Chaffetz Announces Social Security Reform Proposals

Today, Rep. Jason Chaffetz (R-UT) announced his proposals for Social Security reform. With these proposals, Social Security achieves permanent annual balance by 2051, achieves actuarial balance for the next 75 years, and avoids tax increases and trust fund insolvency. Future retirees, including today's very young workers, will have increased certainty regarding their retirement.

"There is no excuse for allowing Social Security to become insolvent," said Chaffetz. "The program is unsustainable in its current form. However, this problem is completely within our power to resolve – without tax increases and while protecting retirees. This series of simple steps will make the program solvent and allow younger generations to more accurately anticipate their own retirement needs."

Social Security is the largest single item in the federal budget. In fiscal year 2011, the federal government spent $730 billion on Social Security, or 20% of the total $3.6 trillion[1] federal budget. Over the next 75 years, Social Security's unfunded liability is $6.5 trillion.[2] The proposals set out by Rep. Chaffetz will improve Social Security's balance over the next 75 years by $7.5 trillion in 2011 present value dollars.[3]

"It's gratifying to see Congressman Chaffetz standing up and offering a substantive proposal that is fair to Social Security recipients and does not increase the burden on taxpayers," said Utah State Senator Dan Liljenquist. "Reality is not negotiable, yet we have ignored the Social Security solvency problem for far too long," said Liljenquist, who has gained national recognition for his pension and Medicaid reforms to address fiscal issues threatening to bankrupt the state.

"Congressman Chaffetz deserves immense credit for putting a specific Social Security reform plan on the table," said Maya MacGuineas, President of Committee for a Responsible Federal Budget. "We applaud his courage in doing so and hope that those who don't endorse his approach put forth their own ideas rather than attacking his, in order to begin a true national dialogue on how to make the necessary fixes to this important program."

[1] Department of the Treasury, Final Monthly Treasury Statement for Fiscal Year 2011
[2] 2011 Annual Report of Social Security Board of Trustees table IV.B6
[3] Office of the Chief Actuary, Social Security Administration, memo dated November 9, 2011, table 1b.

Highlights of Social Security Reform Proposals

Total Social Security benefits would continue to grow but at a slower rate, and this slower growth rate allows the system to avoid insolvency. The vast majority of retirees, particularly those with average or below average lifetime earnings, would receive a larger check than they are getting today. Some will actually get an increase over what they would be getting without reform.

Using current benefits as a baseline and adjusting these benefits for inflation, middle and lower income retirees in future years will get essentially the same or better benefit than current retirees.

Provisions of Social Security Reform Proposals

The proposed reform improves Social Security by implementing the following reforms:

1. Implements longevity indexing by increasing normal retirement age from 67 for those born in 1960 to 68 for those born in 1966 and to 69 for those born in 1972. In years after 1972, the normal retirement age is increased one month every two years. Early retirement age remains unchanged at 62.

2. Changes cost-of-living-allowance calculation from CPI-W to chained CPI-W which is a more accurate representation of inflation. According to the Bureau of Labor Statistics, "The [chained CPI] is designed to account for . . . consumer substitution between CPI item categories."[4] Change takes effect in December 2015.

3. Adds additional bend point at 50th percentile for calculating primary insurance amount (also known as progressive price indexing). For workers with lifetime earnings above the 50th percentile, primary insurance amount grows across generations by combination of CPI-W growth and average wage growth instead of just average wage growth. Change begins for newly eligible retirees in 2016 and ends in 2055.

4. Increases number of years from 35 to 40 that are included for calculation of Average Indexed Monthly Earnings by adding one additional computational year for those becoming eligible in 2012, 2014, 2016, 2018, and 2020.

5. Indexes special minimum benefit to wages instead of CPI beginning in 2012. Currently, very few retirees benefit from the special minimum. In 2011, the special minimum benefits are $791 per month for 30 years of coverage and $394 per month for 20 years of coverage. Proposal allows for five years of child care to be included as creditable coverage if not already creditable.

6. Increases benefits by 5% for beneficiaries starting at age 85. Change begins in 2012.

7. Implements annual means test which reduces benefit up to 50% for couples earning more than $360,000 in most recent tax year. Change impacts retirees newly eligible in 2019 or later. Means testing thresholds are indexed annually by increases in average wage index.

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[4] Bureau of Labor Statistics, Frequently Asked Questions about the Chained Consumer Price Index for All Urban Consumers (C-CPI-U)

	Actuarial Balance	Annual Balance	Share of Annual Balance w/o Interaction
1. Raise Normal Retirement Age (longevity indexing)	0.98%	2.30%	39%
2. Chained CPI for COLA	0.49%	0.71%	12%
3. Additional Bend Point, Reduce PIA Factor	0.92%	2.14%	36%
4. Increase Years for AIME Calculation from 35 to 40	0.47%	0.72%	12%
5. Special Minimum Benefit	-0.11%	-0.17%	-3%
6. 85+ Benefit	-0.10%	-0.14%	-2%
7. Means Testing	0.24%	0.36%	6%
Total w/o Interactions	2.92%	5.92%	100%
Total w/ Interactions	2.43%	4.77%	
GOAL (2085)	2.22%	4.24%	

Impact of Social Security Reform Proposals on the Federal Budget

Under current law, Social Security's deficit is projected to be 1.34% of GDP in 2040 and 1.45% of GDP in 2085. In today's economy, 1.45% of GDP amounts to a substantial $220 billion. With Rep. Chaffetz' Social Security reform proposals, Social Security deficits begin to gradually decrease in 2030 and turn into modest surpluses in 2051.

Social Security Annual Deficit as Percent of GDP[5]

Year	Current Policy	Proposed Reform	Improvement
2020	-0.42%	-0.34%	0.08%
2030	-1.27%	-0.74%	0.53%
2040	-1.34%	-0.39%	0.96%
2050	-1.23%	-0.02%	1.21%
2060	-1.25%	0.16%	1.41%
2070	-1.29%	0.19%	1.49%
2080	-1.40%	0.18%	1.57%
2085	-1.45%	0.18%	1.63%

The Social Security Administration usually measures Social Security's costs, revenues, and deficits as a percent of taxable payroll. Under current law, Social Security's 75-year actuarial balance is -2.22% of taxable payroll, and its annual balance in year 75 is -4.24% of taxable payroll. With Rep. Chaffetz Social Security reform proposals, both annual balance and actuarial balance are positive.

Social Security Actuarial and Annual Balances as Percent of Taxable Payroll[6]

	Current Law	Change due to Proposal	Result
Annual Balance	-4.24%	4.77%	0.53%
Actuarial Balance	-2.22%	2.43%	0.21%

[5] Calculations based on 2011 Annual Report of Social Security Board of Trustees, table VI.F6 and Office of the Chief Actuary, Social Security Administration, memo dated November 9, 2011, table 1.
[6] Office of the Chief Actuary, Social Security Administration, memo dated November 9, 2011, table A.

What Happens Under Current Law Without Reform?

Contrary to claims by opponents of reform, Social Security has been running a deficit since 2010 and will be incurring annual deficits permanently unless the system is reformed. The following table shows Social Security's cash deficits for years 2010 to 2020. Included in the revenue amounts are general fund transfers to offset the reduction in Social Security taxes

Social Security Cash Flow, 2009 to 2020[7]

Year	Revenues (billions)	Expenditures (billions)	Difference (billions)
2009	$701	$682	$19
2010	$673	$715	-$38
2011	$693	$738	-$46
2012	$751	$772	-$21
2013	$794	$814	-$19
2014	$843	$861	-$17
2015	$890	$911	-$21
2016	$939	$965	-$26
2017	$988	$1,023	-$35
2018	$1,040	$1,087	-$47
2019	$1,091	$1,161	-$70
2020	$1,141	$1,240	-$99

Reform opponents argue that Social Security has a $2.6 trillion trust fund that is backed by the full faith and credit of the U.S. government. However, despite arguments that these government bonds are no different than ordinary Treasury bonds, these bonds are simply obligations that government owes itself, meaning that redeeming these Treasury IOUs requires the government to cut spending elsewhere, raise taxes, issue more debt to the public, or monetize debt through the Federal Reserve.

Reform opponents have also falsely claimed that Social Security has not added one penny to the deficit because Social Security is legally prohibited from deficit spending. However, as the above table demonstrates, Social Security is now operating at a deficit on a cash basis. Reform opponents counter that the Social Security trust fund paid $118 billion in interest in 2010 and about $115 billion in interest in 2011.[8] However, these interest payments are not real money. They are simply accounting mechanisms that transfer phantom money from one government account to another.

[7] 2010 Annual Report of Social Security Board of Trustees, Table VI.F9
[8] 2011 Annual Report of Social Security Board of Trustees, table VI.C6

Why can't we just raise the Social Security tax cap?

Reform opponents argue that Social Security should be saved by raising taxes on high income households, particularly by raising or eliminating the Social Security tax cap. They are wrong for several reasons.

First, Social Security taxes are capped ($106,800 in 2010 and $110,100 in 2011) because benefits are capped, meaning that benefits are not increased for earnings above the cap.

Second, due to Social Security benefit formulas, benefits are already very progressive. Income replacement rates are higher for low and middle income (63% and 42%) than for high income (28%).[9] Internal rates of return are higher for low and middle income (4.6% and 2.4%) than for high income (0.8%).[10]

Third, higher income households on average already pay a higher effective tax rate, even when payroll taxes are included, than middle and lower income households, according to studies by the Congressional Budget Office[11], Joint Committee on Taxation[12], and the Congressional Research Service[13].

Fourth, while some argue that the percent of wages subject to Social Security is lower than it was in the 1980s and early 1990s, the percent of wages covered is currently higher than it was in the 1950s, 1960s, and most of the 1970s and hasn't changed much since 1995.[14]

Fifth, even if the tax cap were eliminated and benefits for those above the current tax cap were not increased, Social Security would still be operating at a deficit.[15]

Finally, reform opponents argue that taxes as a percent of GDP are at historic lows which allegedly justify tax increases. However, tax revenues as a percent of GDP are low because unemployment is high, not because rates are too low or the tax base is too narrow. Historically tax revenues have equaled 18% of GDP[16], and CBO projects that tax revenues as a percent of GDP will reach 18.4% of GDP by 2021[17] even if all of the Bush-era tax changes are maintained.

Conclusion

The Congressional Budget Office projects federal government non-interest spending to reach 25% of GDP in 2035[18]. Including interest, federal spending will reach 34% of GDP. Since these levels are not sustainable, Congress must slow the growth in federal spending. This proposal allows Social Security benefits to increase, and middle and lower income retirees in the future will receive Social Security checks that, adjusted for inflation, are essentially equal to or greater than benefits received by current retirees.

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9 Congressional Budget Office, 2011 Long-Term Projections for Social Security: Additional Information, Exhibit 10
10 Office of the Chief Actuary, Social Security Administration, Actuarial Note 2009.5, July 2010
11 Congressional Budget Office, Average Federal Tax Rates in 2007, June 2010
12 Joint Committee on Taxation, JCX-43-11
13 Congressional Research Service, Report R42043
14 Social Security Administration, 2010 Annual Statistical Summary, F.B1
15 Congressional Budget Office, Social Security Policy Options, pages 33-34, July 2010
16 Office of Management and Budget, FY 2012 Budget Historical Tables, Table 1.2
17 Congressional Budget Office, 2011 Long-Term Budget Outlook, table 1-2
18 Id.