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The following is a re-typed report I received from the SSA regarding removing the cap from Social Security. Enclosed is a copy of the previously faxed material. In a few days, I will end via email another report which will outline removing the cap while reducing payroll taxes.

Sincerely,
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Social Security

MEMORANDUM

Date: October 20, 2003

To: Steve C. Goss, Chief Actuary

From: Alice H. Wade, Deputy Chief Actuary
Chris Chaplain, Actuary

Subject: Estimated Long-Range OASDI Financial Effects of Eliminating the *OASDI Contribution and Benefit Base*—**INFORMATION**

This memorandum provides estimates of the financial effect on the Social Security (OASDI) program for eliminating the OASDI contribution and benefit base. All estimates are based on the intermediate assumptions of the 2003 Trustees Report. The estimates reflect the assumption that the total amount of covered earnings would diminish as a result of increasing the base. This would occur because many workers who have earnings above the base would be able to modify the form of their compensation in reaction to a change in the marginal payroll tax rates to which the earnings are subjected.

Background

The contribution and benefit base for Social Security (OASDI) is \$87,900 for earnings in 2004. Under current law, this base will be indexed in future years to increases in the level of the average annual wage as measured by SSA average wage index. The contribution and benefit base serves the following two purposes:

- A. As a contribution base, it establishes the maximum annual amount of covered earnings subject to OASDI payroll taxes
- B. 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



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average wage level in the U.S. economy. The percentage of covered earnings that is taxable has decreased from ninety percent in 1982 to eighty-five percent in 2001. This is mainly due to relatively larger increases in earning levels for those above the maximum. Under the intermediate assumptions of the 2003 Trustees Report, this percent of earnings that is taxable is projected to decline to about 83.8 percent for 2012 and later.

Description of Proposals

Two proposals for eliminating the benefit and contribution base are analyzed in this memorandum. The first, *Proposal 1*, eliminates the contribution and benefit base for the purpose of (1) determining earnings subject to payroll taxes and (2) crediting earnings for computing benefits. *Proposal 2* eliminates the contribution and benefit base only for the purpose of determining earnings subject to payroll taxes.

Eliminating the contribution and benefit base would result in an increase in the amount of payroll taxes for workers with earnings above the present-law base. If the additional earnings subject to payroll tax are also credited for the purpose of computing OASDI monthly benefit amounts, then the income from additional taxes payable over the long-range (75-year) period would be partially offset by the cost of additional benefits. However, the cost of additional benefits over the period would be less than the income from additional taxes. This is because:

- A. The OASDI benefit formula is progressive (workers who are affected by this provision generally have high career-average earnings and relatively low marginal benefit formula factors); and
- B. A significant portion of the additional benefits related to additional taxes payable during the period would not be received until after the long-range period.

Proposal 1:

Under proposal 1, the contribution and benefit base would be eliminated for earnings in years after 2003, for both the purpose of computing payroll tax and for setting limits on the amount of earnings credited in OASDI benefit computations. For example, a worker with covered earnings of \$200,000 in 2004 would pay employee payroll taxes of \$12,400 (more than double the amount under current law, with a similar increase for the employer), but would also be credited the total \$200,000 as 2004 earnings when determining OASDI benefits. The worker's benefits would be higher than under present law.

Proposal 2:

Under proposal 2, the contribution and benefit base would become a benefit base only. The base would be eliminated for the purpose of computing payroll tax, but would continue to be used to set limits on the amount of earnings credited in OASDI benefit computations. For example, a worker with covered earnings of \$200,000 in 2004 would pay employee payroll taxes of \$12,400 (more than double the amount under current law, with a similar increase for the employer), but would only be able to credit about \$87,900 as 2004 earnings when determining OASDI benefits. The worker's benefits would be the same as under present law.



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Long-Range Financial Effect of Proposals

Both proposals would improve the long-range actuarial balance significantly. Under proposal 1, the long-range OASDI actuarial balance is estimated to increase by 1.70 percent of taxable payroll. Thus, the long-range actuarial deficit of 1.92 percent of taxable payroll under present law would be reduced to a deficit of .22 percent of taxable payroll. Under proposal 2, the long-range OASDI actuarial balance is estimated to increase 2.17 percent of taxable payroll. Thus, the long-range actuarial deficit of 1.92 percent of taxable payroll under present law would be completely eliminated and the resulting actuarial balance would be a positive .25 percent of taxable payroll. All estimates are based on the intermediate assumptions of the 2003 Trustees Report.

A table for each of the proposals is included in this memorandum. These tables include individual-year estimates of:

- A. The annual income rates, annual cost rates, and annual balance of the combined Trust Funds of the Old-Age and Survivors Insurance (OASI) and the Disability Insurance (DI) programs,
- B. The combined OASI and DI Trust Fund ratio, and
- C. The taxable payroll in current dollars, both under the proposal and under current law.

The tables provide an analysis of the effects of the proposed plans on the financial status of the Social Security OASDI program. The tables include annual and 75-year-summarized cost rates, income rates, and balances for the OASDI program under the proposals. In addition, the tables also provide the trust fund ratio (TFR) 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 be exhausted in 2042. The year of exhaustion is pushed to 2075 under proposal 1. Under proposal 2, the combined OASI and DI Trust Funds do not exhaust during the 75-year-long-range period. However, under both proposals, the trust fund ratio is decreasing at the end of the long-range period.

Each 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.

Alice H. Wade

Chris Chaplain