

Memorandum

August 21, 2003

To: Bob Pozen

From: Steve Goss

Subject: Preliminary Estimates for a Proposal to Reduce Benefits above the Level Provided at the 30<sup>th</sup> Percentile under Present Law

This note provides preliminary estimates for a proposal that we have developed based on the goals and specifications you have provided. The basic goals are as follows:

- 1) Reduce benefits for the highest earners consistent with CPI-indexing the benefit formula.
- 2) Maintain the full present-law scheduled benefit level for workers retiring with career average earnings below the 30<sup>th</sup> percentile of all such retirees.
- 3) Provide phased reductions for workers with career-average earnings between the highest earners and the 30<sup>th</sup> percentile.
- 4) Begin reductions for beneficiaries becoming eligible in 2012 and continue reductions until the level projected for 2077 under the 2003 Trustees Report is reached.

In order to meet these specifications, we have developed the following three-step approach.

(A) Begin by computing the percentage benefit reduction that would apply for the highest career-average earner becoming eligible for a retired worker benefit in each year 2012 and later based on CPI-indexing the PIA formula (as specified in Model 2 of the President's Commission to Strengthen Social Security). The maximum reduction used for this purpose is the reduction that would be achieved for the earner becoming eligible in 2077, using the intermediate assumptions of the 2003 Trustees Report, which is a reduction of about 50 percent.

(B) Then create a new "bend point" in the Social Security PIA formula at the level of the career-average earnings of the retiree at the 30<sup>th</sup> percentile of those becoming eligible for benefits in 2010, and wage index this bend point forward like the two current bend points. This new bend point is estimated to be 28.6 percent of the way up from the current first bend point to the current second bend point.

(C) Calculate the percentage reduction to the "PIA factors" (32 and 15) that applies beyond the new PIA bend point that will provide the benefit reduction described above for the "maximum" earner reaching retirement eligibility for each year 2012 and later. Depending on the rate at which the average earnings level actually grows in real terms, the maximum specified reduction to PIA factors above the new bend point might be reached before or after 2077.

This proposal would replicate benefit reductions for the very highest career-average earners that are provided under a CPI-indexed benefit formula. Benefit levels would be reduced to a lesser extent for workers with lower career-average earnings, with no reduction for those below the 30<sup>th</sup> percentile of career-average

earnings (AIME). The attached table provides illustrations of the benefit reductions that would apply. The ultimate reductions would be attained for those becoming eligible for benefits in 2077 under the 2003 Trustees Report intermediate assumptions. At this point, 86.42 percent of the incremental benefits provided under current law for those workers with career-average earnings above the 30-th percentile would be eliminated. Thus, benefits provided under the Social Security program would be much flatter for earnings above this level. The career average indexed earnings level used for Social Security benefit purposes is currently about \$17,731 at the 30<sup>th</sup> percentile, and is estimated to be about \$25,000 at the 30<sup>th</sup> percentile for retirees becoming eligible for benefits in 2012.

The highest earning workers would have an ultimate reduction of about 50 percent in their benefit level. Lesser reductions would apply for lower career-average earners. After this reduction is achieved standard "wage indexing" of benefit levels would resume. Ultimately, this proposal would lower total OASDI benefit payments by about 29 percent. The reduction for benefits payable in 2077, the last year of the 75-year valuation period, is estimated at roughly 25 percent for all beneficiaries then receiving a benefit. This provides well over one half of the 35-percent reduction in benefit payments that would be projected to occur for 2077 if the law is not changed by that time. By about the end of the century, the average reduction in all benefits would be expected to match the maximum 29-percent reduction in benefits under the proposal, which is expected to be realized for those becoming newly eligible for a benefit in 2077 and later.

Based on preliminary analysis this proposal is estimated to reduce the OASDI actuarial deficit of 1.92 percent of taxable payroll by roughly 1.3 percent of payroll, to a level of roughly 0.6 percent of payroll. Thus, this proposal is estimated to eliminate about 2/3 of the current projected OASDI actuarial deficit. The year of OASDI combined Trust Fund exhaustion would be extended by enactment of this proposal for likely about 10 years, or more, beyond the year 2042 (the year during which exhaustion is projected to occur under current law). The cash-flow shortfall of the OASDI program for 2077 and subsequent years through the end of this century would be expected to be reduced by about 70 percent.

All estimates are based on the intermediate assumptions of the 2003 Trustees Report. These include assumed ultimate annual growth rates of 4.1 percent in the average wage in OASDI covered employment, and 3.0 percent in the Consumer Price Index for Urban Wage Earners.



Steve Goss, Chief Actuary  
Social Security Administration

Table 1

## Pozen PIA Indexing Provision--- PRELIMINARY ESTIMATE

	With Ult Real TF Int Rate of 3.0	With Ult Real IA Yld Rate of 3	With Annuity Net Yld Rate 3		Change in OASDI Contrib Rate	OASDI Contrib Rate
Year	Cost Rate	Income Rate	Annual Balance	TFR 1-1-yr		
2003	10.89	12.70	1.81	288		12.40
2004	10.82	12.69	1.88	309		12.40
2005	10.73	12.70	1.97	330		12.40
2006	10.65	12.70	2.05	352		12.40
2007	10.67	12.72	2.05	372		12.40
2008	10.73	12.73	2.00	392		12.40
2009	10.84	12.74	1.90	410		12.40
2010	10.99	12.76	1.78	426		12.40
2011	11.16	12.80	1.64	440		12.40
2012	11.37	12.82	1.45	452		12.40
2013	11.61	12.84	1.23	461		12.40
2014	11.87	12.86	0.99	468		12.40
2015	12.15	12.88	0.73	472		12.40
2016	12.46	12.90	0.44	473		12.40
2017	12.78	12.92	0.14	471		12.40
2018	13.11	12.94	-0.17	467		12.40
2019	13.43	12.96	-0.47	462		12.40
2020	13.77	12.98	-0.79	454		12.40
2021	14.11	13.00	-1.11	444		12.40
2022	14.43	13.02	-1.41	434		12.40
2023	14.71	13.04	-1.67	422		12.40
2024	14.98	13.06	-1.92	411		12.40
2025	15.23	13.07	-2.16	398		12.40
2026	15.45	13.09	-2.37	384		12.40
2027	15.67	13.10	-2.56	370		12.40
2028	15.85	13.12	-2.74	356		12.40
2029	16.01	13.13	-2.88	341		12.40
2030	16.14	13.14	-3.00	326		12.40
2031	16.23	13.15	-3.08	311		12.40
2032	16.30	13.16	-3.14	296		12.40
2033	16.34	13.16	-3.18	280		12.40
2034	16.35	13.17	-3.19	265		12.40
2035	16.35	13.17	-3.17	250		12.40
2036	16.32	13.17	-3.14	235		12.40
2037	16.27	13.18	-3.10	221		12.40
2038	16.21	13.18	-3.04	206		12.40
2039	16.15	13.17	-2.97	192		12.40
2040	16.08	13.17	-2.90	177		12.40
2041	16.01	13.17	-2.83	163		12.40
2042	15.94	13.17	-2.76	149		12.40
2043	15.87	13.17	-2.70	134		12.40
2044	15.81	13.17	-2.64	120		12.40
2045	15.76	13.17	-2.59	106		12.40
2046	15.71	13.17	-2.55	92		12.40
2047	15.67	13.17	-2.50	78		12.40
2048	15.63	13.17	-2.46	63		12.40
2049	15.60	13.17	-2.43	49		12.40
2050	15.57	13.17	-2.40	34		12.40
2051	15.54	13.17	-2.38	20		12.40
2052	15.53	13.17	-2.36	5		12.40
2053	15.51	13.17	-2.34	--		12.40
2054	15.49	13.17	-2.32	--		12.40
2055	15.47	13.17	-2.30	--		12.40
2056	15.45	13.17	-2.28	--		12.40
2057	15.43	13.17	-2.25	--		12.40
2058	15.40	13.17	-2.23	--		12.40
2059	15.36	13.17	-2.19	--		12.40
2060	15.33	13.17	-2.16	--		12.40
2061	15.29	13.17	-2.12	--		12.40
2062	15.25	13.17	-2.08	--		12.40
2063	15.22	13.17	-2.05	--		12.40
2064	15.19	13.17	-2.02	--		12.40
2065	15.15	13.17	-1.99	--		12.40
2066	15.12	13.16	-1.96	--		12.40
2067	15.10	13.16	-1.93	--		12.40
2068	15.07	13.16	-1.91	--		12.40
2069	15.05	13.16	-1.88	--		12.40
2070	15.02	13.16	-1.86	--		12.40
2071	15.00	13.16	-1.84	--		12.40
2072	14.98	13.16	-1.82	--		12.40
2073	14.95	13.16	-1.79	--		12.40
2074	14.93	13.16	-1.77	--		12.40
2075	14.91	13.16	-1.75	--		12.40
2076	14.88	13.16	-1.73	--		12.40
2077	14.86	13.16	-1.70	--		12.40
2078	14.84	13.16	-1.68	--		12.40
Summarized						
	CostRt	IncRt	ActBal	Change in		
2003	OASDI	OASDI	OASDI	ActBal		
-2077	14.26	13.71	-0.55	1.36		

Based on Intermediate Assumptions of the 2003 Trustees Report  
With Ult Real Int Rate of 3.00

Office of the Actuary  
Social Security Administration  
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**Table A. Projected Change in PIA for Illustrative Earnings Levels---Proposal to Gradually Reduce the PIA for Those with Career Earnings Above the 30th Percentile -- Illustrations for Eligibility in 2012 and 2077**

	<u>"MAX"</u> <u>100%ile</u>	<u>"High"</u> <u>82%ile</u>	<u>"Medium"</u> <u>54%ile</u>	<u>42%ile</u>	<u>34%ile</u>	<u>30%ile</u>	<u>"Low"</u> <u>25%ile</u>
<b><u>Current Benefit levels---2003 Eligibility</u></b>							
Career Average Earns--2001Level	\$80,400	\$52,675	\$32,922	\$25,000	\$20,000	\$17,731	\$14,815
resent Law PIA for 2003 (monthly)	\$1,978	\$1,631	\$1,229	\$1,018	\$885	\$824	\$747
Percent of PL PIA Above 30%ile	58.3%	49.5%	32.9%	19.0%	6.8%	0.0%	0.0%
<b><u>Current and Proposed Benefit levels---2012 Eligibility</u></b>							
Career Average Earns--2010Level	\$113,100	\$74,254	\$46,409	\$35,242	\$28,193	\$24,995	\$20,884
resent Law PIA for 2012 (monthly)	\$2,785	\$2,299	\$1,733	\$1,435	\$1,247	\$1,162	\$1,052
Proposal PIA for 2012 (monthly)	\$2,755	\$2,279	\$1,723	\$1,430	\$1,246	\$1,162	\$1,052
Percent Reduction	1.1%	0.9%	0.6%	0.3%	0.1%	0.0%	0.0%
<b><u>Current and Proposed Benefit levels---2077 Eligibility</u></b>							
Career Average Earns--2075Level	\$1,540,800	\$1,011,659	\$632,287	\$480,126	\$384,101	\$340,522	\$284,529
resent Law PIA for 2077 (monthly)	\$37,939	\$31,324	\$23,613	\$19,555	\$16,995	\$15,832	\$14,339
Proposal PIA for 2077 (monthly)	\$18,834	\$17,936	\$16,889	\$16,338	\$15,990	\$15,832	\$14,339
Percent Reduction	50.4%	42.7%	28.5%	16.5%	5.9%	0.0%	0.0%

Based on intermediate assumptions of the 2003 Trustees Report.

Proposal designed to provide annual PIA reductions for the "MAX" earner equivalent to CPI-indexing, by reducing the PIA factors applicable to career average earnings (AIME) above the 30th Percentile. The same reductions apply dollars of AIME above the level of the 30th Percentile for all workers. Reductions begin for 2012, and stop at the reduction projected for 2077 under the 2003 Trustees Report intermediate assumptions.

OCACT/SSA

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