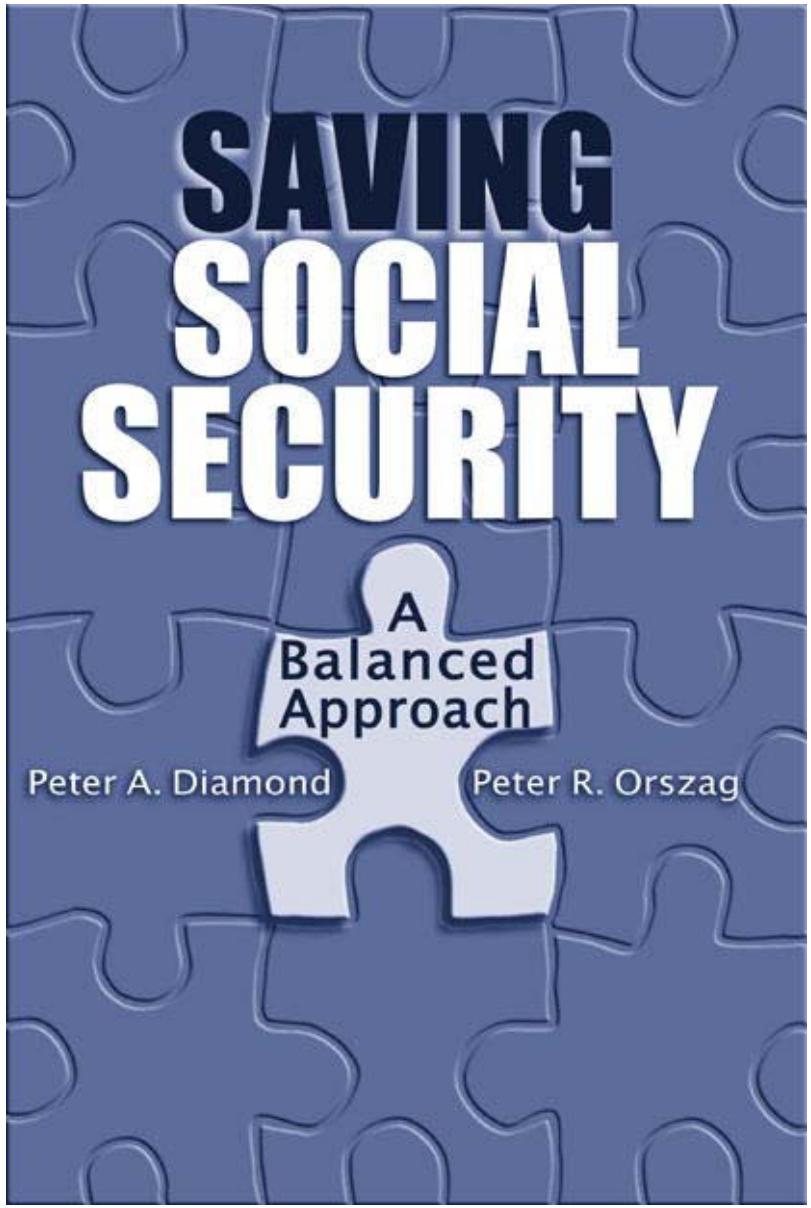

Overview of *Saving Social Security*

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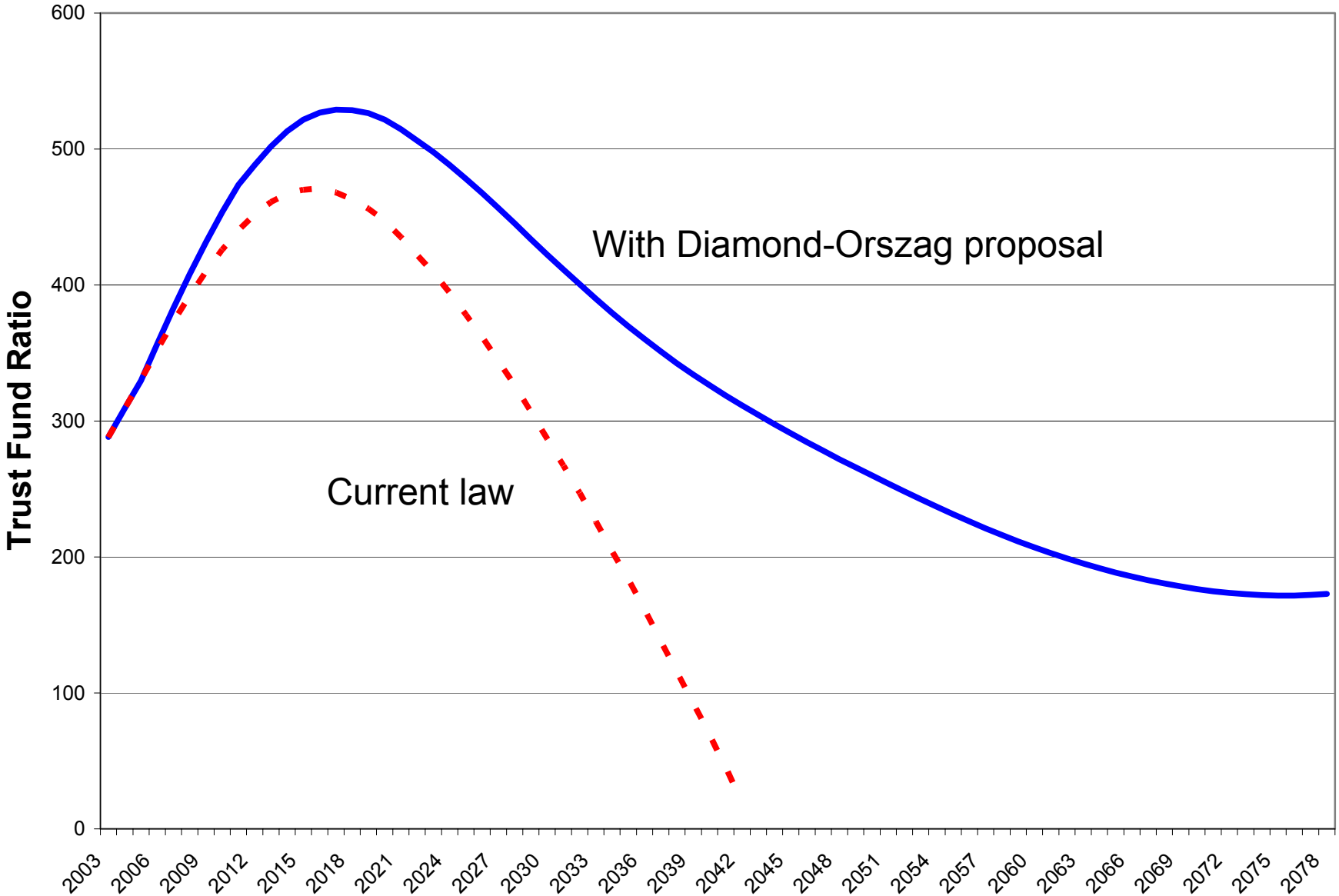
Saving Social Security

- Restore long-term sustainable solvency
- Do not destroy program in order to save it
- No accounting gimmicks or magic asterisks
  - No general revenue transfers, no ignoring risks of stocks
- Combine benefit reductions and revenue increases, rather than relying solely on either
  - Follow precedent of 1983 Greenspan reforms

A Progressive Reform

- Protect most vulnerable: disabled workers, young surviving children, lifetime low earners, widows
- Ask average earners to accept modest sacrifices
- Ask higher earners to play somewhat larger role in reaching long-term balance

Bottom line: Sustainable solvency



Bottom line: Benefits for medium earners

Age in 2004	Percentage change in benefits from those under current benefit formula	Inflation-adjusted benefit at full benefit age relative to 55-year-old in 2004
55	0.0%	100%
45	-0.6%	110%
35	-4.5%	118%
25	-8.6%	125%

- Benefit reductions less substantial for lower earners and more substantial for higher earners.
- Benefit reduction for 25-year-olds smaller than under 1983 reforms.

Bottom line: Payroll tax rate

	Employee rate	Combined employer-employee rate	Note: Combined rate needed to finance benefits under current benefit formula
2005	6.2%	12.4%	12.4%
2015	6.2%	12.5%	12.4%
2025	6.4%	12.7%	12.4%
2035	6.6%	13.2%	12.4%
2045	6.8%	13.7%	17.0%
2055	7.1%	14.2%	17.7%

- If 2045 increase implemented this year, $35,000 earner would pay extra $37 per month in combined employer-employee taxes
- For 25-year-old average earner, present value of additional combined ***lifetime*** tax is 0.3 percent of career wages

Structure of plan to restore solvency

Three-part plan linked to three causes of deficit:

- Life expectancy
- Income inequality
- “Legacy debt”

Part 1: Life expectancy

- Life expectancy at age 65 has risen by 4 years for men and 5 years for women since 1940
- It is expected to continue rising in the future

- Increasing life expectancy raises value of Social Security benefits to workers, because benefits last as long as recipient is alive
- By same token, however, improving life expectancy raises Social Security's cost, because beneficiaries collect benefits over a longer period

Part 1: Life expectancy adjustment

- Goal: Offset effect of increasing life expectancy on Social Security solvency

- Each year, calculate cost to Social Security from increased life expectancy of those approaching retirement

- Do **not** increase retirement age/full benefit age

- Instead:
- Offset **roughly half** the cost of increasing life expectancy through **gradual benefit reduction**
- Offset **roughly half** the cost through **gradual payroll tax increase**

Part 2: Income inequality

- Share of earnings above maximum taxable earnings base ($87,000 in 2003) has increased from 10% in 1983 to 15% in 2002

- Life expectancy of people with higher earnings and more education has grown much more rapidly than that of those with lower earnings and less education

Part 2: Income inequality adjustments

- Goal: Limit effects of changes in earnings patterns and life expectancies on Social Security financing and lifetime progressivity

- Balance benefit and revenue changes

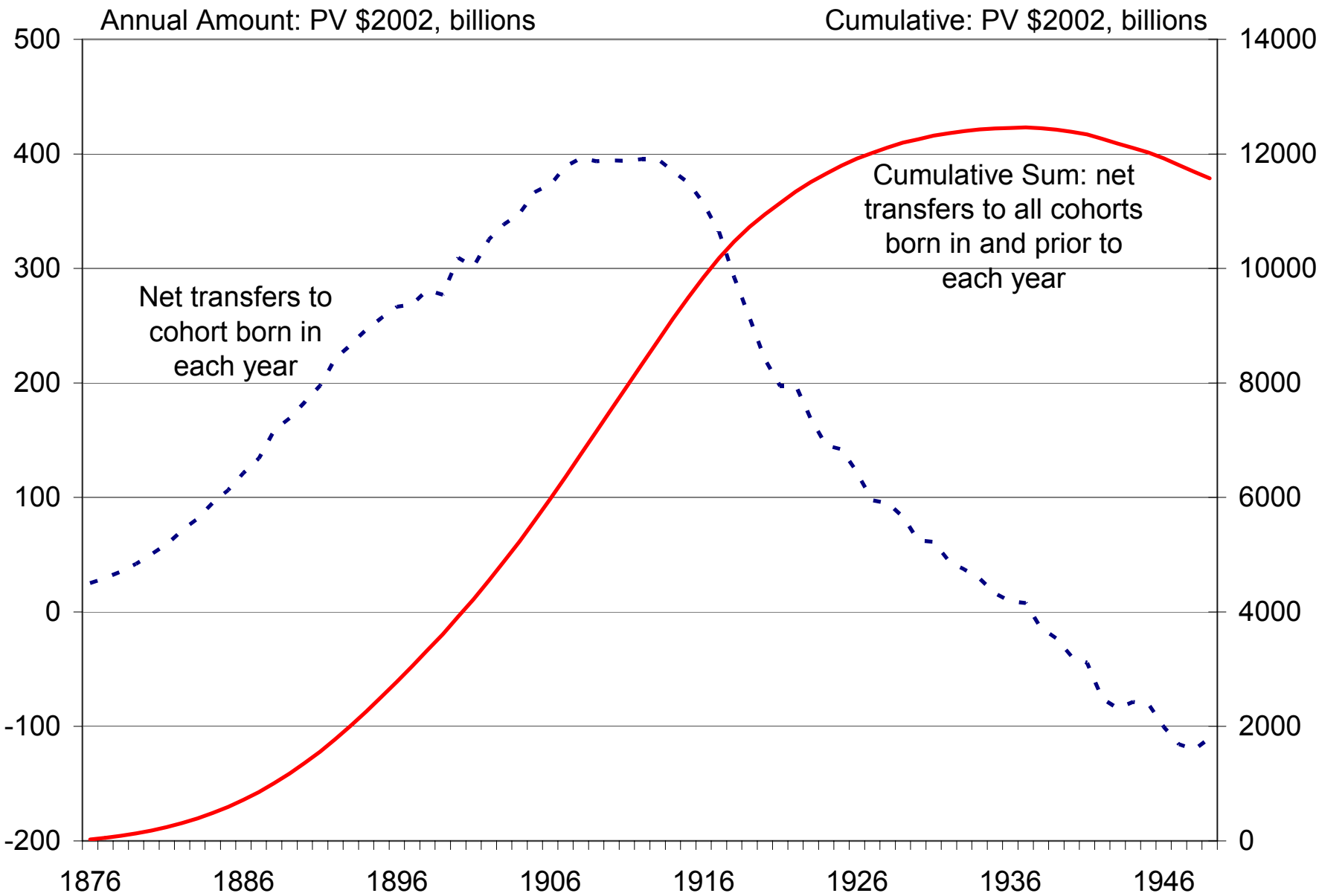
- Gradually **raise maximum taxable earnings base** until share of earnings above base is about half-way back to 1983 level (i.e., until it reaches 13 percent)

- **Reduce benefits in the top tier of benefit formula** (affects top 15 percent of beneficiaries)
  - Instead of providing 15 cents in benefits for each dollar of lifetime earnings in the top tier (above $44,000 in lifetime earnings), gradually reduce benefit rate to 10 cents of benefits for each dollar in that tier.

Part 3: Legacy debt

- Early beneficiaries received benefits greater than contributions plus market interest rate
- Without these generous benefits, Social Security's assets would be much greater today. Those assets would earn interest, which could finance future benefits.
- "Legacy debt" reflects the absence of those assets
- Legacy debt does not mean that decision to provide generous benefits to early beneficiaries was unsound, nor does it imply that Social Security is a bad deal now

Part 3: Legacy debt



Part 3: Legacy debt, continued

- Cannot take back past benefits -- and policy-makers likely unwilling to reduce benefits for current retirees or near-retirees
- Size of legacy debt largely determined.
  - If benefits protected for 55+ in 2004, legacy debt amounts to more than $11 trillion.
- Issue: how to finance legacy debt across different generations/different people within generations.
- Two extremes:
  - Push legacy debt onto far distant generations (fail to enact reform)
  - Force transition generations to pay off legacy debt (transition to fully funded program)

Part 3: Legacy debt adjustments

- Goal: Move towards stabilizing ratio of the legacy debt to taxable payroll and distributing the cost more fairly.

- **Mandatory Social Security coverage** for newly hired state and local workers, to ensure all workers bear portion of legacy cost

- **Legacy charges**
  - 3 % legacy tax on earnings above maximum taxable earnings base (to ensure very high earners pay part of legacy cost in proportion to full earnings).
  - Universal legacy charges: benefit reductions and modest increases in payroll tax and 3% legacy tax, which begin in 2023 right after last reduction legislated in 1983.

Plan to Improve Social Insurance

- **Low earners** with 35+ years of work receive benefit equal to poverty line in 2012. After 2012, benefits for low earners would gradually increase above poverty line.
- **Widows** typically suffer 30% drop in living standards when husband dies. Increase benefits to leave survivor with ¾ of what couple received. For those with low benefits, financed by broader program. For those with high benefits, alter timing of benefits on couple-by-couple basis.
- **Disabled workers** as a whole held harmless over next 75 years. Shift benefits toward workers who become disabled at younger ages and in earlier years.
- **Young survivors** of deceased workers as a whole are held harmless over next 75 years, with same adjustment as for disabled workers.
- Provide **protection against unexpectedly high inflation** in years when a worker is between ages 60 and 62. Repeat of 1980-81 inflation rates would reduce real benefits for a particular group by almost 25 percent.

Individual Accounts

- Individual accounts, such as 401(k)s and IRAs, provide useful supplements to Social Security and can be improved and coverage expanded.
- Individual accounts are inappropriate for ***basic*** tier of income during retirement, disability, and other times of need.
  - Social Security is *only* source of income for 20% of beneficiaries, provides 90+ percent of income for 1/3
- Individual account system may respond to political pressure for early withdrawals, no annuitization, inadequate protection of inexperienced investors, and other features that undermine retirement security
- Our plan does ***not*** include individual accounts within Social Security.

Conclusions

- Our plan represents most auspicious way of reforming the program because it:
  - combines benefit and revenue adjustments;
  - restores long-term balance and sustainable solvency to Social Security;
  - does not assume any transfers from general revenue;
  - does not rely on substantial reductions in disability and young survivor benefits to help restore long-term balance;
  - strengthens the program's protections for low earners and widows;
  - does not divert Social Security revenue into individual accounts; and
  - preserves Social Security's core social insurance role, providing a base income in time of need that is protected against financial market fluctuations and unexpected inflation.

Additional background: Similar provisions in other plans

Proposed reform	Plans including similar or related proposals
Adjustments for increasing life expectancy	
Adjust benefits	President's Commission (Model 3), Pozen, Aaron-Reischauer, Kolbe-Stenholm, Breaux-Gregg, Personal Security Accounts, Gramlich
Adjust revenue	None
Adjustments for earnings inequality	
Increase MTEB	Ball, Kolbe-Stenholm, some members of President's Commission
Reduce high benefits	President's Commission (Model 3), Pozen, Kolbe-Stenholm, Breaux-Gregg, Gramlich
Adjustments for legacy cost	
Universal coverage	Personal Security Accounts, Maintain Benefits, Aaron-Reischauer, Breaux-Gregg, Ball, Gramlich
Legacy tax on high earnings	Pozen
Universal legacy charge	Maintain Benefits (included future payroll tax increase not explicitly linked to legacy cost)

Additional background: Disability reforms

- Workers who become disabled at younger ages currently "lock into" lower real benefit level than rest of their cohort
- Our reform would allow them to partially share in productivity gains over time

Year disability benefits begin	Benefit change upon receipt of disability benefits	Benefit change when disabled worker reaches full benefit age		
		Disabled at age 25	Disabled at age 45	Disabled at age 55
2015	-0.5	43.7	20.1	9.8
2025	-1.9	42.9	19.4	9.2
2035	-6.2	36.7	14.2	4.5
2045	-10.2	30.9	9.4	0.0
2055	-13.9	25.4	4.9	-4.1

Additional background: Low earners

Age at end of 2004	Change in benefits from scheduled benefit baseline		Benefit for minimum wage worker as fraction of poverty threshold[a]
	For average earner	For minimum wage worker	
55	0.0	0.0	89.4
45	-0.6	11.2	107.3
35	-4.5	6.8	109.0
25	-8.6	2.2	116.2
15	-12.4	-2.1	124.1

Additional background: High earners

Age at end of 2004	Change in benefits from scheduled benefit baseline		Total change in benefit for high-earning workers including interactions
	For average earner	Applying only to high-earning workers	
55	0.0	0.0	0.0
45	-0.6	-4.1	-4.7
35	-4.5	-8.7	-12.8
25	-8.6	-8.7	-16.6
15	-12.4	-8.7	-20.1

Additional background: Traditional benefit comparison

Age at end of 2004	Authors' plan	Model 2[b]	Model 3[c]	
			At full benefit age	At age 62
55	0.0	-3.0	-1.5	-11.3
45	-0.6	-3.9	-2.0	-11.8
35	-4.5	-20.6	-10.9	-19.8
25	-8.6	-28.2	-15.2	-23.7
15	-12.4	-35.1	-19.4	-27.5
5	-16.0	-41.3	-23.3	-31.0
0	-17.7	-44.2	-25.2	-32.7

Additional background: Combined benefit comparison for average earner two-earner couple

Year turning age 65	Authors' plan	Model 2		
		Traditional benefits	Expected combined benefits	
			Not adjusted for risk	Adjusted for risk[b]
2012	-0.0	-0.9	0.0	-0.5
2022	-0.6	-9.9	-6.1	-8.5
2032	-3.7	-18.2	-8.3	-15.2
2042	-7.8	-25.7	-5.9	-20.5
2052	-11.7	-32.5	-6.3	-26.1
2075	-19.7	-45.9	-20.5	-39.6

Additional background: Combined benefit comparison for average earner one-earner couple

Year turning age 65	Authors' plan	Model 2		
		Traditional benefits	Expected combined benefits	
			Not adjusted for risk	Adjusted for risk[b]
2012	-0.0	-0.9	-0.3	-0.6
2022	-0.6	-9.9	-7.3	-9.0
2032	-3.7	-18.2	-11.5	-16.2
2042	-7.8	-25.7	-12.3	-22.2
2052	-11.7	-32.5	-14.8	-28.1
2075	-19.7	-45.9	-28.7	-41.7

Table 1-1. Summary of Effects of Proposed Reforms

Proposed reform	Effect on actuarial balance	
	As share of taxable payroll	As share of actuarial deficit
Adjustments for increasing life expectancy		
Adjust benefits	0.26	13
Adjust revenue	0.29	15
Subtotal	**0.55**	**29**
Adjustments for increased earnings inequality		
Increase taxable earnings base	0.25	13
Reduce benefits for higher earners	0.18	9
Subtotal	**0.43**	**22**
Adjustments for fairer sharing of legacy cost		
Make Social Security coverage universal	0.19	10
Impose legacy tax on earnings over taxable maximum	0.55	29
Impose legacy charge on benefits and revenue	0.97	51
Subtotal	**1.71**	**89**

Table 1-1. Summary of Effects of Proposed Reforms (Continued)

Reforms to strengthen social insurance functions		
Enhanced benefits for lifetime low earners	-0.14	-7
Increased benefits for widows	-0.08	-4
Hold-harmless provisions for disabled workers and young survivors	-0.21	-11
Completion of inflation protection of benefits	0.0	0
Subtotal	**-0.43**	**-22**
Interactions of above reforms	-0.26	-14
Total effect	**2.00**	**104**
Alternative: reform existing estate tax	0.60	31

Increasing life expectancy differences