# CONGRESSIONAL BUDGET OFFICE
# COST ESTIMATE

July 21, 2004

## H.R. 3821
### Bipartisan Retirement Security Act of 2004

*As introduced in the House of Representatives on February 24, 2004, with subsequent modifications specified by the sponsors' staff*

## SUMMARY

H.R. 3821, the Bipartisan Retirement Security Act of 2004, introduced by Representatives Kolbe and Stenholm, would make numerous changes to the Social Security system.[1] The bill would establish a system of individual accounts (IAs) funded by the existing payroll tax, and would generally reduce defined benefits compared with current law. Some provisions would raise scheduled benefits for some recipients or increase payroll taxes for some workers.

H.R. 3821 would redirect approximately 2.3 percentage points of the current 12.4 percent payroll tax for Old-Age, Survivors and Disability Insurance (OASDI) to individual accounts, which would belong to covered workers. The principal and interest in those accounts would be disbursed in the form of annuities that would supplement Social Security benefits. (They would be paid to a worker's heirs if the individual dies before claiming benefits.) Those distributions would be taxed as Social Security benefits are taxed under current law, and the receipts would be credited to the OASDI trust funds.

The bill would lower benefits specified under current law by:

- Adjusting parameters in the benefit formula;

- Accelerating the schedule for increasing the normal retirement age (NRA)—the age at which workers may collect unreduced benefits—so that the NRA reaches 67 for those born in 1949 (under current law, those born in 1960 would be the first to have an NRA of 67);

- Raising the actuarial reduction for workers and aged spouses claiming benefits before the NRA, while increasing the delayed retirement credit for workers claiming after the NRA;

---

1. At the request of the sponsors' staff, CBO assumed numerous corrections and changes in the legislative language of H.R. 3821 to carry out the sponsors' intent and to reflect assumed enactment in the fall of 2004.

- Basing benefits of retired workers on all years of earnings (compared with the top 35 years under current law);

- Reducing annual cost-of-living adjustments (COLAs) for Social Security and other indexed programs, including various indexed provisions of the individual income tax; and

- Adjusting benefits for life expectancy.

H.R. 3821 would further alter the benefit formula by:

- Replacing the current 32 percent middle bracket in the formula for calculating benefits with two brackets: one 70 percent and one 20 percent; and reducing the 15 percent rate for the top bracket to 10 percent;

- Increasing the minimum benefit for low-paid beneficiaries with many years of work;

- Increasing the benefit for some widows and widowers to 75 percent of the couple's benefit; and

- Limiting spousal benefits for high-earning married couples.

The legislation would increase payroll tax revenues by increasing the maximum amount of earnings subject to the payroll tax. In addition, H.R. 3821 would transfer funds between government accounts by:

- Crediting to the Social Security trust funds the income taxes on benefits that are currently credited to the Medicare trust fund; and

- Specifying certain amounts to be transferred from the general funds of the Treasury into the Social Security trust funds.

On balance, enacting H.R. 3821 would increase the unified budget deficit by about $668 billion over the next 10 years, CBO estimates. The bill would increase direct spending by $974 billion over the 2005-2014 period, while boosting revenues by $306 billion over the same period (see Table 1). The off-budget surplus (primarily Social Security) would decrease by $612 billion over the next 10 years; the on-budget deficit would climb by $56 billion over the same period.

**TABLE 1. ESTIMATED BUDGET IMPACT OF H.R. 3821, FISCAL YEARS 2005-2014**

| | By Fiscal Year, in Billions of Dollars | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
| | | | | | **CHANGE IN OUTLAYS** | | | | | |
| Individual Accounts | 1.0 | 76.9 | 109.1 | 116.6 | 124.2 | 131.9 | 139.2 | 146.8 | 154.3 | 162.2 |
| Social Security Benefits | 0 | -1.1 | -3.0 | -5.5 | -8.8 | -13.2 | -18.8 | -25.6 | -33.5 | -42.3 |
| SSI and Other Programs | -0.1 | -1.3 | -2.2 | -3.0 | -3.5 | -4.0 | -4.7 | -5.0 | -5.8 | -6.5 |
| Total | 0.9 | 74.5 | 103.9 | 108.1 | 111.8 | 114.6 | 115.7 | 116.2 | 115.1 | 113.4 |
| | | | | | **CHANGE IN REVENUES** | | | | | |
| Payroll Taxes | 1.0 | 14.3 | 23.4 | 29.6 | 32.2 | 33.0 | 33.4 | 34.1 | 35.1 | 36.1 |
| Income Taxes | -0.1 | -0.5 | -0.2 | 0.1 | 0.5 | 1.5 | 5.5 | 7.3 | 9.1 | 10.9 |
| Total | 0.9 | 13.8 | 23.2 | 29.7 | 32.7 | 34.5 | 38.9 | 41.5 | 44.2 | 47.1 |
| Net Increase in the Deficit | * | 60.7 | 80.7 | 78.4 | 79.1 | 80.1 | 76.8 | 74.7 | 70.9 | 66.4 |

NOTE: * = Less than $50 million.

The additional direct spending would be the result of an estimated $1,162 billion in federal outlays for individual accounts, which would be partially offset by a $188 billion reduction in spending for Social Security benefits and other programs. The additional revenue would result from the proposed increase in the maximum amount of an individual's earnings subject to the Social Security payroll tax and from the proposed change in the inflation index used for aspects of the individual income tax (which will also apply to various federal spending programs).

H.R. 3821 would have substantial long-run effects on the Social Security program and the federal budget. CBO projects and analyzes those impacts over the next century in a separate report entitled "Long-Term Analysis of H.R. 3821, the Bipartisan Retirement Security Act of 2004," issued on July 21, 2004.

## BACKGROUND

In 2003, the federal government spent a total of $479 billion on the Social Security program. That year, about 47 million people received Social Security benefits: 29.5 million retired workers; 5.9 million disabled workers; and 11.6 million family members of retired, disabled, or deceased workers. Social Security has two components. The Old-Age and Survivors Insurance (OASI) program provides benefits to retired workers, members of their families, and their survivors; the Disability Insurance (DI) program pays benefits to disabled workers younger than the normal retirement age and their dependents. OASI is by far the larger program; last year it accounted for about 85 percent of spending for the two parts combined (referred to as OASDI). On average, retired workers received a monthly OASDI benefit of about $922 in December 2003; disabled workers received an average of $862 in DI benefits.

Benefits are financed primarily through payroll taxes, with half collected from employers and half from workers. The combined rate, currently 12.4 percent, is levied on wages and self-employment income covered by the OASDI program, up to a maximum of $87,900. (That threshold rises annually with average earnings in the economy.) Last year, 154 million workers were covered by Social Security, earned taxable wages of $4.3 trillion, and paid $534 billion in Social Security payroll taxes.

The Social Security system also is credited with the income taxes that approximately one-third of its beneficiaries (those with the highest income) pay on their Social Security benefits. Such revenues totaled about $13 billion in 2003.

### How Benefits Are Calculated

All Social Security benefits are based on a worker's primary insurance amount (PIA). In turn, the PIA depends on a measure of a worker's career earnings in employment subject to the Social Security payroll tax, expressed as his or her average indexed monthly earnings (AIME).

**AIME**. For people who attain age 62 after 1990, the AIME is calculated based on the highest 35 years of earnings on which the individual paid Social Security taxes (up to the taxable maximum, which is $87,900 in 2004). Earnings before age 60 are indexed to compensate both for inflation and for real (after-inflation) growth in wages, and earnings after age 59 enter the computations at their actual levels. Dividing the total earnings by 420 (35 years times 12 months) yields the AIME.

**PIA**. The PIA is the monthly amount payable to a worker who begins receiving Social Security retirement benefits at the age at which he or she is eligible for full benefits or payable to a disabled worker who has never received a retirement benefit. (The age of eligibility is discussed in the next section.)

The PIA formula is designed to ensure that initial Social Security benefits replace a larger proportion of preretirement earnings for people with low average earnings than for those with higher earnings. For workers who turn 62, become disabled, or die this year, the formula is:

PIA = (90 percent of the first $612 of the AIME) + (32 percent of the AIME between $612 and $3,689) + (15 percent of the AIME over $3,689)

The thresholds at which the percentage of the AIME changes are known as “bend points.” They change each year along with changes in the average annual earnings for the labor force as a whole. Consequently, as wages rise over time, initial benefits increase at a similar pace.

Workers who are 62 now, who had average earnings throughout their career, and who wait to claim benefits until they reach the age at which they will be eligible for full benefits (65 and 10 months for this group) will receive a monthly benefit of $1,321. That payment will replace about 41 percent of their earnings in the year before they claimed benefits. If, instead, they claim benefits this year soon after their 62nd birthday, they will be eligible for a permanently reduced benefit of $942 a month. That amount will replace about 34 percent of their pretax earnings last year.

In addition, at the end of each year, SSA adjusts the PIA by the amount of any increase in the consumer price index (CPI). The 2.1 percent cost-of-living adjustment that took effect in December 2003 reflected the increase in the CPI for urban wage earners and clerical workers (CPI-W) that occurred between the third quarter of 2002 and the third quarter of 2003.

Because of Social Security’s indexing rules, the payments received by newly eligible beneficiaries reflect both increases in prices and real growth in earnings throughout the economy during the years that those beneficiaries worked. Later increases in their payments—through annual COLAs—reflect only increases in prices after the beneficiaries became eligible for benefits. Thus, as long as real wages continue to rise, new beneficiaries will generally receive higher real benefits than older beneficiaries.

**Monthly Benefits**. The PIA governs all benefits paid under Social Security. A retired or disabled worker may receive 100 percent of the PIA; a spouse or child of a retired or disabled worker may receive 50 percent of the worker's PIA. For survivors, the rules differ for elderly surviving spouses and for younger widows and widowers who are caring for the deceased worker's children. The former may receive 100 percent of the worker's PIA, while the latter may be eligible for 75 percent. Eligible surviving children similarly may receive 75 percent of the PIA. The actual percentages any of these beneficiaries receive often differ from those percentages for a variety of reasons, as discussed below.

*Early and Delayed Retirement.* Under current law, the age at which a worker becomes eligible for full Social Security retirement benefits—the normal retirement age (NRA)—depends on the worker's year of birth. For people born before 1938, the NRA was 65. For slightly younger workers, it increases by two months per birth year, reaching 66 for people born in 1943. The NRA remains at 66 for workers born between 1944 and 1954 and then begins to increase in two-month increments again, reaching 67 for workers born in 1960 or later. For workers whose 62nd birthday falls this year, the NRA is 65 years and 10 months.

Workers can begin receiving permanently reduced monthly retirement benefits as early as age 62. People who start collecting retirement benefits at age 62 this year will incur a permanent 24.2 percent reduction in their monthly benefits. As the normal retirement age rises to 67 for future groups of workers, that maximum reduction will also increase. (Once the NRA is 67, the maximum permanent reduction will be 30 percent.) Similarly, workers who delay collecting benefits beyond their normal retirement age receive a delayed-retirement credit to compensate them for the reduction in the length of time they will receive benefits.[2]

The size of the early-retirement reduction for workers is intended to be "actuarially fair"—in the sense that the total value of the reduced monthly benefits that an average worker could expect to receive between age 62 and death is similar to the total value of the full monthly benefits that the worker could expect to receive over that time by waiting until he or she was eligible for full benefits.

More than two-thirds of the workers who began receiving Social Security retirement benefits in the past decade started collecting benefits before the NRA. The majority of those early recipients began collecting benefits at age 62.

*Earnings Test.* Social Security benefits are reduced if recipients who have not attained the NRA earn more than a certain amount. The rules, known as the retirement earnings test, apply to earnings but not to income from dividends, pensions, or interest. This year, the benefits of Social Security recipients who have not yet reached the NRA will be reduced by $1 for each $2 they earn above $11,640. That earnings threshold automatically rises each year to match the increase in a national index of average wages. Workers whose initial benefits are reduced because of the retirement earnings test will receive higher monthly benefits later.

2. Starting with beneficiaries born in 1943, each year delayed beyond the normal retirement age (which will be 66 for that group), up to age 70, will add 8 percent to their retired-worker benefits. The delayed-retirement credit for workers reaching the normal retirement age this year is 6.5 percent.

*Maximum Family Benefits*. The total amount of benefits that a family can receive on the basis of a worker's earnings record is limited by a family cap (which is generally between 150 percent and 188 percent of the worker's PIA, although family benefits in DI cases are subject to additional limitations). The family maximum generally applies when three or more family members are entitled to benefits.

In general, if their marriage lasted at least 10 years, ex-husbands and ex-wives are entitled to the same benefits based on their former spouse's earnings as they would be if they had remained married. Benefits for former spouses do not count against the family maximum.

*Dual Entitlement*. If a spouse or widow(er) has worked long enough to earn retired- or disabled-worker benefits on his or her own, Social Security does not pay the full amount of both benefits. Instead, it pays the larger of the two amounts for which the recipient is eligible. Those people who receive their own benefit plus a portion of the other benefit are labeled "dually entitled."

As a rule of thumb, the lower earner of a couple does not receive any spousal benefits if he or she earned at least one-third as much as the spouse earned. However, upon the death of a spouse, the lower earner of a couple generally receives additional benefits based on the earnings record of the deceased spouse.

## MAJOR PROVISIONS OF H.R. 3821

### Individual Accounts

H.R. 3821 would establish a new system of individual accounts (labeled individual security accounts), which would be funded primarily through receipts from the existing payroll tax and earnings on the accounts' investments. Beginning in 2006, workers born after 1949 would have a portion of their payroll taxes deposited into the IAs—3 percent of their wages under $10,000 and 2 percent of wages above that level up to the taxable maximum. Payroll taxes credited to the Social Security trust funds would be reduced by a corresponding amount. The $10,000 threshold would be adjusted each year to reflect changes in the average wage in the economy. (The bill also would permit voluntary additional contributions to the IAs, but neither CBO nor the Joint Committee on Taxation has estimated the impact of this aspect of the proposed legislation.)

Initially, the IAs would be managed by the Social Security Administration (SSA), which would credit deposits into the accounts and allocate them according to the investment options selected by the accountholder. If the balance of an account exceeds $7,500 (indexed to inflation after 2006), the accountholder could request SSA to transfer the funds to a private investment institution. Whether the funds are administered by SSA or a private institution, the accounts would be considered nonfederal for all budget purposes. Moreover, the rules for distributing the proceeds of the accounts would be the same regardless of who administers them.

Distributions from the accounts would generally commence when the accountholders begin drawing Social Security retirement benefits. However, if, by that time, an account were to grow sufficiently large to permit the accountholder to purchase an indexed annuity that would equal or exceed (in combination with the recipient's Social Security benefit) 185 percent of the poverty line, the worker could withdraw those excess funds for any purpose. All distributions from the accounts would be treated for income tax purposes as if they were Social Security benefits.

## Changing the AIME, PIA, and Actuarial Adjustment Factors

As described earlier, under current law, Social Security benefits are calculated by applying a formula to a summary measure of a worker's career earnings. The average indexed monthly earnings (AIME) is converted into a primary insurance amount (PIA) using a three-bracket formula intended to provide lower-wage earners with relatively higher benefits than higher-wage earners. Actual monthly benefits include adjustments to account for early or delayed retirements, an earnings test for beneficiaries under the age for unreduced retirement benefits, and a maximum on benefits paid on one earnings record.

**Including Additional Years of Earnings in AIME Calculations**. H.R. 3821 would alter the AIME calculation in two ways. First, the number of years in the averaging period (the denominator) would gradually increase from 35 years to 40 years over the 2006-2014 period. Second, the total earnings to be averaged (the numerator) would be increased from 35 years of earnings to all years of earnings in 2014 and beyond (see Table 2).

The effects of these changes to the AIME calculation would vary significantly across the beneficiary populations. Workers who are employed steadily after completing their education and work late in life could see a noticeable increase in their benefits. For example, a worker who was employed at the average wage in the economy after graduating from high school at age 18 until he retired at the normal retirement age (age 66) in 2014 would see a 24 percent benefit increase. In contrast, a similar classmate who worked 10 fewer years before age 62 and who begins collecting benefits at that age would experience an 11 percent drop in benefits.

**TABLE 2. SUMMARY OF PROPOSED CHANGES IN THE CALCULATION OF AVERAGE INDEXED MONTHLY EARNINGS**

| Newly Eligible in: | Current Law | Proposed Changes | | | | |
|---|---|---|---|---|---|---|
| | All Years | 2006-2007 | 2008-2009 | 2010-2011 | 2012-2013 | 2014 + |
| Years of Included Earnings (numerator) | 35 | 37 | 39 | 41 | 43 | all |
| Years to be Averaged Over (denominator) | 35 | 36 | 37 | 38 | 39 | 40 |

**Changes to the PIA Calculation**. H.R. 3821 would modify the formula used to calculate PIAs in several ways (see Table 3):

- The current 32 percent bracket would be divided into a 70 percent bracket and a 20 percent bracket;

- The percentage applied to the top bracket would be reduced from 15 percent to 10 percent over the 2006-2015 period;

- The percentages in the revised formula—except the 90 percent bracket—would be reduced by 2.5 percent annually from 2012 to 2030, and all bracket percentages would be reduced by 1.5 percent a year from 2031 to 2060; and

- The PIAs calculated under the new formula would be reduced by factors reflecting improved life expectancies of new retirees.

**TABLE 3. FORMULAS FOR DERIVING THE PIA FROM AIME (FOR 2004) UNDER H.R. 3821**

| Eligible Beginning in | First Bracket: First $612 | Middle Bracket (s) | | Top Bracket: Above $3,689 | Assumed Percentage Factor For Life Expectancy |
|---|---|---|---|---|---|
| 2004 | 90.0% | 32% of next $3,077 | N.A. | 15.0% | N.A. |
| 2015 [a] | 90.0% | 63.3% of next $513 | 18.1% of next $2,564 | 9.0% | 98.9 |
| 2030 [a] | 90.0% | 43.3% of next $513 | 12.4% of next $2,564 | 6.2% | 94.5 |
| 2060 [a] | 57.2% | 27.5% of next $513 | 7.9% of next $2,564 | 3.9% | 87.2 |

NOTES: PIA = Primary Insurance Amount; AIME = Average Indexed Monthly Earnings; N.A. = not applicable.

a. Dollar amounts in this table are 2004 levels to facilitate comparison. Actual amounts would be indexed by the growth in average wages. Bracket percentages for years after 2004 reflect the changes that would result from H.R. 3821.

To illustrate the potential effects on recipients, CBO has estimated the PIAs for three hypothetical retirees in various cohorts of future beneficiaries (see Table 4). The retirees are assumed to have steady earnings at one of three levels: 50 percent of the average earnings, the average earnings, and the maximum earnings subject to Social Security payroll taxes. The calculations use 2004 earnings levels for ease of comparison.

The first panel of Table 4 illustrates the effects of the addition of the new bracket, the lowering of the percentage in the top bracket from 15 to 10, and the annual reductions of the bracket percentages of 2.5 percent (2012-2030) and 1.5 percent (2031-2060). In combination, the PIA changes would have significantly greater effects on workers with higher earnings than on those further down the earnings distribution. For example, those who always earned the maximum taxable wage would see traditional Social Security benefits reduced, relative to those under the current formula, by 34 percent in 2030 and 58 percent in 2060 before adjustments for mortality improvements; low earners would experience a 1 percent increase in 2030 and a 36 percent decrease in 2060.

**TABLE 4. PIAs FOR HYPOTHETICAL WORKERS BECOMING ELIGIBLE FOR BENEFITS IN VARIOUS YEARS BASED ON 2004 EARNINGS LEVELS (IN 2004 DOLLARS)**

| Becoming Eligible in | Earner at 50% of Average Earnings | Earner at 100% of Average Earnings | Earner at Maximum Taxable Earnings |
|---|---|---|---|
| | PIA Excluding Life Expectancy Adjustment | | |
| 2004 | 798 | 1,242 | 1,866 |
| 2015 [a] | 922 | 1,173 | 1,538 |
| 2030 [a] | 805 | 976 | 1,226 |
| 2060 [a] | 512 | 620 | 779 |
| | PIA Including Assumed Life Expectancy Adjustments | | |
| 2004 | 798 | 1,242 | 1,866 |
| 2015 [a] | 912 | 1,160 | 1,520 |
| 2030 [a] | 760 | 922 | 1,158 |
| 2060 [a] | 446 | 541 | 679 |

a. These monthly benefits would be supplemented by payouts from IAs.

H.R. 3821 also would provide for reductions in the bracket percentages to reflect future changes in life expectancies at age 62. Specifically, the bill would adjust those percentages starting in 2012 by a ratio that captures the increase in life expectancy at age 62 for the each cohort as it reaches that age. For any given cohort, the ratio would equal life expectancy at age 62 for the cohort reaching age 62 in 2008 divided by the life expectancy at age 62 for the cohort reaching age 62 three years prior to the cohort in question. (For example, the ratio used for the cohort reaching age 62 in 2020 would reflect the difference between the life expectancy of the cohort reaching age 62 in 2017 and the one reaching age 62 in 2008.) Life expectancy would be computed by sex each year, based on projected mortality rates, and would be the population-weighted average of the male and female numbers. In general, the ratio would get smaller each year; the bill specifies that it could not increase from year to year even if life expectancy falls.[3] Under the mortality assumptions used by CBO (and the

3. This reduction for rising life expectancy is only applied to DI beneficiaries upon conversion to retired-worker benefits at the normal retirement age. The reduction in the DI worker benefits at conversion is not as large as it would be for the non-disabled, to reflect the reduced number of years the disabled worker spent in the labor market. The reduction equals the weighted average of the benefit with and without the full adjustment for longevity improvements applicable at the time of DI claim, where the weight is elapsed years relative to potential career (40 years). Thus, for example, beneficiaries with a potential career of 30 years would experience only three-fourths of the adjustment.

intermediate assumptions of the Social Security trustees), these adjustments would further reduce monthly PIAs by 5.6 percent in 2030 and 12.7 percent in 2060.

These calculations do not include distributions from the IAs. Over time, payouts from IAs would become an increasingly important component of retirement income, and total benefits (including those payouts) might or might not be greater than benefits under current law. (See CBO "Long-Term Analysis of H.R. 3821, the Bipartisan Retirement Security Act of 2004," July 2004.)

**Minimum Social Security Benefit**. A new formula for raising benefits for long-term workers with relatively low earnings would be introduced for workers becoming eligible for benefits beginning in 2014. (The existing formula for a special minimum PIA affects relatively few workers and is gradually diminishing in importance because it is not adjusted for real wage growth.) H.R. 3821 specifies that a new minimum PIA would be calculated based on a worker's quarters of coverage (QCs). The minimum PIA would be 2 percent of the poverty level for each QC above 40 (10 years of earnings) and up to 80 QCs, and 1 percent of the poverty level for QCs above 80 but not more than 160. Thus, for someone with 20 years of earnings, the minimum PIA would typically be 80 percent of the poverty level; at 40 years, the amount would be 120 percent of the poverty level. (For disabled workers, fewer quarters would be required because of their shortened careers.) Beginning in 2014, the effective poverty levels would be increased with average wages.

**Adjustments for Early and Delayed Retirement**. The bill would increase the reduction factors for retired workers who apply for benefits before the NRA, and increase the credit for postponing benefits after the NRA. The reduction factors for spousal benefits also would be increased. When the NRA reaches 67, the proposed changes would have the effect of reducing the PIA for benefits at age 62 by 37 percent for retired workers (compared with 30 percent under current law) and by 42 percent for spousal benefits (compared with 35 percent under current law). For those who postpone receiving benefits, H.R. 3821 would increase the delayed retirement credit to 10 percent per year until age 70, instead of the 8 percent adjustment under current law.

## Using a New CPI Measure for COLA Computations

H.R. 3821 would further slow the growth in benefits by lowering annual COLAs for Social Security and most indexed benefit programs. It also would increase revenues by reducing various adjustments in the income tax code. The bill would substitute the consumer price index for urban consumers (CPI-U) for the consumer price index for urban wage and clerical workers (CPI-W) as the basis for the COLA. It also would adjust the increases to reflect a perceived bias in the way the CPI measures price increases. Many economists believe that the CPI-U and CPI-W overstate price increases because they do not fully reflect the responses of consumers to changes in the relative prices of goods and services. Although the Bureau of Labor Statistics has made major strides in improving the CPI, the basic measures still contain one major source of bias generally referred to as "upper level substitution bias." Recently, the BLS has constructed an alternative CPI, the chained consumer price index for urban consumers (C-CPI-U), which attempts to capture and eliminate that bias.

Effectively, H.R. 3821 would index benefits by the lesser of the CPI-U and the C-CPI-U. Based upon the experience of the last decade or so and the CPI-U increases it projects, CBO estimates that this change would reduce COLAs by about 0.3 percentage points annually.

The impact of this proposed change on beneficiaries would depend on the number of years they were affected by the reduced COLA. For a retired worker who begins to collect benefits at age 62 and lives for 20 years, the reduction in the last year of life would be about 5.4 percent. For a disabled worker awarded benefits at age 45 who lives to a comparable age, the reduction would be 10 percent.

**Increase in the Benefit and Contribution Base**

The benefit and contribution base, which is also referred to as the maximum taxable wage (TAXMAX), limits the amount of wages subject to the OASDI payroll tax and represents the upper bound on annual wages that is used in benefit computations. The TAXMAX is increased annually to reflect increases in the average wage in the economy; in 2004 it stood at $87,900. H.R. 3821 would increase the TAXMAX in four steps to $133,200 in 2008. In subsequent years, the SSA Commissioner would set the level such that 87 percent of earnings would be taxable each year.

**Acceleration of the Increase in Social Security Eligibility Age**

As a part of the Social Security Amendments of 1983, the age at which individuals could receive unreduced retirement benefits was increased from 65 to 67 in two stages. The first stage raised the age by two months a year each year from 2000 to 2005, so that workers turning 62 in 2005 will face an NRA of 66. The second stage is scheduled for 2017-2022, when the age will increase from 66 to 67. H.R. 3821 would shift the second stage to begin in 2006 and end in 2011.

### Increase in Benefits for Surviving Spouses

H.R. 3821 would boost payments to some surviving spouses by ensuring that benefits equal 75 percent of a couple's combined benefits. Under current law, surviving spouses generally receive the higher of their own retired worker benefit or the deceased spouse's benefit. For single-earner couples in which each spouse receives unreduced benefits, the surviving spouse receives two-thirds of the couple's benefits. In two-earner couples, a surviving spouse could receive as little as 50 percent of the couple's combined benefit. Under the bill, the new minimum benefit for the surviving spouse could not exceed the average PIA for retired-worker benefits in the December before the month of entitlement to the widow(er)s benefit (or, if the month of entitlement is December, then that same month). The proposed change would be implemented for those who apply for a surviving spouse's benefit after 2005.

### Limitation on Benefits of Married Couples to the Level of the Maximum Worker Benefit

The bill would limit benefits for couples in many cases where the primary worker's earnings are above the national average. Specifically, the spousal benefit would be reduced in any situation where the couple's benefit would exceed the PIA of a worker who always earned the TAXMAX and reached eligibility age in the same year as the primary earner. Therefore, in the extreme, where the primary earner has earned the TAXMAX each year, no spousal benefit would be paid.

### Transfers To Social Security Trust Funds

H.R. 3821 would bolster the balances in the Social Security trust funds by redirecting the income taxes on Social Security benefits that are currently credited to Medicare's Hospital Insurance (HI) program and by creating a new transfer from general funds.

**Redirection of HI's Share of Taxes on OASDI Benefits**. Under current law, a portion of Social Security benefits is subject to the income tax, and those income tax revenues are transferred to the OASDI and HI trust funds. For recipients whose income, including 50 percent of OASDI benefits, exceeds $25,000 for individuals and $32,000 for couples, up to 50 percent of benefits are subject to income taxation; the additional income taxes are credited to the OASDI funds. For recipients with incomes above $34,000 (for individuals) or $44,000 (for couples), up to 85 percent of benefits can be taxed; the resulting additional taxes are credited to the HI trust fund.

H.R. 3821 would redirect to the OASDI trust funds increasing portions of the amounts that would be credited to HI under current law until, beginning in 2020, all taxes on Social Security benefits would flow into the OASDI trust funds. The provision would not affect total revenues, but transfers that would have been entirely on-budget (from the general fund to the HI trust fund) would now consist of an on-budget payment with an off-budget receipt (to the OASDI trust funds).

**General-Fund Transfer**. The bill would establish a new general-fund transfer to the OASI trust fund, which would gradually climb to equal 0.57 percent of earnings subject to the payroll tax (see Table 5).

**Table 5. SPECIFIED TRANSFERS TO THE OASI TRUST FUND UNDER H.R. 3821**

| | By Fiscal Year | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014-2019 | 2020-2043 | 2044-2063 | After 2063 |
| Percent of Earnings Subject to the Payroll Tax | 0.02 | 0.04 | 0.10 | 0.12 | 0.13 | 0.20 | 0.24 | 0.29 | 0.33 | 0.39 | 0.47 | 0.57 |

## ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary effects of H.R. 3821 over the 2005-2014 period are shown in Table 6. The costs of the legislation fall primarily in function 650 (Social Security), but it also would affect functions 550 (health), 570 (Medicare), 600 (income security), and 700 (veterans' benefits).

## BASIS OF ESTIMATE

For this estimate, CBO assumes that H.R. 3821 will be enacted this fall. CBO's analysis shows the effect of each provision as if it were enacted alone. In a separate section, we present the major interactions among them.

**TABLE 6. ESTIMATED ON-BUDGET AND OFF-BUDGET EFFECTS OF H.R. 3821**

| | By Fiscal Year, in Billions of Dollars | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
| Estimated Revenues | | | | | | | | | | |
| On-budget | -0.1 | -0.5 | -0.2 | 0.1 | 0.5 | 1.5 | 5.5 | 7.3 | 9.1 | 10.9 |
| Off-budget | 1.1 | 15.1 | 24.6 | 30.9 | 33.5 | 34.2 | 34.4 | 35.1 | 35.9 | 36.9 |
| Total | 1.0 | 14.5 | 24.3 | 31.0 | 34.0 | 35.6 | 39.9 | 42.4 | 45.1 | 47.9 |
| Estimated Outlays | | | | | | | | | | |
| On-budget | 0 | 0.5 | 1.0 | 3.7 | 4.5 | 4.8 | 10.5 | 15.6 | 21.5 | 27.5 |
| Off-budget | 1.0 | 74.8 | 104.1 | 105.7 | 108.5 | 110.9 | 106.2 | 101.6 | 94.4 | 86.7 |
| Total | 1.0 | 75.3 | 105.1 | 109.4 | 113.0 | 115.8 | 116.7 | 117.1 | 115.9 | 114.2 |
| Net Increase or Decrease (-) in the Deficit | | | | | | | | | | |
| On-budget | 0.1 | 1.0 | 1.2 | 3.6 | 4.0 | 3.4 | 5.0 | 8.2 | 12.3 | 16.6 |
| Off-budget | -0.1 | 59.7 | 79.5 | 74.8 | 75.1 | 76.8 | 71.8 | 66.5 | 58.5 | 49.8 |
| Total | * | 60.7 | 80.7 | 78.4 | 79.1 | 80.1 | 76.8 | 74.7 | 70.9 | 66.4 |

NOTE: * = Less than $50 million.

To analyze the effects of the bill, CBO relied chiefly on data from the Social Security Administration—much of it published in the *Annual Statistical Supplement* or Trustees' reports or available on SSA's Web site, some of it unpublished. (In many cases, CBO updated the *Supplement* data to December 2003 using its 1 percent sample of SSA's Master Beneficiary Record.) The unpublished data come chiefly from SSA's Continuous Work History Sample—another 1 percent sample of workers and recipients that provides data on people's lifetime earnings and benefit histories.

## Individual Accounts

Under section 2 of H.R. 3821, the government would create about 145 million individual accounts in 2006—one for every covered worker born on or after January 1, 1950. Three percent of earnings up to $10,000, and 2 percent of earnings over that figure (up to the taxable maximum) would go into the accounts. Those amounts would be “carved out” of the current 12.4 percent payroll tax.

In fiscal year 2006, CBO expects that the government will collect $613 billion from the Social Security payroll tax.[4] About 87 percent will be paid on behalf of people born in 1950 or later. About 30 percent will represent taxes on the first $10,000 of earnings and 70 percent on the rest, implying that about 2.3 percent of earnings up to the taxable maximum would be deposited in IAs under this bill. Diverting 2.3 percentage points of the current payroll tax for three-quarters of fiscal year 2006 (which starts in October 2005) would lead to $74 billion in federal outlays for IA contributions in that year, about 12 percent of the receipts from Social Security taxes for that fiscal year.

Those outlays would climb rapidly, reaching an estimated $156 billion in 2014. In that year, CBO expects the government to collect $877 billion in Social Security payroll taxes under current law. By then, workers born after 1949 would account for about 97 percent of payroll, so that the government's contributions to IAs would approach 2.3 percentage points—or about 18 percent—of the entire tax.

Workers and their employers would not notice any immediate difference on January 1, 2006. The payroll tax would remain unchanged. When the government credits the money to the workers' accounts, those sums would be recorded as outlays in the federal budget. The funds would no longer belong to the government and would become the property of the account holders (even though holders would face restrictions on their use). The accounts' ownership, and not the federal government's role in managing the funds, is the key test that determines their budgetary treatment.[5]

H.R. 3821 sets out a timetable for establishing the accounts, although it does not fully spell out the mechanics of implementation. CBO assumes that the Social Security Administration, whose Commissioner would be in charge of the new system, would initially run the new program much as it now handles the crediting of payroll taxes. Currently, employers remit withheld taxes to the Internal Revenue Service every payday, but only once a year do they file the W-2 forms that the government needs to match those taxes to particular workers. Thus, SSA posts earnings to individuals' records with a lag—generally in the spring of the next calendar year. To meet the bill's schedule, SSA would have to follow that approach initially, although with time and funding it might add features such as timelier crediting of contributions and investment earnings. Thus, CBO assumes that the government would pool IA contributions in 2006 and credit them with a rate of interest tied to Treasury securities, before matching them with their specific owners.

---

4. That figure includes $601 billion in revenues plus $12 billion from federal agencies, which pay the employer share just like any other employer. By convention, because the government cannot levy taxes on itself, those contributions are classified as offsetting receipts in the budget, not as revenues.

5. Congressional Budget Office, *The Budgetary Treatment of Personal Retirement Accounts*, CBO Paper (March 2000).

In general, H.R. 3821 copies many features of the proposed IAs from the federal employees' Thrift Savings Plan (TSP), the government's 401(k)-type program, a giant venture that now manages more than $100 billion in assets on behalf of 3 million current and former federal employees. The board that runs the TSP recovers ongoing administrative costs from participants' accounts, and H.R. 3821 envisions that the new Individual Security Fund Board would do likewise. But SSA would incur some costs long before the first contributions were credited. CBO thus assumes that those costs would be paid directly from the Treasury (as the TSP's authorizing legislation provided). In 2001, SSA estimated the costs of establishing a universal system of personal accounts at $1.2 billion to $2.3 billion (in 1999 dollars), depending on design features.[6] Updating those figures for inflation—and projecting costs near the lower end of the resulting range, because IAs under H.R. 3821 would initially have few frills—CBO estimates startup costs of $2.5 billion spread over the 2005-2007 period.

The budgetary impact of the IAs would occur only when the government sends the contributions to the accounts. From that point, transactions of the accounts—investment gains and losses and eventual distribution—would be nonbudgetary. The first payouts, except to heirs of workers who die, would occur in 2012 (when people born in 1950 reach age 62); and with just a few years' worth of contributions and earnings, those annuities would be small.

### Provisions Affecting the Initial Primary Insurance Amount

Five provisions of H.R. 3821 would affect computation of the primary insurance amount (PIA), which determines all benefits under the Social Security system. They would affect only people who become eligible in 2006 or later. People with 10 years of covered work become eligible for Social Security early-retirement benefits at age 62. Over the 2006-2014 period, CBO projects that:

- About 30 million people will reach age 62, with the first baby-boomers reaching that mark in 2008;
- Almost 90 percent, or 27 million, will be fully insured for retirement benefits;
- About 15 percent, or 4 million, will already be on the disability insurance rolls; leaving
- About 22 million eligible for Social Security early-retirement benefits, of whom

---

6. Social Security Administration, *SSA's Estimates of Administrative Costs Under a Centralized Program of Individual Accounts* (January 2001).

- About 18 million will actually file for benefits by 2014; most of the rest will do so by 2019.

Two of the five provisions would affect disabled workers as well; CBO expects that about 8 million people will qualify for those benefits in the 2006-2014 period.

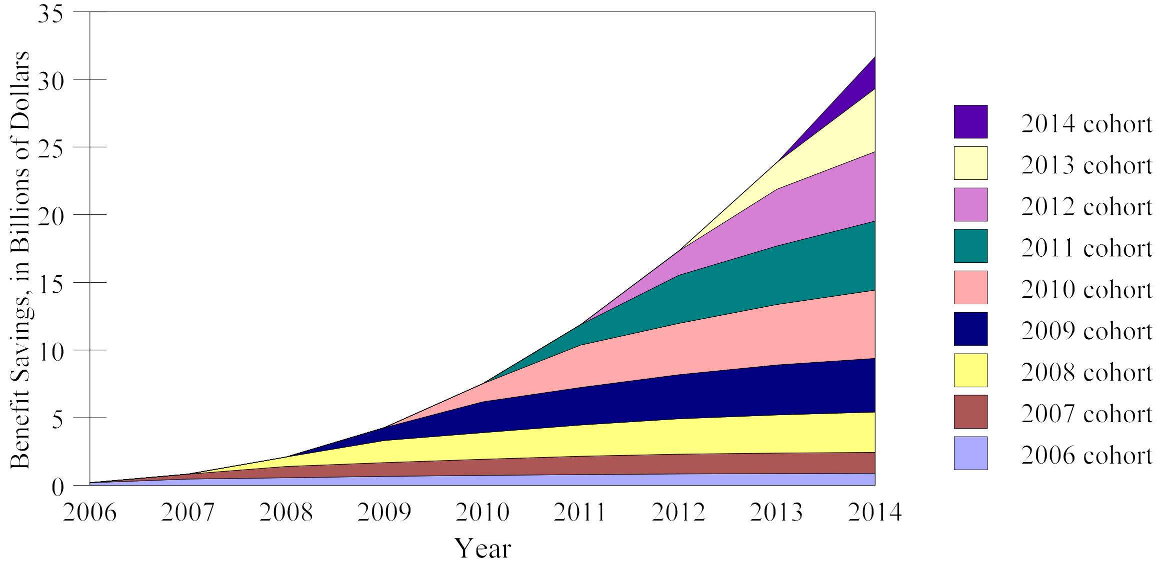
All of the provisions that affect the PIA would be phased in gradually. As a result, they would share a fundamental pattern (see Figure 1). Many people file for Social Security promptly at age 62; for each single group reaching that age, savings would approximately double between the first and second years. (With recipients' birthdays scattered throughout the year, the government would save an average of 6 months of benefits in the first year but 12 months in the second.) Savings would then continue to rise gradually as more people claim benefits, with another jump around the fifth year, when people who wait until the NRA join the rolls. For each cohort, the savings would be larger than for its predecessor—partly because cohort sizes generally rise during this period but chiefly because the bill phases in larger reductions for each new group of retirees. Table 7 shows the projected budgetary impact of each of these provisions over the 2005-2014 period, assuming they were enacted individually. (The interactions among them are discussed later.)

**Lengthen the Averaging Period**. The first step in calculating the PIA involves indexing the worker's earnings and averaging the top 35 years. Section 5 of H.R. 3821 would affect that first step by averaging earnings over 40, not 35 years. It would also count all earnings—not just the highest years. The provision would not apply to disabled workers.

A 2001 study by SSA researchers estimated that lengthening the averaging period to 40 years would trim the average PIA by about 5 percent for men and 6.5 percent for women.[7] CBO estimates a slightly smaller effect for men (about 4 percent) because many men have worked for more than 40 years and those additional earnings would be counted under this bill. Few

7. Sandell, Steven H., Howard M. Iams, and Daniel Fararas, "The Distributional Effects of Changing the Averaging Period and Minimum Benefit Provisions," *Social Security Bulletin*, Vol. 62, No. 2 (September 1999).

**Figure 1. Effects of Selected Provisions of H.R. 3821 on Cohorts Becoming Eligible for Retired-Worker Benefits in 2006 through 2014**




Source: Congressional Budget Office.

Note: Provisions include those that are phased in gradually to affect people eligible in 2006 or later: lengthening the averaging period for AIME, adding a fourth bracket, reducing bend rates, modifying PIAs for life expectancy, increasing the actuarial reduction and delayed retirement credit, and accelerating the scheduled increase in the NRA.

women in the cohorts retiring over the next 10 years will have worked for more than 40 years.[8] People eligible in 2014 or later, when the provision would be phased in, would experience that full effect. For older retirees, the effects would be more modest: a PIA reduction of about 1 percent for people eligible in 2006 and 2007, about 2 percent for those who reach 62 in 2008 and 2009, and so forth.

The size of the effect would rise as more retirees encounter the provision's full impact. Savings would be less than $50 million in 2006 and would grow to $5.7 billion in 2014.

8. H.R. 3821 would exempt the lower-earning spouse in a married couple—historically, usually the wife—from the longer averaging period. That exemption would be complicated to implement, and CBO omitted it when analyzing the bill.

**TABLE 7. ESTIMATED BUDGETARY IMPACT OF PROVISIONS AFFECTING THE PIA**

| | By Fiscal Year, in Billions of Dollars | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
| **Lengthen averaging period for AIME, include all earnings** | | | | | | | | | | |
| OASDI benefits [a] | 0 | * | -0.1 | -0.3 | -0.7 | -1.2 | -1.9 | -2.9 | -4.1 | -5.7 |
| SSI benefits | 0 | * | * | * | * | * | 0.1 | 0.1 | 0.2 | 0.2 |
| Net Outlays | 0 | * | -0.1 | -0.3 | -0.7 | -1.2 | -1.9 | -2.8 | -4.0 | -5.4 |
| **Adopt a Four-Bracket Formula** | | | | | | | | | | |
| OASDI benefits [a] | 0 | * | * | * | * | -0.1 | -0.1 | -0.1 | -0.2 | -0.3 |
| SSI benefits | 0 | * | * | * | * | * | * | * | * | * |
| Net Outlays | 0 | * | * | * | * | * | -0.1 | -0.1 | -0.2 | -0.2 |
| **Multiply bend rates except 90 percent by .975 annually** | | | | | | | | | | |
| OASDI benefits [a] | 0 | 0 | 0 | 0 | 0 | 0 | 0 | -0.1 | -0.4 | -1.1 |
| SSI benefits | 0 | 0 | 0 | 0 | 0 | 0 | 0 | * | * | * |
| Net Outlays | 0 | 0 | 0 | 0 | 0 | 0 | 0 | -0.1 | -0.4 | -1.0 |
| **Modify PIA formula for life expectancy** | | | | | | | | | | |
| OASDI benefits [a] | 0 | 0 | 0 | 0 | 0 | 0 | 0 | * | -0.1 | -0.2 |
| SSI benefits | 0 | 0 | 0 | 0 | 0 | 0 | 0 | * | * | * |
| Net Outlays | 0 | 0 | 0 | 0 | 0 | 0 | 0 | * | -0.1 | -0.2 |
| **Establish minimum benefit** | | | | | | | | | | |
| OASDI benefits [a] | 0 | 0 | 0 | 0 | * | * | * | 0.2 | 0.8 | 2.1 |
| SSI benefits | 0 | 0 | 0 | 0 | * | * | * | * | -0.1 | -0.3 |
| Net Outlays | 0 | 0 | 0 | 0 | * | * | * | 0.2 | 0.7 | 1.8 |

NOTES: PIA=Primary Insurance Amount, AIME=Average Indexed Monthly Earnings, OASDI=Old-Age, Survivors and Disability Insurance, SSI=Supplemental Security Income.

Estimates reflect the effects of each provision if enacted separately. Interactions between provisions are presented later in this cost estimate.

* = Less than $50 million.

a. Off-budget.

**Adopt a New Four-Bracket Formula**. The second step in calculating the PIA applies a three-part formula. For people eligible in 2004, the PIA equals 90 percent of the first $612 of AIME, 32 percent of the next $3,077, and 15 percent of any excess. (These percentages are often referred to as "bend rates.")

Section 8 of H.R. 3821 would split the 32 percent band into 70 percent and 20 percent brackets. It would also trim the rate applied to the top bracket to 10 percent. The shift would take place over the 2006-2015 period, and would affect both retired and disabled workers.

CBO judges that the provision would have little net effect on outlays for benefits. When the provision is fully phased in, CBO expects that it would reduce the average PIA for male retired workers by 3 percent while boosting women's by 4 percent. For disabled workers—who tend, on average, to have less education and lower earnings than retired workers—the provision, when mature, would leave men's PIA little-changed while increasing women's by 7 percent. In 2014—one year shy of the full phase-in—the provision would reduce OASI benefits by $1.4 billion and boost DI benefits by $1.2 billion, for a net impact of just $0.3 billion, CBO estimates.

**Reduce Bend Rates**. Section 9 would gradually reduce the bend rates in the PIA formula over the 2012-2060 period. All of those percentages—except for the lowest, 90 percent factor—would be multiplied by 0.975 annually through 2030. From 2031 through 2060, that multiplier would be 0.985 and would apply to all of the bend rates. The provision would not apply to disabled workers.

Although this provision would have powerful effects in the long run, its effects over the next decade are modest. By 2014, only three cohorts would be affected: people eligible in 2012 would see their PIA reduced, on average, by about 1.3 percent, those eligible in 2013 by 2.6 percent, and the 2014 cohort by 3.8 percent. Savings in 2014 would total $1.1 billion.

**Modify PIAs for Life Expectancy**. Beginning in 2012, section 10 would reduce the PIAs by a factor based on the improvement in life expectancy for people age 62. Someone who turns 62 this year may expect to live about 21 more years—about 22 years for women, 19 for men. Over the next few decades, SSA's actuaries expect that figure to improve by about 0.3 percent a year. If that is borne out, under H.R. 3821 the PIAs would be multiplied by .997 for people eligible in 2012, by .994 for people eligible in 2013, by .991 for the 2014 cohort, and so forth. The provision would not affect disabled workers.

Like the previous provision, this one would have large effects in the long run but muted impacts in the 2005-2014 period. In 2014, CBO estimates savings of $0.2 billion.

**Minimum PIA**. Finally, section 3 would establish a new minimum PIA that would depend solely on how many years an insured worker spent in covered employment. The guarantee would affect both retired and disabled workers and would apply whenever it exceeded the regular PIA.

The proposed floor would be linked to the Census Bureau's poverty threshold—$8,628 for someone 65 or older and living alone in 2002—adjusted for inflation through 2012 and for wage growth thereafter. A retired worker who had 80 quarters (20 years) of work, twice the required number, would be guaranteed 80 percent of that figure. One who had 30 years of work would be guaranteed 100 percent, and anyone with 40 or more years would be promised 120 percent. For disabled workers, the exact formula would depend on their age at disability, which ended their career before the 40-year mark.

The bill would first offer the guarantee in 2009, but a slow phase-in would delay any significant effects until 2013. CBO estimates that the provision would cost about $2.1 billion in 2014, split almost evenly between OASI and the DI program.

**SSI offsets.** The impact of each of the provisions just discussed on spending for Social Security benefits would be partly offset by costs or savings in the needs-tested Supplemental Security Income (SSI) program, also administered by SSA. In 2004, SSI will pay an estimated $34 billion in benefits to 6.7 million aged or disabled people with low income and few assets. The basic SSI benefit is currently $564 a month, which is reduced if the recipient has other income (including Social Security). About 2.4 million people get benefits under both programs—more than one-third of SSI recipients, but just 5 percent of Social Security beneficiaries.

Because of those overlaps, changing Social Security benefits automatically leads to effects on SSI. Generally, CBO estimates that about 5 percent of the Social Security cost or savings would be offset in the SSI program. However, a higher rate (15 percent) would apply for two provisions—splitting the 32-percent bracket and guaranteeing a minimum benefit—that would raise benefits for some lower-income beneficiaries, who are especially likely to participate in both programs. CBO estimates that the changes in Social Security benefits would add less than $500 million to annual SSI spending during the 2005-2014 period.

Changing Social Security and SSI benefits, in turn, might affect spending in the government's two large healthcare programs, Medicare and Medicaid. SSI beneficiaries are automatically covered under Medicaid, so that making more people eligible for SSI could boost Medicaid outlays (and vice versa). Most participants in the Supplementary Medical Insurance program (Medicare Part B) have their premiums withheld from Social Security checks, as will enrollees in the new prescription drug program (Medicare Part D). Both programs have features that link the premium, directly or indirectly, to Social Security benefits, so they too could be affected by H.R. 3821. CBO has not fully modeled those potential effects, but preliminary analysis indicates that they would add less than $500 million to outlays over the 2006-2014 period.

## Other Tax and Benefit Provisions

A variety of other provisions of H.R. 3821 would affect Social Security benefits (and other governmental activities) but would not directly alter the PIA formula (see Table 8).

**Reduce Cost-of-Living Adjustments (COLAs)**. Once people become eligible for Social Security, their PIA rises annually in step with the consumer price index for urban wage and clerical workers (CPI-W). Over the 2006-2014 period, CBO assumes that annual COLAs will average 2.2 percent.

Section 7 of the bill would link COLAs instead to the "chained" CPI, a new series published by the Department of Labor that attempts to remove the effect of upper-level substitution bias. CBO estimates that change would reduce annual COLAs by 0.3 percentage points. Unlike the provisions discussed earlier, this proposal would apply to current beneficiaries, not just people who become eligible in the future. It would also affect other benefit programs and the federal income tax code.

CBO estimates that reducing annual COLAs by 0.3 percentage points would reduce Social Security outlays by growing amounts, reaching $15.4 billion in 2014, or about 1.9 percent of total benefits in that year. The bill would also affect many other programs—notably SSI, civil service and military retirement, Railroad Retirement, and some veterans' benefits—that pay COLAs similar or identical to Social Security's. In total, those programs are about one-third the size of Social Security and savings would be about one-third as large. Parts of the Medicare and Medicaid programs are pegged to the overall CPI, and changing that index would save $1 billion in 2014.

Every January, income-tax tables are adjusted for the CPI to prevent inflation from pushing people into higher brackets—the phenomenon commonly known as "bracket creep." The Joint Committee on Taxation estimates that curbing those annual adjustments by 0.3 percentage points annually would add $14.9 billion to revenues in 2014.

## TABLE 8. ESTIMATED BUDGETARY IMPACT OF OTHER TAX AND BENEFIT PROVISIONS

| | By Fiscal Year, in Billions of Dollars | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
| Reduce COLAs | | | | | | | | | | |
| OASDI benefits [a] | 0 | -1.2 | -2.8 | -4.4 | -6.1 | -7.8 | -9.6 | -11.5 | -13.4 | -15.4 |
| SSI benefits | 0 | -0.1 | -0.2 | -0.3 | -0.5 | -0.6 | -0.8 | -0.8 | -1.1 | -1.2 |
| Other cash benefits | 0 | -0.3 | -0.7 | -1.2 | -1.6 | -2.0 | -2.5 | -2.9 | -3.4 | -3.8 |
| Medicare and Medicaid | 0 | -0.1 | -0.1 | -0.2 | -0.2 | -0.3 | -0.5 | -0.7 | -0.8 | -1.0 |
| Net Outlays | 0 | -1.6 | -3.8 | -6.0 | -8.4 | -10.8 | -13.5 | -15.8 | -18.7 | -21.5 |
| Revenues | 0 | 0.6 | 2.2 | 3.2 | 4.0 | 5.1 | 9.2 | 11.1 | 13.0 | 14.9 |
| Increase actuarial reduction | | | | | | | | | | |
| OASDI benefits [a] | 0 | -0.1 | -0.3 | -0.8 | -1.6 | -2.9 | -4.5 | -6.4 | -8.4 | -10.6 |
| SSI benefits | 0 | * | * | * | 0.1 | 0.1 | 0.2 | 0.3 | 0.3 | 0.4 |
| Net Outlays | 0 | -0.1 | -0.3 | -0.8 | -1.6 | -2.8 | -4.3 | -6.1 | -8.1 | -10.2 |
| Accelerate scheduled increase in NRA | | | | | | | | | | |
| OASDI benefits [a] | 0 | * | -0.2 | -0.6 | -1.2 | -2.2 | -3.6 | -5.4 | -7.6 | -10.0 |
| SSI benefits | 0 | * | * | * | * | 0.1 | 0.1 | 0.2 | 0.3 | 0.4 |
| Net Outlays | 0 | * | -0.2 | -0.5 | -1.1 | -2.1 | -3.5 | -5.2 | -7.3 | -9.6 |
| Increase taxable maximum | | | | | | | | | | |
| OASDI benefits [a] | 0 | 0 | * | 0.1 | 0.1 | 0.3 | 0.5 | 0.7 | 0.8 | 0.9 |
| Federal employer share [a] | -0.1 | -0.8 | -1.1 | -1.3 | -1.2 | -1.1 | -1.0 | -0.9 | -0.9 | -0.8 |
| Net Outlays | -0.1 | -0.8 | -1.1 | -1.2 | -1.1 | -0.9 | -0.6 | -0.2 | * | 0.1 |
| OASDI revenues [a] | 1.0 | 14.3 | 23.4 | 29.6 | 32.2 | 33.0 | 33.4 | 34.1 | 35.1 | 36.1 |
| Income tax revenues | -0.1 | -1.1 | -2.4 | -3.1 | -3.5 | -3.6 | -3.7 | -3.8 | -3.9 | -4.0 |
| Net Revenues | 0.9 | 13.2 | 21.0 | 26.5 | 28.7 | 29.4 | 29.7 | 30.4 | 31.2 | 32.2 |
| Increase widow(er)'s benefits | | | | | | | | | | |
| OASDI benefits [a] | 0 | 0.2 | 0.4 | 0.7 | 0.9 | 1.1 | 1.3 | 1.6 | 1.8 | 2.0 |
| SSI benefits | 0 | * | -0.1 | -0.1 | -0.2 | -0.2 | -0.3 | -0.3 | -0.4 | -0.4 |
| Net Outlays | 0 | 0.1 | 0.3 | 0.5 | 0.7 | 0.9 | 1.1 | 1.3 | 1.4 | 1.6 |
| Limit benefits for married couples | | | | | | | | | | |
| OASDI benefits [a] | 0 | * | * | -0.1 | -0.1 | -0.3 | -0.7 | -1.4 | -2.4 | -3.8 |

NOTES: OASDI=Old-Age, Survivors and Disability Insurance, SSI=Supplemental Security Income, COLA=cost-of-living adjustment, NRA=normal retirement age.

* = Less than $50 million.

a. Off-budget.

**Increase Actuarial Reduction and Delayed Retirement Credit (DRC**). Section 6 of H.R. 3821 would raise the actuarial reduction for people who file for benefits before the normal retirement age. For people who reach 62 between 2005 and 2016, the NRA is 66 under current law; their benefit will equal 75 percent of the PIA if they file at age 62, 80 percent at age 63, and so forth. (Those reductions last for a lifetime.) The bill would increase those reductions in steps. Taken alone—that is, without the bill's accompanying increase in the NRA, discussed below—that change would reduce the benefit to 69 percent of the PIA for people who file at 62 from 2010 through 2016.

Historically, most people have filed for benefits at one of two ages: 62 or 65. For most of them, 65 represented both the NRA and the age of Medicare eligibility. The first group affected by past increases in the NRA—people who reached 62 in 2000, and whose NRA was 65 and 2 months—reached 65 last year, and showed some movement from 65 to their new NRA. However, 62 remained by far the most popular age for claiming benefits.

CBO estimates that, although many workers would claim benefits at roughly the same ages as they would under current law (thus incurring larger reductions in benefits), others would postpone claiming benefits in response to the changes. For both groups, however, the effects would be to reduce benefit payments over the 2006-2014 period. Significant savings—$10 billion in 2014 and $34.3 billion for the 2006-2014 period—would result.

**Accelerate the Scheduled Increase in NRA**. Under current law, the NRA will rise to 66 for people who turn 62 in 2005 and stay there for 12 years. Starting in 2017, it will climb again in two-month steps until reaching 67 for people who turn 62 in 2022 or later.

Section 13 would eliminate that 12-year hiatus. Instead, the NRA would reach 67 in 2011. Because most people file for reduced benefits before the NRA, that change would have a significant effect on outlays in the next 10 years because more people would be subject to an actuarial reduction for filing before the NRA and even more would experience larger reductions than under current law. CBO estimates savings of $10.0 billion in 2014.

Over the very long run, those savings would disappear. For anyone born in 1960 or later, the NRA would be 67 under both current law and H.R. 3821. Thus, savings would fade by mid-century as people born before 1960 die.

**Increase the Taxable Maximum**. Section 12 would increase the taxable maximum in stages. In 2005, the ceiling would rise to $90,225, only a little higher than under current law. (The maximum is indexed to average wages; CBO expects the 2005 figure, which will be announced in October, to be $89,100.) By 2008, the maximum would reach $133,200, versus an estimated $98,400 under current law. After 2008, SSA would adjust the maximum annually to ensure that 87 percent of total covered earnings are subject to the payroll tax.

The Joint Committee on Taxation estimates that the provision would bring in additional payroll taxes of $1.1 billion in 2005 and $30 billion or more annually in 2008 and beyond (including the federal government's share for its employees). Approximately 10 percent would be offset by lower income-tax receipts.

Raising the taxable ceiling also means that people with high earnings would eventually receive bigger Social Security benefits. That effect is small over the 10-year period—just $0.9 billion in 2014—because the people affected would have spent only a fraction of their careers at the new, higher ceiling.

**Increase Widow(er)s' Benefits**. Under current law, a widow or widower may receive 100 percent of the deceased worker's PIA, with adjustments for early retirement or for any DRC that the worker had earned.[9] That may be anywhere between half and three-quarters of what the couple would receive if both were still alive:

- If the worker filed at the NRA (for 100 percent of the PIA) and the uninsured spouse received 50 percent of the PIA, the survivor's benefit—100 percent—equals two-thirds of the couple's.

- If the worker filed at NRA but the spouse was 3 years younger—a typical age gap between husbands and wives—their combined benefit probably equaled 137.5 percent of the PIA, and the widow's benefit is 73 percent of the couple's benefit.

- If the two had equal earnings and identical retired-worker benefits, the surviving spouse continues to get the same amount, or half of the couple's combined benefit.

The possible combinations are infinite, but those common examples illustrate some typical declines in Social Security income at widowhood.

H.R. 3821 would allow widows and widowers to receive 75 percent of what the couple would receive if both were still alive. The provision, however, would apply only to future applicants, and the resulting benefit—before any actuarial reduction—would be capped at the previous December's average PIA for retired workers. (In December 2003, that amount was $937.)

---

9. Early retirement affects a widow(er)'s benefit in two ways. First, if the widow(er) files before the NRA, his or her benefit is actuarially reduced. Second, if the deceased worker filed for retirement benefits before the NRA, the survivor's benefit is limited to the amount the worker would be receiving, with a floor of 82.5 percent of the PIA.

In the absence of a cap, the provision would cost about $16 billion a year if it applied to widows and widowers already on the rolls. (In addition, it could draw many extra beneficiaries—chiefly widowers whose late wives were fully insured, but who previously had no reason to claim as widowers because their spouse's benefit was lower.) Imposing the cap, however, shrinks that cost by about seven-eighths. And making it prospective would further limit the cost. CBO estimates that the provision would cost $2 billion in 2014.

**Limit Benefits for Married Couples**. Together, a high earner and uninsured spouse may get a large Social Security benefit. In December 2003, the average PIA for spouse beneficiaries (the so-called "governing PIA") was about $1,230. If the worker and spouse both received an unreduced benefit—100 percent and 50 percent, respectively, of the PIA—their combined benefit would total $1,843.

H.R. 3821 would limit the combined benefit payable to a retired-worker couple, before actuarial reduction, to the PIA for someone the worker's age who worked at the taxable maximum for an entire career. For a retired worker age 62 in 2004, that cap would be $1,866 before the upcoming COLA. The provision would limit spousal benefits for workers who become eligible in 2006 or later.

If the provision had been effective in the recent past, it would have affected more than 75 percent of new spouse beneficiaries. Not all of them would have borne the proposal's full brunt; in dual-entitlement cases—about half of the total—where the spouse was fully insured, his or her own benefit would act as a floor.

Applying the provision prospectively greatly limits savings in the first few years, largely because most couples affected would consist of a male worker who files at 65 or the NRA (not at 62) and a younger wife. By 2014, CBO estimates savings of $3.8 billion.

## Interactions Among Provisions

Many of the provisions of H.R. 3821 would have effects that overlap. On balance, over the next 10 years, interactions would amplify the bill's effect—that is, in 2006 the entire package would increase the deficit by $2.1 billion more (and in 2014 by $5.4 billion more) than the sum of its separate provisions (see Table 9).

**TABLE 9. ESTIMATED BUDGETARY IMPACT OF INTERACTIONS AMONG PROVISIONS**

| | By Fiscal Year, in Billions of Dollars | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
| Payments to IAs [a] | 0 | 2.1 | 3.5 | 4.5 | 5.0 | 5.2 | 5.3 | 5.4 | 5.6 | 5.8 |
| OASDI benefits [a] | 0 | * | * | * | * | -0.1 | -0.2 | -0.3 | -0.4 | -0.4 |
| SSI benefits | 0 | * | * | * | * | * | * | * | * | * |
| Net Outlays | 0 | 2.1 | 3.5 | 4.5 | 4.9 | 5.1 | 5.1 | 5.1 | 5.2 | 5.4 |

NOTES: ISAs=Individual Security Accounts, OASDI=Old-Age, Survivors and Disability Insurance, SSI=Supplemental Security Income.

* = Less than $50 million.

a. Off-budget.

There are two notable interactions. First, raising the taxable maximum (section 12) would boost payroll tax revenues by $282 billion over the 2006-2014 period. About one-sixth of that amount would be deposited into individual accounts, thus adding to outlays as well.

The second major interaction is related to the NRA. Because most people file for Social Security benefits before their NRA, they face an actuarial reduction. Section 6 of the bill would increase that reduction; section 13 would raise the NRA. The two provisions reinforce each other. In general, other interactions among benefit provisions operate the other way: for example, adjusting PIA for life expectancy would save less if the PIA has already been reduced under other provisions, and guaranteeing a minimum benefit would cost more if the regular formula is pared back. But in the 10-year period, the two NRA-related provisions dominate, so that the package would save $0.4 billion more in benefits in 2014 than the sum of its provisions.

## Provisions With No Net Budgetary Effect

Two provisions of H.R. 3821 would shift money to the Social Security trust funds but without any effect on the government's bottom line (see Table 10).

First, over the 2011-2020 period, the bill would end the practice of crediting certain income taxes on benefits to the Hospital Insurance trust fund. Those funds would appear on Social Security's balance sheet instead. Expected transfers to the HI trust fund climb from $18 billion in 2011 to $24.6 billion in 2014 under current law. The bill would redirect 10 percent of those amounts to the Social Security trust funds in 2011, 20 percent in 2012, and so forth, until the percentage reaches 100 percent in 2020. The shift in 2014 would total $9.8 billion (40 percent of the expected amount under current law).

Second, the bill would institute a new transfer from the general fund to the Social Security trust funds. It would rise from 0.02 percent of taxable payroll in 2006 to 0.33 percent in 2014. CBO estimates that the resulting transfer would amount to $1 billion in 2006 and $23.3 billion in 2014.

**TABLE 10. ESTIMATED IMPACT OF PROVISIONS WITH NO NET BUDGETARY EFFECT**

| | Outlays, by Fiscal Year, in Billions of Dollars | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
| Transfer certain taxes to OASDI instead of HI | | | | | | | | | | |
| OASDI (off-budget) | 0 | 0 | 0 | 0 | 0 | 0 | -1.8 | -4.1 | -6.8 | -9.8 |
| Medicare (on-budget) | 0 | 0 | 0 | 0 | 0 | 0 | 1.8 | 4.1 | 6.8 | 9.8 |
| Transfer from general fund | | | | | | | | | | |
| OASDI (off-budget) | 0 | -1.0 | -2.1 | -5.4 | -6.8 | -7.7 | -12.4 | -15.6 | -19.6 | -23.3 |
| Treasury (on-budget) | 0 | 1.0 | 2.1 | 5.4 | 6.8 | 7.7 | 12.4 | 15.6 | 19.6 | 23.3 |

NOTES: OASDI=Old-Age, Survivors and Disability Insurance, HI=Hospital Insurance (Medicare Part A).

**ESTIMATE PREPARED BY:** Paul Cullinan and Kathy Ruffing

**ESTIMATE APPROVED BY:**

Robert A. Sunshine
Assistant Director for Budget Analysis