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New Research from EBRI:

Options Available to Close Social Security Funding Shortfall

WASHINGTON—A number of options available to eliminate the Social Security program's long-term funding shortfall are presented in a review published today by the nonpartisan Employee Benefit Research Institute (EBRI).

The study discusses a range of possible reform options, all of which have been part of various reform proposals over the last two decades, and draws upon data presented in the annual Social Security Trustees' report available online at www.ssa.gov/OACT/TR/2009/ These options would either:

- ***Reduce benefits*** (by lowering the scheduled increase in future benefit levels by changes to the benefit formula, or by raising the normal retirement age), or
- ***Raise taxes*** (by changing the amount of earnings that are taxable and used for the calculation of benefits under Social Security) and changes in benefits taxation.

The degree to which any of the options presented in the study would improve the long-term funding status of Social Security depends on how much emphasis policymakers might place on a specific provision. Consequently, the study in the September *EBRI Notes*, www.ebri.org, presents a range of options showing a variety of possible specific results.

The Social Security program currently is facing a long-term projected financial shortfall, due in large part to the changing demographics and aging of the U.S. population. This projected shortfall, the study says, has been the center of discussion whenever advocates and policymakers have called for significant changes to the program to address the shortfall. Without changes, the program ultimately will be able to pay only about 75 percent of benefits promised under current law.

The financial status of the Social Security program is measured annually by its trustees in terms of the program's present value of future *revenues* (primarily from the Social Security payroll tax) relative to the present value of its future *costs* over the next 75 years. This measure is called the "75-year actuarial balance" of the program. In 2009, the program's actuarial balance was reported as –2.00 percent of taxable payroll, meaning that the program would need additional revenues equal to 2 percent of taxable payroll for each year over the next 75 years to match the projected future current-law costs over the 75-year period.

The impact of the options discussed in this study is expressed as the improvement in the percentage of taxable payroll (or actuarial balance) due to each provision. Here are some examples:

- **Lifting the Tax Cap:** The current maximum taxable earnings cap could be removed, making all earnings taxable for covered workers. If the current-law benefit cap for the calculation of benefits is retained when the cap is lifted, the improvement in the system's financing would be 2.19 percent. If all earnings are credited toward benefits, the improvement would be 1.84 percent. Another option would be to increase the maximum taxable amount to 90 percent of Social Security-covered earnings (currently the maximum is at just over 80 percent). If this option is phased in from 2010 to 2015 and all newly taxed earnings are included in the benefit calculation, the improvement in the actuarial balance would be 0.84 percent.

- **Benefit Formula Changes:** Changing the formula used to calculate benefits also would affect the program's long-term funding shortfall. One example is to increase the number of years used in the calculation of the average indexed monthly earnings. Currently, the formula takes the highest 35 years for those receiving retiree benefits, but the calculation could be increased to 38 or 40 years. If this is done only for retirees and survivors (but not for disabled beneficiaries), the improvement in actuarial balance would be 0.31 percent for 38 years and 0.49 percent for 40 years.

- **Changing Retirement Age**: One often-discussed proposal is to increase the age at which beneficiaries qualify for full Social Security benefits. This change can be done in many ways, depending on how quickly the normal retirement age is increased and whether the increase is linked to the growing longevity of the covered population. The chart below lists a few ideas on how the age could be raised, and shows the resulting improvement in the Social Security actuarial balance. The improvements range from 0.10 percent for increasing the normal retirement age to 67 now, instead of waiting until 2017, to 0.62 percent for increasing the normal retirement age now to 67 and then by one month every two years until reaching age 70.

Provisions Affecting Retirement Age

Provision	Improvement in Actuarial Balance
Shorten the hiatus in normal retirement age increase now instead of for those turning 62 in 2017	0.10%
Shorten the hiatus in normal retirement age increase now instead of for those turning 62 in 2017, then increase normal retirement age to 68 by one month every two years	0.46%
Shorten the hiatus in normal retirement age increase now instead of for those turning 62 in 2017, then increase normal retirement age to 70 by one month every two years	0.62%
Shorten the hiatus in normal retirement age increase now instead of for those turning 62 in 2017, then increase normal retirement age to 68 by two months every year	0.58%
Index benefits to longevity after the normal retirement age reaches 67 under current law. This would increase the normal retirement age one month every other year.	0.37%

Source: Social Security Administration, Office of the Actuary, *Provisions That Could Change the Social Security Program,* http://ssa.gov/OACT/solvency/provisions/index.html

The EBRI study, which takes no position on any of the proposals, concludes by cautioning that the cited actuarial balance improvement percentages cannot simply be added together because they sometimes have offsetting effects. Therefore, depending on the various combinations of provisions chosen, the improvement in the funding status will be something less than the sum of the individual effects. Consequently, a number of the proposals cited in the study may be necessary to achieve an actuarial balance.

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