

How Will Likely Social Security and Medicare Reforms Impact Your Clients?

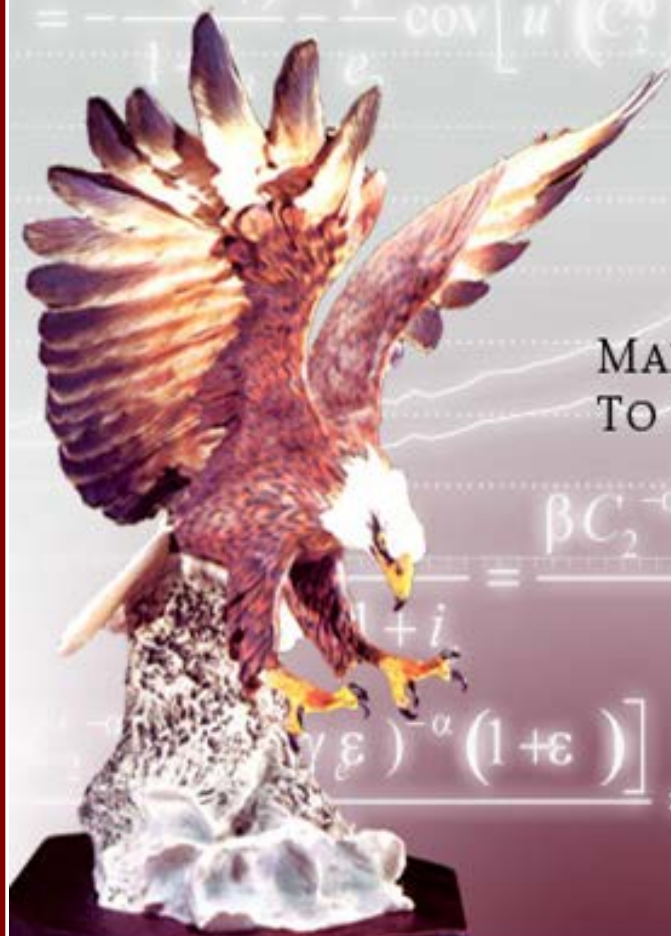
November 21, 2014

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MARKET ORIENTED SOLUTIONS
TO PUBLIC POLICY PROBLEMS



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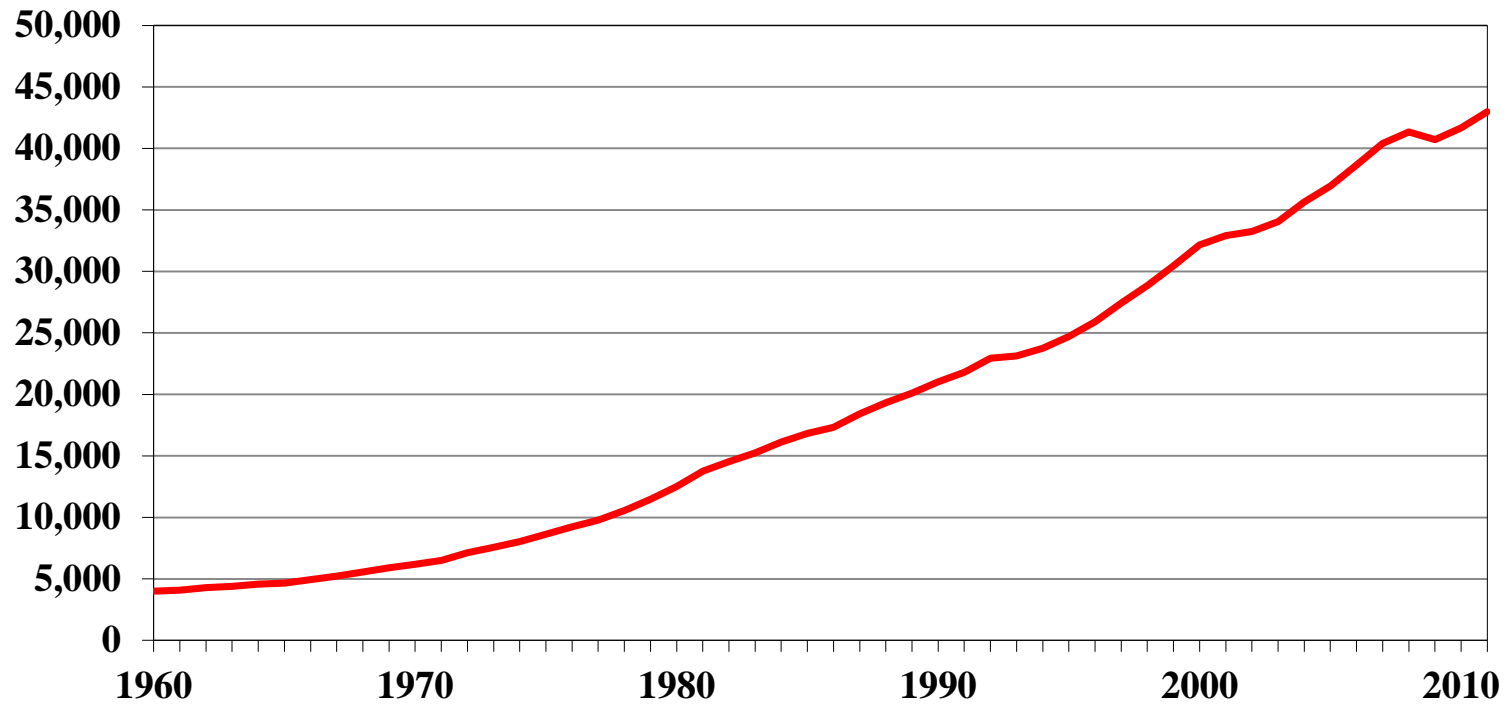
How SS Benefits are Calculated



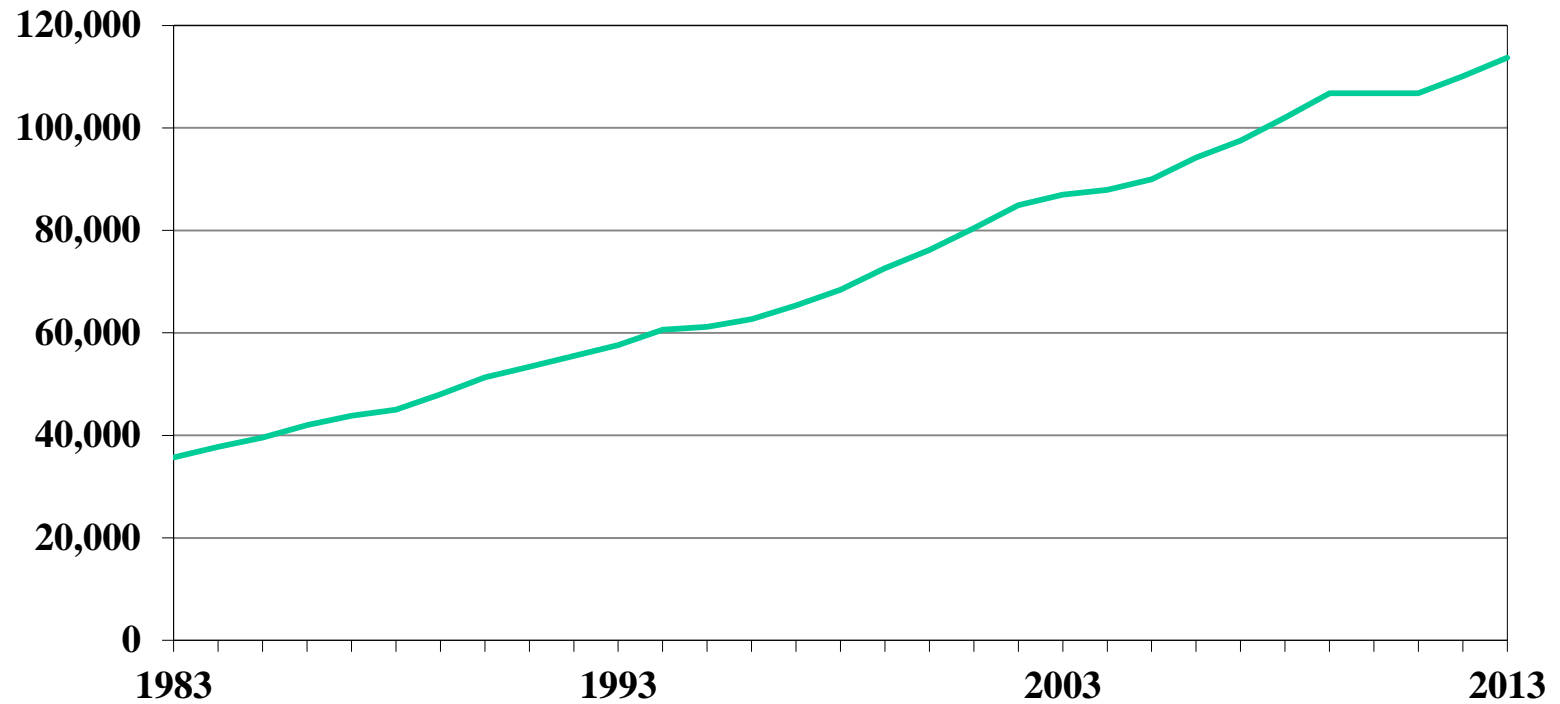
Averaged Indexed Monthly Earnings

- Assume that 2014 is the year an individual becomes eligible for SS.
- Past earnings are indexed by the ratio of 2012 national average wages to any prior year.
- The average indexed monthly earnings (AIME) takes the sum of the 35 highest indexed earning years and divides by 420 (the number of months in 35 years).

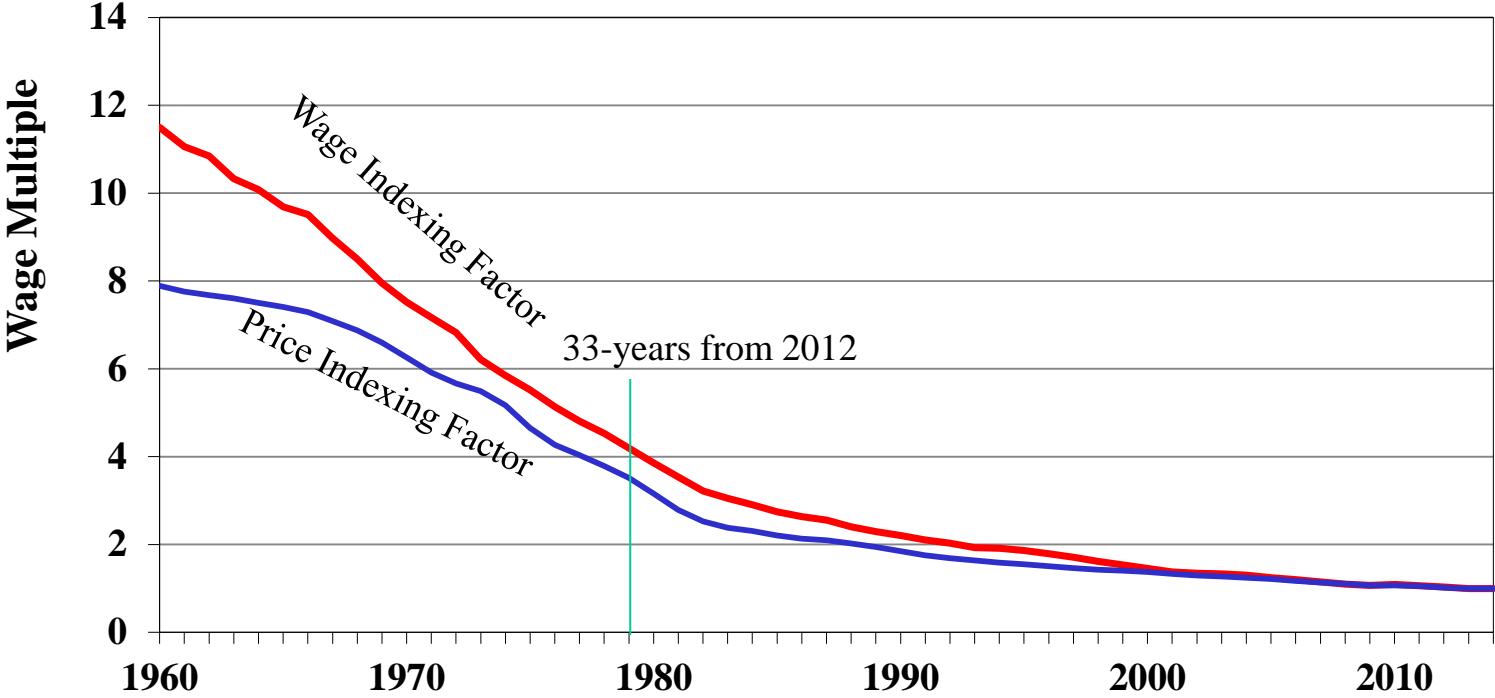
Average Wage Indexing Series



Taxable Max History



Wage and Price Indexing Values Assuming 2014 Retirement



Social Security Benefit Bend-Points

Those Newly Eligible in 2014

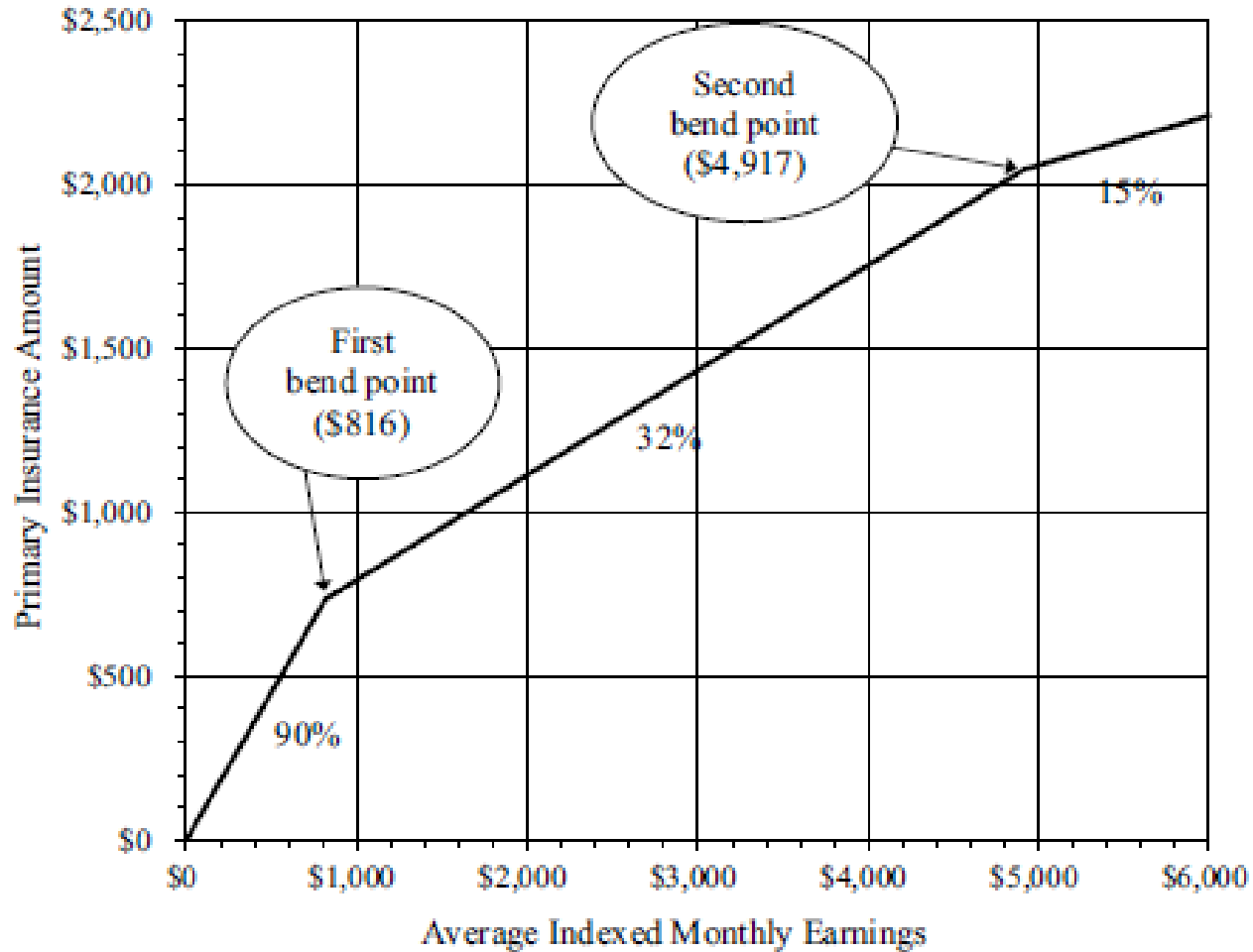


Figure V.C1, 2014 Social Security Trustees Report

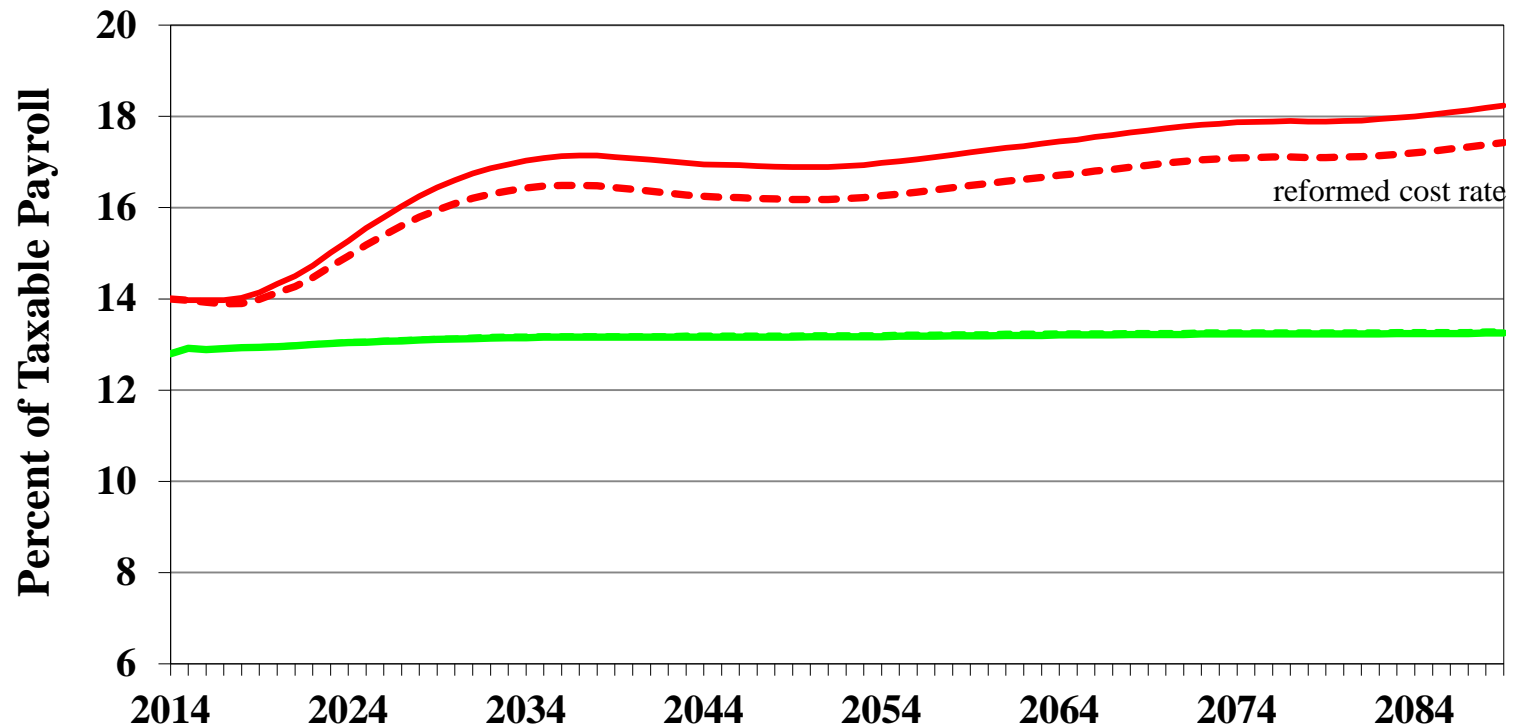
We Must Set Aside Funds While We
Are Working For Retirement
Consumption
of Both Goods and Health Care



Effect of System Tweaks



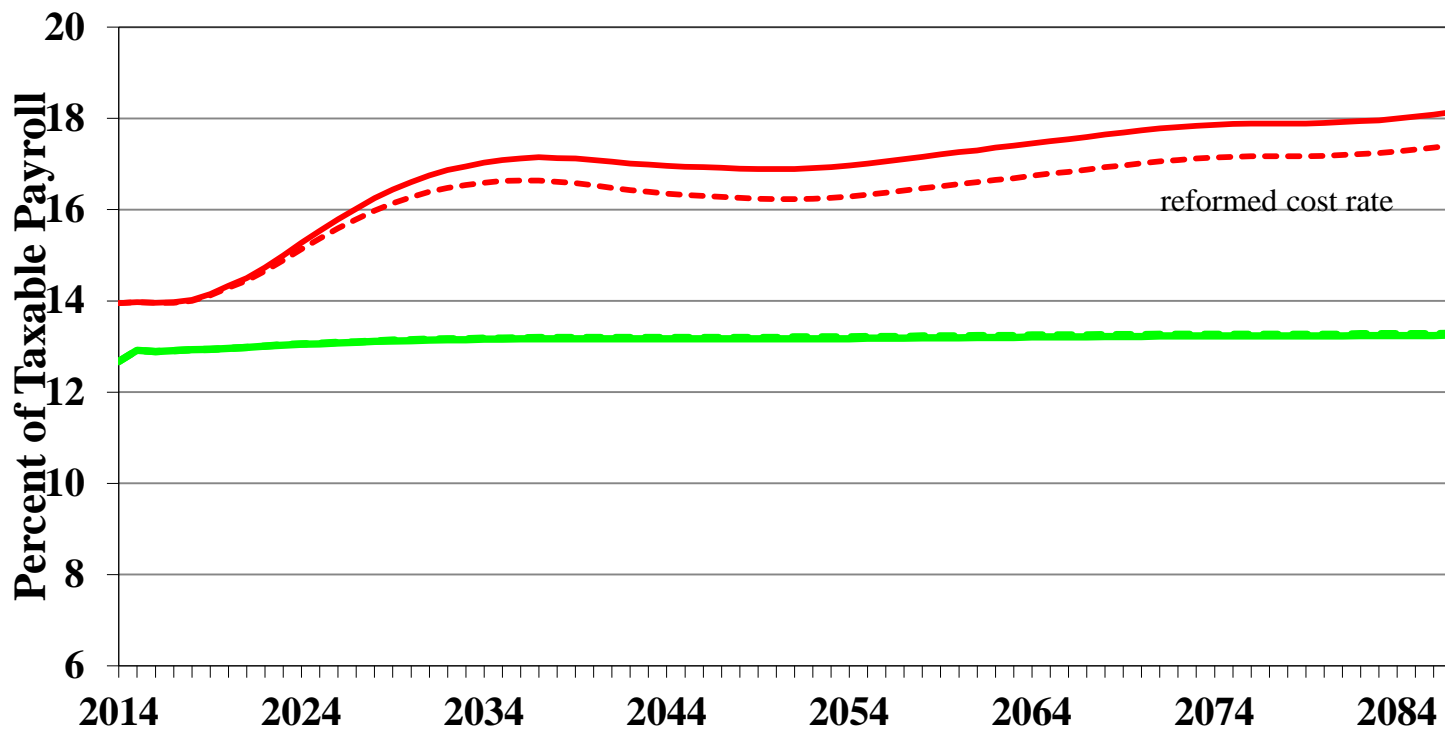
Beginning December 2015, use the superlative (or chained) CPI for COLAs



Social Security Actuaries: <http://www.ssa.gov/OACT/solvency/provisions/index.html>



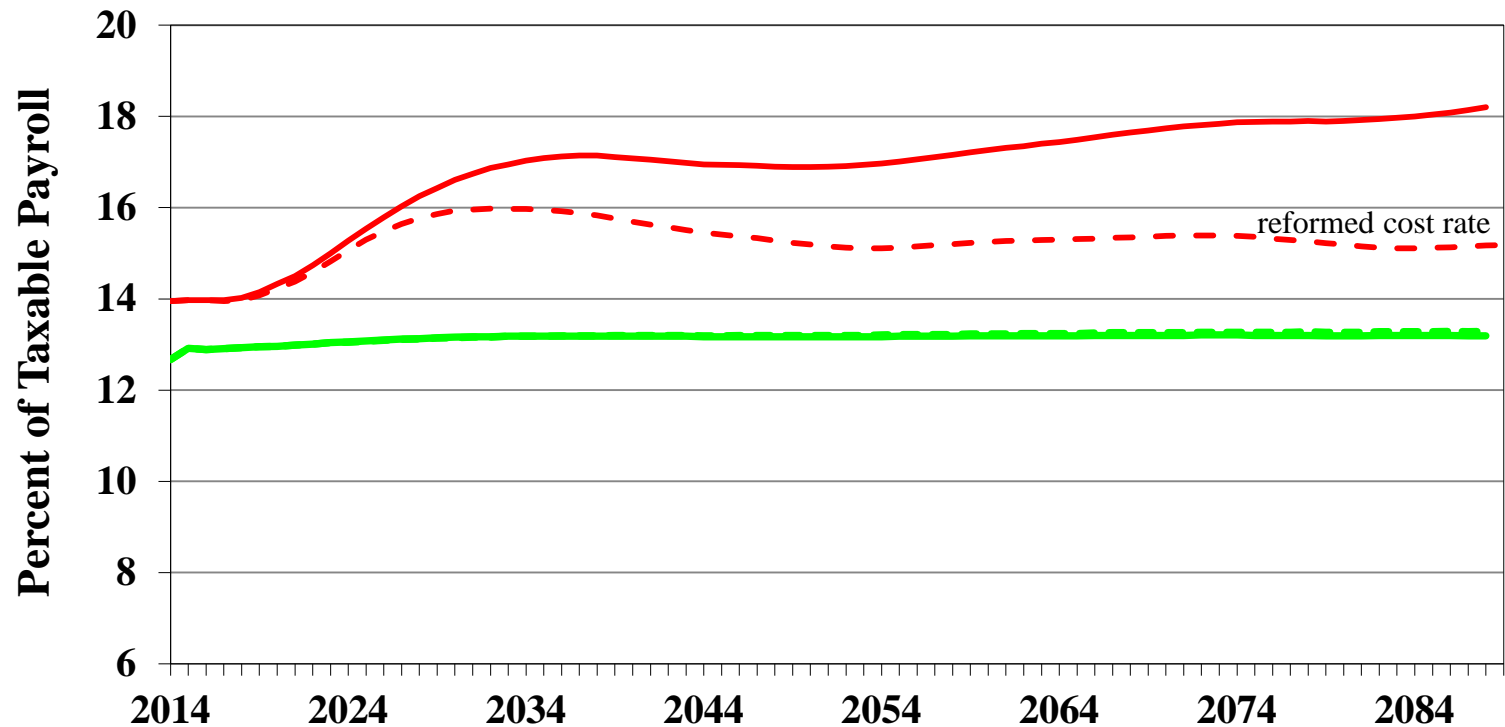
Increase the number of years used to calculate benefits for retirees and survivors (but not for disabled workers) from 35 to 40, phased in 2015-2023



Social Security Actuaries: <http://www.ssa.gov/OACT/solvency/provisions/index.html>



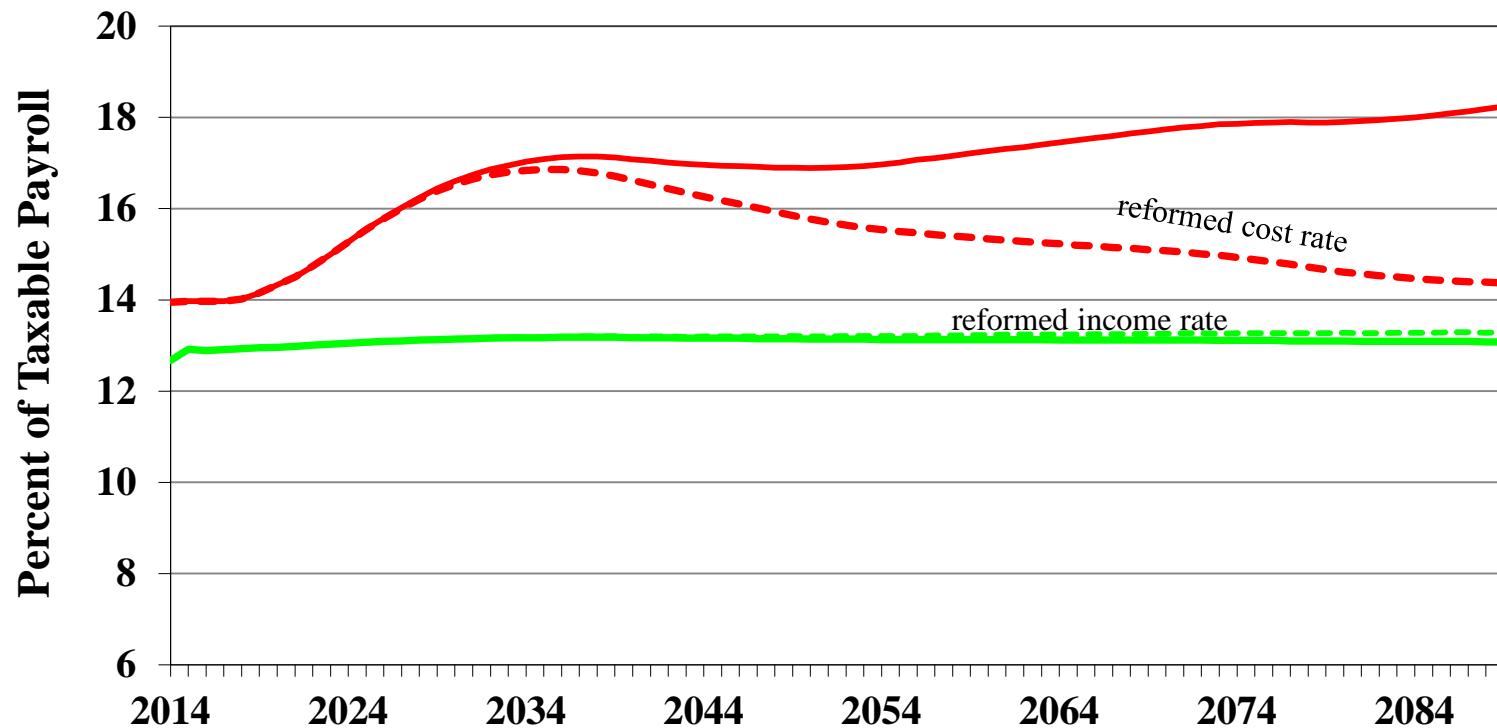
Increase the normal retirement age (NRA) 3 months per year starting for those age 62 in 2017 until NRA reaches 70 in 2032. Thereafter, index the NRA to maintain a constant ratio of expected retirement years (life expectancy at NRA) to potential work years (NRA minus 20). Also, increase the earliest eligibility age (EEA) from 62 to 64 at the same time the NRA increases from 67 to 69; that is, for those attaining age 62 in 2021 through 2028. Keep EEA at 64 thereafter.



Social Security Actuaries: <http://www.ssa.gov/OACT/solvency/provisions/index.html>



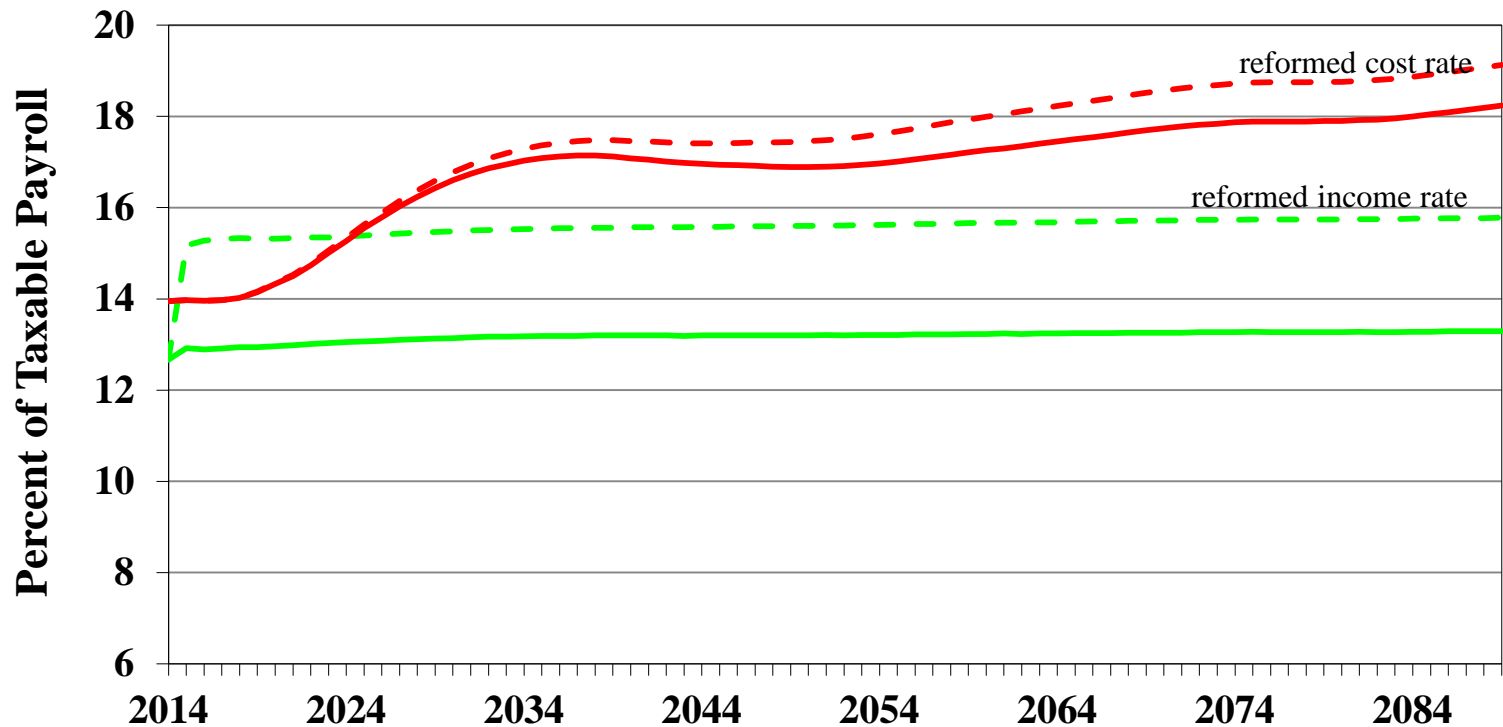
Progressive Price Indexing With Bottom 30% Harmless



Social Security Actuaries: <http://www.ssa.gov/OACT/solvency/provisions/index.html>



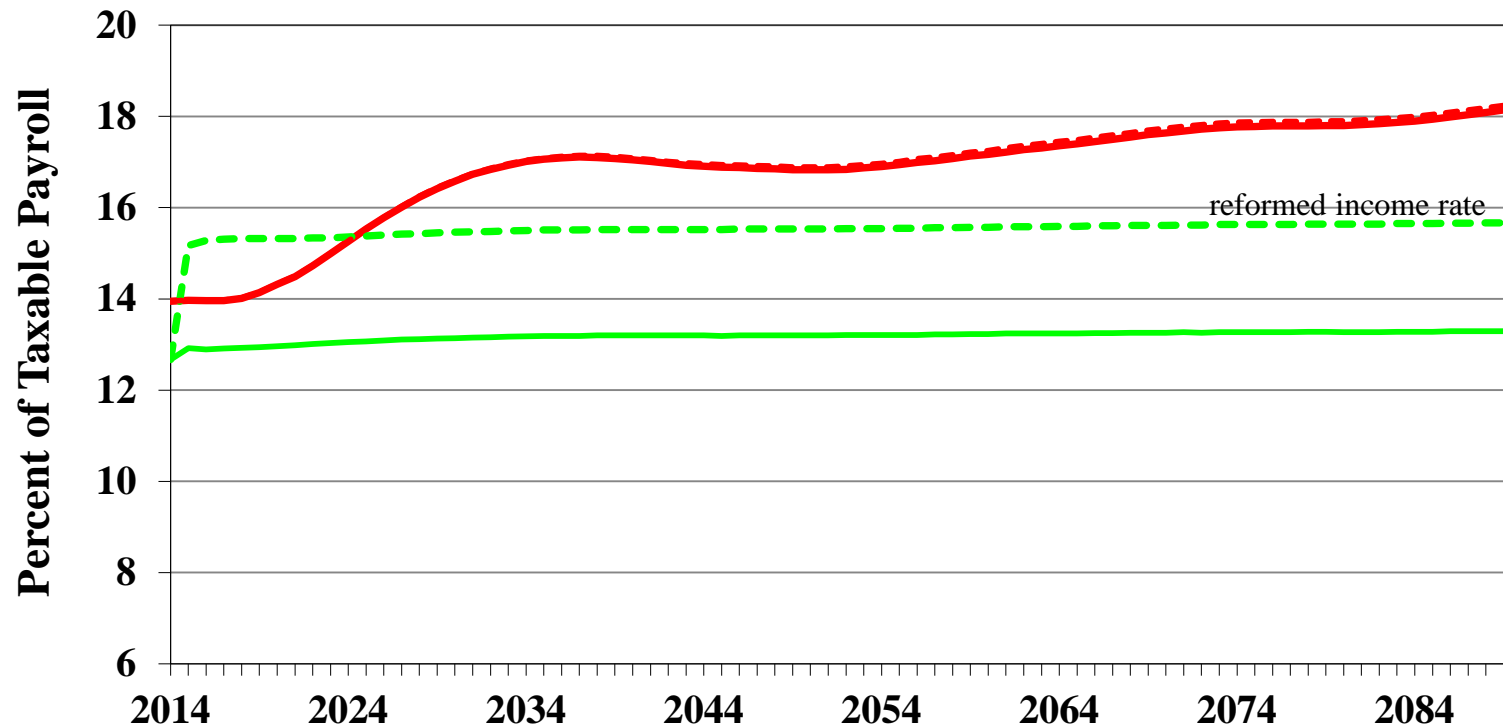
Eliminate Taxable Maximum



Social Security Actuaries: <http://www.ssa.gov/OACT/solvency/provisions/index.html>



Eliminate Taxable Max for Taxes Only



Social Security Actuaries: <http://www.ssa.gov/OACT/solvency/provisions/index.html>



Effect of Possible System Reforms



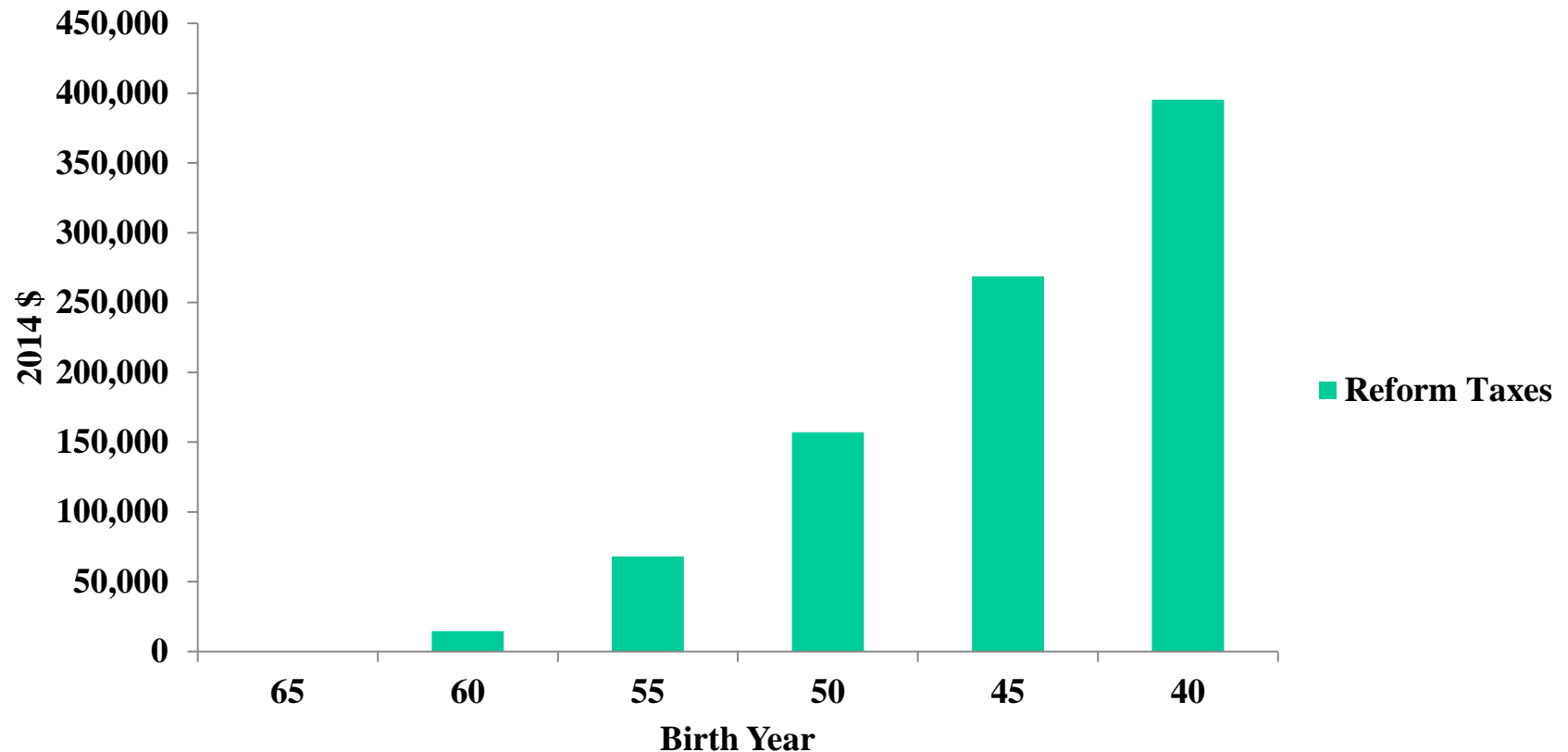
Effect on Very High Earners

1.6 x Average SS Earnings



Present Value of Additional Taxation if Taxable Max is Eliminated

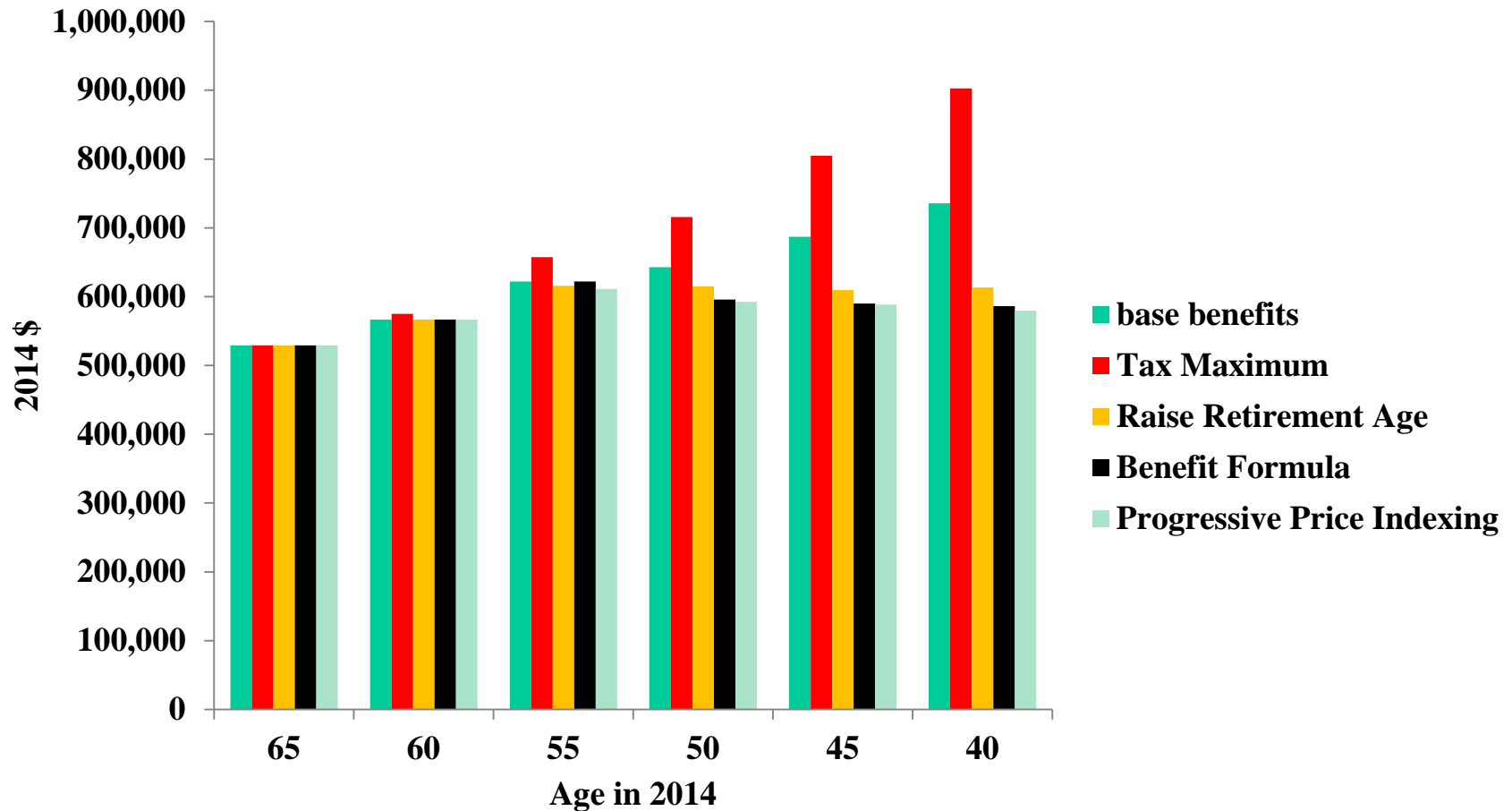
Men, Earnings at 1.6 x Taxable Max
Reform Taxes



Authors' estimates assume income adjusted life expectancies, 2.9 percent real discount rate, present values at age 65, and benefit receipt beginning at the current or reformed normal retirement ages.

Reforms and Age 66 Social Security Wealth

Men, Very High Earnings (1.6 x Taxable Max)



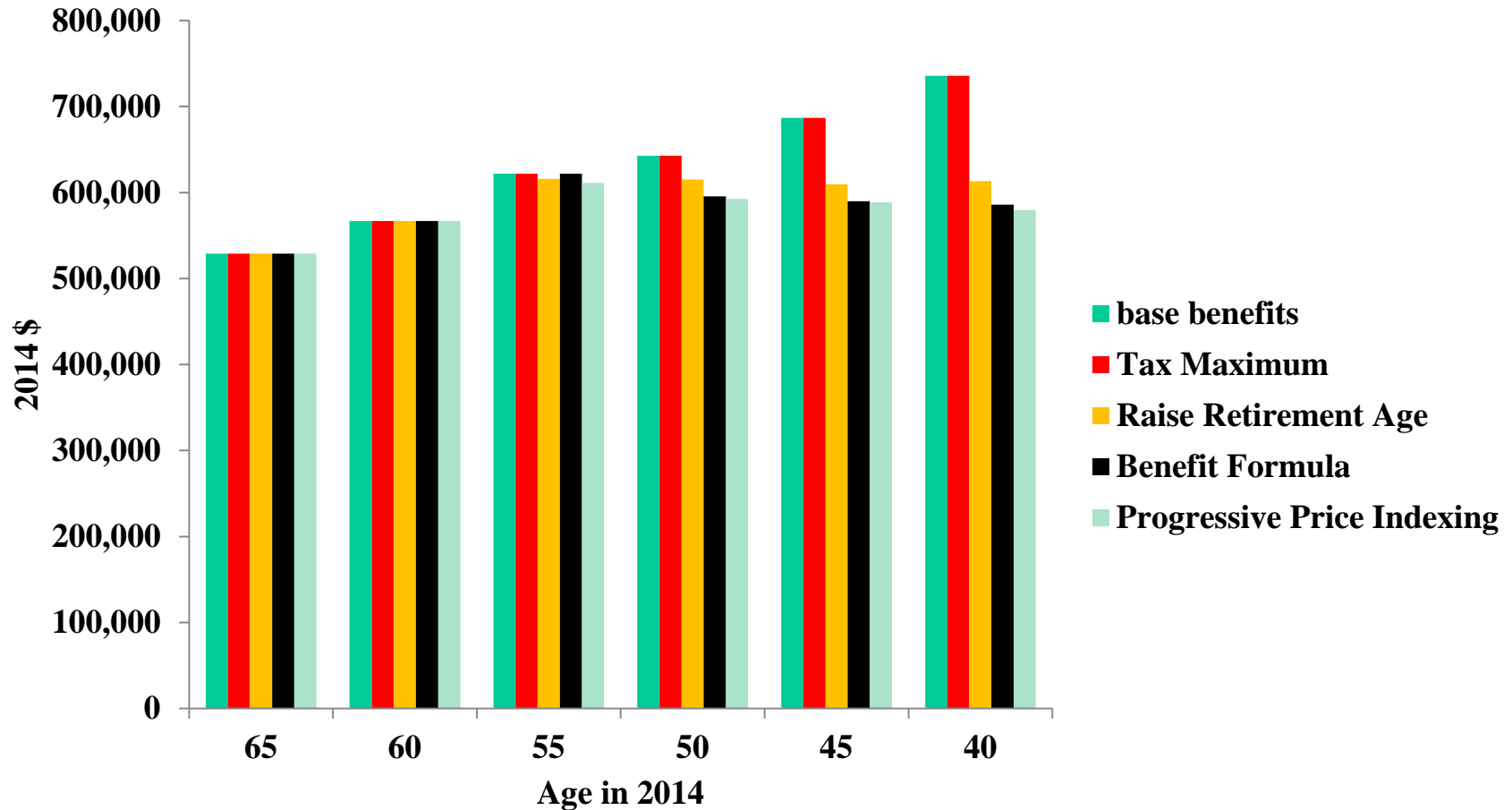
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Effect on High Earners



Reforms and Age 66 Social Security Wealth

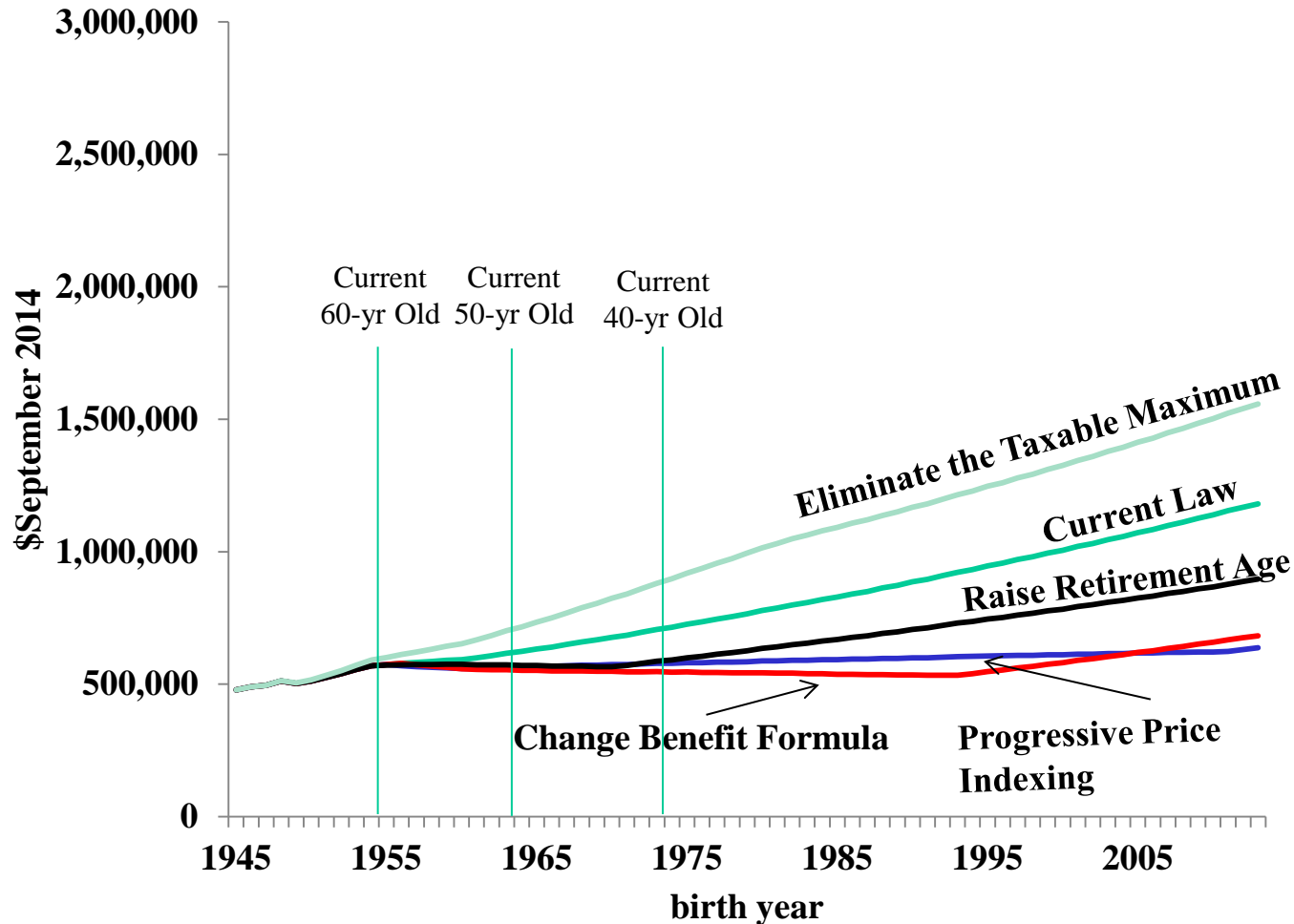
Men, Taxable Maximum Earnings



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Reforms and Social Security Wealth

September 2014 \$

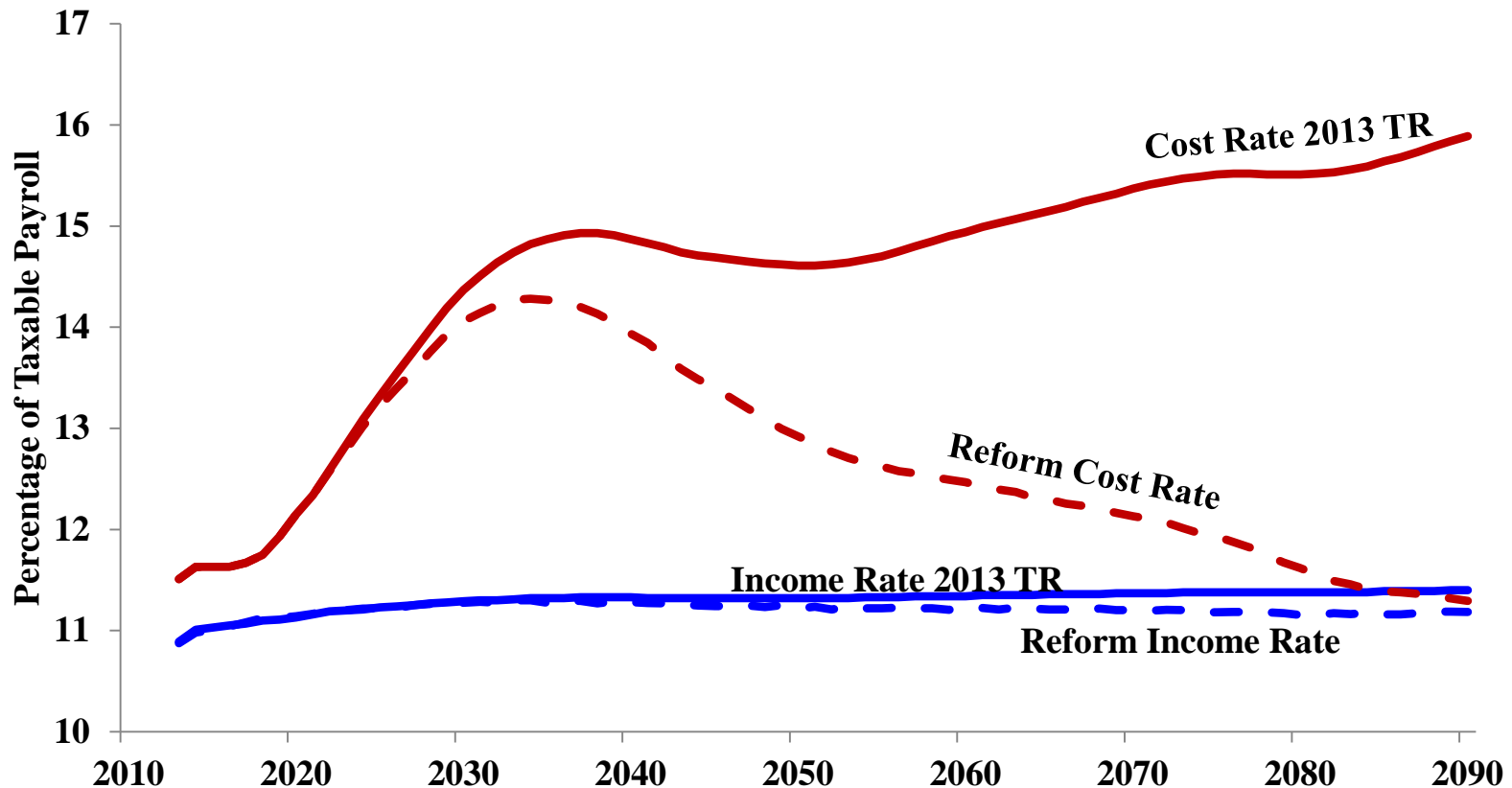


Evolution of the Reformed System's Finances



Social Security's Cost and Income for the Current and Reformed Programs

Old-Age and Survivors Insurance (OASI)



Source: OASI cost and income rates from the 2013 Trustees Report and reformed cost and income rates estimated by authors based on reform provisions (B1.3 and C1.3) estimates from the Social Security Administration's Office of the Chief Actuary. <http://www.ssa.gov/OACT/solvency/provisions/index.html>

Medicare: What We Might Expect



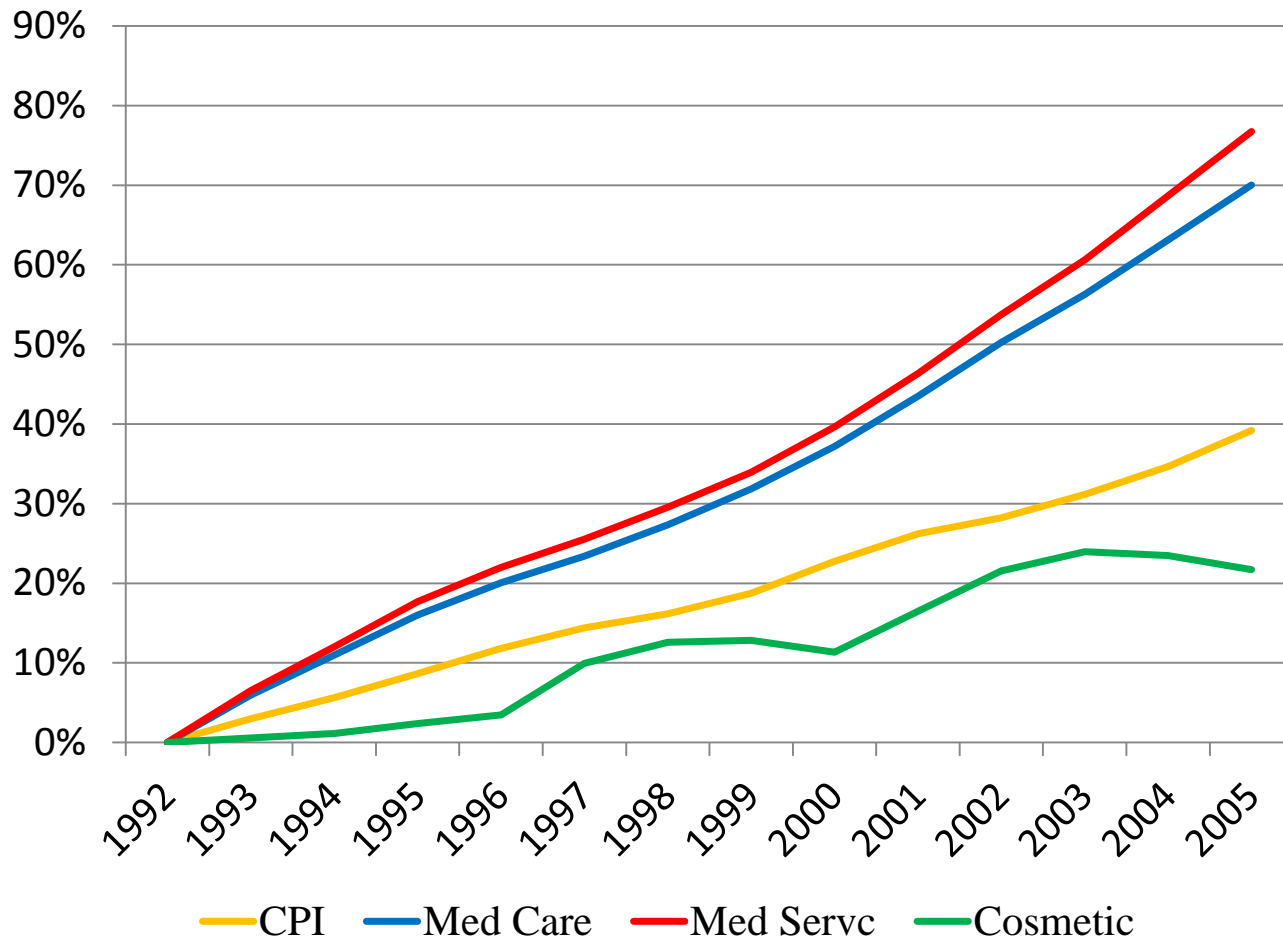
What Can Private Medicare Accomplish?



Estimating Demand Side Effects Based on RAND HIE Estimates

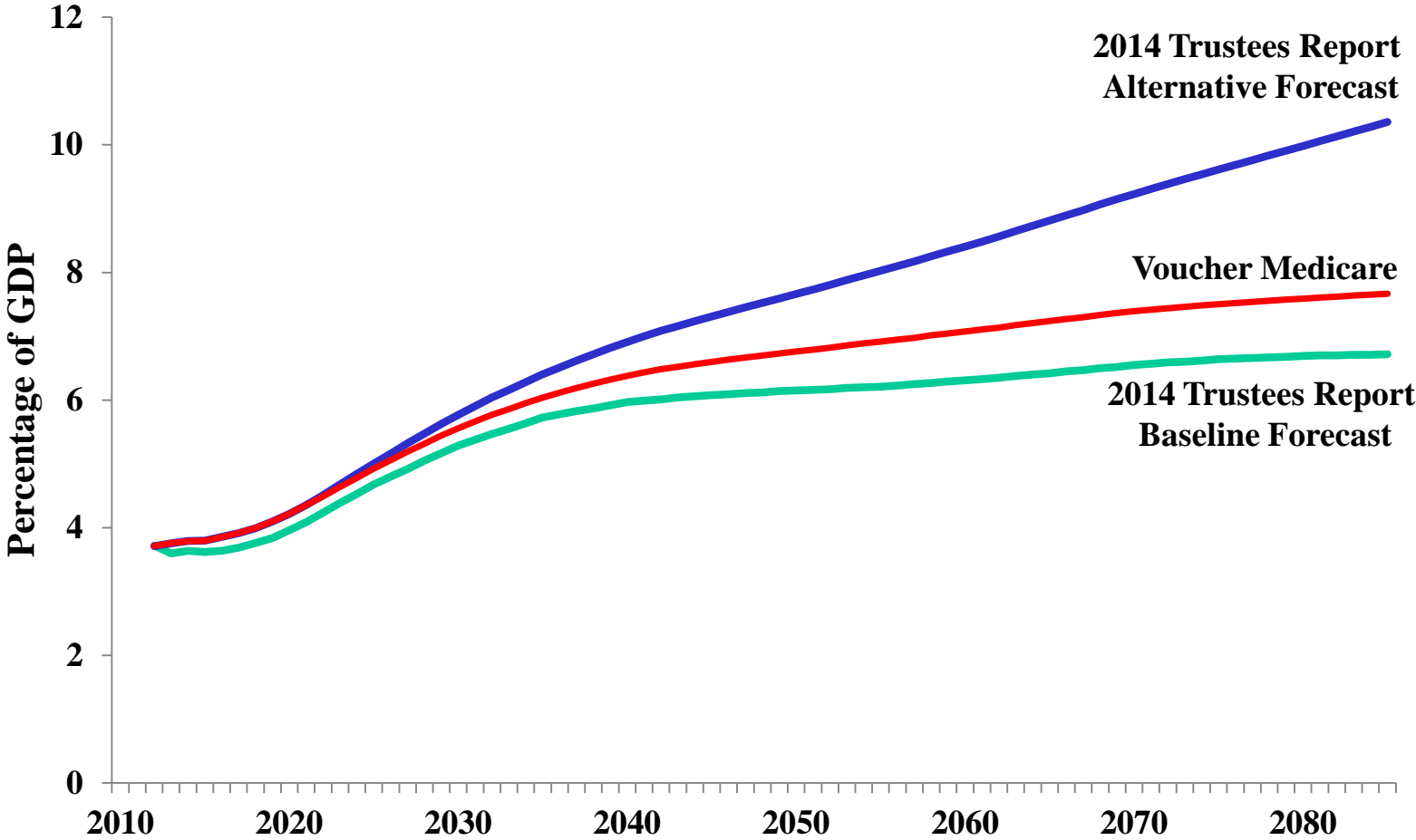
- Identify Ratio of Total Deductible to average spending on Medicare Covered Services.
- Identify spending reduction due to deductibles (as a percent of average spending in the no deductible case) from the RAND HIE estimate.
- Apply RAND results to Medicare at each age
- Estimate Reformed Medicare Spending by taking into account retiree spending requirement up to the deductible.

Cosmetic Surgery and General Health Care Inflation



Medicare Spending Forecasts

Voucher Medicare



Progressive Indexing as one Solution to the “Need” Issue

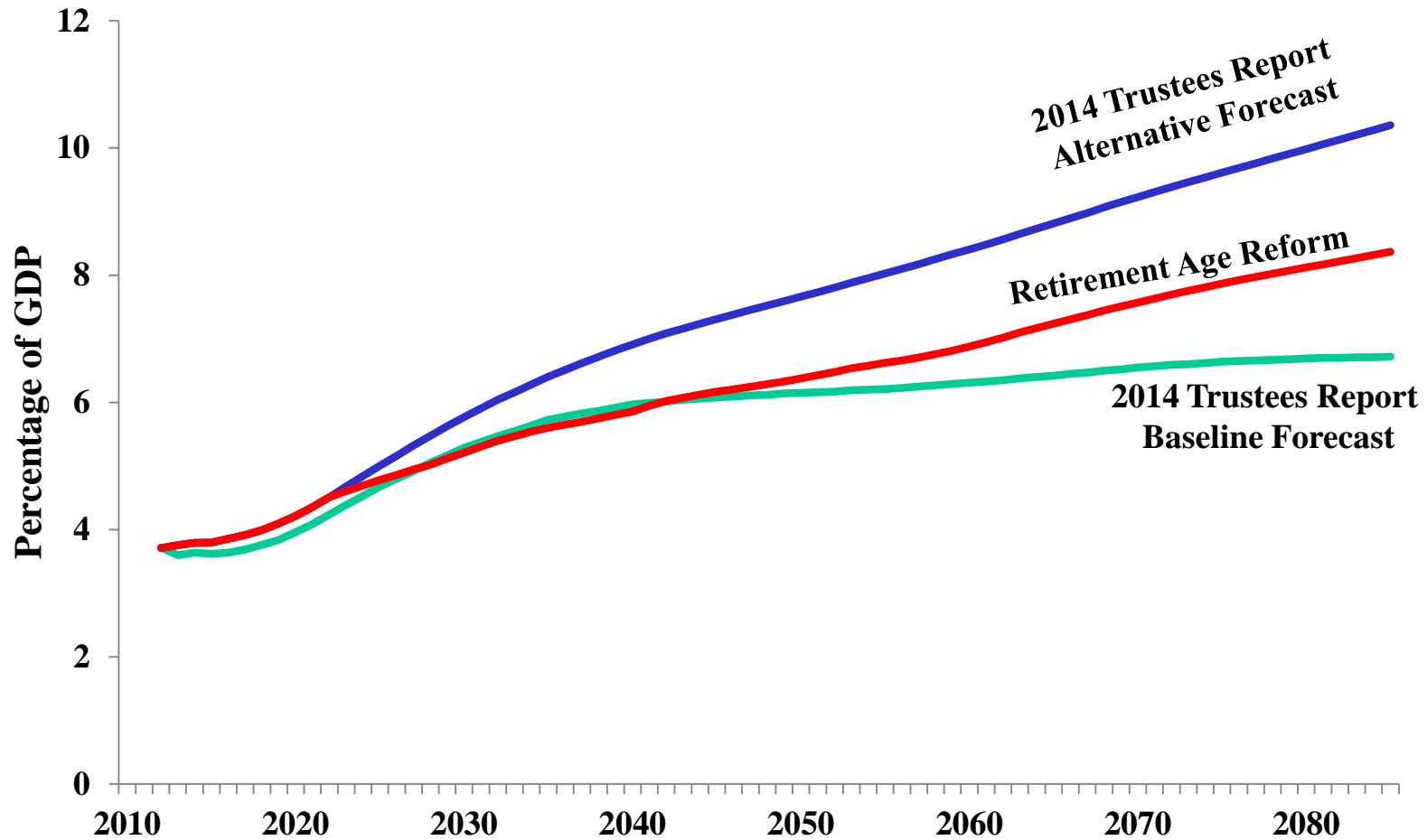


An Alternative Reform Involves Means Testing Traditional Medicare

- Begin means testing in 2022.
- Lowest 30% of elderly income distribution receive average of the Trustees alternative spending estimate.
- Highest earners ultimately receive 10% of average Alternative spending by 2085

Medicare Spending Forecasts

Retirement Age Increase

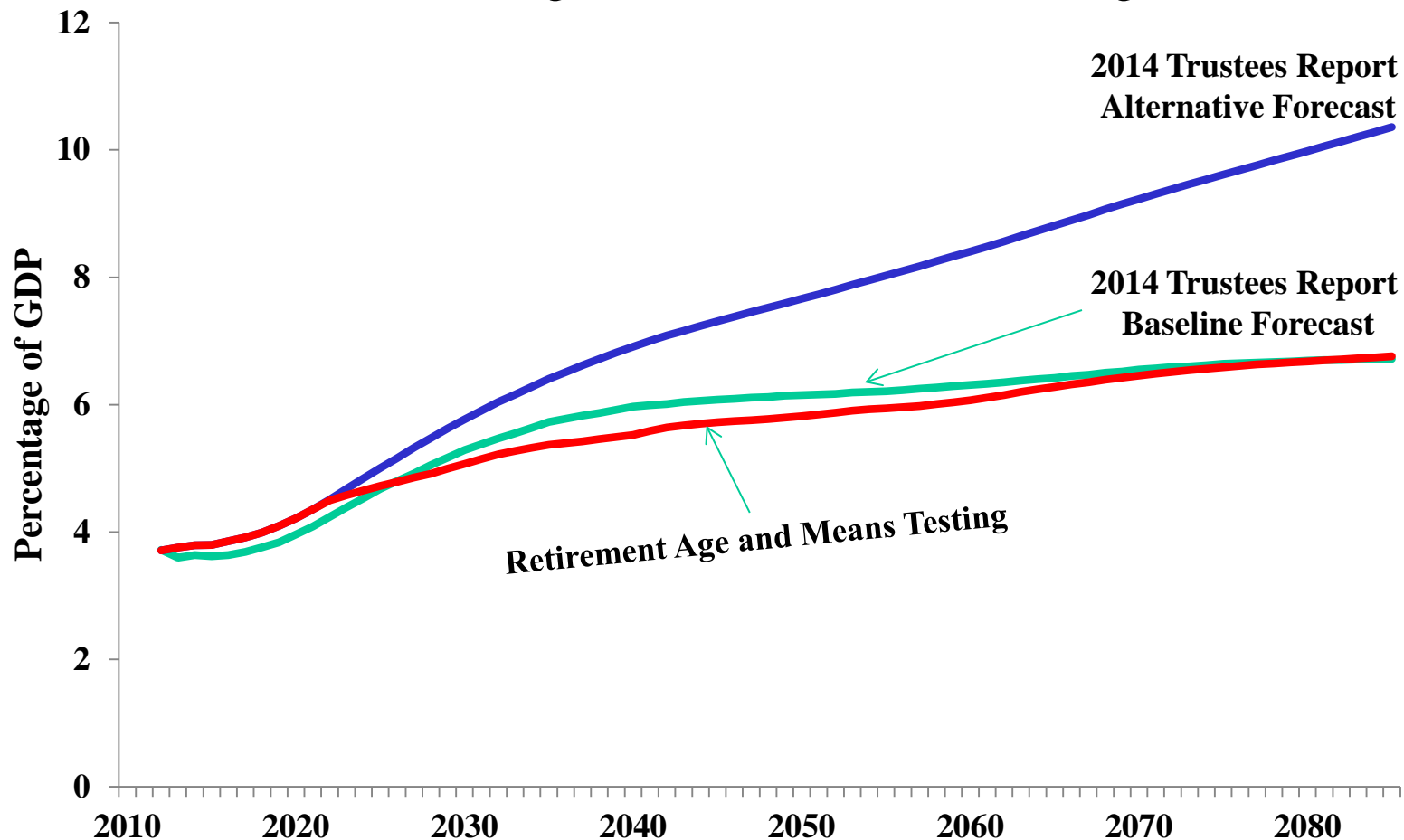


Reform – Retirement age increase begins in 2022, reaching 70 in 2040.



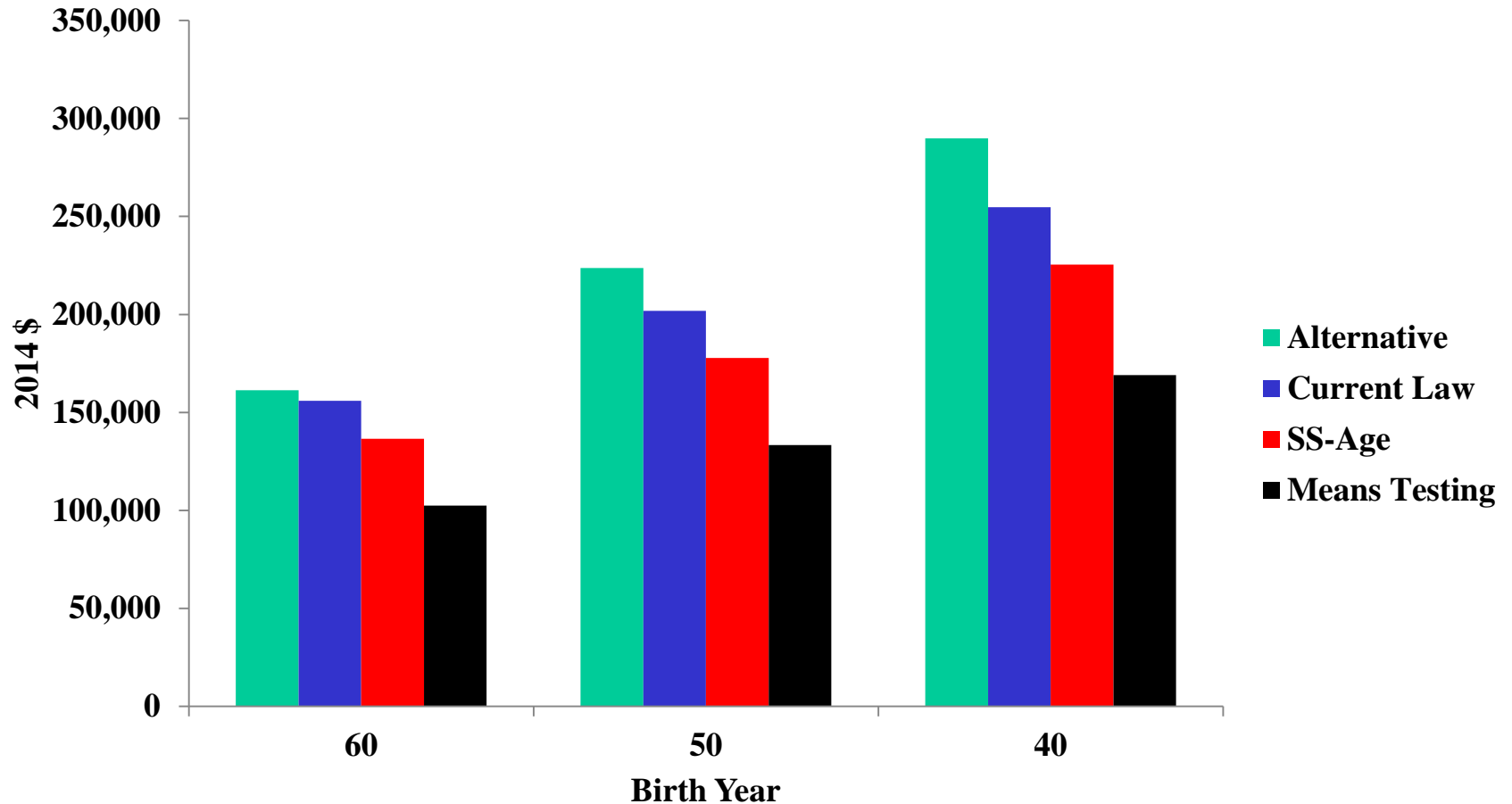
Medicare Spending Forecasts

Retirement Age Increase and Means Testing



Reform – Retirement age increase begins in 2022, reaching 70 in 2040. Means testing begins in 2022, lowest 30% receive average Alternative spending, highest earners ultimately receive 50% of average Alternative spending by 2085.

Reform and Medicare Wealth at Retirement Age

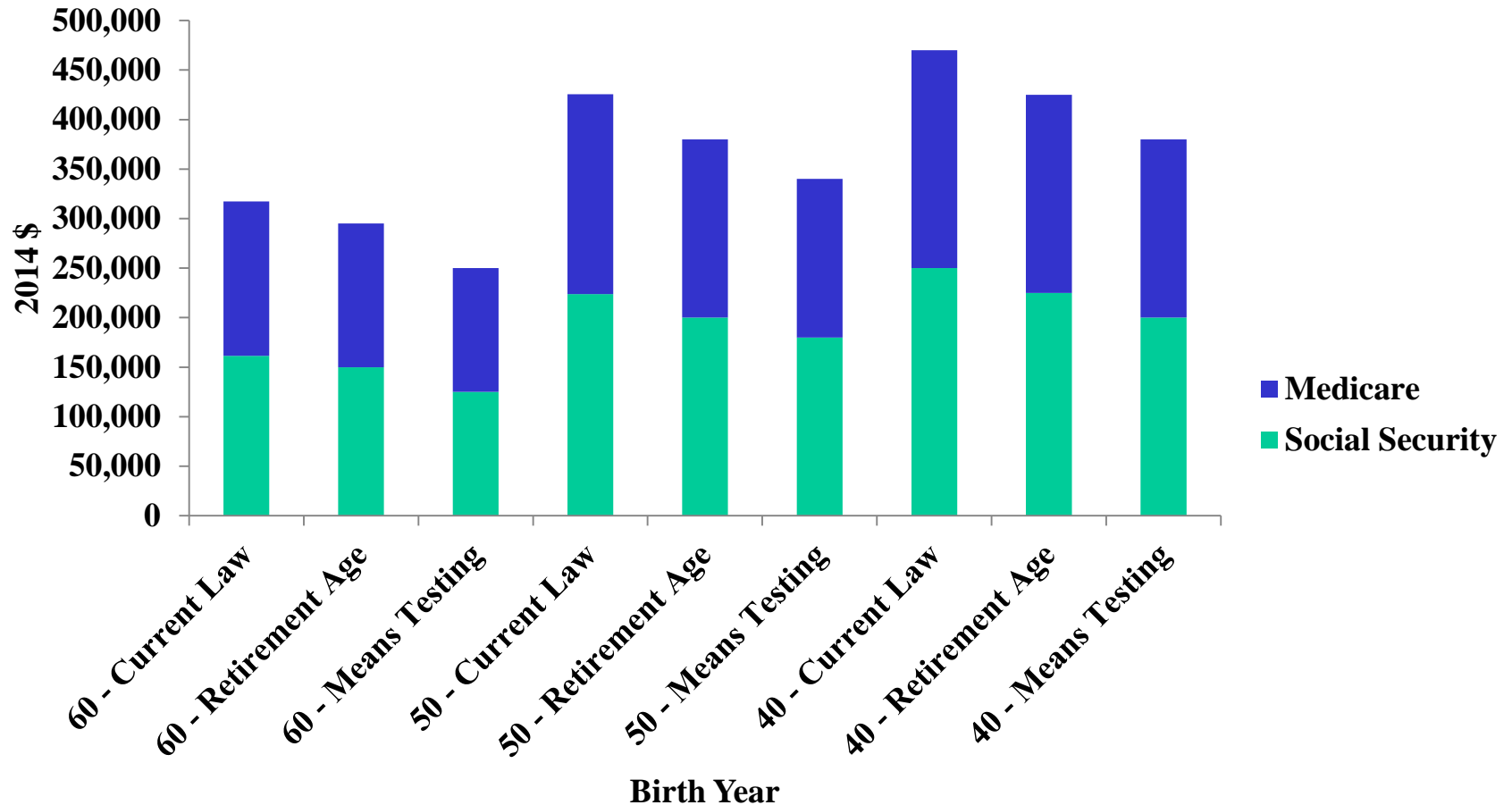


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Total Entitlement Retirement Wealth



Reform and Total Entitlement Wealth at Retirement

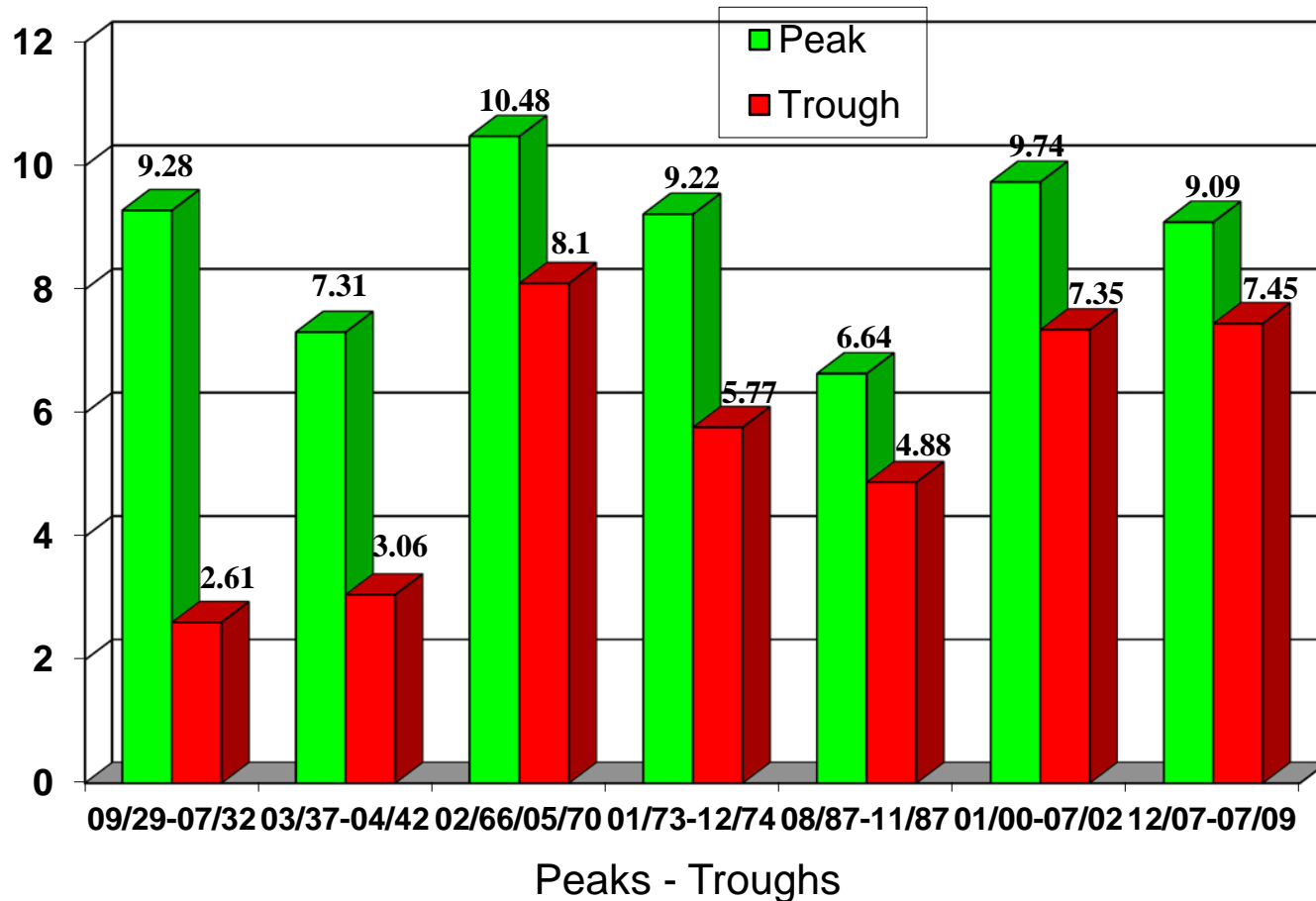


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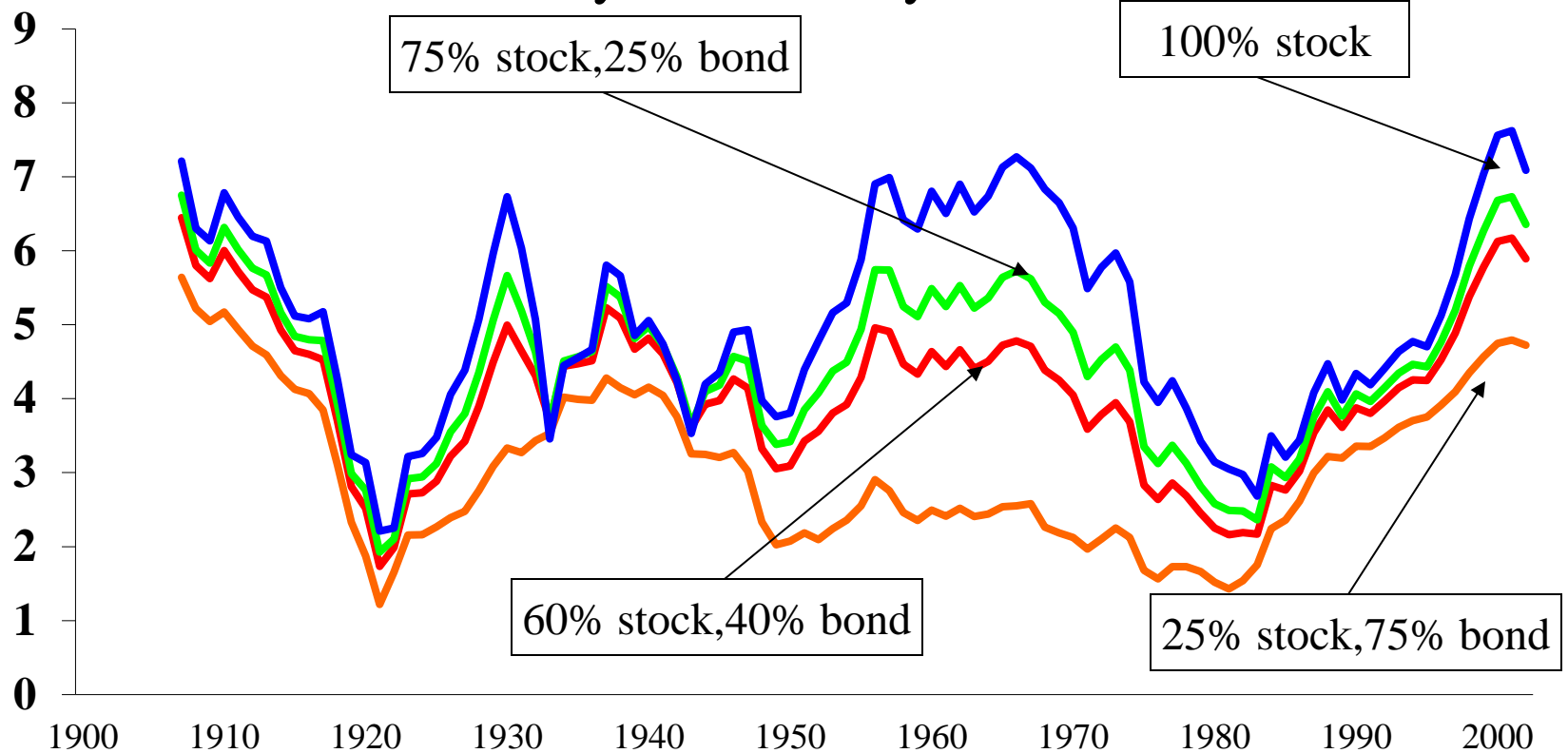
Reform will Mean That Wealthier
Retirees Will Have to Provide a
Greater Share of Their Retirement
Expenses With Their Own
Investments.
But Aren't Private Accounts Too
Risky?

Stock Market Peaks and Troughs

Annual Rates of Return on 35-year Portfolios

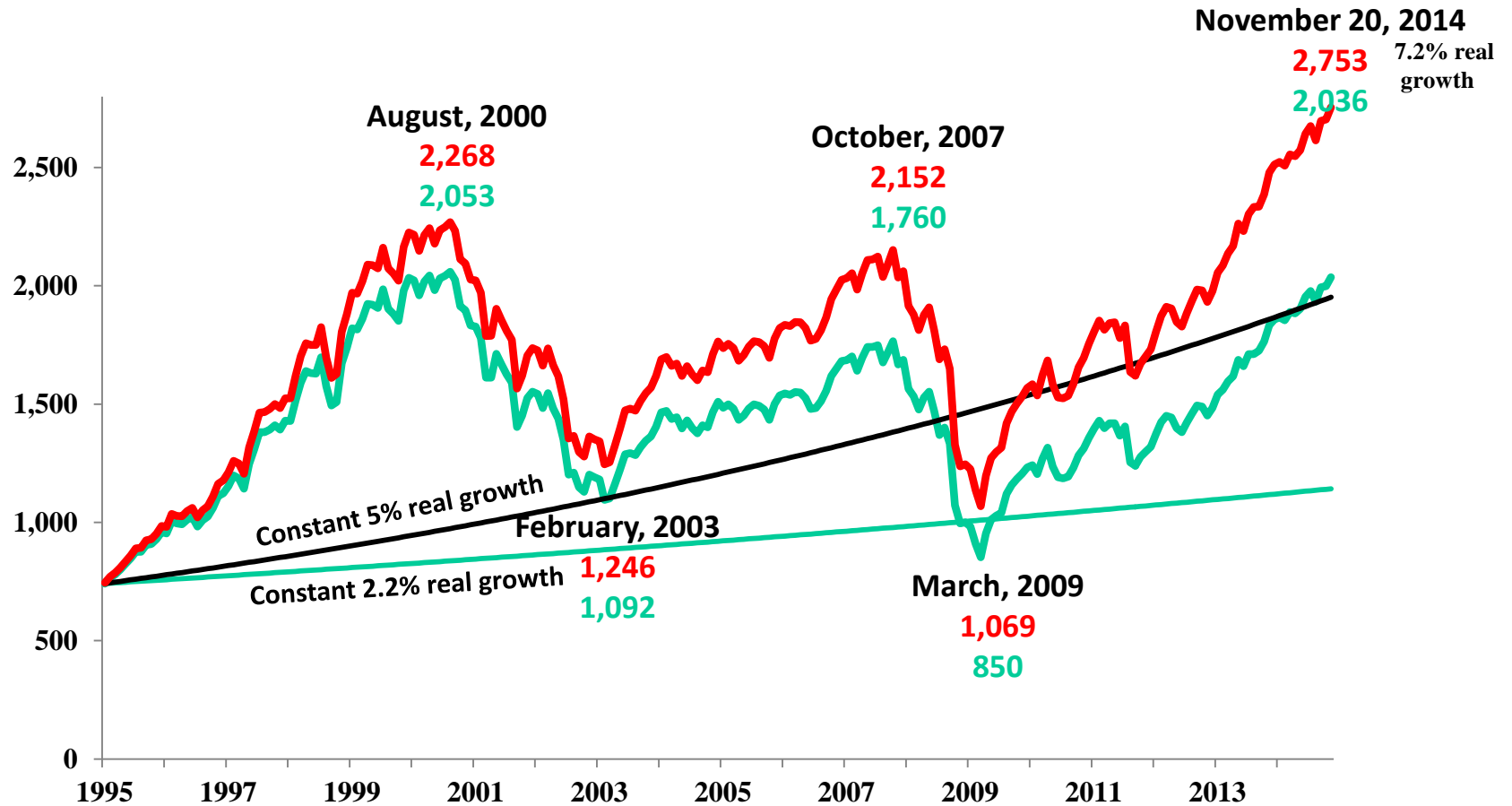


Rate of Return on 35-Year Investment Annuitized at Retirement by retirement year



S&P 500 Index: With Dividends

October 2014\$



Source: Robert Shiller's webpage <http://www.econ.yale.edu/~shiller/data.htm>.



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