DECEMBER 2010

Commentary

BUFFIN PARTNERS INC. ECONOMIC INVESTMENT AND ACTUARIAL RESEARCH

Social Security Solvency and Sustainability

The United States National Commission on Fiscal Responsibility and Reform presented its report at the beginning of December with the title *The Moment of Truth*. The report recommended a six-part plan to put the United States on a path to fiscal health, promote economic growth, and protect the most vulnerable members of society. The Commission's proposals in this plan would achieve nearly $4 trillion in deficit reduction through 2020, reduce the deficit to 2.3% of GDP by 2015; reduce tax rates and abolish the alternative minimum tax; place a cap on revenue at 21% of GDP and reduce spending to below 22% and eventually to 21%; ensure lasting Social Security solvency; stabilize debt by 2014 and reduce debt to 60% of GDP by 2023 and to 40% by 2035. The six major components of the proposed plan are: discretionary spending cuts; comprehensive tax reform; health care cost containment; mandatory savings; social security reforms; and process changes.

This issue of *Commentary* discusses only the Commission's proposals for Social Security Solvency and Sustainability. The Commission stated that its focus on Social Security was motivated by "reform for its own sake and not for deficit reduction." This motive and its candid enunciation represented a welcome admission that, indeed, Social Security does not contribute to the deficit. The Commission's statement and explanation of its motive has now effectively countered the contrary ideological view that has been expounded over the last decade. The Commission recommended a package of changes to the existing structure of Social Security, essentially maintaining its basic design and provisions. The Commission did not recommend that the structure of Social Security be modified to encompass individual accounts as had been proposed by the previous Administration. The Commission acknowledged that the solvency position of Social Security is projected at above 100% until around the year 2037 and that the projected shortfall for achieving 100% solvency for the next 75 years is only 1.92% of covered payroll (only 0.96% each for employers and employees). The Commission correctly perceived the long-term challenge to the solvency and sustainability of the system as mainly requiring some parametric adjustments so as to avoid difficulties in meeting scheduled benefit payments in full after 2037.

The Commission presented ten specific proposals relating to Social Security: (1) Make retirement benefit formula more progressive; modify the current three-bracket formula to a more progressive four-bracket formula, with changes phased in slowly; change the current bend points factors of 90%/30%/15% to 90%/30%/10%/5% by 2050 with the new bend point added at median lifetime income; (2) Reduce poverty by providing an enhanced minimum benefit for low-wage workers: create a new special minimum benefit that provides full career workers with a benefit no less than 125 percent of the poverty line in 2017 indexed to wages thereafter; (3) Enhance benefits for the very old and the long-time disabled; add a new "20-year benefit bump up" to protect those Social Security recipients who have potentially outlived their personal retirement resources; (4) Gradually increase early and full retirement ages, based on increases in life expectancy; after the normal retirement age (NRA) reaches 67 in 2027 under current law, index both the NRA and early eligibility age (EEA) to increases in life expectancy, effectively increasing the NRA to 68 by about 2050 and 69 by about 2075, and the EEA to 63 and 64 in lockstep; (5) Give retirees more flexibility in claiming benefits and create a hardship exemption for those who cannot work beyond 62; allow Social Security beneficiaries to collect half of their benefits as early as age 62, and the other half at a later age; also direct the Social Security Administration (SSA) to design a hardship exemption for those who cannot work past 62 but who do not qualify for disability benefits; (6) Gradually increase the taxable maximum to cover 90 percent of wages by 2050; (7) Adopt improved measure of CPI; use the chained CPI, a more accurate measure of inflation, to calculate the cost of living adjustment for Social Security beneficiaries; (8) Cover newly hired state and local workers after 2020 and require state and local pension plans to share data with Social Security; (9) Direct SSA to better inform future beneficiaries on retirement options; direct SSA to improve information on retirement choices, better inform future beneficiaries on the financial implications of early retirement, and promote greater retirement savings; (10) Begin a broad dialogue on the importance of personal retirement savings.

These ten recommendations merit careful consideration and debate. Their overall effect would be to extend the 100% solvency position beyond 2037 to the end of the official 75-year projection period and achieve a broad balance between revenues and expense at the end of the 75-year period, without making fundamental changes to the existing structure of the system.

Buffin Partners Inc.

P.O. Box 1255
Sparta, NJ 07871
Phone: (973) 579-6371
Fax: (973) 579-7067
Email: commentary@buffinpartners.com