POTENTIAL RETIREMENT CRISIS

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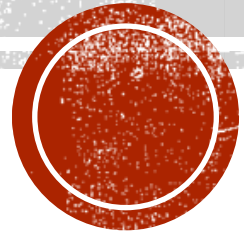


SOCIAL SECURITY IN THE U.S.

- Commonly used term to refer to the federal Old Age, Survivors, and Disability Insurance program (OASDI)
- Consists of two government run trust funds: Old Age and Survivors Insurance Trust Fund (OASI) and Disability Insurance Trust Fund (DI)
- First signed into law by President Franklin Roosevelt in 1935
- Funded primarily by a payroll tax imposed on employers and employees
- Pays out retirement benefits to eligible retirees who have contributed to the program for at least 40 quarters of credit
  - Can retire beginning at age 62
  - Full retirement age is 65, 66, or 67 based on birth date

TRUST FUND OPERATIONS, 2016 (in billions)				
	OASI	DI	HI	SMI
Reserves (end of 2015)	$2,780.3	$32.3	$193.8	$69.5
Income during 2016	797.5	160.0	290.8	419.4
Cost during 2016	776.4	145.9	285.4	393.3
Net change in Reserves	21.1	14.1	5.4	26.1
Reserves (end of 2016)	2,801.3	46.3	199.1	95.6

WHAT IS HAPPENING?

- At the rate of contributions and the rate of retirement, Social Security will be depleted in the foreseeable future

- There is a large number of American retirees suffering a drop in their standards of living
  - Low interest rates
  - Stagnated wages

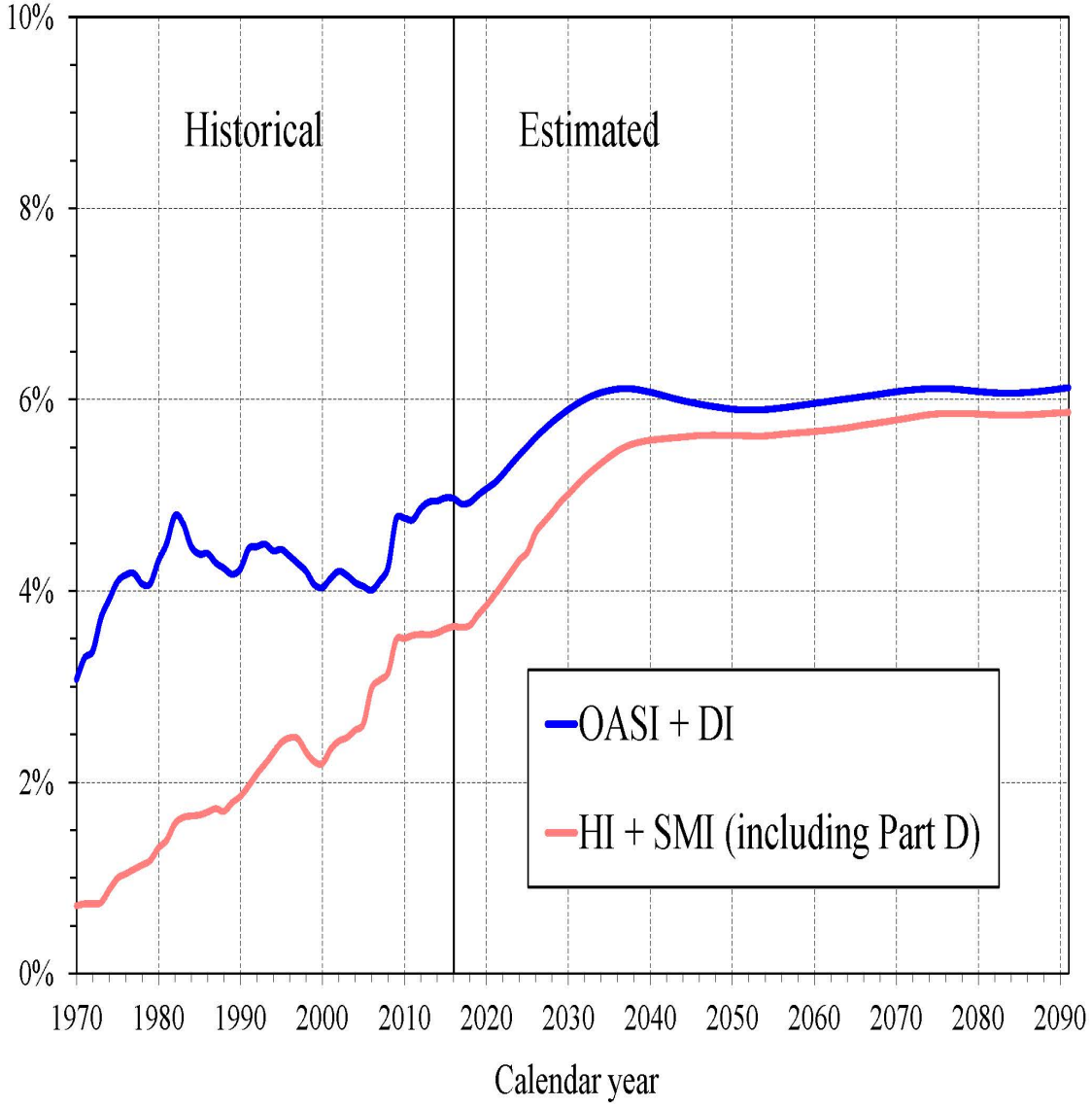
WHAT IS HAPPENING?

- In the 82 years of operation, Social Security has collected roughly $19.9 trillion and has paid out roughly $17.1 trillion
  - $2.8 trillion left in the two combined trust funds
  - Surplus is invested into special, non-marketable U.S. government bonds
- Trustees have projected for assets in the trust funds to exceed the costs until 2022
- Both funds are projected to be depleted by 2034
- Without the interest income, Social Security has been in deficit since 2010
- After 2034, projected income will only cover about 75% of scheduled benefits through 2091

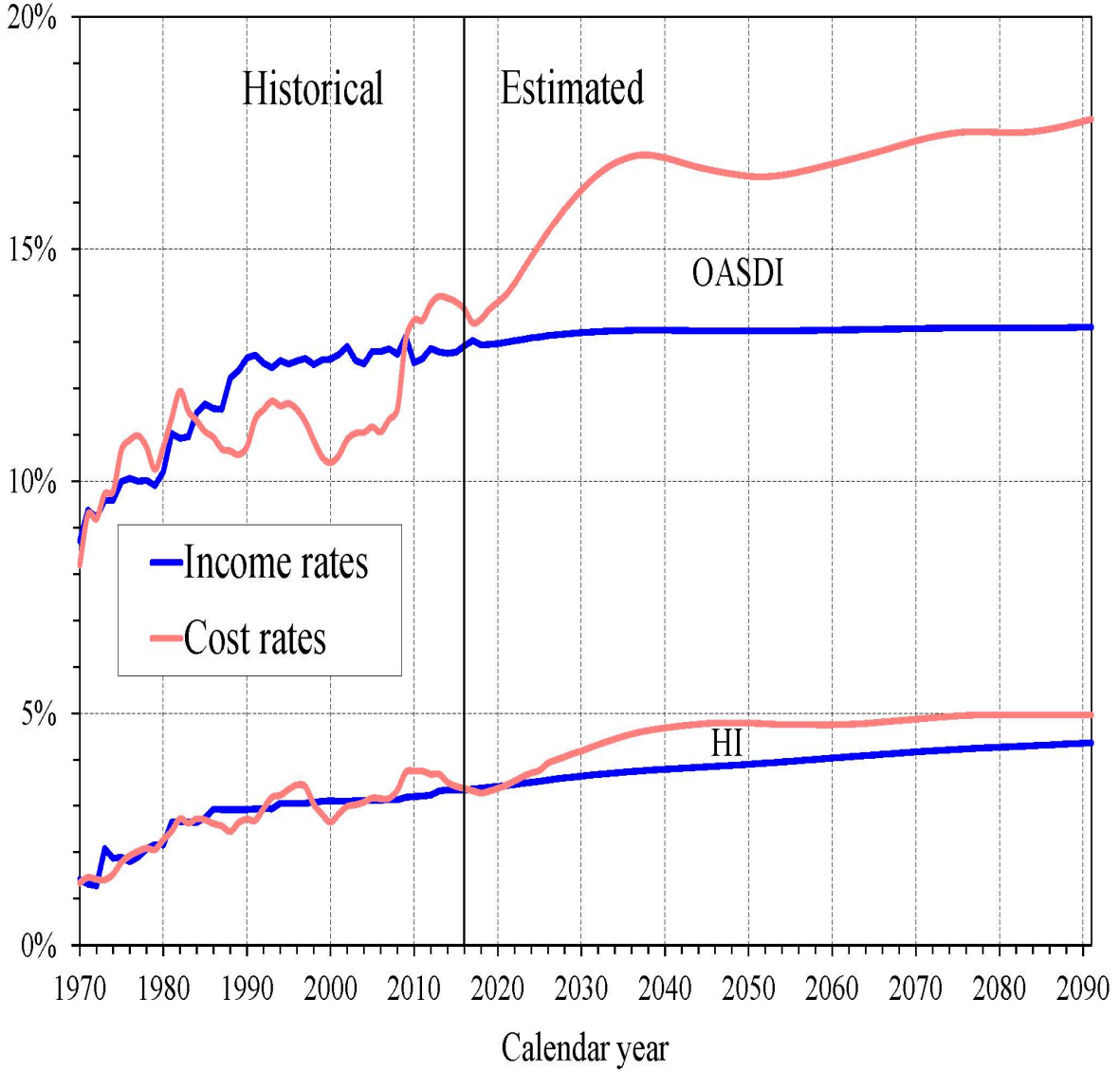
WHY IS THIS HAPPENING?

- Number of retirees continues to grow substantially faster than the number of covered workers
  - Lower birth rates have caused lower rates of growth in labor force
  - Ratio of workers to retirees went from 35:1 in 1935 to less than 3:1 today
  - About 10,000 of the baby boomer generation is retiring everyday
- Income growth is slowing to a sustainable trend as the economic recovery is finishing
- People are living longer past their retirement age, receiving more benefits
  - Average life expectancy was 61 in 1935; 75 today

Percentage of GDP



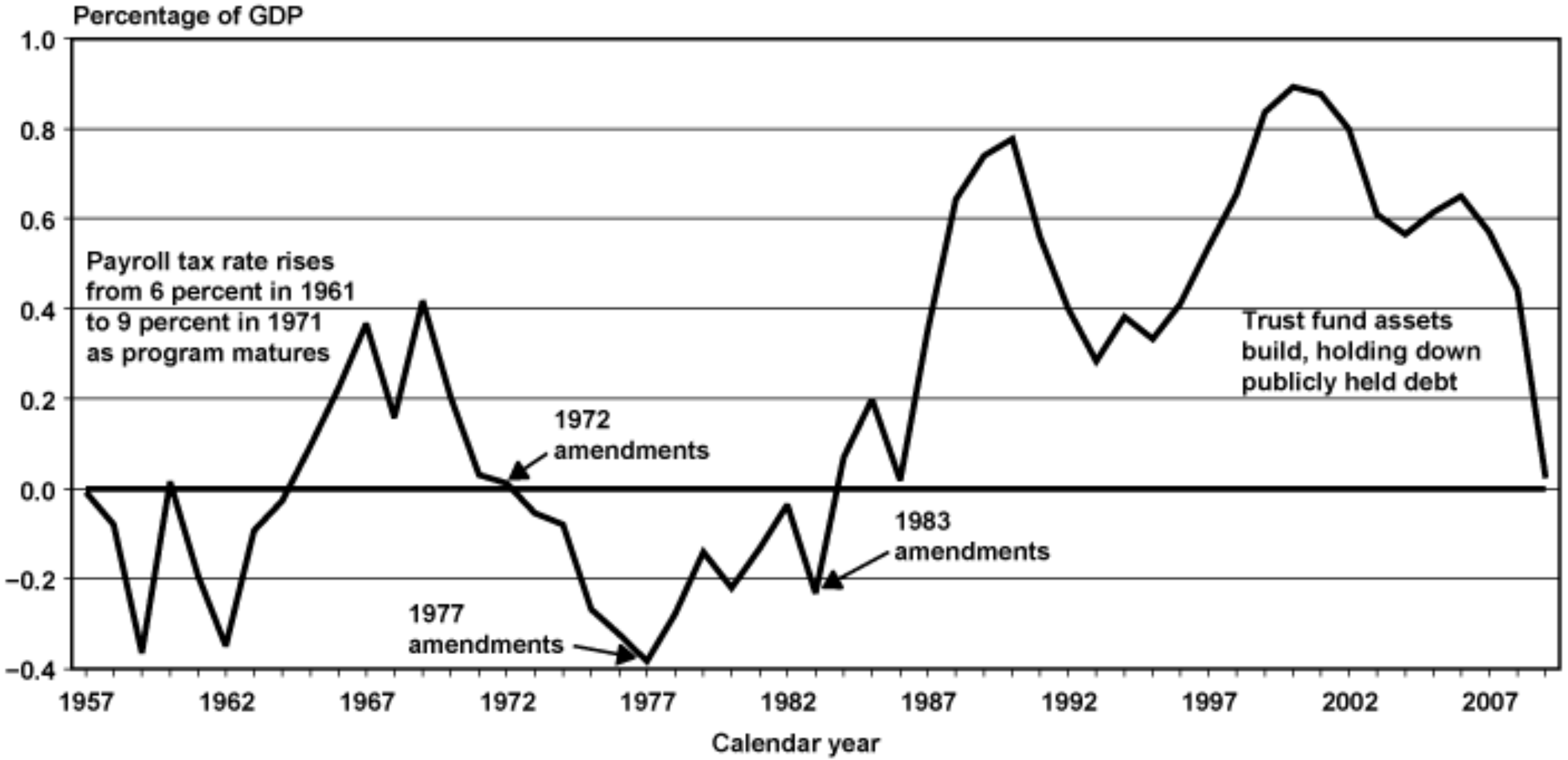
Percentage of Taxable Payrolls



AMENDMENTS IN 1977 AND 1983

- In 1972, legislatures enacted a one-time 20% increase in benefits
- High inflation in the 1970s caused benefits to exceed contributions
  - Benefits were automatically adjusted for inflation starting in 1972
- Cost of living adjustments were recalculated to return to sustainable levels
- Increased tax withholdings from 2% to 6.15%
- Continued problems for Social Security due to stagflation
- Introduced income tax on Social Security benefits

Net Cash Flows of OASDI



POTENTIAL FIXES

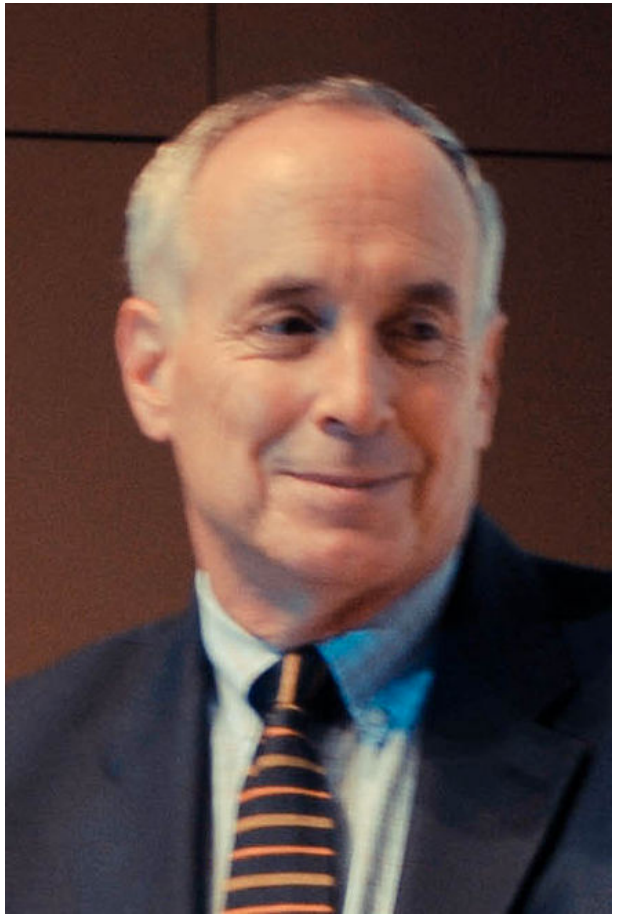
- Increase payroll tax
- Reduce benefits
- Increase retirement age
- Increase the payroll ceiling
- Increase percentage of covered workers
- Taking money from other parts of the budget

NEW ZEALAND

- Universal, flat dollar benefit
- Benefit is set by poverty line
- Simpler than the U.S. public pension system
  - Universal retirement age at 65
- Purpose is only to prevent people from becoming poor and destitute
- Further savings must be done privately
- Difficult to implement in the U.S.

LAURENCE KOTLIKOFF

- Economics Professor at Boston University
- Focus and expertise in public finance
- Auerbach-Kotlikoff Model
  - First large scale computable general equilibrium life cycle model
  - Tracks behavior of economies with large numbers of overlapping generations
  - Used to study future fiscal and demographic transitions
- Author of various columns and essays focusing on Social Security



TAKEAWAYS FROM KOTLIKOFF

- Trustees should focus on the infinite horizon rather than the 75 year projection
  - The 75 year projection only captures 42% of total system's shortcomings
- $23 trillion fiscal gap measured over the infinite horizon
- Social Security is underfinanced by 32%
  - There needs to be an immediate and permanent 32% increase in payroll taxes
  - OR, an immediate and permanent 22% cut from benefits
- Social Security cannot be financed by other departments of government
  - Overall fiscal system is underfinanced by 58% ($210 trillion fiscal gap)

CASE STUDY: PUERTO RICO

- Disability Insurance Fraud
- Close to 40% of residents in Puerto Rico are on Disability Insurance
  - Rates are even higher when the residents' parents have also been on Disability Insurance
- The Social Security Department has overpaid benefits to thousands of claims that has resulted in losses of millions of dollars
  - Man was receiving benefits for a mood disorder that prevented him from working ($108,233 received)
  - Doctors charged a $150-500 "patient" fee to falsely create documents for patients to receive disability benefits
- In 2011, 40 individuals were prosecuted, finding over $4 million in overpayments

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