SOCIAL SECURITY ADMINISTRATION

SOCIAL SECURITY

Office of the Chief Actuary

September 12, 2012

The Honorable Kay Bailey Hutchison
United States Senate
Washington, D.C. 20510

Dear Senator Hutchison:

We are writing in response to your request on August 1, 2012 for estimates of the financial effects on Social Security of a proposal to restore 75-year solvency for Social Security. We have worked closely with Ashley Fingarson of your staff in the development of the proposal. The estimates provided here reflect our understanding of the intent. All estimates are based on the intermediate assumptions of the 2012 Trustees Report. The estimates presented reflect the combined efforts of many in our office, but particularly Dan Nickerson, Jason Schultz, Tiffany Bosley, Michael Clingman, Katie Kraft, and Kyle Burkhalter.

The proposal includes the following two provisions:

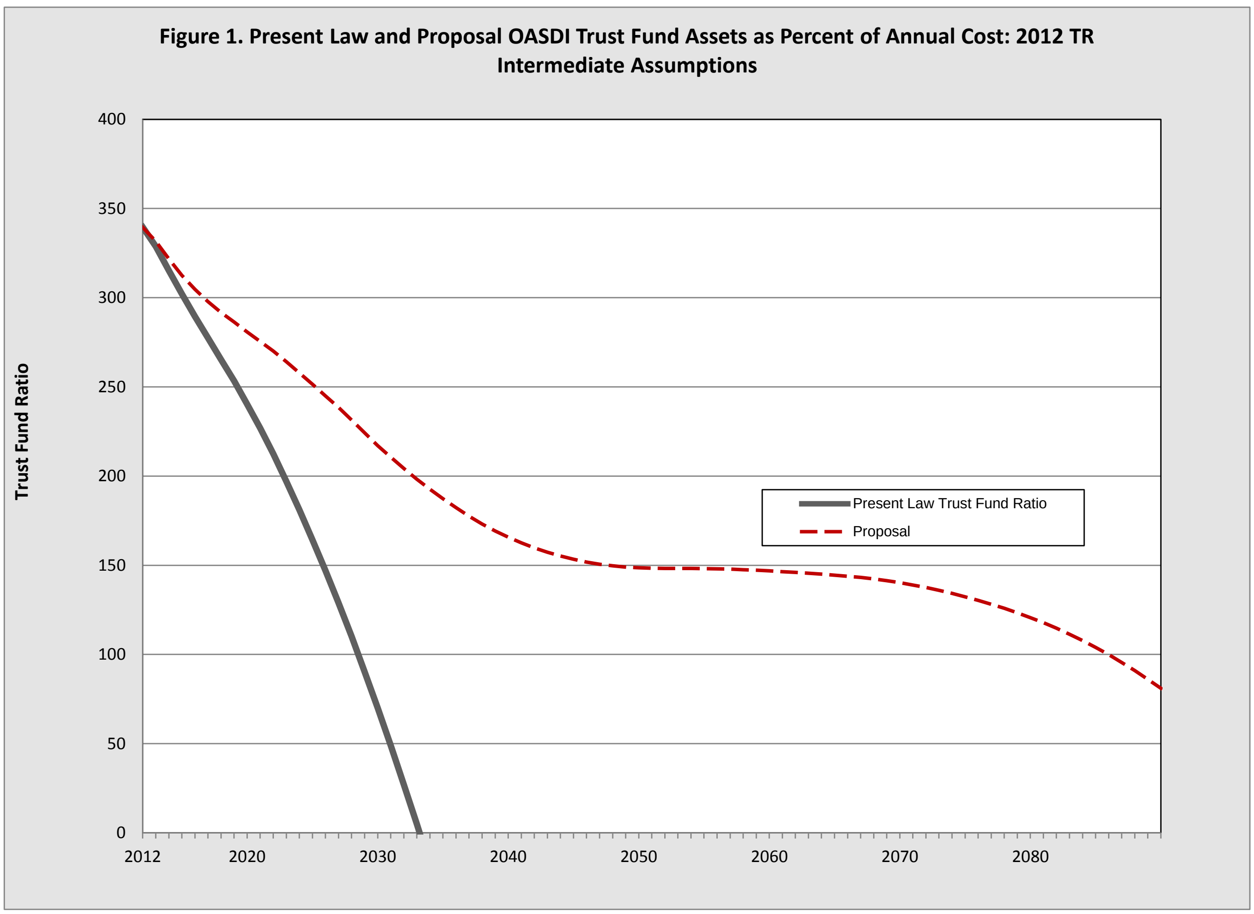
- The Normal Retirement Age (NRA) will increase 3 months each year starting with individuals reaching age 62 in 2016 and stop when the NRA reaches age 70 for individuals reaching age 62 in 2031 and later. The Earliest Eligibility Age (EEA) will increase by 3 months per year starting with individuals reaching age 62 in 2016 and will stop when the EEA reaches age 64 for individuals reaching age 62 in 2023 and later.

- The annual cost-of-living adjustment (COLA) for all OASDI benefits will be computed for each year starting December 2012 exactly as specified in current law and will then be reduced by 1 percentage point, but not to less than zero. When the COLA is reduced by less than one percentage point for any year, the remaining potential reduction will not be carried over to a subsequent year.

The balance of this letter provides a summary of the estimated effects of enacting this proposal on the actuarial status of the OASDI program, a description of our understanding of the intent of the proposal, and detailed estimates of the effects of enactment.

Summary of Effects on Actuarial Status

Figure 1 below illustrates the expected change in the combined Old Age, Survivors Insurance (OASI) and Disability Insurance (DI) Trust Fund assets, expressed as a percent 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 2012 Trustees Report. The level of assets for the theoretical combined OASI and DI Trust Funds would remain positive through 2086, permitting full payment of scheduled benefits on a timely basis. The level of Trust Fund assets expressed as a percentage of annual program cost would decline gradually, but steadily, from 340 percent at the beginning of 2012 to 96 percent of annual cost at the beginning of 2087. At the end of the 75-year period, assets in the combined trust funds would be declining by 4 percentage points per year relative to annual program cost. With enactment of the proposal, the OASDI program would therefore be projected to be solvent for the next 75 years but would not meet the requirements of sustainable solvency, which additionally requires that trust fund assets be stable or rising as a percent of annual program cost at the end of the 75-year period.

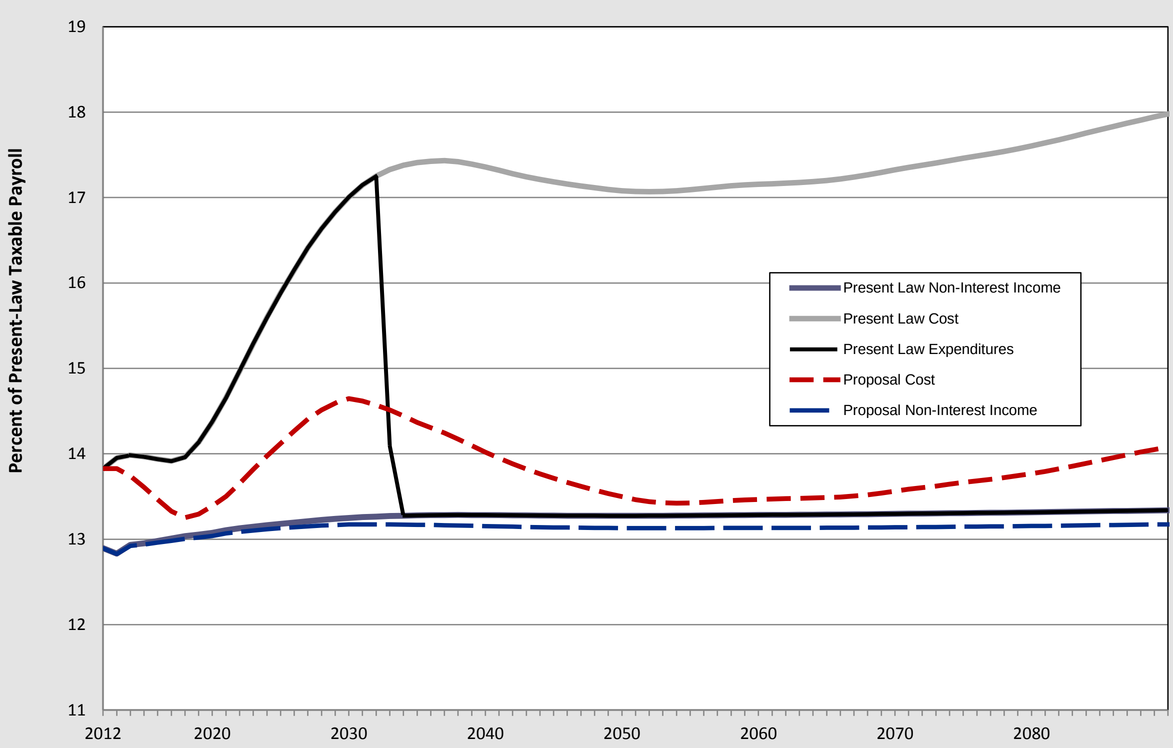


Note: *Trust Fund Ratio* for a given year is the ratio of assets in the combined OASI and DI Trust Fund assets at the beginning of the year to the cost of the program during the year.

Enactment of the proposal would improve the long-range OASDI actuarial balance by 2.66 percent of taxable payroll, reducing the actuarial deficit of 2.67 percent of taxable payroll under current law with an actuarial deficit of 0.01 percent of payroll.

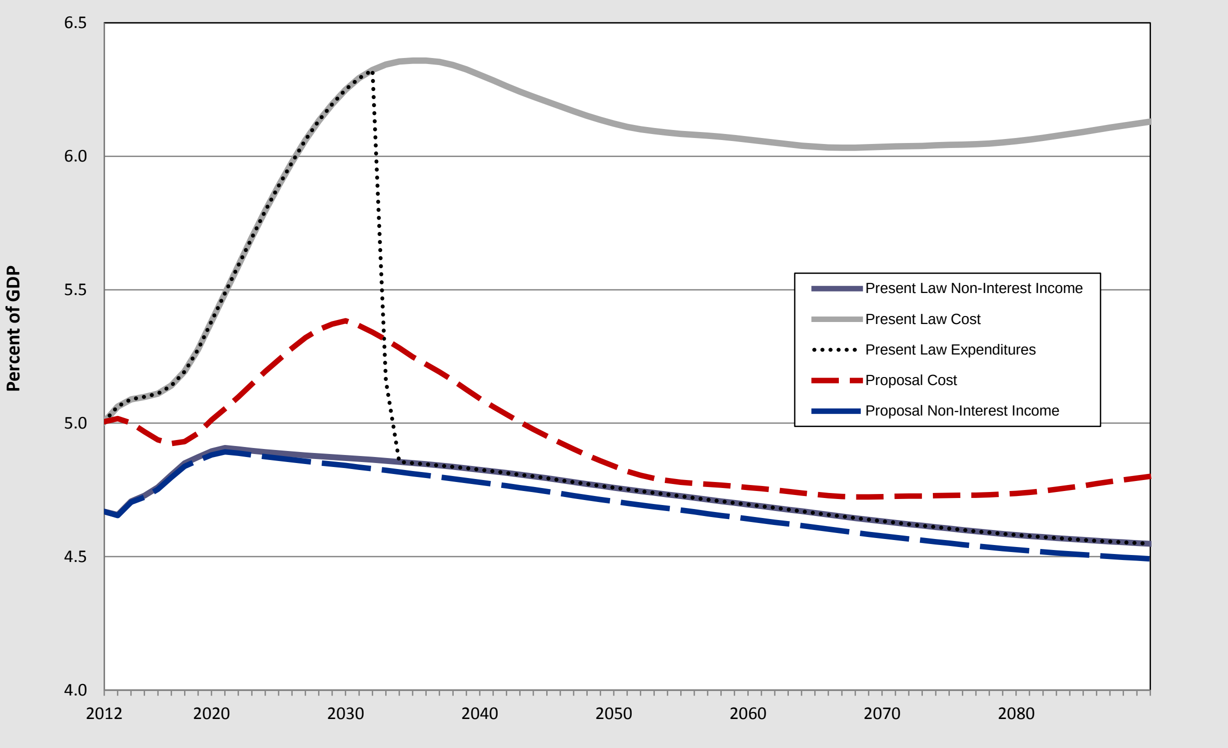
Figure 2 below illustrates annual projected levels of cost and income as a percent of taxable payroll under current law. The projected levels of cost are shown for present-law scheduled and payable benefits (when less than the cost for scheduled benefits) and for benefits under this proposal. Under this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

Figure 2. Proposal and Present Law Cost and Non-Interest Income as Percent of Taxable Payroll: 2012 TR Intermediate Assumptions



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 current law and this proposal.

Figure 3. Proposal and Present Law Cost and Non-Interest Income as Percent of GDP: 2012 TR Intermediate Assumptions



<u>Plan Specification for Provisions of the Hutchison Proposal</u>

(1) Increase the Normal Retirement Age and Earliest Eligibility Age

Under current law, the normal retirement age (NRA) will increase 2 months per year beginning with individuals attaining age 62 in 2017 until it reaches age 67. Thus, the NRA for individuals attaining age 62 in 2022 and later is age 67. Individuals who delay receipt of benefits until after reaching their NRA receive increases in their benefits (delayed retirement credits) at a rate of 8 percent for each delayed year up to age 70. The earliest eligibility age (EEA) under current law does not change in the future; it remains at age 62.

This provision would increase the NRA by 3 months per year beginning with individuals attaining age 62 in 2016 until the NRA reaches age 70. Thus, the NRA for individuals attaining age 62 in 2031 and later would be age 70.

This provision also changes the earliest eligibility age (EEA) for retirement benefits from age 62 to age 64. The EEA would increase 3 months per year starting with individuals attaining age 62 in 2016 and stopping with individuals attaining age 62 in 2023. For individuals attaining age 62 after 2023, the EEA would be age 64. We assume that increasing the EEA would increase the indexing year (for both PIA bend points and AIME) and the earnings computation period used for the AIME. Thus, earnings used in calculating an individual's average indexed monthly earnings (AIME) would continue to be indexed to the second year before the individual's year of initial eligibility. However, we assume no change in the requirements for fully insured status. Disabled worker benefits would continue to be payable from the Disability Insurance Trust Fund until conversion to retired worker status at NRA.

This provision alone would reduce the long-range OASDI actuarial deficit by an estimated 1.20 percent of taxable payroll and would reduce the annual deficit for the 75th projection year (2086) by 1.84 percent of payroll.

(2) Modify the Annual Cost-of-Living Adjustment (COLA)

Under current law, the level of OASDI benefits for individuals eligible for each December are increased based on the increase in the Consumer Price Index for Urban Wage earners and Clerical Workers (CPI-W). The computation quarter for a December COLA is the average level of the CPI-W for the third calendar quarter of that year. The COLA is equal to the increase in the CPI-W, if any, from the computation quarter used for the last COLA to the current year computation quarter. If the increase rounds to zero, or the CPI-W decreased over this period, then there is no COLA.

Under this provision, the COLA would be computed for each December in a two-step process. First, a preliminary COLA would be computed exactly as if this provision in this proposal had never been enacted. Second, the preliminary COLA would be reduced by 1 percentage point, but not to less than zero. In years when the preliminary COLA is computed as less than 1.0 percent, the final COLA would be zero, and the unused portion of the 1-percentage-point reduction will not be retained and carried over to any subsequent COLA. Based on this specification we estimate that the average reduction to COLAs in the future will be about 0.937 percentage point.

This provision alone would reduce the long-range OASDI actuarial deficit by 1.62 percent of taxable payroll and would reduce the annual deficit for the 75th projection year (2086) by 2.14 percent of payroll.

Detailed Financial Results

Summary Results by Provision

Table A provides estimates of the effects on the OASDI long-range actuarial balance for each provision of the proposal separately, and on a combined basis. Summary estimates are also provided for the effect on the annual balance (the difference between income rate and the cost rate, expressed as a percent of present-law taxable payroll) for the 75th projection year, 2086.

Benefit Illustrations

Tables B1 and B2 provide illustrative examples of the projected change in benefit levels under this proposal for beneficiaries retiring at age 65 in future years at various earnings levels. Table B1 compares the changes in initial benefit levels to both scheduled and payable present-law benefits. Table B2 compares the changes in benefit levels at ages 65, 75, 85, and 95 to scheduled benefits under present law. Table B2 shows that benefit levels under the proposal, relative to present law scheduled levels, would be reduced on an accumulating basis for retirees after their age of initial eligibility as a result of the reductions to the COLA. Reductions in the COLA apply to all benefit levels after 2012, including benefits for retirees who attain 65 in 2012 and would therefore have become initially eligible for retirement benefits in 2009.

In addition, Table B3 provides an indication of various factors for the individuals represented in each of the 10 groups, based on data from 2007. This distribution is useful in understanding the nature of the individuals who have the various levels of career-average earnings achieved with varying numbers of years with non-zero earnings.

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 2012, the trust fund ratio is projected to decline slowly but steadily, reaching a projected level of 96 percent of the next year's annual program cost at the beginning of 2087. Because the ratio of trust fund assets to annual program cost would be declining by 4 percentage points per year at the end of the 75-year period, the proposal does not meet the requirements for sustainable solvency. The actuarial deficit for the OASDI program over the 75-year projection period would be improved by an estimated 2.66 percent of taxable payroll, from an actuarial deficit of 2.67 percent of payroll projected under current law to an actuarial deficit of 0.01 percent of payroll under the proposal.

The annual balance for the OASDI program (non-interest income minus cost) would be improved for all years after 2012. The projected annual deficits for years after 2012 would be substantially smaller than under current law. The annual deficit for 2086 would be 0.79 percent of payroll, or 3.71 percent of payroll less than under current law.

Program Transfers and Assets

Column 5 of **table 1a** provides a projection of asset level for the combined OASI and DI Trust Funds under the proposal, expressed in present value January 1, 2012 dollars, using projected Trust Fund interest rates. 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 5 for comparison with other values in the table.

Effect on the Federal Budget and Debt

Table 1b shows the projected effects of enactment of this proposal, in present value discounted dollars, on (1) the Federal unified budget and on-budget annual balances, and (2) the levels of publicly held debt and total Federal debt. Table 1b.n provides the estimated nominal-dollar effects of enactment of the proposal for years 2012 through 2022. 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 OASDI program is accounted for on an off-budget basis in the Federal Budget and therefore does not directly affect the on-budget expenditures or balances. In addition, the OASDI program has no direct net effect on the total Federal debt liability, which is comprised of publicly held debt plus debt owed to the Federal trust funds. Any accumulated assets in the trust funds, which are liabilities of the U.S. Treasury, would instead be borrowed from and owed to the public if the trust funds had not run net surpluses over past years. Any changes in OASDI cash flow from this or other OASDI legislation do not directly affect total Federal debt, or on-budget annual balances. The exception would be a provision that provides specified transfers from the General Fund of the Treasury to the trust funds. Such transfers would represent a decrease in the on-budget balance and an increase in the total Federal Debt. As there are no such transfers specified in this proposal, values in columns (6) and (7) of tables 1b and 1b.n are zero for this proposal.

However, when the on-budget and off-budget operations are considered on a "unified" basis, as is often the case, any changes in OASDI cash flow (non-interest income and cost) generally translate directly into cash-flow effects on the unified budget, and accumulated effects on that portion of total Federal debt that is borrowed from the public. The extent to which OASDI annual cash-flow surpluses and deficits influence other federal spending and tax levels is speculative and is not addressed in this analysis.

The effect of the plan on OASDI program cash flow (column 2) and on unified budget cash flow (column 3) is expected to be positive throughout 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 additional interest on the accumulated debt indicated in column 4.

The projected reduction in publicly held debt under this proposal, $9.0 trillion in present value by the end of 2086, is exactly equal to the change shown in table 1a, from an OASDI unfunded obligation of $8.6 trillion through 2086 to a projected positive OASDI Trust Fund asset level of $0.4 trillion at the end of 2086. Thus, under budget scoring convention (which assumes the OASDI Trust Funds can and would borrow $8.6 trillion from the General Fund of the Treasury through 2086, even though this is not allowed under the law), the total federal debt would be unaffected by the proposal. The $9.0 trillion of debt owed to the public would be replaced by a net increase in the amount owed to the trust funds of $9.0 trillion. It is important to note that these estimates are based on the intermediate assumptions of the 2012 Trustees Report and thus are not consistent with estimates made by the OMB or the CBO based on their assumptions.

Annual Trust Fund Operations as a Percent of GDP

Table 1c provides annual cost, annual expenditures (on a payable basis), and annual non-interest 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 percent 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 $8.6 trillion in present value is replaced with a positive trust fund balance of $0.4 trillion in present value through the end of the period. This change is the combination of the following:

- A $0.4 trillion net decrease in income from the two provisions of the proposal (column 2). Revenue from taxation of Social Security benefits is reduced due to diminished benefit levels under the proposal provisions. However, this reduction is partially offset by expected increased payroll tax revenue from raising the EEA and NRA (individuals working more at older ages).

- A $9.3 trillion decrease in cost from the two provisions of the proposal that affect OASDI benefits (column 3).

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

Sincerely,

Stephen C. Goss, Chief Actuary

Alice H. Wade, Deputy Chief Actuary

Christopher J. Chaplain, Supervisory Actuary

Enclosures