

What Effect Does Earnings Dispersion Have on Social Security Financing?

Steve Goss, Chief Actuary
Karen Glenn, Deputy Chief Actuary
Social Security Administration

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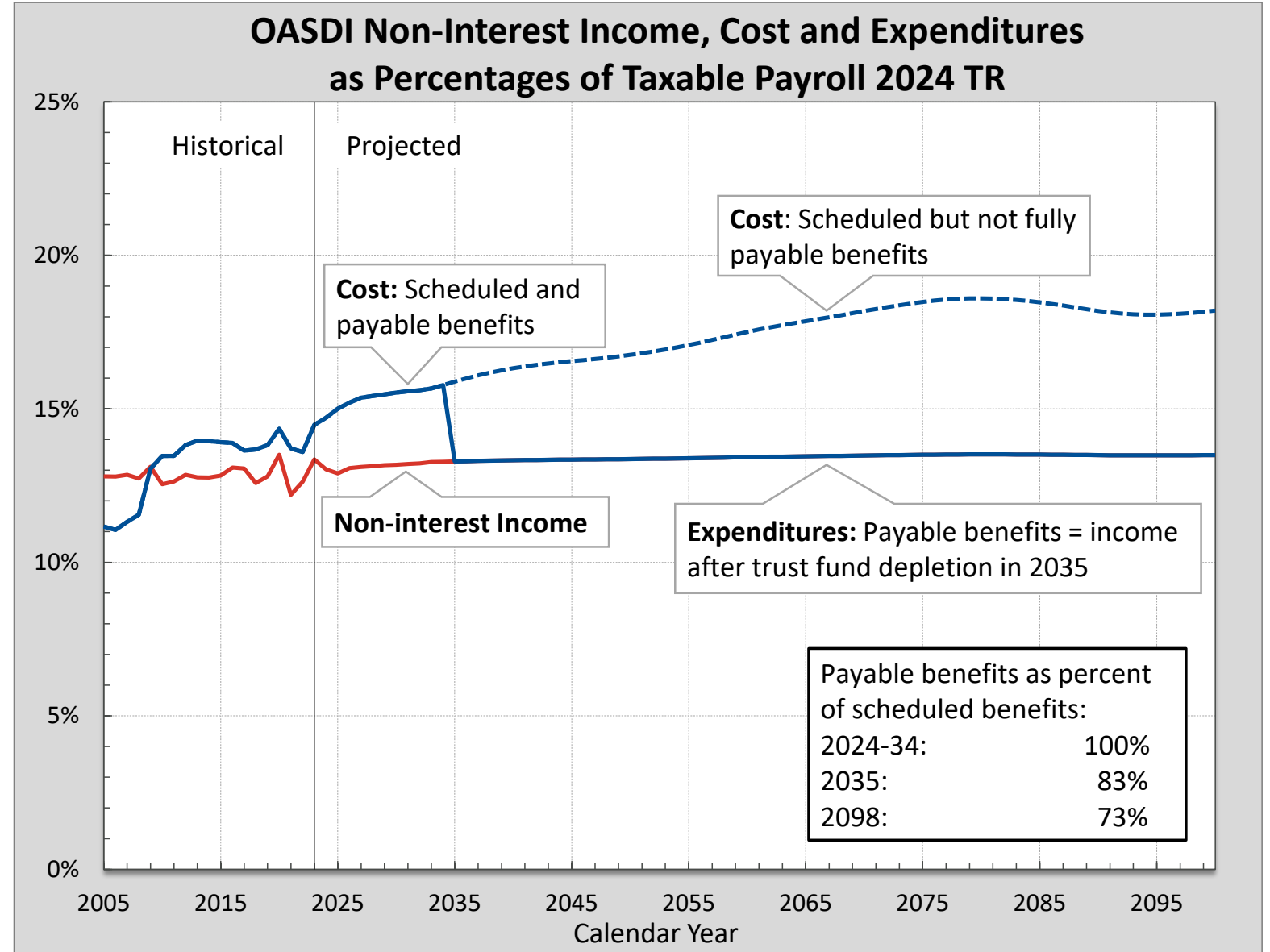
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Agenda

- Social Security current actuarial status: reserve depletion by 2035— isn't it all about demographics?
- What is earnings dispersion and why does it matter?
- How earnings dispersion has affected projections since 1983
- Assumptions for the future

OASDI Annual Cost Rises Above Non-Interest Income: Trust Fund Reserve Depletion Is Now Projected for 2035

The main reason for the rise in cost relative to payroll and GDP is well-known to be the changing age distribution of the population.

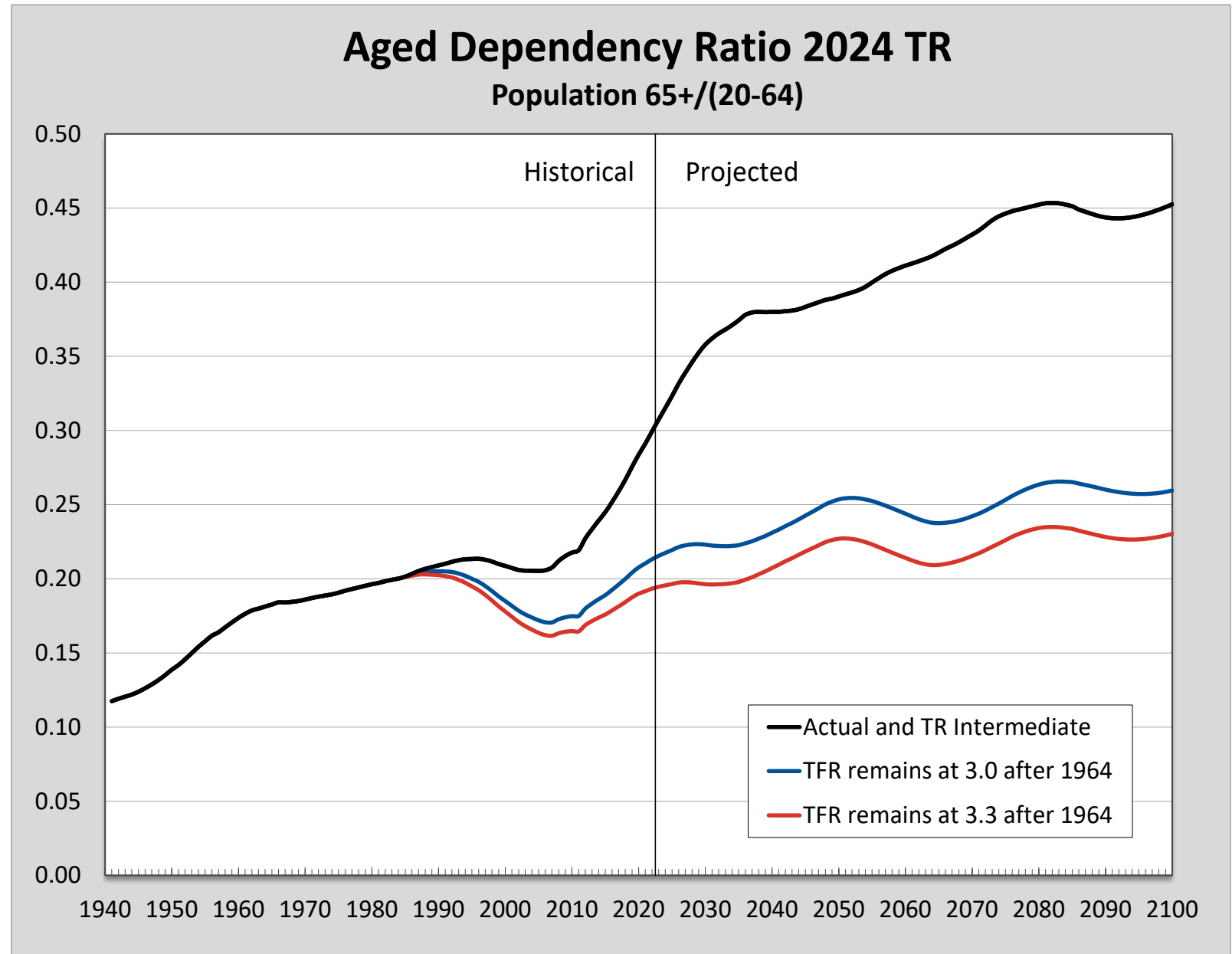


Change in Age Distribution

The drop in birth rates after 1965 has caused a sharp increase in the “aged dependency ratio” between 2010 and 2040.

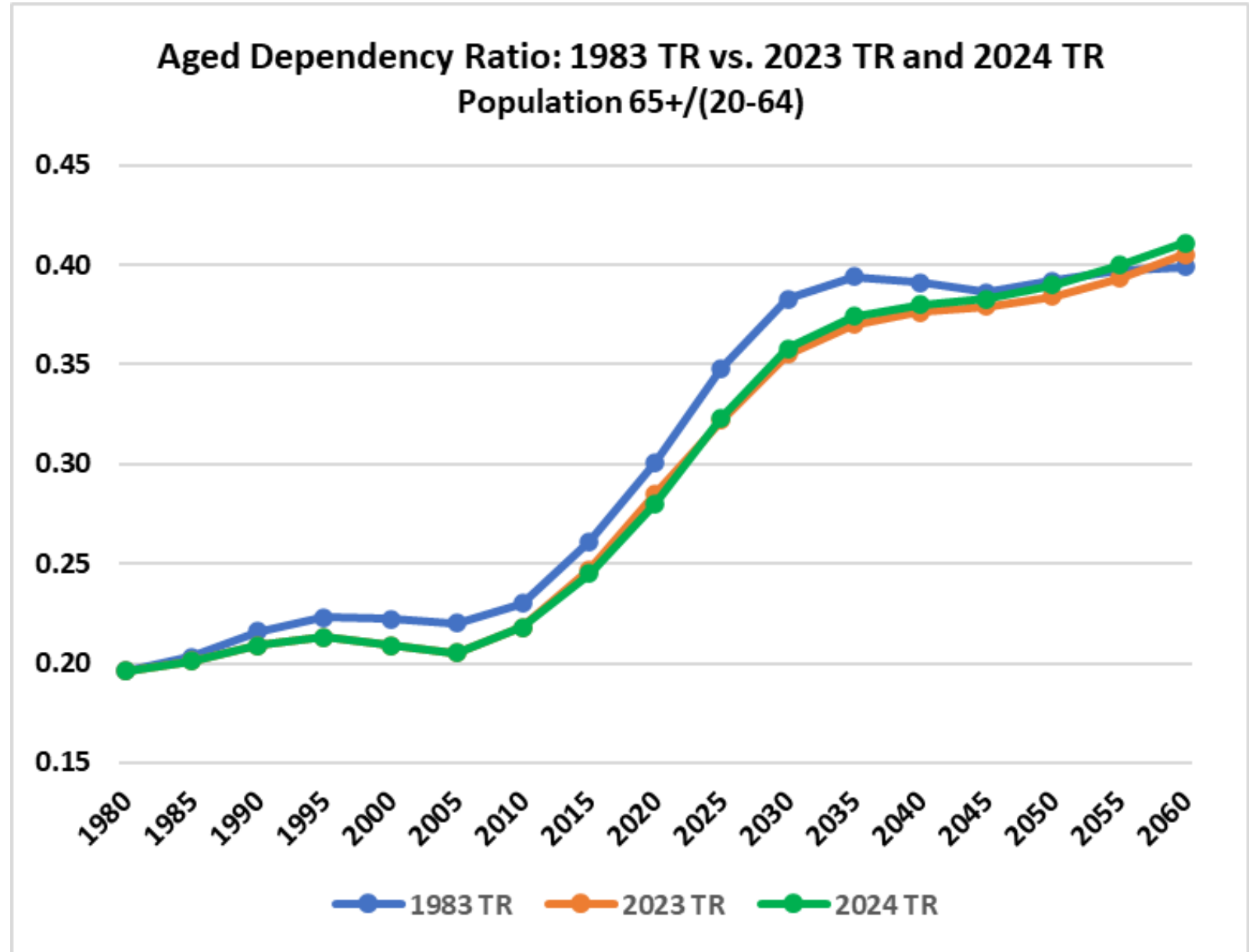
However, this was known and anticipated in 1983.

So why has the projected year of OASDI Trust Fund reserve depletion changed from 2063 in the 1983 TR to 2035 now?



Especially Given the Aged Dependency Ratio Was Projected to Rise Even Higher in the 1983 Trustees Report!

The lower current level of this ratio alone should have improved the actuarial status and delayed the projected year of trust fund reserve depletion from the 1983 report to the 2024 report. But we have the opposite. Why?



If Not Demographics, It Must Be Economics

- In the 1983 Trustees Report, we assumed an increase in average real earnings of about 24 percent between 1983 and 2000, and that *the increase would be similar for workers at all earnings levels*
- Overall, average real earnings actually increased slightly more than expected—by 28 percent over that period
- However, the increase was NOT similar at all earnings levels:
 - Workers earning above the taxable maximum, representing about 6 percent of workers, experienced a 62 percent real increase
 - While the other 94 percent of workers experienced only a 17 percent real increase
- ***Why does this matter?***

Increased “Earnings Dispersion”

- Faster growth in annual earnings for high earners than for medium and low earners increases the “spread” in the relative earnings distribution, increasing the share of all earnings for the top percentiles
- If all earnings are taxed at the same rate (like the Medicare HI payroll tax), then dispersion does not matter
- But Social Security has a “taxable maximum” level of earnings—so a relative shift in earnings to workers earning over the taxable maximum reduces the share of overall earnings subject to tax

Why Does Earnings Dispersion Matter?

- For Social Security, earnings are taxable only up to the taxable maximum level (\$168,600 for 2024), which has been indexed since 1983 by the change in the total average wage index (AWI) for the US economy
- In 1983, the indexed taxable maximum was intended and expected to maintain the percent of all OASDI covered earnings subject to tax (the “taxable ratio”) at 90 percent
- Earnings dispersion, or increasing the spread in the distribution, was not anticipated
- Specifying periodic adjustments to the taxable maximum to maintain 90 percent taxable was considered, but indexing was chosen

Why Does Earnings Dispersion Matter?

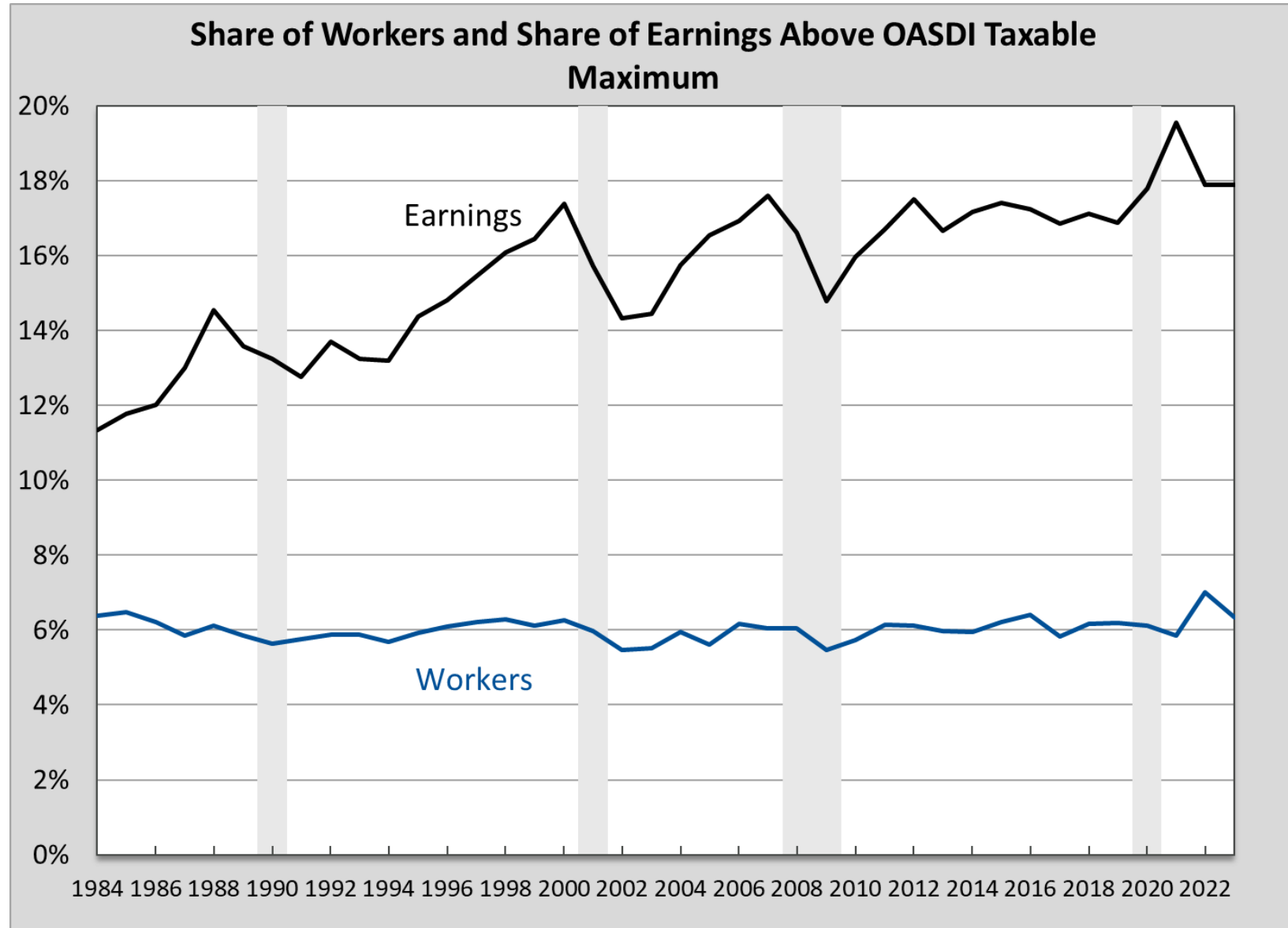
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- The increased earnings dispersion has reduced the taxable ratio from the intended 90 percent to around 82.5 percent by 2000, and it has remained close to that level (on average) since then
- This has decreased payroll taxes coming in—directly!
- But scheduled benefits have been reduced less—due to the progressive PIA formula, with annual earnings and bend points indexed by the AWI

OASDI Covered Earnings in Excess of the Taxable Maximum

The share of *workers* with earnings above the taxable maximum has remained fairly stable around 6 percent.

The share of *earnings* above the taxable maximum rose from 1983 to 2000 and then roughly leveled off except for cyclic effects. Temporarily elevated in 2021 and 2022 due to large increase in AWI in 2021. Actual for 2023 likely to be lower than estimated.

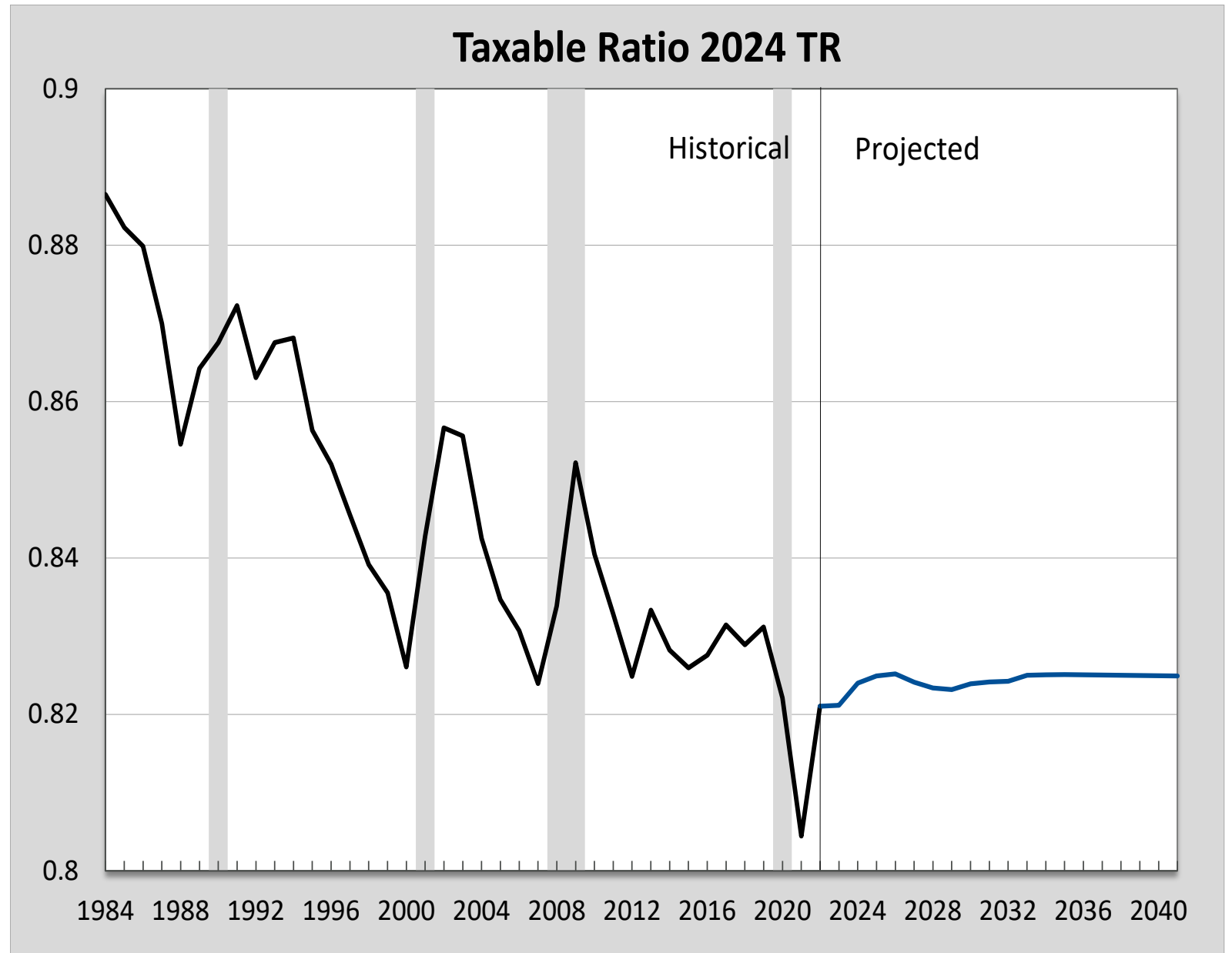


Dispersion Has Reduced the Taxable Ratio for OASDI Covered Earnings

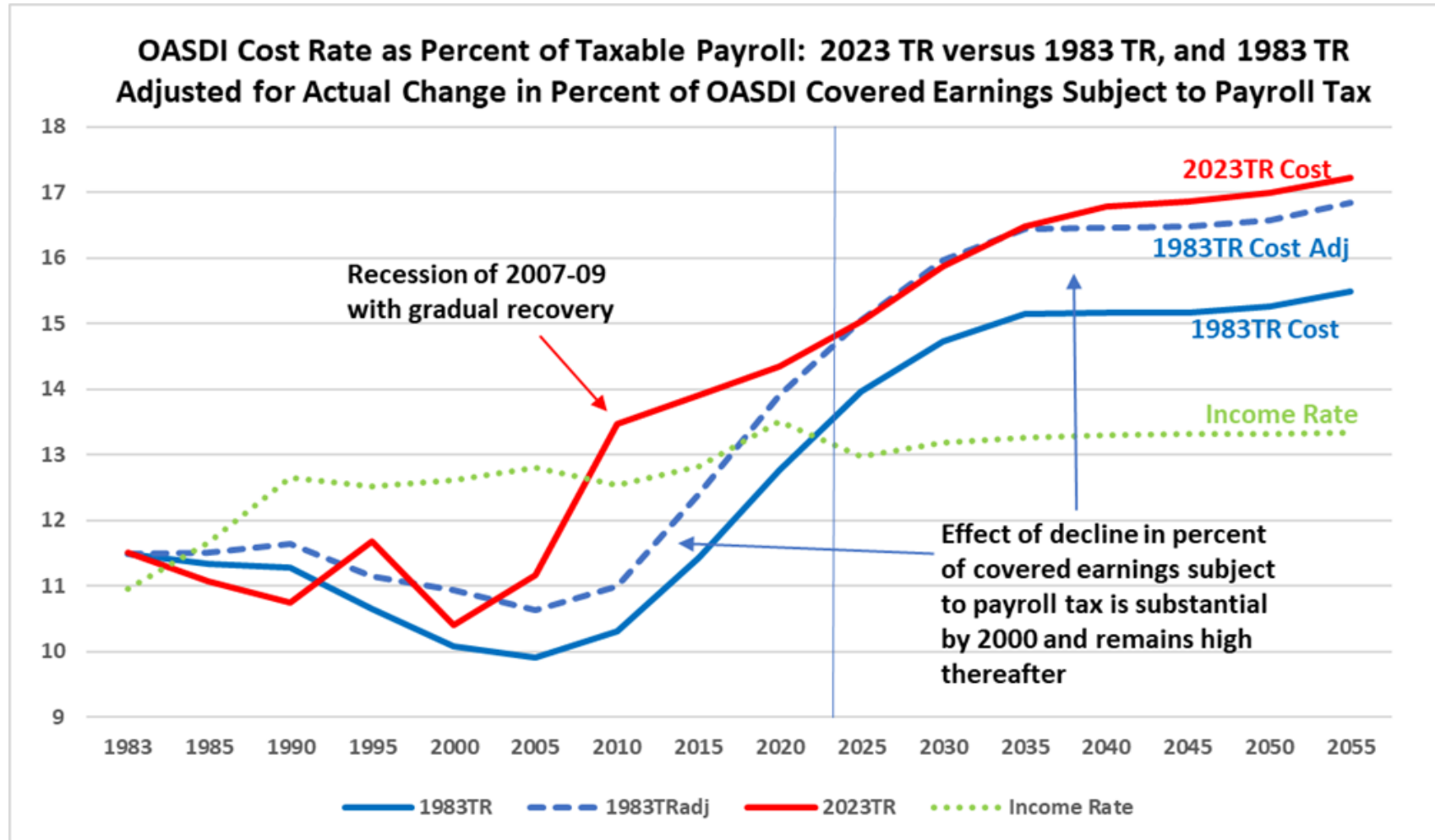
The ratio dropped to 82.5 percent by 2000 and has remained there except for cyclic effects.

This drop was NOT anticipated in 1983.

So payroll tax was lower than expected in 1983, by over 8 percent since 2000.



The Reduced Share of Earnings Subject to Payroll Tax Explains Most of the Increase in Cost as Percent of Payroll and Earlier Trust Fund Reserve Depletion, Compared to the Projection in 1983



But the depth of the 2007-09 recession and slow recovery further reduced expected trust fund accumulation through 2019.

Level of the Taxable Maximum

- As noted, the taxable ratio declined from about 90 percent in 1983 to about 82.5 percent by 2000, and roughly remained level since then
- The taxable maximum under current law is \$168,600 in 2024; raising it to \$350,000 (more than double!) would now capture 90 percent of all earnings
- Some have proposed raising the level, perhaps gradually, so it reaches and then maintains a 90-percent taxable ratio

Assumptions for the Future

- We assume that the taxable ratio ***for wage and salary workers*** will fluctuate somewhat in the future, averaging about 82.5 percent over the next 10 years
- ***For self-employment earnings***, the taxable ratio is lower than for wages
- We assume that total self-employment earnings will grow somewhat faster than total wages, causing average earnings to grow slightly faster than the taxable maximum (indexed by average wages alone)...
- Therefore, the ***overall*** taxable earnings ratio drifts downward very slightly after 2033

For More Information, Go To www.ssa.gov/oact/

There you will find:

- The 2024 and all prior OASDI Trustees Reports
- Detailed single-year tables for recent reports
- Our estimates for comprehensive proposals and individual provisions
- Actuarial notes
- Actuarial studies
- Extensive databases
- Congressional testimonies—including https://www.ssa.gov/OACT/testimony/SenateBudgetComm_20230712.pdf
- Presentations by OCACT employees