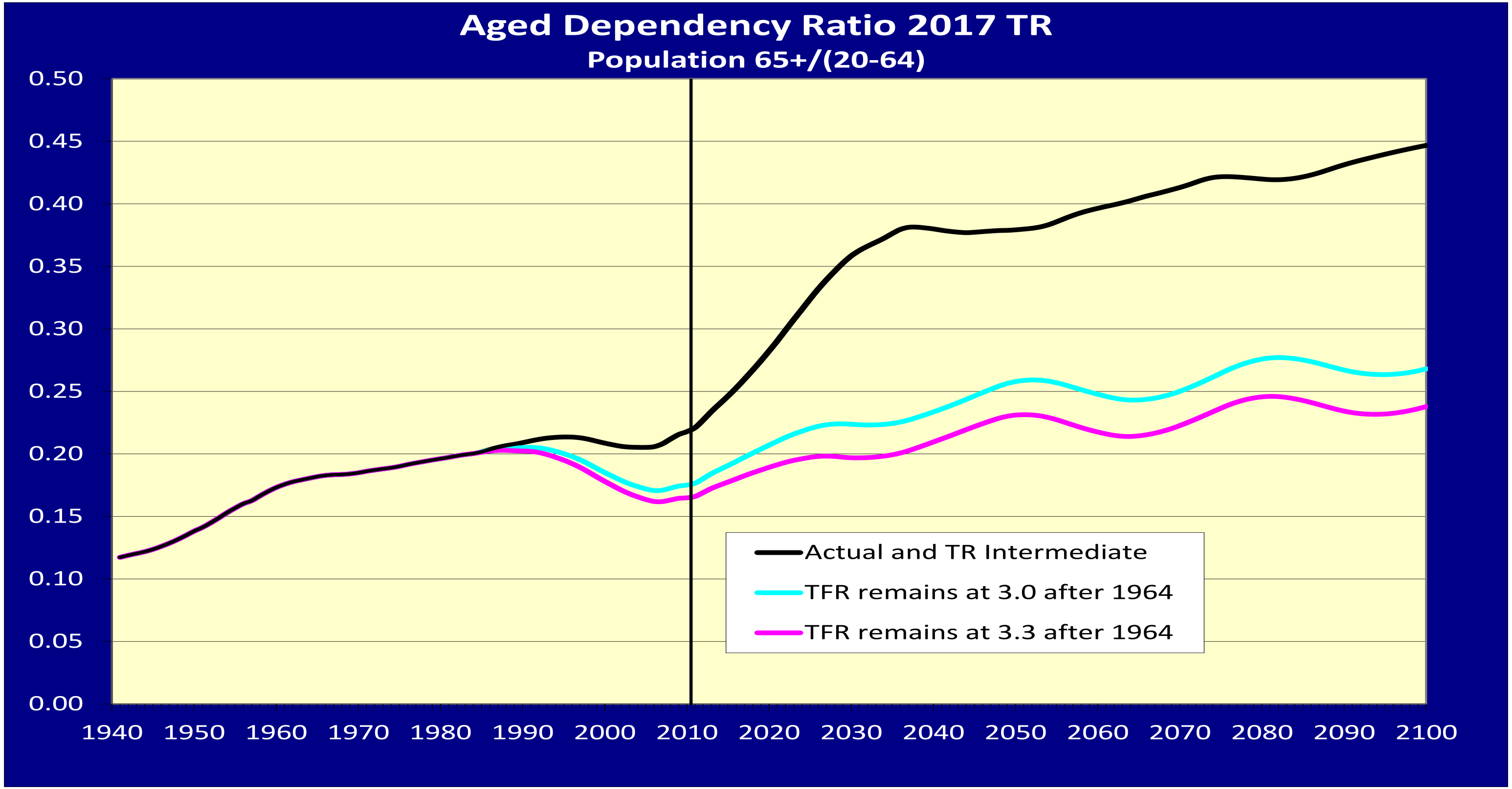


Increasing Cost as Percent of Taxable Payroll and GDP due to Aging

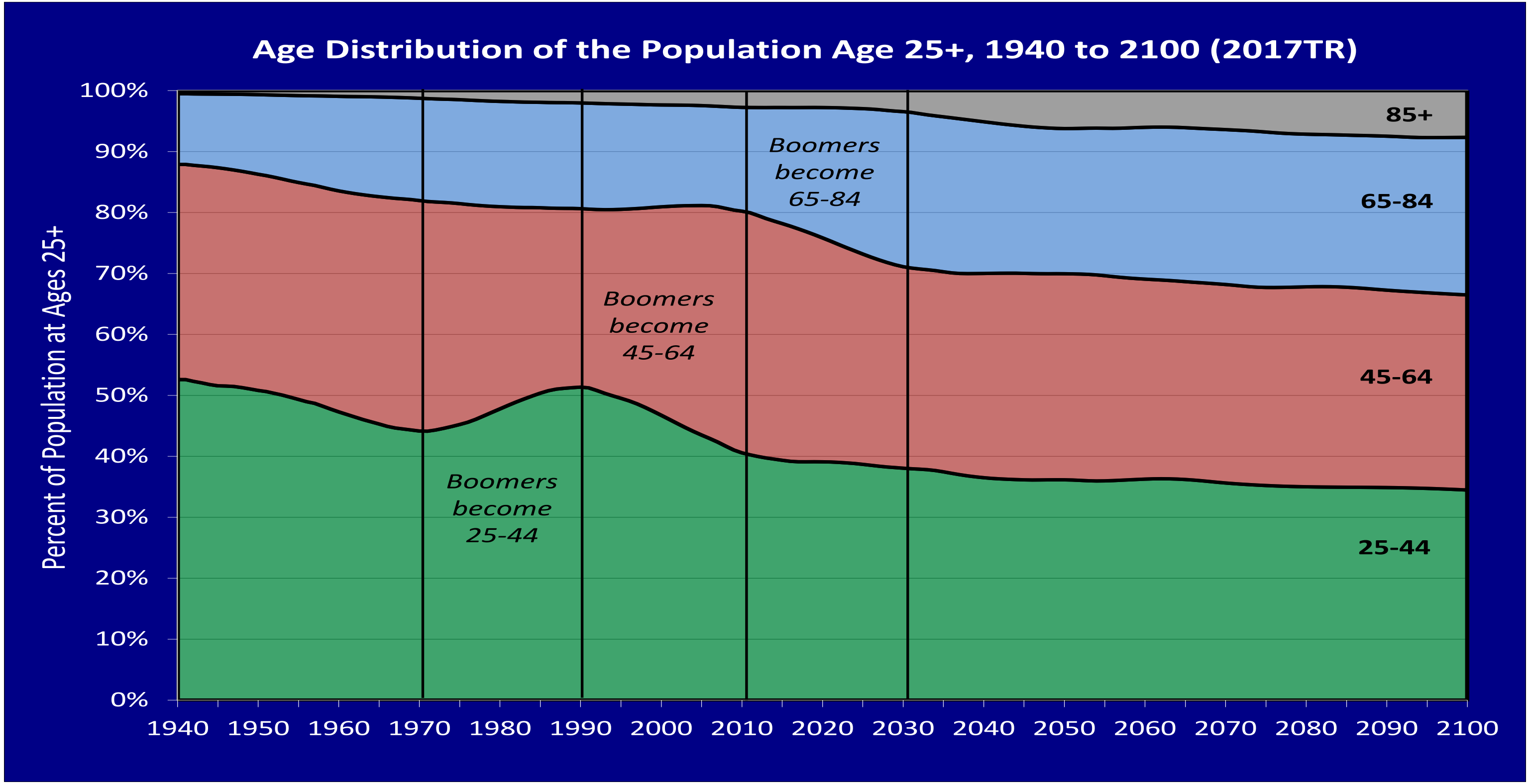
- “Macro Aging”
  - Changing age distribution— getting older
  - Mainly from permanent drop in birth rates after 1965
- “Micro Aging”
  - People are living longer
  - Lower death rates
  - Higher life expectancy

Aging (change in age distribution)

Mainly due to drop in birth rates

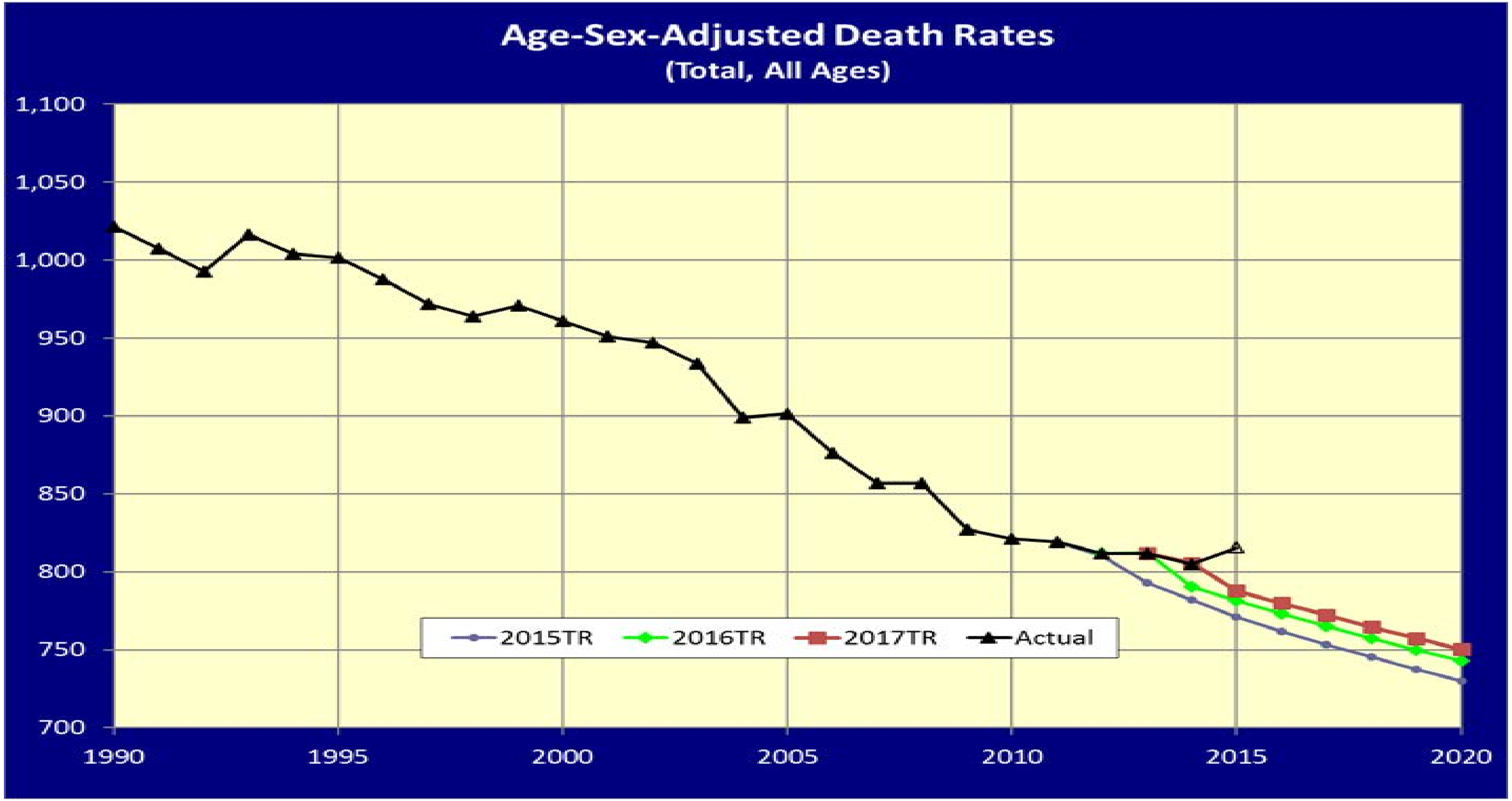


Changing Age Distribution Over Last 20 and Next 20 Years Mainly Due to Population Aging



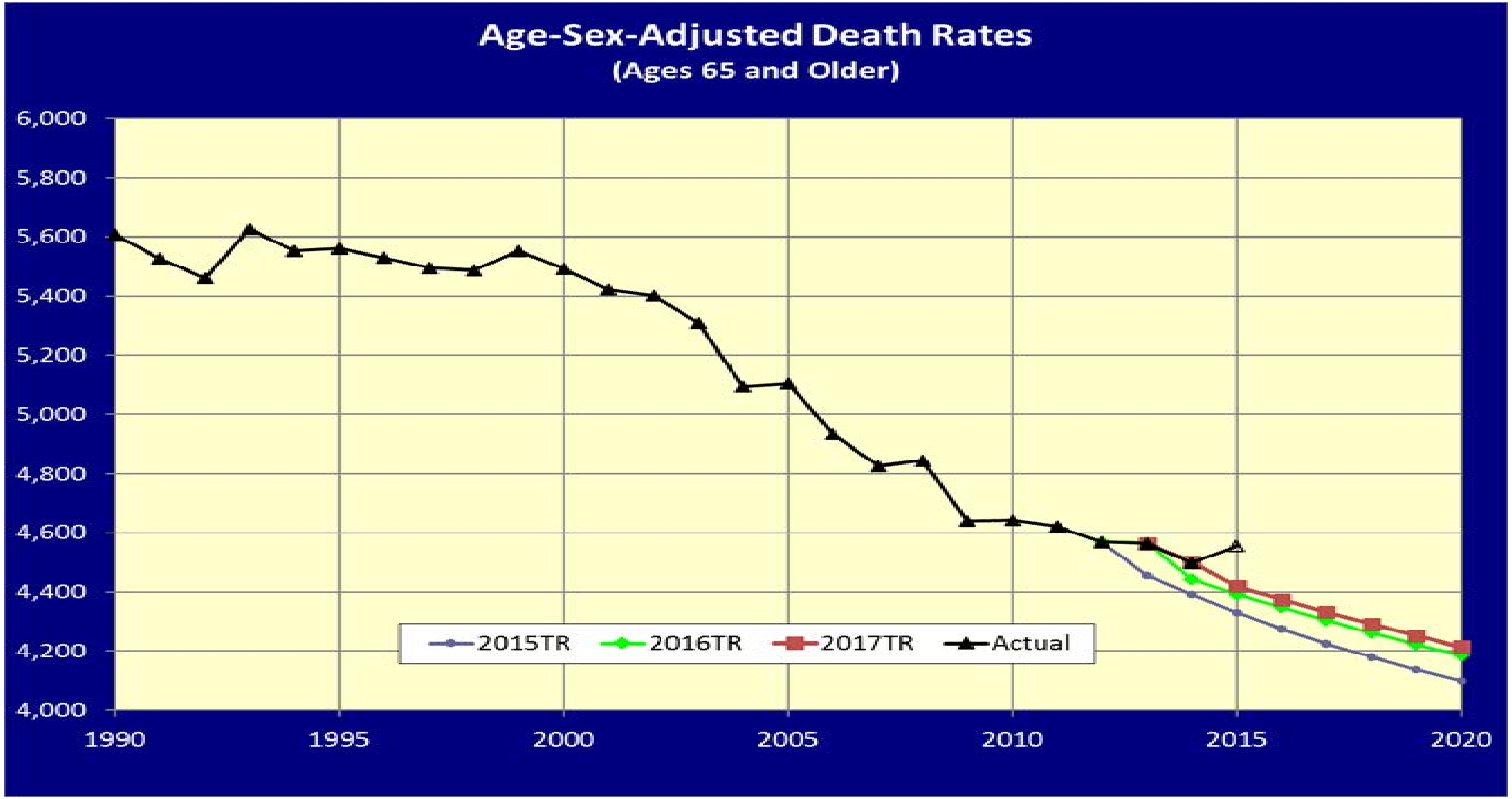
Mortality Experience: All Ages

Reductions continue to fall short of expectations



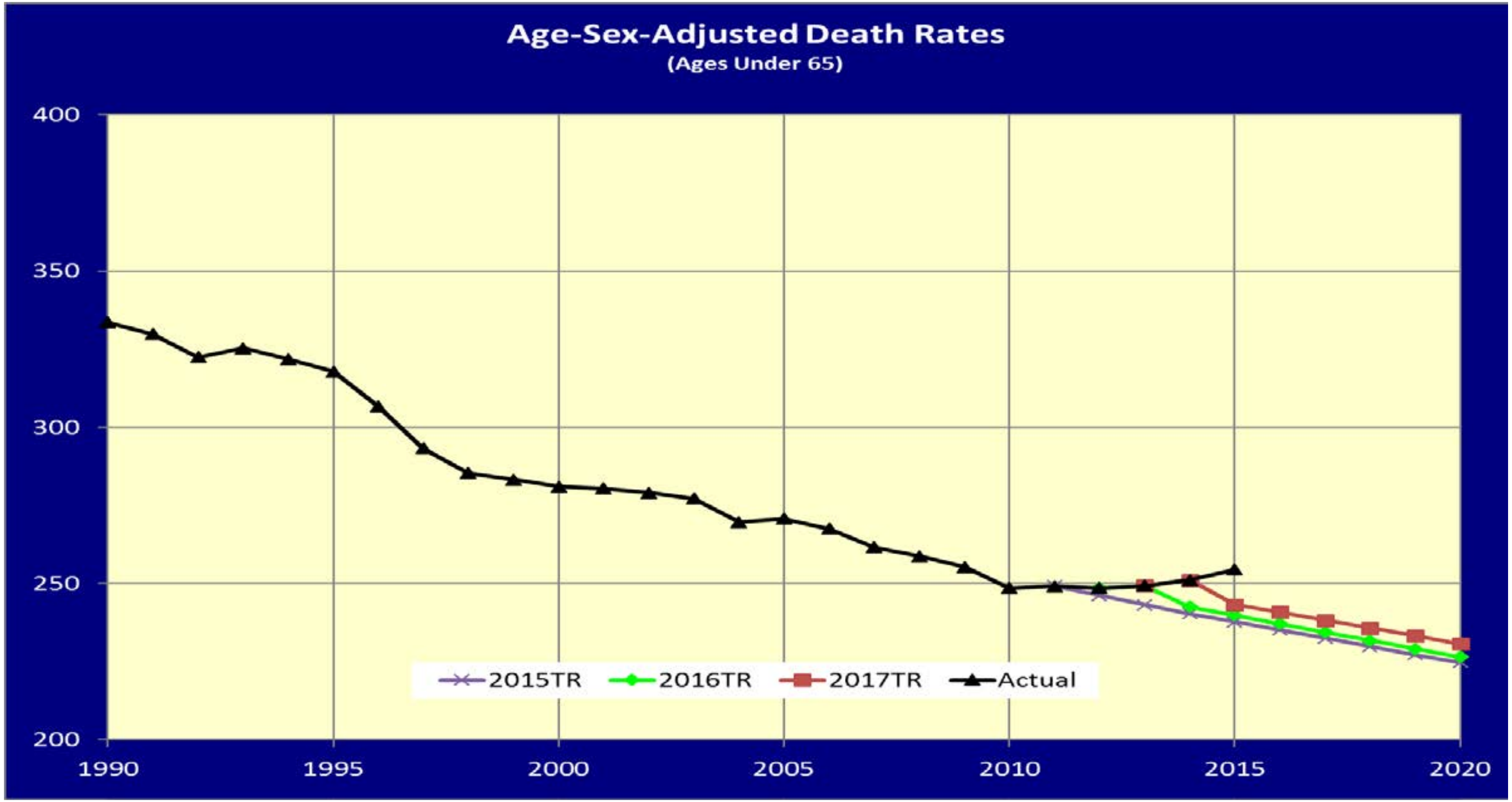
Mortality Experience: Ages 65 and Older

Reductions since 2009 continue to fall short of expectations

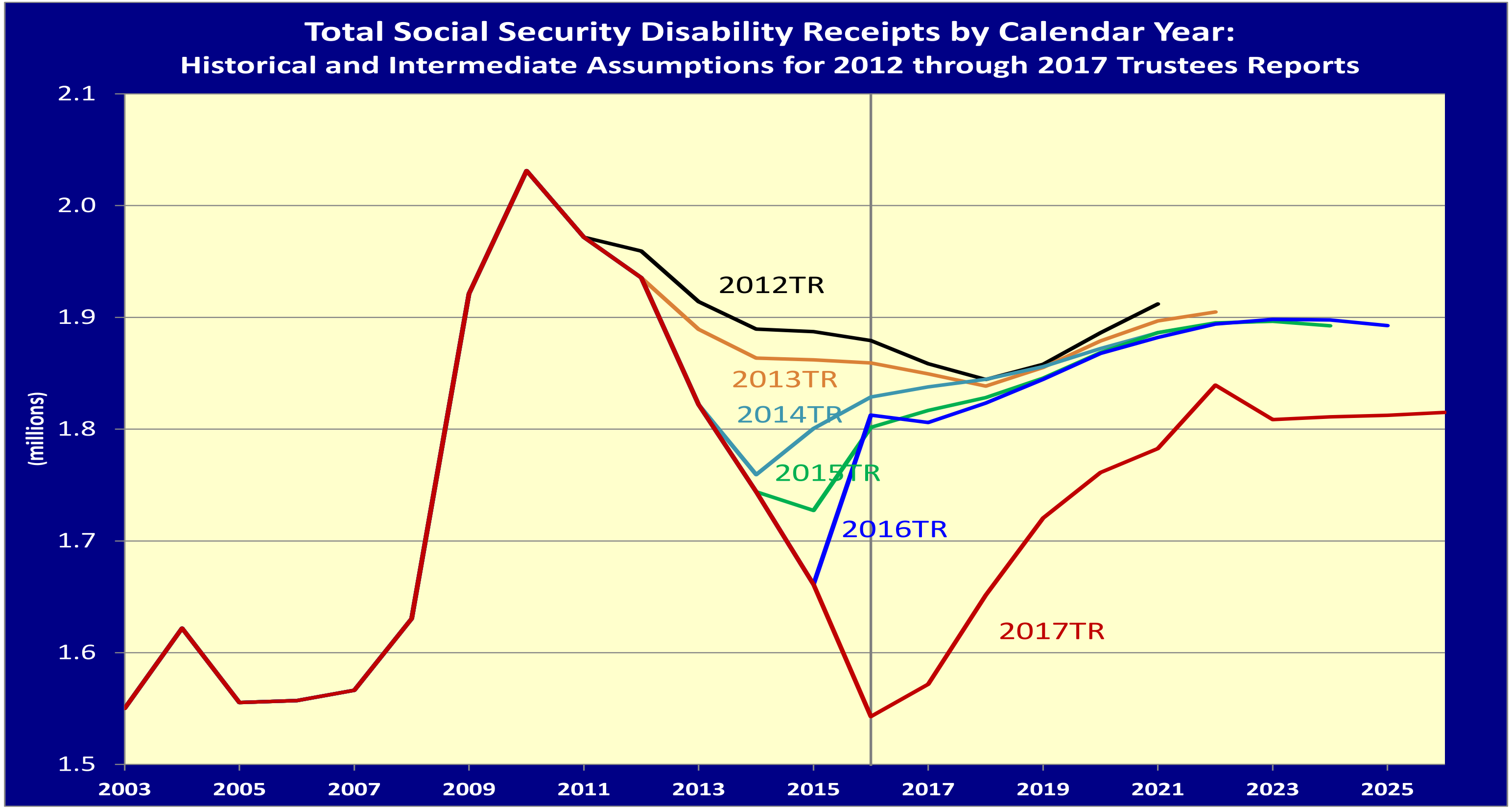


Mortality Experience: Ages Under 65

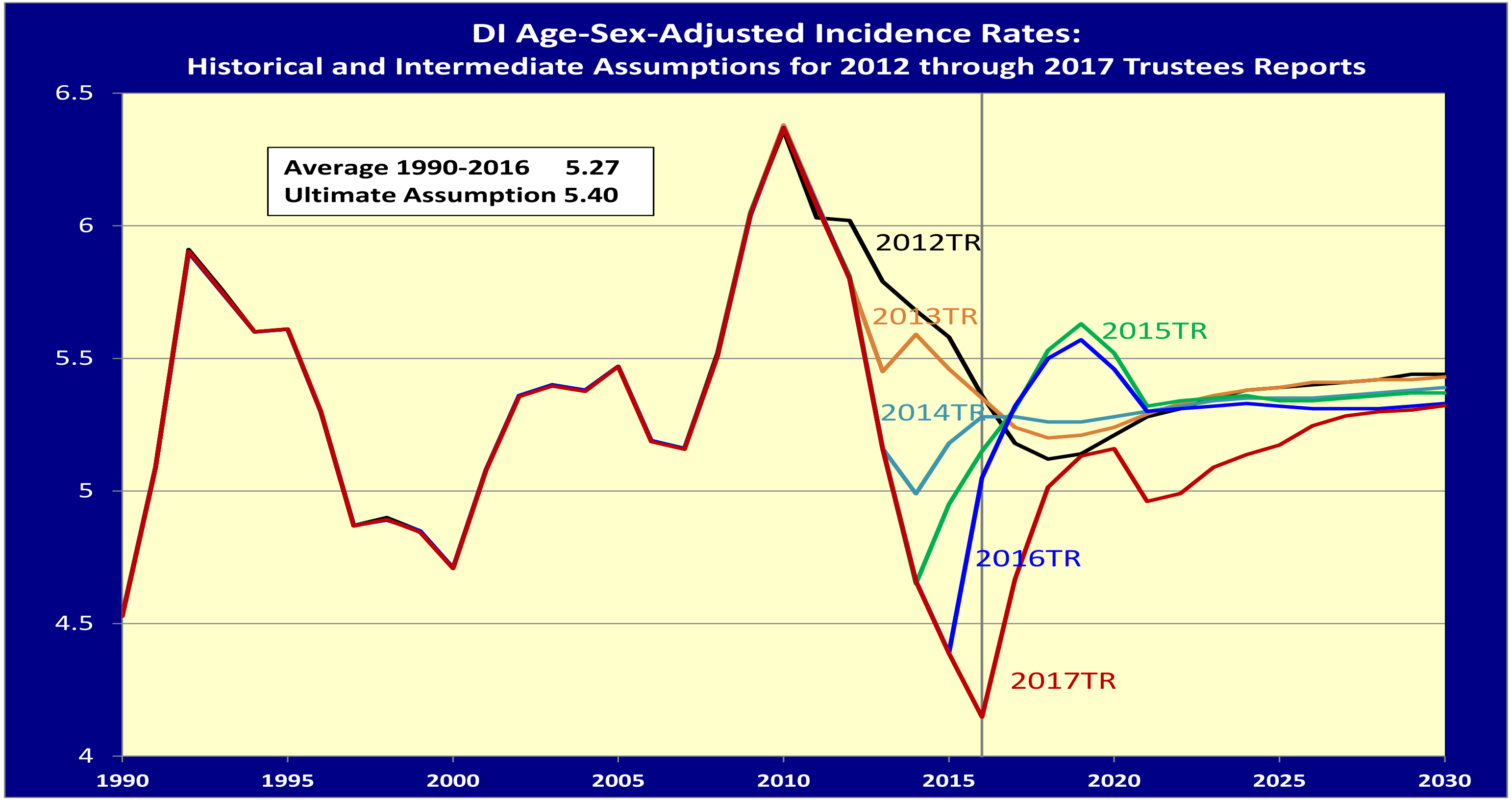
*Actual **increase** since 2010*



Applications for Disability Benefits Continue to Fall

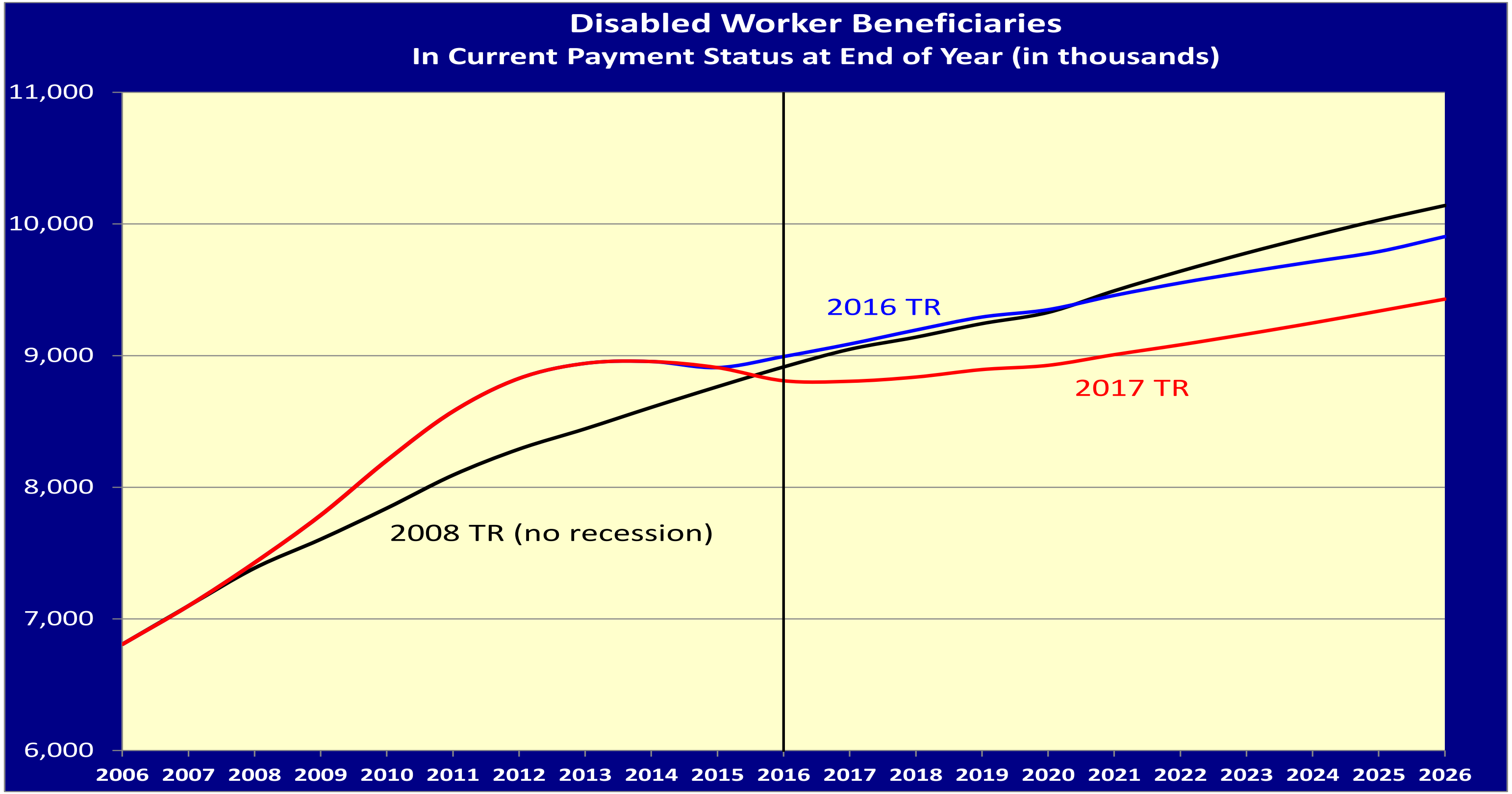


Disability Incidence Rate Falls to Historic Lows



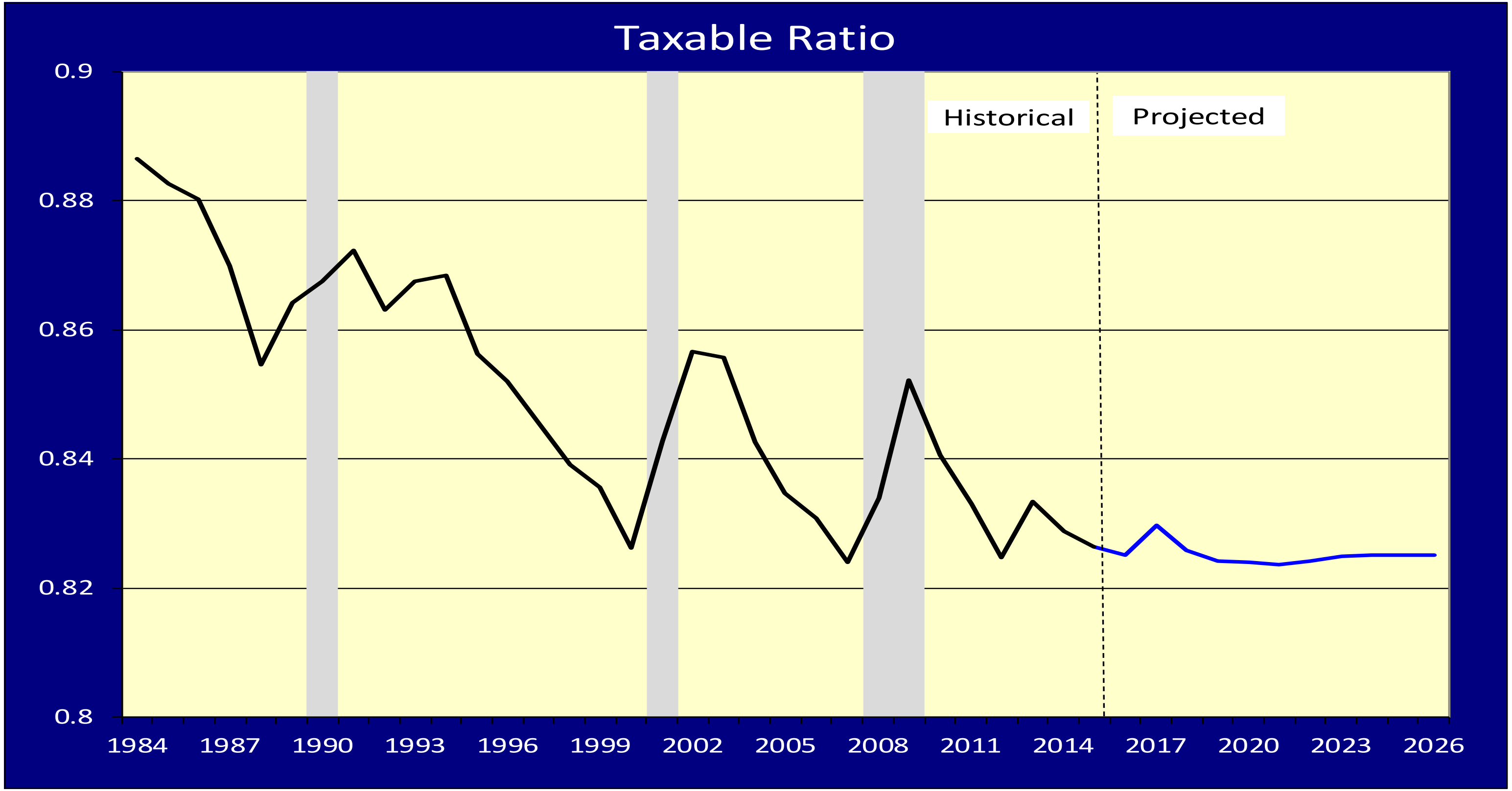
Fewer Disabled Worker Beneficiaries

Fewer now and in near term based on recent applications and incidence rates

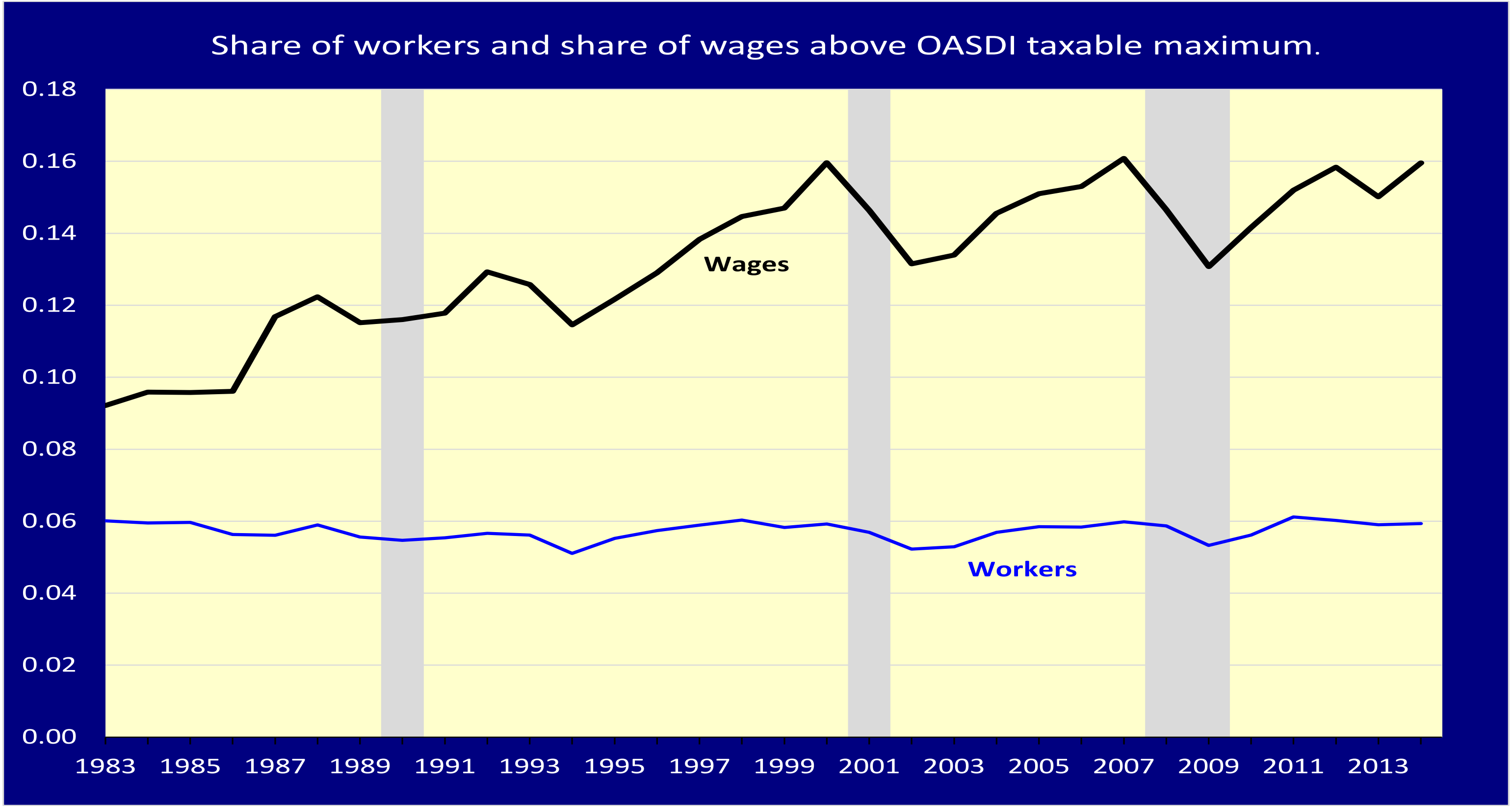


Taxable Ratio

Declined over time: concentration of earnings at the top of the income distribution

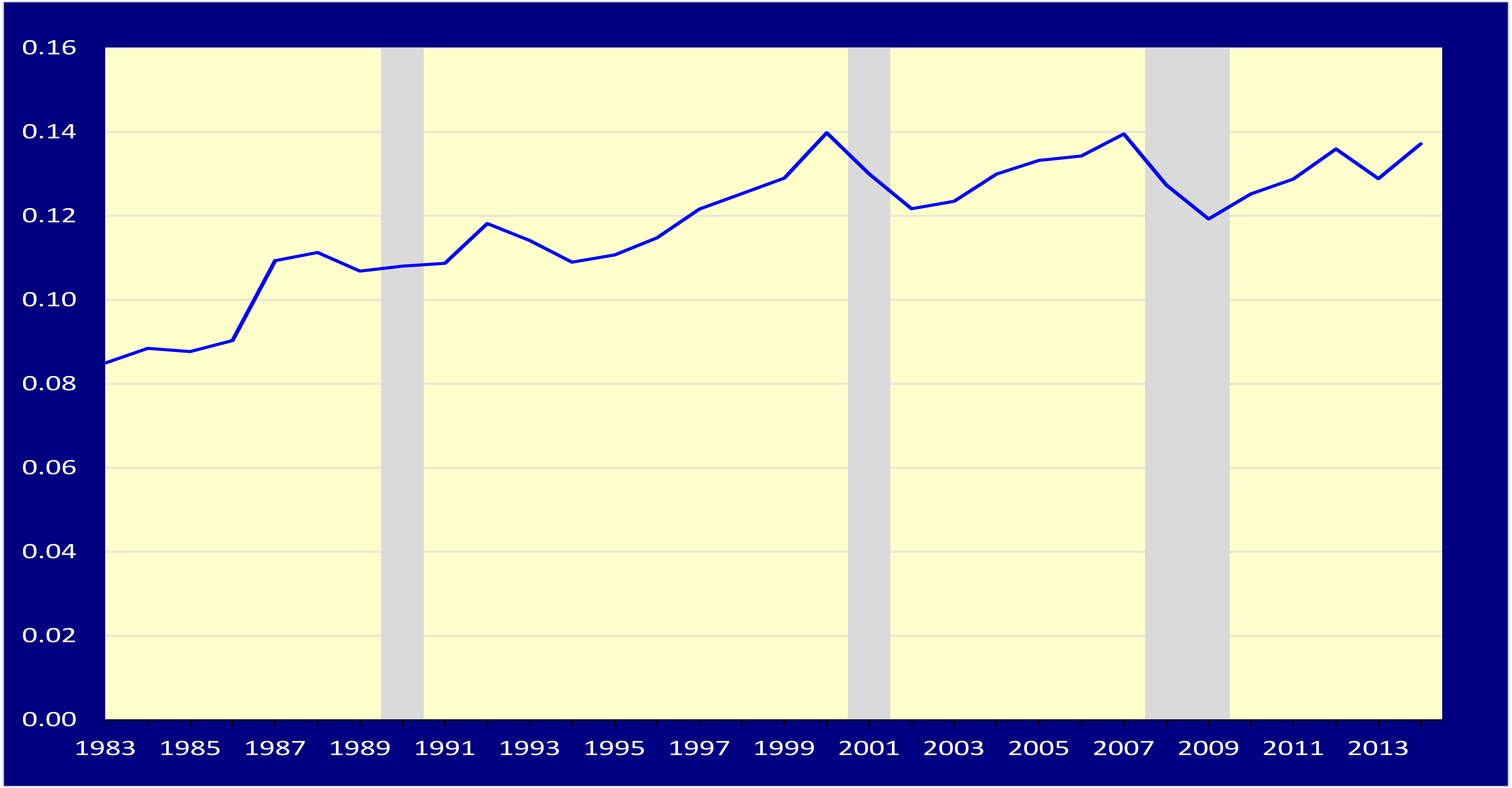


Trend in Wages in Excess of OASDI Taxable Maximum

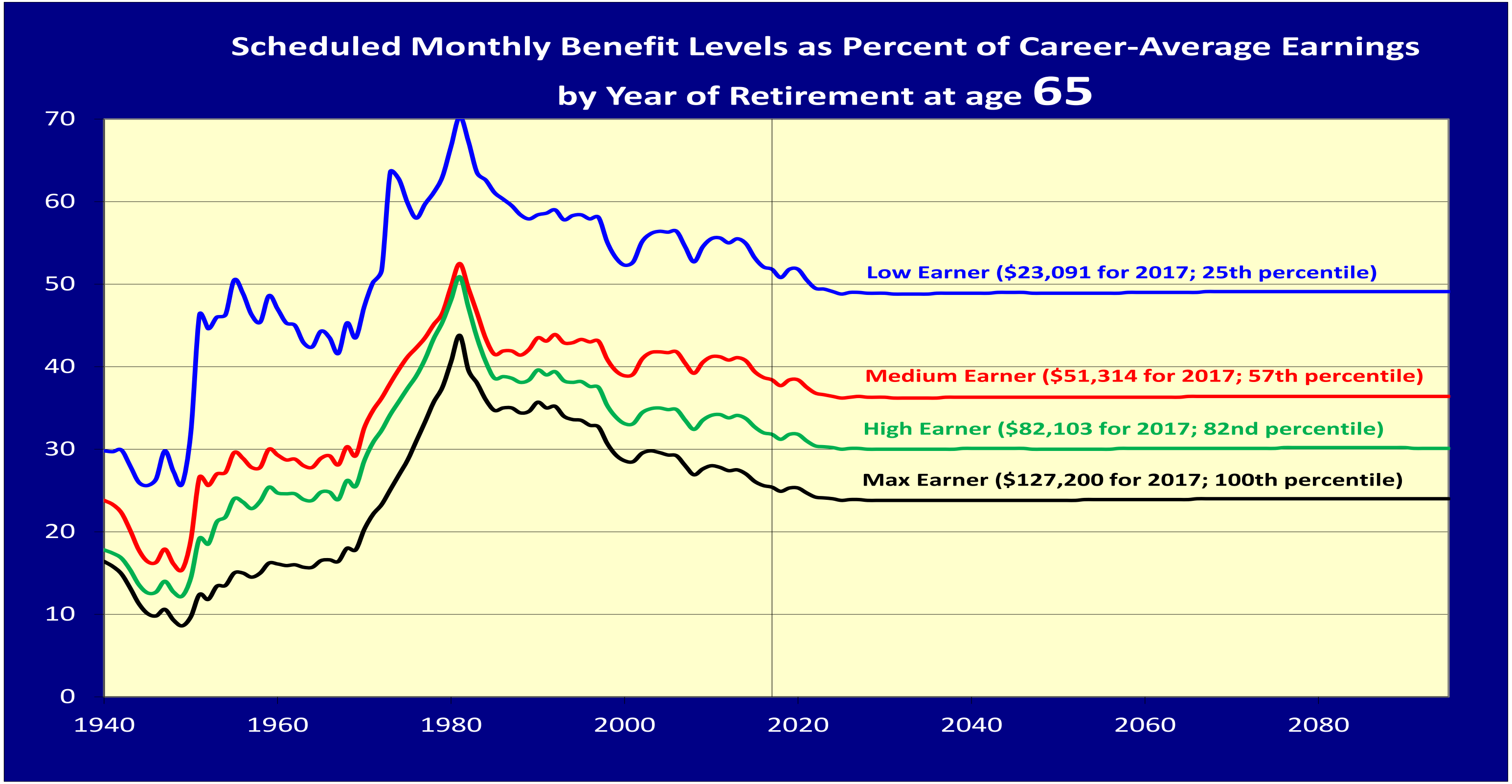


Share of Wages Earned by the Top 1% of Wage Earners

Rises throughout 1980s and 1990s, but fairly flat since 2000

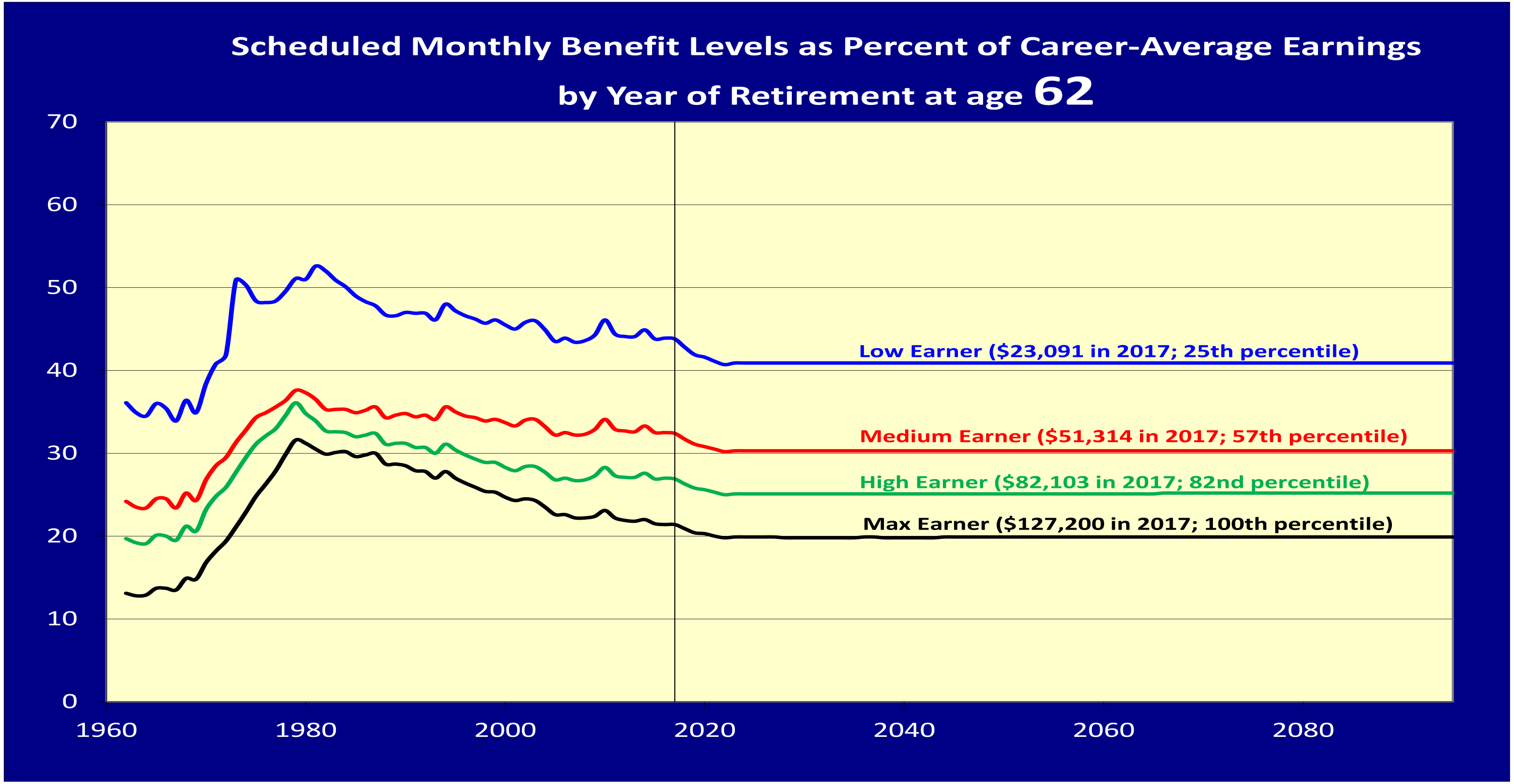


Replacement Rates Based on the 2017 Trustees Report



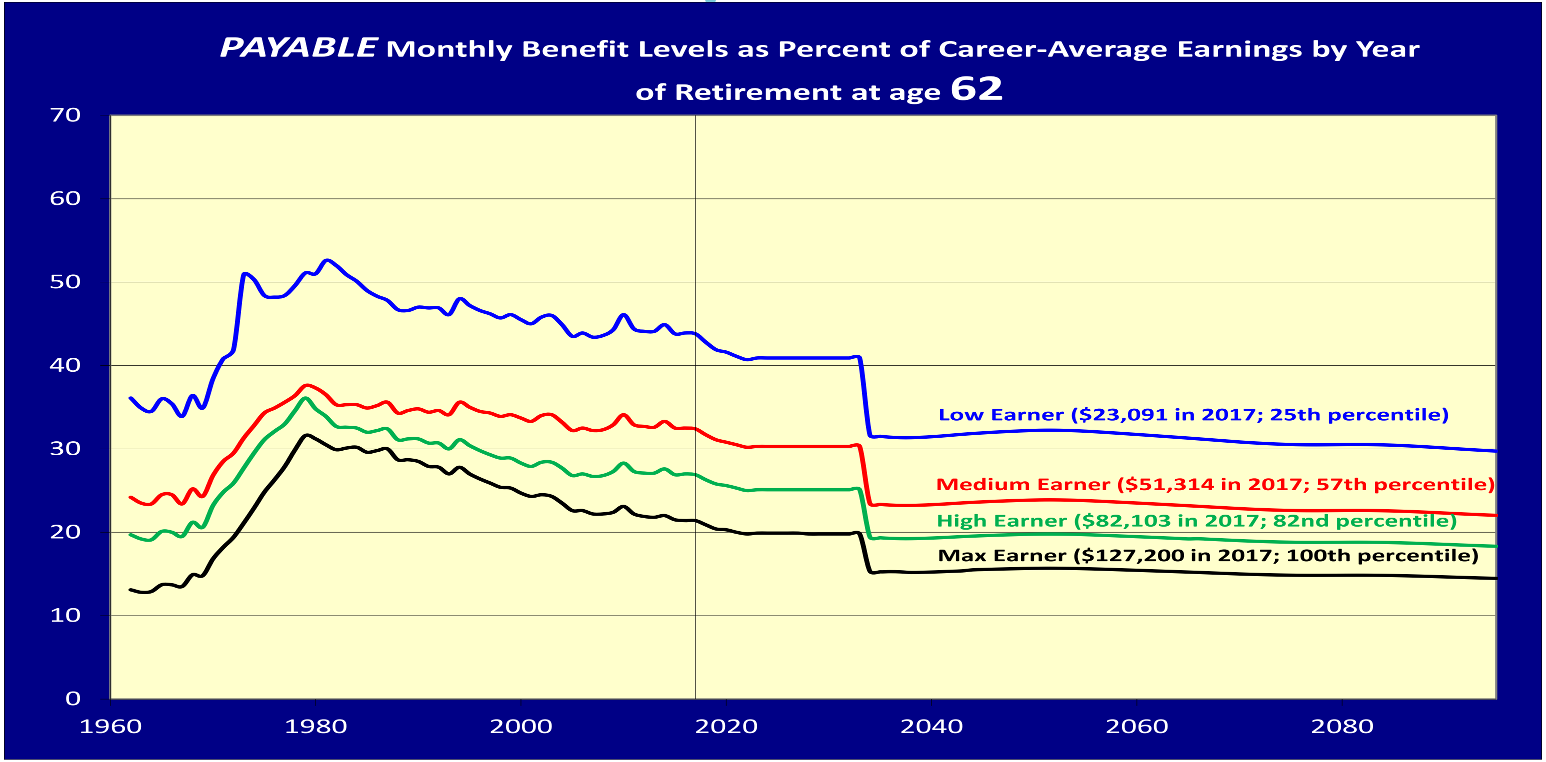
Source: Annual Recurring Actuarial Note #9 at www.ssa.gov/oact/NOTES/ran9/index.html

How About at Age 62, When Most Start Benefits?



Source: Annual Recurring Actuarial Note #9 at www.ssa.gov/oact/NOTES/ran9/index.html

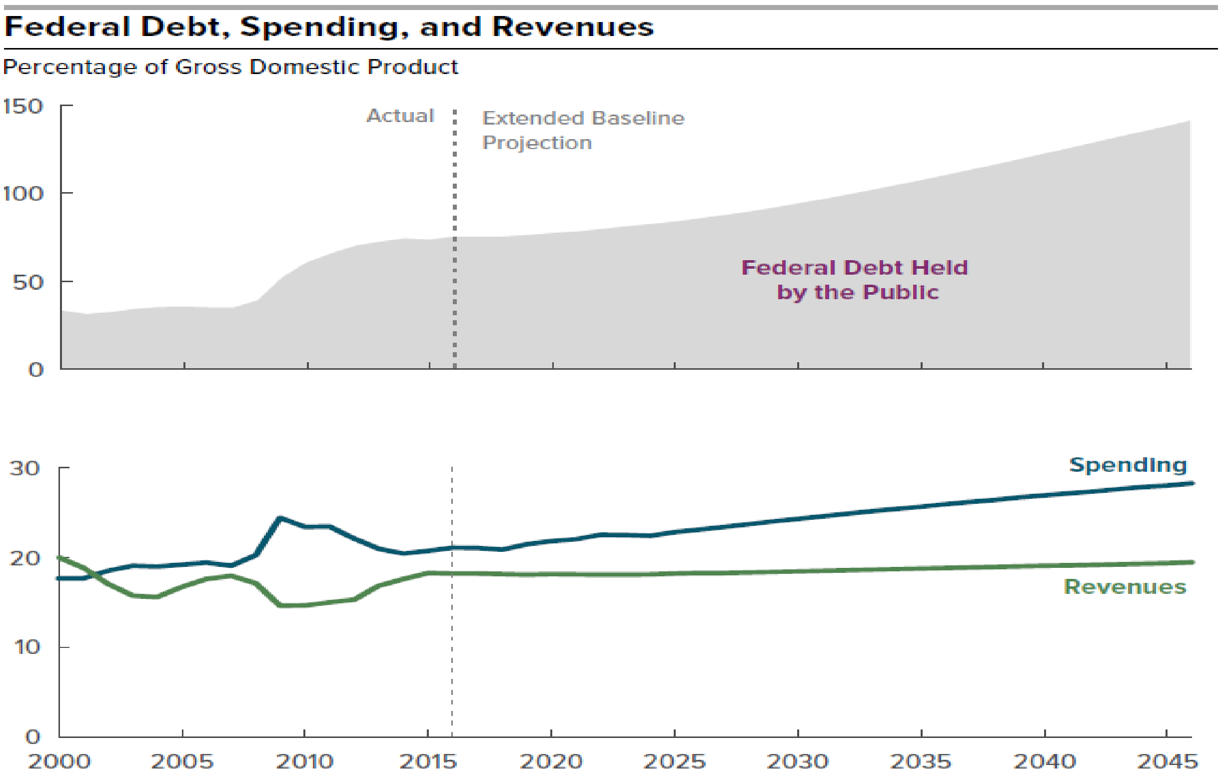
Payable Benefits Under the Law, After Trust Fund Reserves Are Depleted, Are Even Lower



Source: Annual Recurring Actuarial Note #9 at www.ssa.gov/oact/NOTES/ran9/index.html

But, Wait—How About Budget Scoring?

How do entitlements affect Federal debt?



Source: Congressional Budget Office, June 2016

Budget Scoring Is Inconsistent with the Law and All Past Experience

See Actuarial Opinion in the 2017 TR (also 2014-2016 TRs):

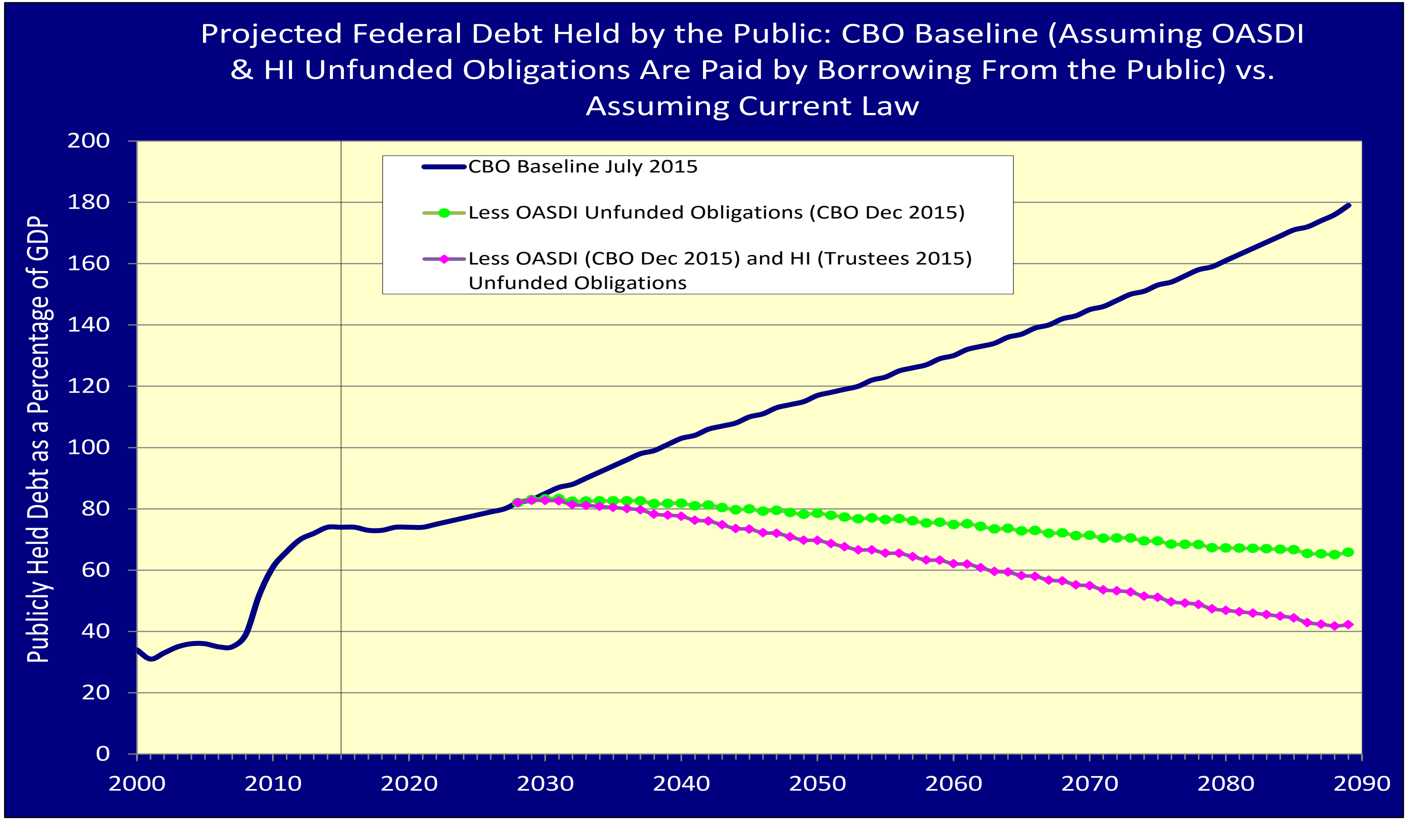
1) Reserve redemptions through 2034 just spend the excess revenues collected and invested in earlier years
   - *This just replaces debt owed to the trust funds with debt owed to the public*

2) If reserves deplete in 2034, the $12.5 trillion unfunded obligation through 2091 cannot be paid under the law
   - *Budget deems these "expenditures" creating publicly held debt*

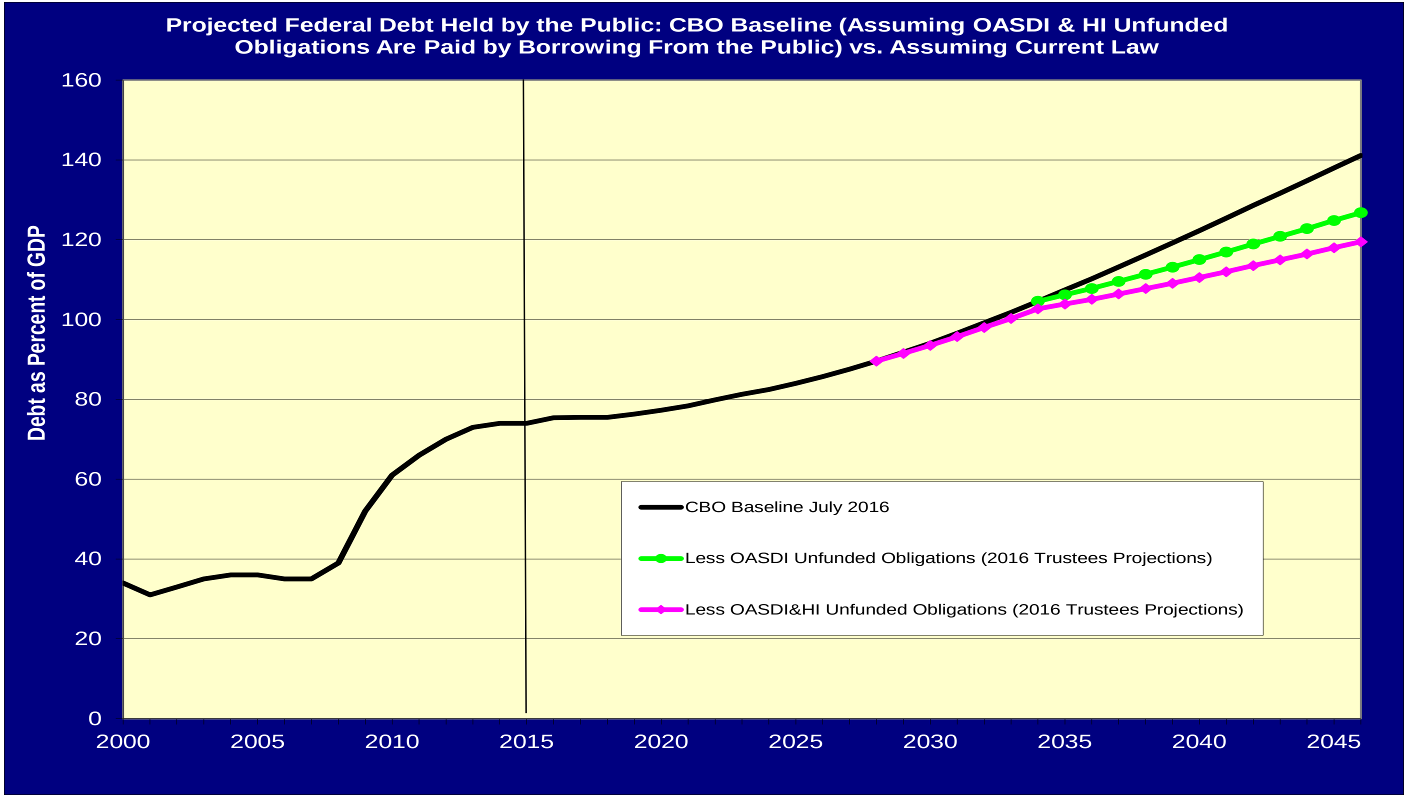
3) Therefore, Trust Fund operations have no direct effect on total Federal debt subject to ceiling in any year—and no *net* effect on publicly held debt over time

What If We Projected Federal Debt Consistent with the Law?

Dramatic difference back in 2015



Starting in 2016, CBO Projects the Total Federal Budget Only 30 Years



The Bottom Line

- Long-term projections provide information to assess solvency and changes needed to eliminate shortfalls
- If trust fund reserves were to deplete:
  - Full benefits cannot be paid timely
  - No pressure on the budget or federal debt
  - So Congress must and will act, as always
- Straightforward solutions:
  - Add revenue and/or lower cost for OASDI
  - Comprehensive changes *implemented* by 2034

How to Fix Social Security Long-Term

How can the financing shortfalls be covered?

- Lower cost (reduce benefits) by about 25%
- Increase revenues by about 33%
- Or some combination of approaches
- Also consider benefit adequacy?

Ways to Lower Cost

- Lower benefits for retirees—not disabled
  - Increase normal retirement age (lowers OASDI cost, but increases DI cost)
  - Can exempt long-career low earners
- Lower benefits mainly for high earners
  - Reduce PIA above some level
  - Often combined with increasing PIA below some level, subject to work year requirements

Ways to Lower Cost (continued)

- Lower benefits mainly for the oldest old
  - Reduce the COLA by using a *chained* version of the CPI
  - Some say instead raise the COLA by using the CPI-E (based on purchases of consumers over age 62)
- Increase the number of years used in calculation (currently 35)
  - Especially hurts those who haven't been in the workforce for more than 35 years

Ways to Increase Revenue

- Raise tax rate on all earners
  - Increasing rate from current 12.4 percent to about 15.3 percent is projected to eliminate the long-range shortfall
- Raise tax on highest earners
  - Increase taxable maximum amount
  - Some tax on all earnings above the maximum

Ways to Increase Revenue (continued)

- Tax employer group health insurance premiums
  - Affects only middle class if taxable maximum remains the same
- Tax certain investment income
  - Consistent with ACA approach?
- Maintain larger trust fund reserves
  - Could do this by investing some portion of reserves in equities
  - Added interest/yield can lower needed taxes

Many comprehensive proposals scored

Example 1: Representative Sam Johnson (R-TX), December 2016

- Make PIA formula less generous but more "progressive" (shortfall ↓32%)
- Change to mini-PIA approach (↓13%)
- Raise the Normal Retirement Age gradually (↓32%)
- Lower the COLA (↓47%)
  - Based on chain-weighted CPI for most beneficiaries; 0.3pp lower on average
  - No COLA if prior year's MAGI is above certain thresholds
- Add a new minimum benefit (↑9%)
- Eliminate taxation of OASDI benefits in 2054 and later (↑15%)
- Would produce *"sustainable solvency"* (shortfall ↓100%)

Go to: https://www.ssa.gov/OACT/solvency/SJohnson_20161208.pdf

Many comprehensive proposals scored

Example 2: Representative John Larson (D-CT), April 2017

- Make PIA formula slightly more generous, more “progressive” (shortfall ↑9%)
- Increase the COLA (↑15%)
  - Based on CPI-E for all beneficiaries; 0.2pp higher on average
  - Index designed to better reflect the purchases of the elderly
- Improve the minimum benefit (↑5%)
- Lower taxation of OASDI benefits slightly (↑7%)
- Tax earnings above $400K (not indexed) with small benefit credit (↓71%)
- Increase payroll tax rate gradually from 12.4 percent to 14.8 percent (↓67%)
- Would produce *“sustainable solvency”* (shortfall ↓112%)

Go to: https://www.ssa.gov/OACT/solvency/JLarson_20170405.pdf

For More Information Go To http://www.ssa.gov/oact/

There you will find:

- The 2017 and all prior OASDI Trustees Reports, back to 1941
- Detailed single-year tables for recent reports
- Our estimates for comprehensive proposals
- Our estimates for the individual provisions
- Actuarial notes; including replacement rates
- Actuarial studies
- Extensive databases
- Congressional testimonies
- Presentations (like this one!)

Questions?