

Recent Social Security Issues from Actuarial, Finance, and Budget Perspectives

Global Challenges and Opportunities Facing the Actuarial Profession
Joint Colloquium of the IACA, PBSS and IAAHS Sections
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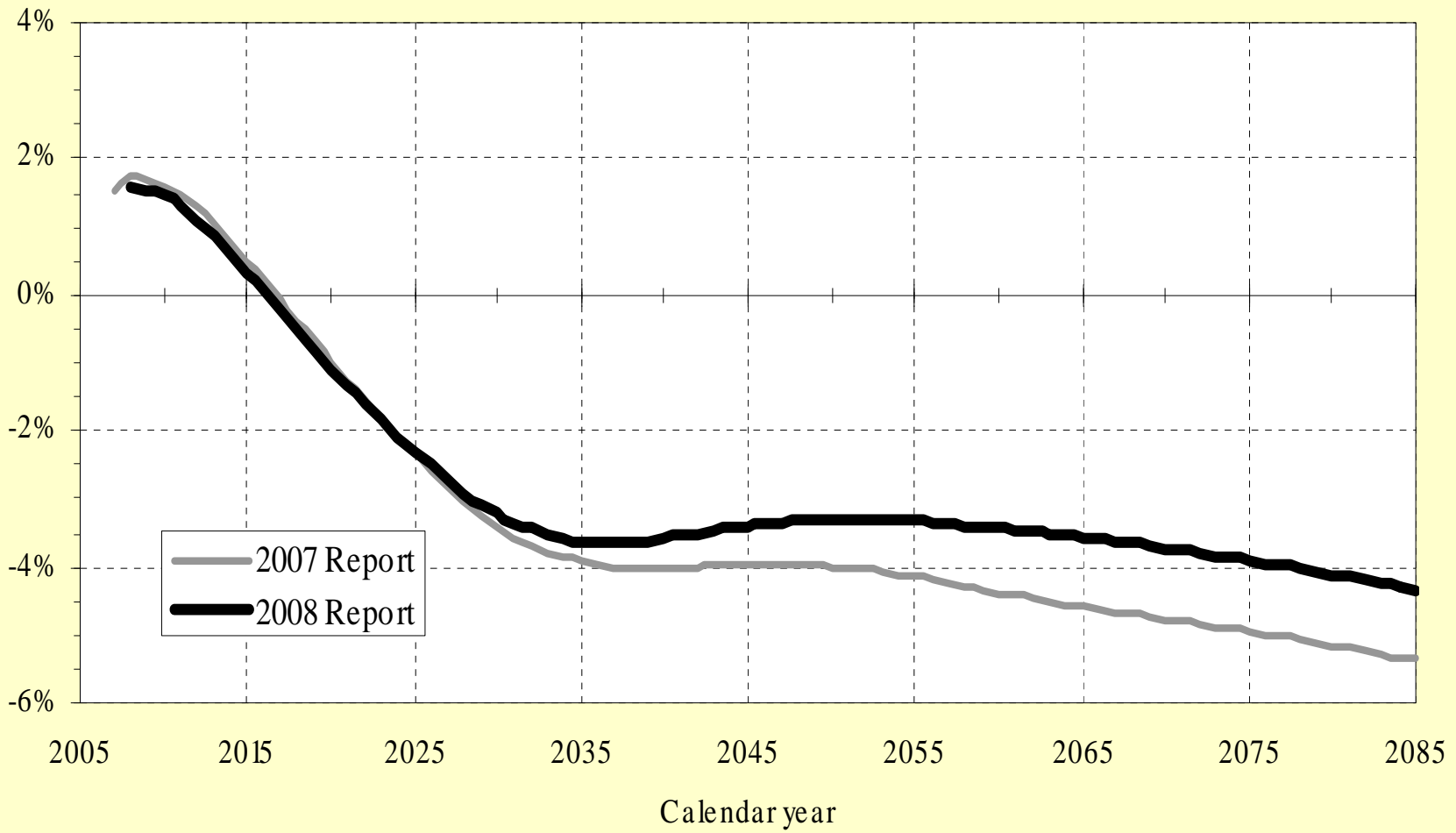
Three Recent Issues

- ◆ Updated US Social Security Projections
- ◆ Asset Accumulation and Financial Economics
- ◆ Federal Budget Implications

1) Updated US Social Security Long-Term (75-Year) Projections

- ◆ Actuarial deficit
 - 1.70 percent of payroll, down from 1.95
- ◆ Annual deficit in 75th year
 - 4.20 percent of payroll, down from 5.20
- ◆ Annual cost in 75th year
 - 17.5 percent of payroll, down from 18.6

Projected OASDI Annual Deficits Are Smaller (percent of payroll)



Unfunded Obligations

- ◆ For 75-year Long-range Projection Period
 - 0.6% of GDP, down from 0.7%
 - 1.6% of payroll, down from 1.8%
 - \$4.3 trillion PV, versus expected \$5.1
- ◆ For Infinite Future
 - 1.1% of GDP, down from 1.2%
 - 3.2% of payroll, down from 3.5%
 - \$13.6 trillion PV, versus expected \$14.3

Why the change after 2024?

- ◆ Largely improvement in projection method for other immigration
- ◆ Other smaller changes offset each other
 - Lower mortality
 - » Recently and assumptions for middle ages
 - Higher legal immigration
 - » Ultimate at 1 million per year, up from 800,000
 - » Net at 750,000 per year, up from 600,000

Other (Undocumented and Temporary Legal) Immigration

- ◆ Improved projection method---
 - NO assumption of changes in law
 - Projected annual net immigration similar to 2007 TR
 - BUT, immigration and emigration explicit
 - Assume 1.5 million enter each year
 - About 500,000 adjust to legal after a few years
 - About 700,000 leave over time

Other-Immigration Effects

- ◆ Results in ---
 - Increased other population at younger ages
 - Reduced other population at older ages
 - Increase in children born
 - Thus, overall large increase in younger population
 - And overall smaller increase in older population
 - Improved actuarial deficit by 0.30 percent of payroll

2) Asset Accumulation and Financial Economics

- ◆ Assets lower tax rates ---IF asset yield rate exceeds growth rate in cost
 - So growth in workforce determines whether advance funding lowers tax rates
- ◆ But this doesn't change the total cost
 - More revenue from asset yield must be drawn from the economy just as taxes are

Asset Yields -- How large

◆ For United States

- Historical averages (since 1926)

- » Equities—about 6.4% real; but high volatility

- » Corporate Bonds—about 3.4% real

- » US Govt Bonds—about 2.9% real; low volatility

◆ For Europe

- Historically lower equity yields.

How about Financial Economics?

- ◆ Higher *expected* yield on equities
 - Devalued due to volatility—uncertainty
 - In effect—project at riskless rate of return
 - » i.e., risk-adjusted yields
- ◆ Same asset level, regardless
- ◆ Seemingly “no extra credit” for equities
 - Is this true???

Still value for equities under FE

- ◆ Low assumed yield for equities will be exceeded more often
- ◆ Gains more likely to exceed losses
- ◆ Thus, realized cash flows will, on average, be favorable
- ◆ Results in lower tax rates on average after the fund is set up and mature.

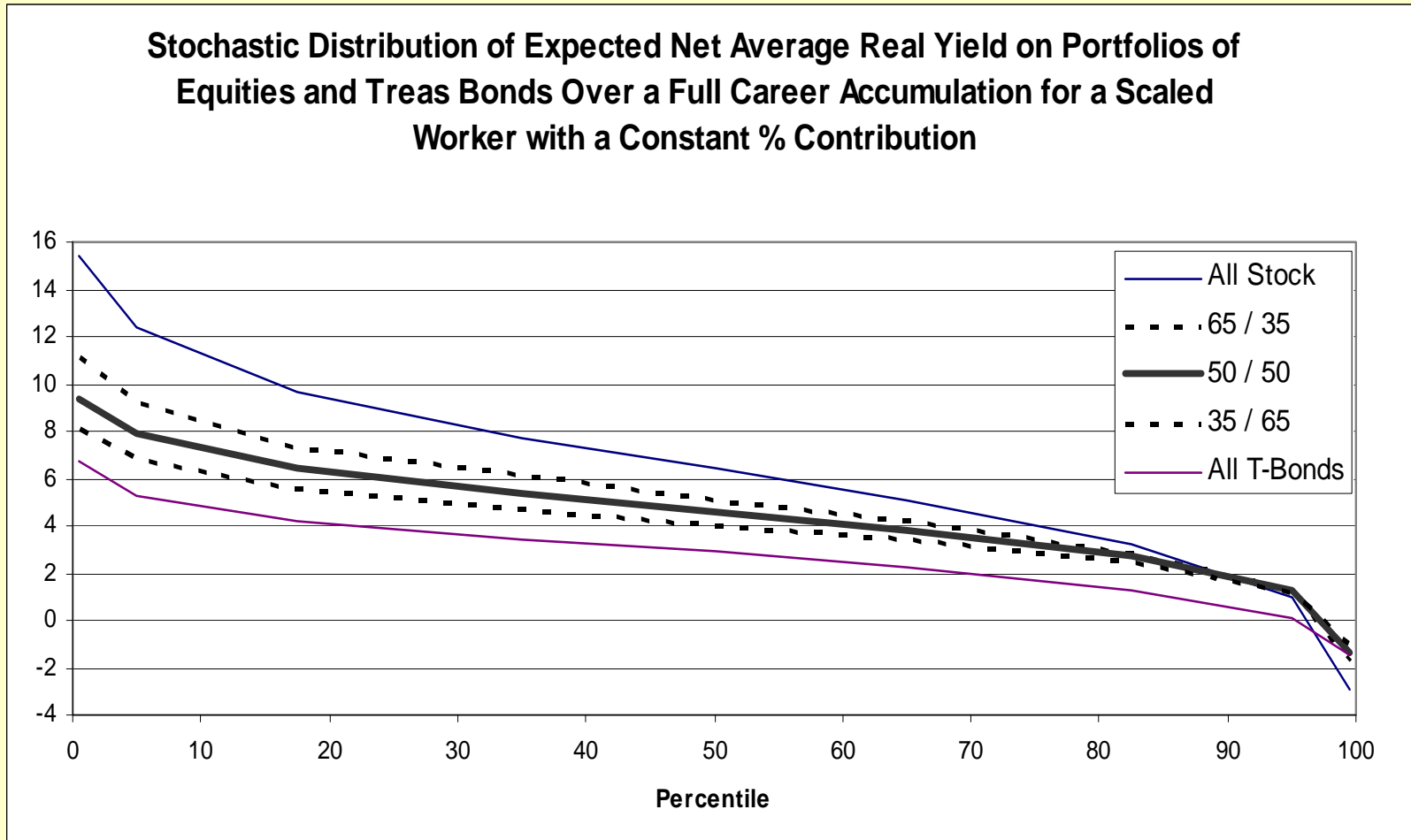
Valuing Volatile Equities

- ◆ Equities sometimes over- or under-valued
 - Swings can distort asset values.
- ◆ A possibility
 - When P/E ratio is high—lower market value
 - When P/E ratio is low—higher market value
 - Dampen fluctuations in cyclic equity prices
 - Better justify higher average equity yields

Financial Economics—Bottom Line

- ◆ Requires higher asset holdings
- ◆ More conservative funding and more conservative yield expectations
- ◆ But actual yields most often higher.
 - So initial cost of higher assets pays off
- ◆ CPP and Railroad Retirement Board

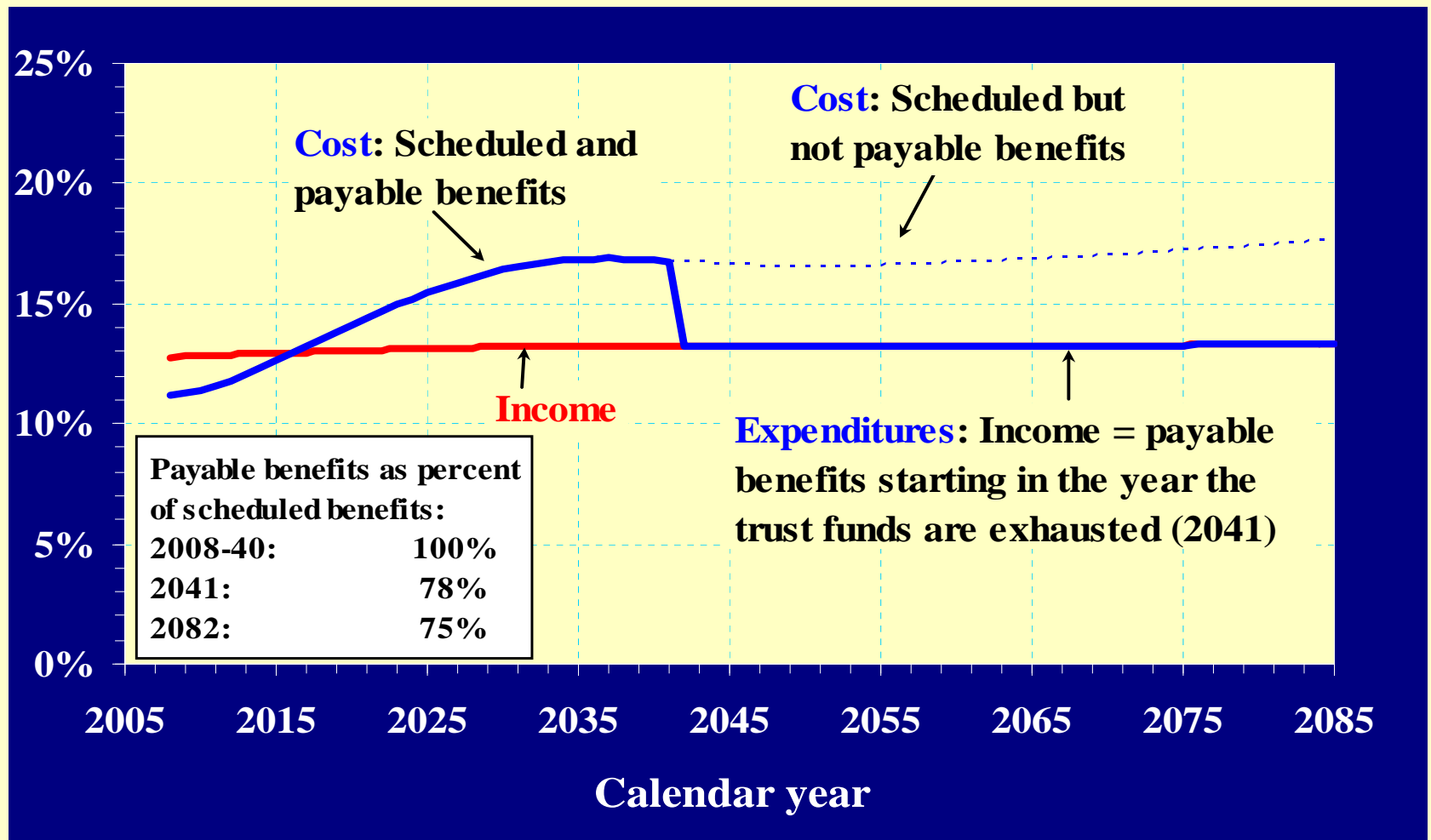
Investment in equities would be expected to increase the return over just Government Bonds, but this would not be certain



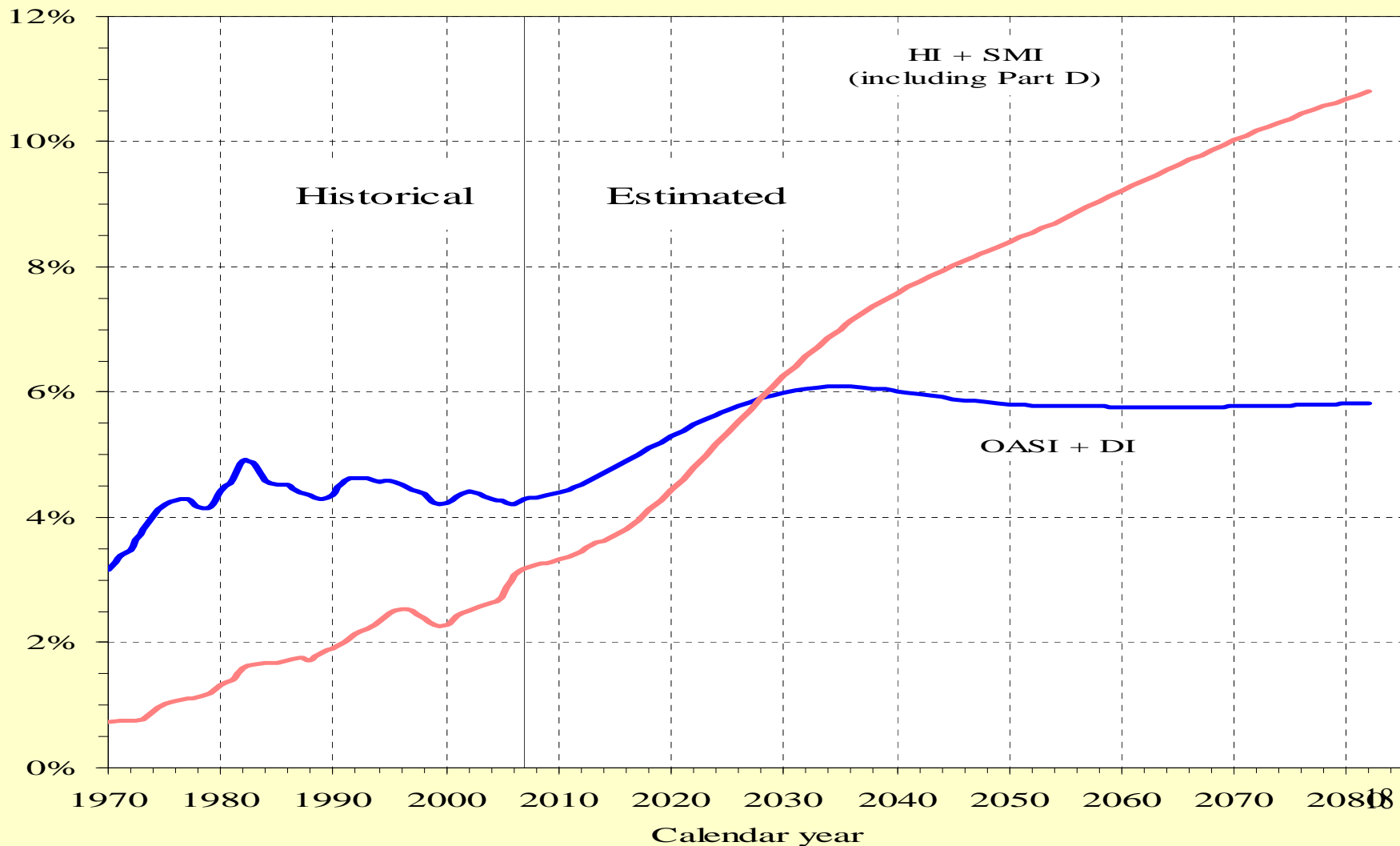
3) Federal Budget Implications

- How does Social Security affect the Federal Unified Budget?

Percent of Scheduled Benefits Payable Drops in 2041 to 78 Percent of Taxes



Social Security Cost Rises from 4.3 to 5.8 percent of GDP; But Medicare Rises from 3.2 to 10.8 percent of GDP by 2082



Federal Budget Implications

- ◆ OASDI has a cumulative \$2.2 trillion surplus since 1937
 - This has decreased the need for borrowing from the public
- ◆ Redeeming Trust Fund Assets will require Treasury to cut spending, increase taxes, or *swap Trust fund debt for publicly-held debt*

Federal Budget Implications

- ◆ Does OASDI create budget problems after fund exhaustion?
 - No
 - Under current law, OASDI could only pay what continuing tax income financed
 - This would be 78 percent of scheduled benefits in 2041

Federal Budget Implications

- ◆ But wouldn't "promised" benefits continue?
 - No
 - Not in full without additional legislation
 - And history tells us that the LACK of borrowing authority for OASDI (and HI) forces action to put the financial house in order
 - The 1977 and 1983 Amendments had substantial reductions in scheduled benefits and increases in revenue

Federal Budget Implications

- ◆ Thus, OASDI is not likely to be a long-term Budget problem
- ◆ History tells us that the rigor enforced by its financing mechanisms will force solutions
- ◆ Decisions on solutions and early enactment would be helpful