



## SOCIAL SECURITY

### MEMORANDUM

Date: February 24, 2005

Refer To: TCA

To: Alice H. Wade, Deputy Chief Actuary

From: Chris Chaplain, Actuary

Subject: Estimated OASDI Financial Effects of Expanding the Amount of Covered Earnings Subject to the Payroll Tax--**INFORMATION**

This memorandum provides estimates of the financial effect on the Social Security (OASDI) program of expanding the amount of covered earnings that is subject to OASDI payroll taxes. The proposal would subject all earnings that are in excess of about \$25,000 over the current taxable maximum to the OASDI payroll tax. Enactment of this proposal would be expected to restore solvency for the OASDI program through the 75-year long-range period. However, the criteria for sustainable solvency would not be met. This analysis was requested by Eva Cargill of Representative Wexler's staff. The estimates are based on the intermediate assumptions of the 2004 Trustees Report.

### **Background**

The contribution and benefit base for Social Security (OASDI) is \$90,000 for earnings in 2005. Under current law, this base will be indexed in future years to increases in the level of the average annual wage as measured by the SSA national average wage index (AWI). The contribution and benefit base serves the following two purposes:

- As a contribution base, it establishes the maximum annual amount of covered earnings subject to OASDI payroll taxes.
- As a benefit base, it establishes the maximum annual amount of earnings creditable for the purpose of benefit computation.

The contribution and benefit base, which is often referred to as the maximum taxable earnings level, has generally been increased automatically each year since 1982 by the rate of growth in the average wage level in the U.S. economy. The percentage of covered earnings that is taxable has decreased from 90 percent in 1982 to about 85 percent in 2004. This is mainly due to relatively larger increases in earnings levels for those above the maximum. Under the intermediate assumptions of the 2004 Trustees Report, this percent of earnings that is taxable is projected to decline to about 83 percent for 2013 and later.

### **Description of Proposal**

The proposal would continue to tax covered earnings up to the current-law contribution and benefit base (\$90,000 in 2005). Earnings between the current-law contribution and benefit base

and \$114,900 (in 2005) would continue not to be subject to the OASDI payroll tax. However, earnings above \$114,900 would be subject to the full 12.4 percent combined employee/employer payroll tax. The \$114,900 threshold would be wage-indexed for years after 2005, in the same manner in which the current-law contribution and benefit base is indexed. Stated another way, this proposal would eliminate the contribution base except for earnings between \$90,000 and \$114,900 (in 2005). The current-law contribution and benefit base would continue to serve as a benefit base; only earnings up to the current-law contribution and benefit base would be credited in determining benefits. This provision would be effective for earnings in 2005 and later.

For example, under this proposal a worker with covered earnings of \$150,000 in 2005 would pay, along with this employer, a total of \$11,160 of OASDI payroll tax on the first \$90,000 of earnings. No payroll tax would be paid on the earnings between \$90,000 and \$114,900. The worker and employer would then pay a total of \$4,352 on the earnings above \$114,900 (\$35,100 X 12.4 percent). Therefore, total payroll taxes for this worker would be \$15,512 under the proposal, compared to \$11,160 under current law (earnings up to the current law wage base).

The proposal would increase the long-range OASDI actuarial balance by an estimated 1.89 percent of payroll tax. Thus, the 75-year long-range actuarial deficit of 1.89 percent of taxable payroll under present law would be eliminated and the resulting actuarial balance would be positive, but less than 0.005 percent of taxable payroll. However, the trust fund ratio would be declining at the end of the period, so sustainable solvency criteria would not be met. All estimates are based on the intermediate assumptions of the 2004 Trustees Report.

Table 1 provides, for this proposal, individual-year estimates of:

- The annual income rates, annual cost rates, and annual balance of the combined Trust Funds of the OASDI Trust Funds;
- The trust fund ratio (TFR), defined as the amount of assets in the OASDI Trust Funds as of the beginning of the year, expressed as a percentage of the outgo from the OASDI Trust Funds during the year, and
- The taxable payroll in current dollars, both under the proposal and under current law.

The tables provide an analysis of the effects of the proposal on the financial status of the OASDI program. The table includes annual and 75-year-summarized cost rates, income rates, and balances for the OASDI program under the proposal. In addition, the table also provides the trust fund ratio for each year until the OASDI Trust Funds are projected to be exhausted. The TFR is defined as the amount of assets in the OASDI Trust Funds as of the beginning of the year, expressed as a percentage of the outgo from the OASDI Trust Funds during the year. Under present law, the OASDI Trust Funds are projected to become exhausted in 2042. Under this proposal, the OASDI Trust Funds would not be expected to become exhausted during the 75-year long-range period. However, under the proposal, the projected trust fund ratio is decreasing at the end of the long-range period. Thus, sustainable solvency would not be achieved under this proposal and trust fund exhaustion would be likely within several years after the end of the period.

The table also provides estimates of annual taxable payroll, in billions of current dollars, for the proposal and for present law. The percentage increases in taxable payroll due to the proposal are also included.

A handwritten signature in cursive script that reads "Chris Chaplain".

Chris Chaplain

Attachment

**Table 1 Financial Estimates for the OASDI Trust Fund Program**

**Tax all earnings except for earnings between the current-law contribution and benefit base and \$114,900 (in 2005 with amount wage-indexed thereafter)**

Year	Expressed as a percentage of taxable payroll			Trust Fund Ratio 1-1-year	OASDI Taxable Payroll (in billions of dollars)		Increase in Taxable Payroll over Present Law
	Cost Rate	Income Rate	Annual Balance		Proposed Plan	Present Law	
2004	11.07	12.71	1.64	306	4,522	4,522	0.0%
2005	9.54	12.69	3.15	325	5,427	4,762	14.0%
2006	9.43	12.69	3.26	362	5,709	4,999	14.2%
2007	9.39	12.71	3.31	398	5,998	5,244	14.4%
2008	9.42	12.74	3.32	432	6,308	5,502	14.7%
2009	9.53	12.73	3.20	462	6,628	5,770	14.9%
2010	9.63	12.75	3.12	492	6,957	6,047	15.0%
2011	9.76	12.79	3.03	520	7,296	6,331	15.3%
2012	9.96	12.82	2.86	544	7,635	6,614	15.4%
2013	10.17	12.84	2.67	566	7,978	6,901	15.6%
2014	10.39	12.86	2.46	585	8,339	7,213	15.6%
2015	10.64	12.87	2.23	601	8,711	7,534	15.6%
2016	10.90	12.89	1.98	614	9,097	7,868	15.6%
2017	11.18	12.90	1.73	625	9,498	8,214	15.6%
2018	11.46	12.92	1.46	633	9,915	8,575	15.6%
2019	11.75	12.94	1.19	638	10,343	8,944	15.6%
2020	12.04	12.95	0.91	642	10,789	9,329	15.7%
2021	12.34	12.97	0.63	643	11,247	9,724	15.7%
2022	12.62	12.99	0.37	644	11,722	10,135	15.7%
2023	12.91	13.00	0.10	643	12,213	10,557	15.7%
2024	13.18	13.02	-0.16	640	12,722	10,997	15.7%
2025	13.45	13.03	-0.42	636	13,250	11,453	15.7%
2026	13.71	13.05	-0.66	632	13,801	11,930	15.7%
2027	13.94	13.06	-0.88	626	14,380	12,428	15.7%
2028	14.16	13.08	-1.09	621	14,980	12,945	15.7%
2029	14.36	13.09	-1.27	615	15,604	13,486	15.7%
2030	14.54	13.10	-1.44	608	16,258	14,050	15.7%
2031	14.71	13.11	-1.60	601	16,940	14,639	15.7%
2032	14.86	13.12	-1.73	594	17,656	15,256	15.7%
2033	14.98	13.13	-1.85	587	18,404	15,899	15.8%
2034	15.08	13.14	-1.95	580	19,181	16,571	15.7%
2035	15.17	13.14	-2.03	573	19,991	17,272	15.7%
2036	15.23	13.15	-2.09	567	20,840	18,006	15.7%
2037	15.28	13.15	-2.13	560	21,729	18,771	15.8%
2038	15.31	13.15	-2.15	554	22,657	19,570	15.8%
2039	15.33	13.16	-2.17	548	23,619	20,401	15.8%
2040	15.34	13.16	-2.19	542	24,620	21,267	15.8%
2041	15.36	13.16	-2.20	536	25,665	22,172	15.8%
2042	15.37	13.16	-2.20	530	26,758	23,112	15.8%
2043	15.37	13.16	-2.21	524	27,895	24,091	15.8%
2044	15.38	13.16	-2.22	517	29,077	25,111	15.8%
2045	15.39	13.17	-2.22	511	30,301	26,170	15.8%
2046	15.40	13.17	-2.23	505	31,575	27,271	15.8%
2047	15.41	13.17	-2.24	498	32,904	28,415	15.8%
2048	15.42	13.17	-2.25	491	34,283	29,603	15.8%
2049	15.43	13.17	-2.26	485	35,712	30,835	15.8%
2050	15.46	13.17	-2.28	477	37,193	32,116	15.8%
2051	15.49	13.17	-2.31	470	38,738	33,450	15.8%
2052	15.52	13.18	-2.34	462	40,348	34,837	15.8%
2053	15.56	13.18	-2.38	453	42,032	36,285	15.8%
2054	15.60	13.18	-2.42	444	43,779	37,793	15.8%
2055	15.65	13.19	-2.46	435	45,593	39,359	15.8%
2056	15.69	13.19	-2.50	425	47,480	40,990	15.8%
2057	15.74	13.19	-2.55	415	49,447	42,682	15.8%
2058	15.79	13.20	-2.59	405	51,497	44,447	15.9%
2059	15.83	13.20	-2.63	395	53,630	46,287	15.9%
2060	15.88	13.20	-2.67	384	55,849	48,202	15.9%
2061	15.92	13.20	-2.72	372	58,156	50,193	15.9%
2062	15.97	13.21	-2.76	360	60,566	52,268	15.9%
2063	16.03	13.21	-2.81	348	63,073	54,426	15.9%
2064	16.08	13.21	-2.86	335	65,682	56,674	15.9%
2065	16.12	13.22	-2.90	323	68,400	59,018	15.9%
2066	16.17	13.22	-2.95	309	71,226	61,454	15.9%
2067	16.21	13.22	-2.99	295	74,178	63,996	15.9%
2068	16.26	13.23	-3.03	281	77,268	66,659	15.9%
2069	16.30	13.23	-3.07	267	80,476	69,423	15.9%
2070	16.33	13.23	-3.10	252	83,816	72,299	15.9%
2071	16.37	13.23	-3.14	237	87,294	75,296	15.9%
2072	16.41	13.24	-3.17	221	90,914	78,414	15.9%
2073	16.44	13.24	-3.21	205	94,676	81,654	15.9%
2074	16.48	13.24	-3.24	189	98,592	85,026	16.0%
2075	16.52	13.24	-3.28	172	102,670	88,538	16.0%
2076	16.56	13.24	-3.31	155	106,916	92,194	16.0%
2077	16.59	13.25	-3.35	138	111,333	95,998	16.0%
2078	16.63	13.25	-3.38	120	115,932	99,958	16.0%
2079	16.67	13.25	-3.42	101	120,707	104,070	16.0%

Summarized Rates: OASDI				Change in
	Cost Rate	Income Rate	Actuarial Balance	Actuarial Balance
2004				
-2078	13.65%	13.65%	0.00%	1.89%

Based on Intermediate Assumptions of the 2004 Trustees Report

Office of the Chief Actuary  
Social Security Administration  
February 24, 2005