SOCIAL SECURITY
Office of the Chief Actuary

September 7, 2011

The Honorable Bernard Sanders
United States Senate
Washington, D.C. 20510

Dear Senator Sanders:

I am writing in response to your request for estimates of the financial effects on Social Security of a proposal to apply the Social Security payroll tax to earned income over $250,000 beginning 2012. The estimates and analysis provided in this letter reflect clarification of the intent of the proposed bill to be named ***Keeping Our Social Security Promises Act*** based on discussion with Warren Gunnels of your staff. A detailed description of our understanding of the intent of the proposal is included below. All estimates are based on the intermediate assumptions of the 2011 Trustees Report. The estimates presented reflect the combined efforts of many in our office, but particularly Alice Wade, Christopher Chaplain, and William Piet.

The intent of this proposal is identical to the intent of H.R. 797 introduced in the House of Representatives on February 18 of this year by Mr. DeFazio. The estimates we produced for Mr. DeFazio on March 3, 2011, available at http://www.ssa.gov/OACT/solvency/index.html, differ somewhat from those provided now because they were produced under different baseline assumptions, the intermediate assumptions of the 2010 Trustees Report.

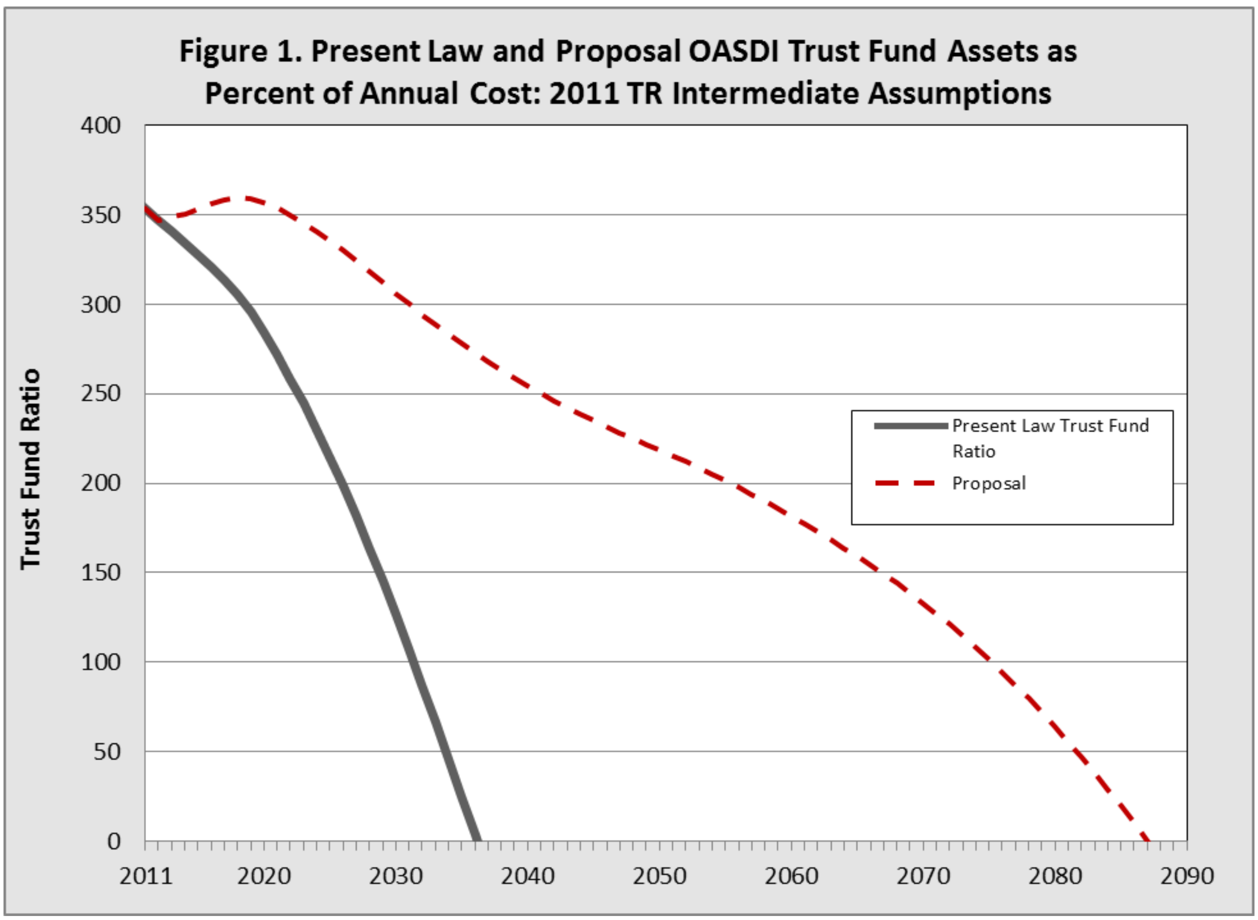
The proposal would modify the Internal Revenue Code of 1986 to subject a worker's OASDI covered earnings in excess of $250,000 in any calendar year after 2011 to the combined OASDI payroll tax rate of 12.4 percent. This is the same tax rate that is applied, under current law, to OASDI covered earnings up to the contribution and benefit base ($106,800 for 2011). Under present law, the contribution and benefit base is scheduled to increase in the future based on increases in the average wage in the U.S. economy. However, the threshold of $250,000 would be constant after 2012 until the contribution and benefit base exceeds this level, at which point the threshold would be set equal to the contribution and benefit base for that and all subsequent years. Earnings subject to tax above the threshold would not be included in earnings credited for the purpose of OASDI benefit computation.

All wages and self-employment earnings in OASDI covered employment during a given year would be reflected in the determination of earnings above the threshold. For workers with more than one employer (including self employment) for a given year, total tax liability for the year would be computed as if all earnings had been received from a single employer for the year, but in no case would any employee or employer pay less tax than they would under current law. To the extent adjustments of payroll tax liability are needed for a given year, employees would make such adjustments on their income tax filing forms. SSA would contact employers regarding any additional tax liability due to multiple jobs for employees during the year.

The balance of this letter provides summary and detailed estimates of the effects of enactment of the proposal.

Summary of Effects on Actuarial Status

Figure 1 below illustrates the expected change in the combined Old-Age and Survivors Insurance (OASI) and Disability Insurance (DI) Trust Fund assets, expressed as a percentage of annual program cost, with enactment of this proposal. Assuming enactment, the OASDI program would be expected to be solvent for the next 75 years, under the intermediate assumptions of the 2011 Trustees Report. The level of assets for the theoretical combined OASI and DI Trust Funds would remain positive through 2085, permitting full payment of scheduled benefits on a timely basis. However, the combined assets would be declining as a percentage of the annual cost of the program at the end of the period. For this reason, the OASDI program would not meet the requirements of sustainable solvency.



Note: *Trust Fund Ratio* for a given year is the ratio of assets in the combined OASI and DI Trust Fund assets at the beginning of the year to the cost of the program during the year.

Enactment of the proposal would improve the long-range OASDI actuarial balance by 2.09 percent of taxable payroll, reducing the actuarial deficit of 2.22 percent of taxable payroll under current law to an actuarial deficit of 0.13 percent of payroll. The assets in the combined OASI and DI Trust Funds would be positive throughout the 75-year period, meaning that solvency would be expected throughout the period. However, assets at the end of 2085, while still positive, would be declining as a percent of annual program cost and so the program would not meet the requirements for sustainable solvency.

Figure 2 below illustrates annual projected levels of cost and income as a percentage of present-law taxable payroll. The projected levels of cost are shown for present-law scheduled benefits ("cost") and payable benefits ("expenditures," when payable benefits are less than scheduled benefits) and for benefits under this proposal. Under this proposal, the combined OASI and DI Trust Funds do not exhaust, and thus payable benefits equal scheduled benefits throughout the 75-year projection period.

Figure 2. Proposal and Present Law Cost and Non-Interest Income as Percent of Taxable Payroll: 2011 TR Intermediate Assumptions

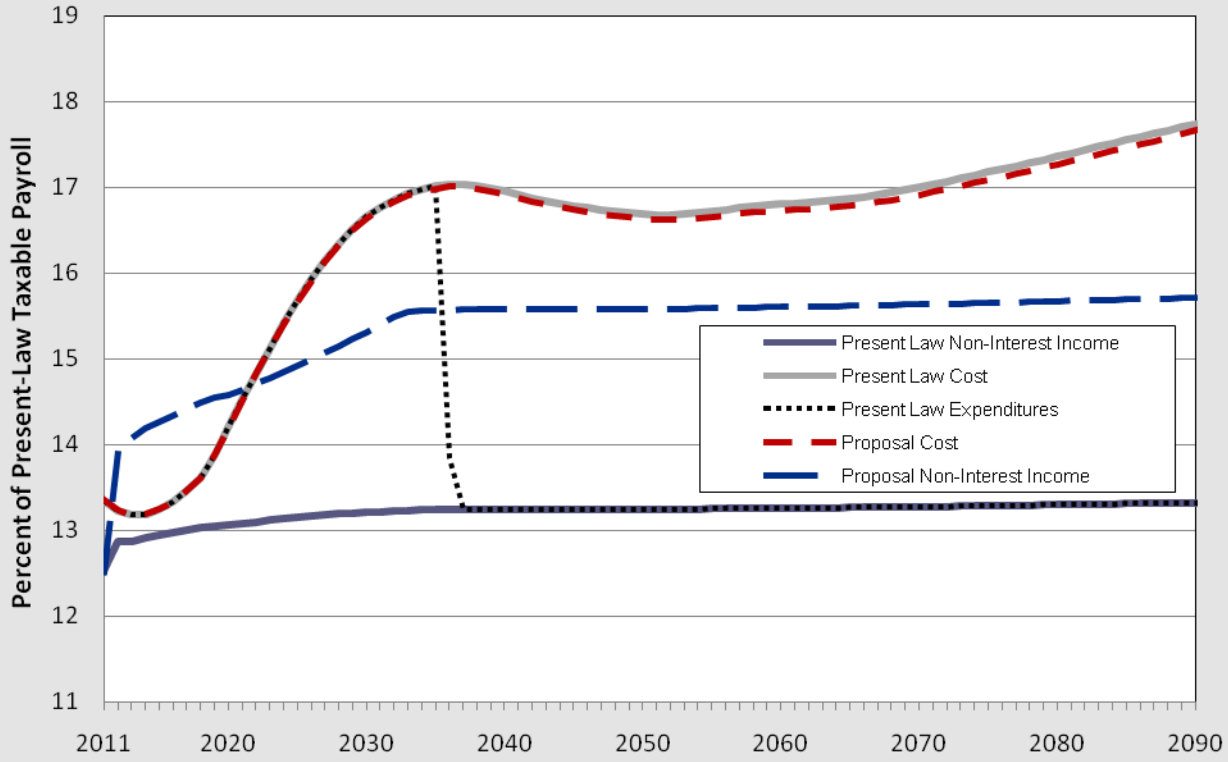
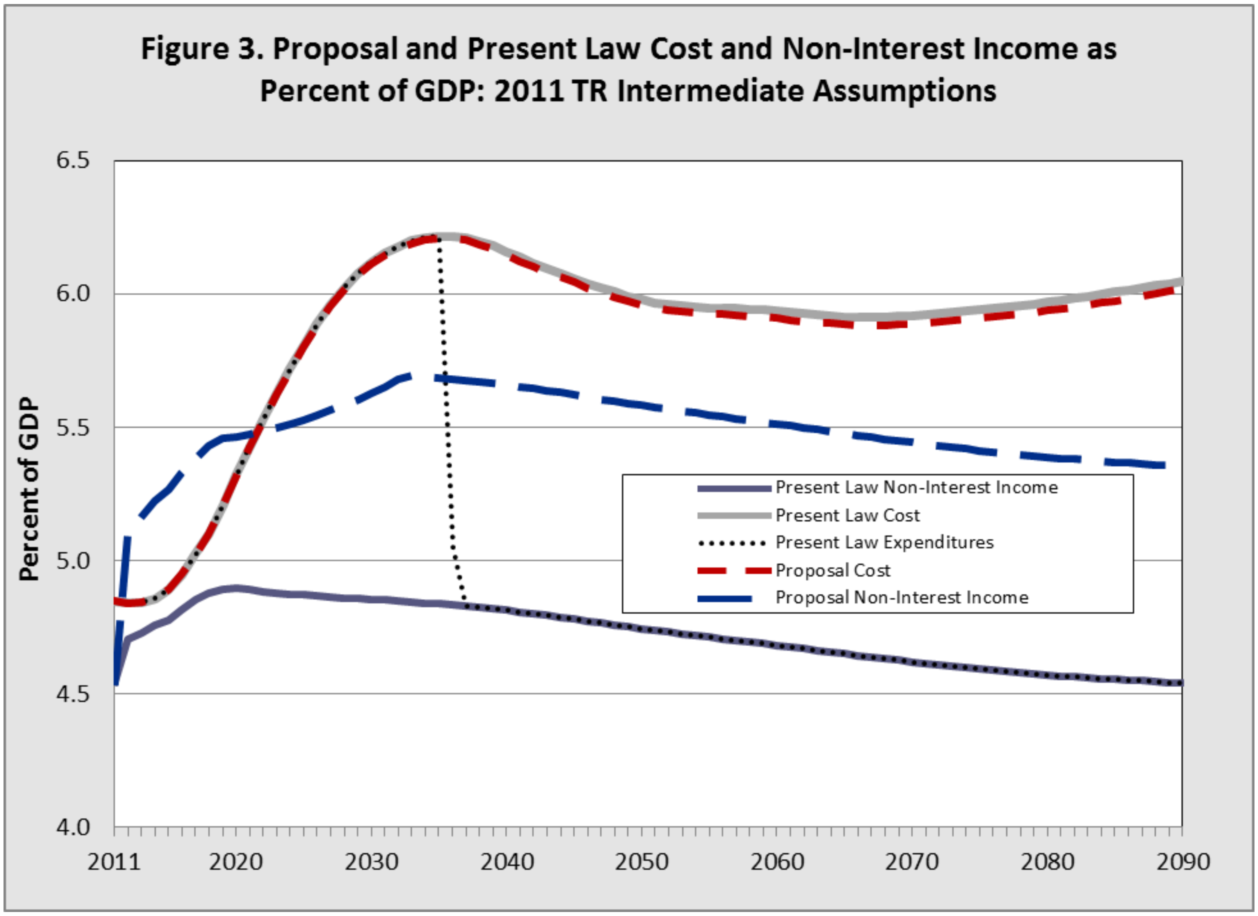


Figure 2 shows that the estimated cost of the OASDI program would be very slightly reduced under this proposal. A slight decrease in benefits is projected to follow from a small decrease in the proportion of employee compensation that would be paid in the form of wages under the current-law contribution and benefit base. This small reduction in wages as a percentage of employee compensation reflects the assumed behavioral response of employees and employers to the additional payroll taxes under the proposal.

It is also useful to consider the projected cost and income for the OASDI program expressed as a percentage of Gross Domestic Product (GDP). The graph below illustrates these levels under both present law and this proposal.



Detailed Financial Results

Benefit Illustrations

Benefit illustrations are not provided for the proposal because benefit levels would not be materially changed from the scheduled benefit levels under current law.

Trust Fund Operations

Table 1 shows the annual cost and income rates, annual balances, and trust fund ratios for OASDI assuming enactment of the proposal. This table also shows the change from present law in these cost rates, income rates, and balances. Included at the bottom of this table are summarized rates for the 75-year long-range period and the expected year of trust fund exhaustion under this proposal.

Table 1 indicates that the OASDI program is projected to be solvent throughout the 75-year projection period assuming enactment of the proposal. After 2018, the trust fund ratio is projected to decline, reaching 10 percent of the next year's annual program cost at the end of the

75-year projection period. The actuarial deficit for the OASDI program over the 75-year projection period would be improved by an estimated 2.09 percent of taxable payroll, from an actuarial deficit of 2.22 percent of payroll projected under current law to an actuarial deficit of 0.13 percent of payroll under the proposal.

Program Transfers and Assets

Column 5 of **table 1a** provides a projection of the asset level for the combined OASI and DI Trust Funds under the proposal, expressed in present value dollars discounted to January 1, 2011. For purpose of comparison, the net OASDI Trust Fund assets, expressed in present value dollars, are also shown for a theoretical Social Security program where borrowing authority is assumed for the Trust Funds. Columns 1 through 3 are all zeros because no General Fund transfers are specified in this proposal. Gross Domestic Product, expressed in present value dollars, is shown in column 6 for comparison with other values in the table.

Effect on the Federal Budget

Table 1b shows the projected effect, in present value discounted dollars, on the Federal unified budget and on-budget cash flows and balances assuming enactment of the proposal. Table 1b.n provides the estimated nominal dollar effect of enactment of the proposal on the annual budget balances for years 2011 through 2020. All values in these tables represent the amount of the *change* that would be expected due to enactment of the proposal, from the level that would be projected under current law.

The effect of the plan on unified budget cash flow (column 3) is expected to be positive for 2012 and throughout the remainder of the long-range period. Column 4 provides the projected effect of implementing the plan on the Federal debt held by the public. Column 5 provides the projected effect on the annual unified budget balances, including both the cash flow effect in column 3 and the change in interest on the accumulated debt indicated in column 4. Under this proposal, Federal debt held by the public would be reduced by about $1.1 trillion in nominal dollars by the end of 2020.

Enactment of this proposal would have no direct effect on the on-budget cash flow or on the total Federal debt subject to limit. There would be essentially no change in the total Federal debt subject to limit because the OASDI combined Trust Fund assets, which are a part of the total Federal debt, would increase by the same amount as the amount of the reduction in publicly-held debt.

It is important to note that these estimates are based on the intermediate assumptions of the 2011 Trustees Report and thus are not consistent with estimates made by the OMB or the CBO based on their assumptions. In addition, estimates in these two tables reflect budget scoring conventions, which presume OASDI benefits would continue to be paid in full after Trust Fund assets become exhausted with borrowing from the General Fund of the Treasury, even though this would not be possible under current law.

Annual Trust Fund Operations as a Percentage of GDP

Table 1c provides annual cost, annual expenditures (on a payable basis), and annual tax income for the OASDI program expressed as a percentage of GDP. These values are shown for both present law and assuming enactment of the proposal. Showing the annual trust fund flows as a percentage of GDP provides an additional perspective on these trust fund operations in relation to the total value of goods and services produced in the United States.

Effects on Trust Fund Assets and Unfunded Obligations

Table 1d provides estimates of the changes due to the proposal in the level of projected trust fund assets under present law and, for years after trust fund exhaustion, the level of unfunded obligations under present law. All values in the table are expressed in present-value discounted dollars. For the 75-year long-range period as a whole, the present-law unfunded obligation of $6.5 trillion in present value is replaced with a positive trust fund balance of $0.04 trillion in present value through the end of the period. This change is the combination of the following:

- A $6.5 trillion increase in revenue from applying the payroll tax to covered earnings above the present-law contribution and benefit base (column 2), less
- A $0.1 trillion reduction in cost from the behavioral response to additional payroll tax, causing a small decrease in the share of employee compensation that is received in wages, and thus a small decrease in total benefits (column 3).

We hope these estimates will be helpful. Please let me know if we may provide further assistance.

Sincerely,

Stephen C. Goss

Stephen C. Goss
Chief Actuary

Enclosures