

US Social Security: Prospects for Reform



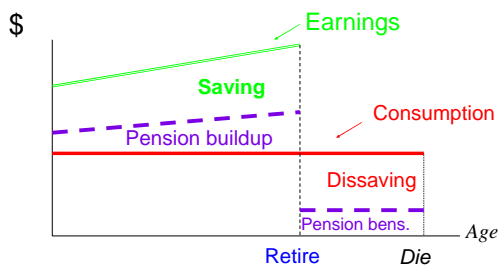
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What's the Risk to Old-Age Economic Security?

- What is OLD AGE?
- In US: $\geq 65 \dots 67?$
 [so what is *old-old*?]
- What risk do people seek to insure against?
 Living too long, poverty



A Life Cycle Model of Saving



The US Social Security System:

- National mandatory old-age system
- Single largest US gov't program
- OASDI=defined benefit, payroll-tax financed, PAYGO (mostly)
- Revenues ~\$627 B
 Mostly payroll taxes on 153M workers (~12.4% of pay, \$4,100/yr/worker)
- Costs ~\$462 B
 Most to 47 M recipients (Av \$9,800/yr/benef)



(2003 Actuarial Report)

Mixed Goals for Social Security



- **Longevity insurance:**
 SS now a *real* annuity.
- **Social Assistance:**
 Benefits redistributive (*means-tested?*).
- **Social Insurance:**
 Benefits depend on *past earnings*; coverage for those who pay into system.

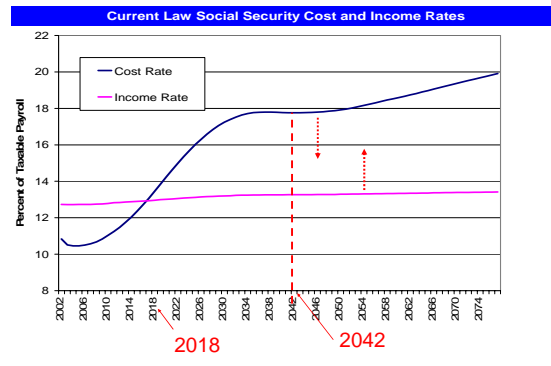
Financing Social Security:

- System mostly "PAYGO"
 - Payroll tax on employees & employers
 - Revenues paid to current retirees immediately.
- OASDI payroll tax: tax rate 12.4%*
 - OASI: 10.52 % } on pay to \$87K ('03, indexed)
 - DI: 1.88 % }
 ==> Most US workers pay more to SS than to IRS.

*Plus HI: 1.45% on all earnings



FACT: Social Security unsustainable. Under current law, annual costs exceed revenues in 2018, shortfalls grow thereafter ('03 data)



PV Shortfall of \$12 Trillion = massive political risk to old-age security ('03 data)

- ✓ Doing nothing is unappealing: benefits would fall by 25-35% if new revenue not found.
- ✓ Raising taxes is expensive: scheduled benefits require 50-80% more payroll taxes.

Current system cannot be counted on to meet benefit promises.

Each year we wait, it grows worse...



How did we get into this?

- **Benefits**
 - DI and OASI benefit promises were expanded
 - More retiring early (despite lower mortality)
 - Large baby boom
 - Benefits tied to wages, not prices
- **Taxes**
 - Falling fertility, unemployment & productivity problems

The Commission to Strengthen Social Security (www.csss.gov)

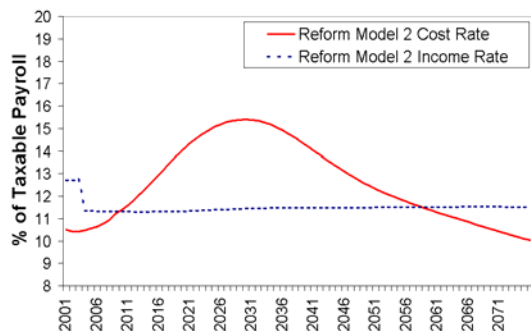
- **The challenge:**
 - ➔ *Improve system fiscal sustainability, and*
 - ☞ Maintain SS benefits for retirees & near-retirees,
 - ☞ Don't raise SS payroll taxes,
 - ☞ Offer *voluntary*, individually-controlled, Personal Retirement Accounts (PRA).
- **The structure:**
 - **Bipartisan:** co-chaired by Sen. Moynihan and Richard Parsons, 8 Democrats, 8 Republicans
 - **Honestly scored** by SSA-OACT using standard assumptions

CSSS plans: Focus here on Model 2:

- ✓ **Maintain traditional SS benefits but price index:**
 - **No benefit cuts** *vis a vis* today, and more than can be paid under current rules, for many
- ✓ **Enhance safety net:**
 - Boost low-earner benefits: 120% of poverty line
 - Boost surviving spouse benefit: 75% of couple (if < av)
- ✓ **PRA: voluntary 4% of payroll tax to \$1,000**
 - If elect PRA, traditional benefits offset at 2% real
 - Cap wage-indexed

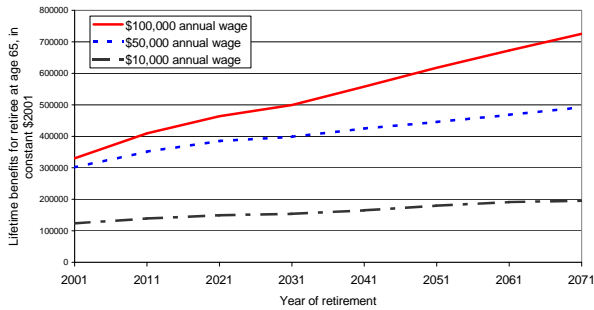
With price indexing, income/cost lines cross:

Reform Model 2 Restores Positive Cash Flow by 2059, Surpluses Thereafter



Why price index?

Over time, wage indexing increases real benefits for workers with identical wages. High wage workers see the biggest increase.



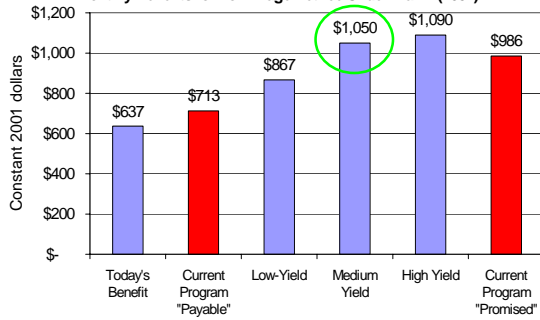
Personal Retirement Account (PRA) structure:

- ✓ **Contributions:**
 - collected centrally, as now, to hold down costs
 - ✓ **Benefits:**
 - no pre-retirement withdrawal
 - partial annuitization required
 - divided in divorce
 - ✓ **Investment Choices:**
 - TSP model: A few *diversified* funds
 - Stocks / Bonds / Govt securities
 - "Standard" 50/50 stock/bond
 - Later, licensed competitors
 - No single stock investments allowed
- *Low cost: 30 bp, probably less*



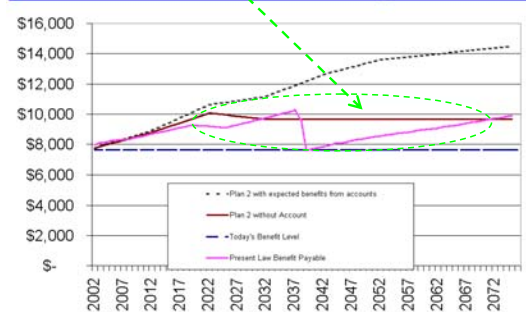
Benefit increases anticipated for low-wage PRA participants (Model 2)

Monthly Benefits for Low-Wage Retiree Under Plan 2 (2052)



Low-earners without accounts do better too:

Low Earner Initial Benefit at Age 65



Other financing issues (Model 2):

- Cashflow positive in 2075 without more general revenue? → Yes
- Actuarial balance enhanced? → Two-thirds of gap met by 2075
- Small transition investment? → 0.49% of GDP when financing needed, \$0.9 Tr in PV

Unifying Themes:

1. **No privatization:** No shutdown of SS
2. **No benefit cuts:** Benefits at least as high as today's
3. **Improve safety net:** Better benefits for lifetime low-wage, survivors.
4. **Wealth building:** All may elect PRA and pass wealth to heirs.
5. **Better diversification:** Investment choice.
6. **Greater transparency:** Benefits related to contributions

Who will benefit?

- **Everyone:** SS more solvent
- **Half of workforce lacking pension**
 - ✓ PRAs build wealth
 - ✓ PRAs diversify saving
 - ✓ PRAs can be inherited
- **Most vulnerable**
 - Low-wage workers
 - Women
 - Minorities



The Danger of Delay...

Each passing year makes matters worse:

- Life expectancy rising
- Birth rates remain low
- Immigration little help
- Productivity growth not a "silver bullet"
- Shortfalls loom larger...



Conclusion:

- SS not sustainable
- Acting now offers degrees of freedom
- Personal Retirement Accounts can play a useful role
- CSSS model better solvency, offers choice & progressivity
- Other plans must be scored *honestly*.



Thank you!

Questions? Comments?

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