COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET

Analysis of the 2014 Social Security Trustees' Report
July 28, 2014

The Social Security and Medicare Trustees released their annual reports today on the finances of both programs. The reports are an annual reminder of the action lawmakers should take to ensure the long-term solvency of Social Security and Medicare – both of which continue to face large and growing shortfalls. With regards to Social Security, the Trustees show that:

- The Social Security Disability Insurance (DI) trust fund is on the brink of insolvency, and is projected to be exhausted in 2016 – just 2 years from today. Absent legislation, beneficiaries in that program would face an immediate 19 percent across-the-board benefit cut.

- Assuming reallocation or interfund borrowing, the combined Old Age, Survivors', and Disability Insurance (OASDI) trust fund is projected to be exhausted in 2033. At that point, absent reform, all beneficiaries would face an immediate 23 percent across-the-board benefit cut.

- Over 75 years, Social Security's actuarial imbalance totals **2.88 percent of taxable payroll**, or **1.02 percent of GDP**. This is modestly higher than the 2.72 percent of taxable payroll (0.98 percent of GDP) imbalance that the trustees reported last year.

- The gap between Social Security spending and revenues is projected to grow from 1.3 percent of payroll (0.45 percent of GDP) this year to 3.9 percent of payroll (1.4 percent of GDP) by 2035 and 4.9 percent of payroll (1.7 percent of GDP) by the end of the 75-year window.

- This report represents the fourth straight year where the 75-year shortfall has increased. In the 2010 report, the shortfall was estimated at 1.92 percent of taxable payroll, but it is now about fifty percent larger at 2.88 percent.

Although the projections have worsened somewhat, Social Security's long-term outlook is fundamentally unchanged. The DI trust fund will be insolvent in just two years, and the old-age trust fund by the time today's 48-year-olds reach the normal retirement age – or when today's 60-year-olds turn 79. The report sends a clear signal on the need for lawmakers to act promptly to reform and secure the Social Security programs for current and future generations.

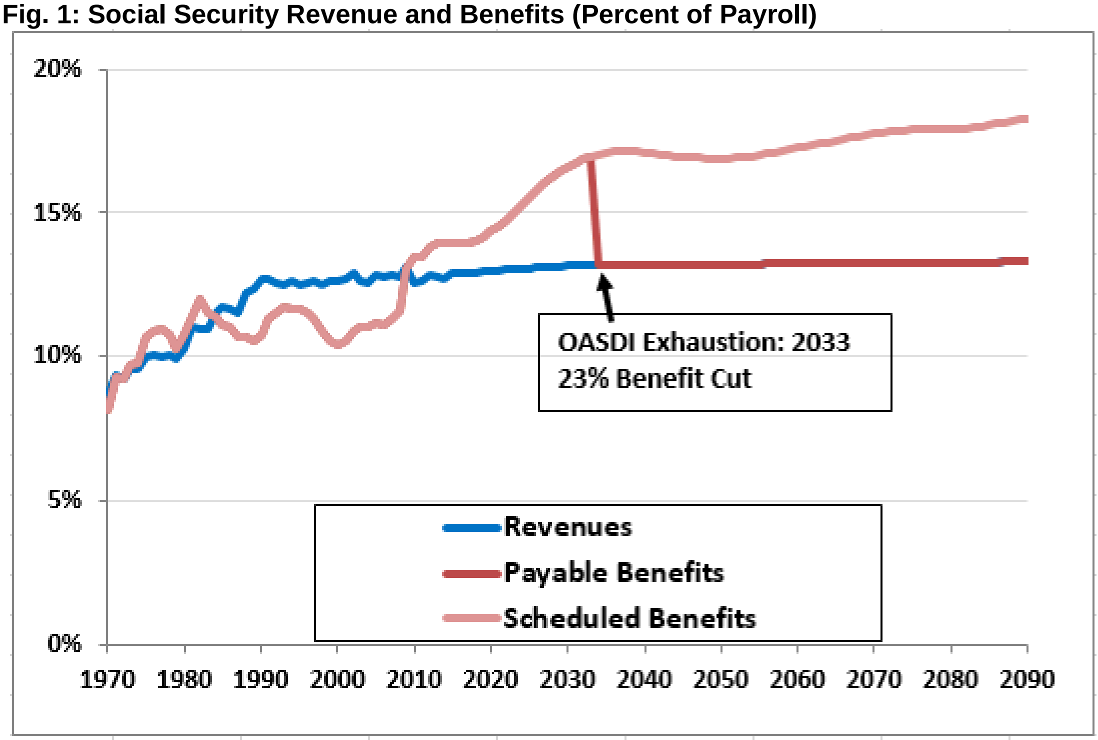
Social Security Projections

As in past years, the Social Security Trustees warn that the program is financially unsound. They project the combined programs to run cash flow deficits for the foreseeable future. This year, those deficits total about $80 billion, which is 1.3 percent of payroll and 0.45 percent of GDP. They are projected to reach 2.5 percent of payroll (0.9 percent of GDP) by 2025, 3.9 percent of payroll (1.4 percent of GDP) by 2035, and 4.9 percent of payroll (1.7 percent of GDP) by 2088.

These growing deficits result from the divergence between Social Security benefits and revenues. As the number of beneficiaries in the program continues to grow, outlays have already increased from 10.4 percent of payroll (4.0 percent of GDP) in 2000 to 14 percent of payroll (4.9 percent of GDP) today. The Trustees project they will continue to grow to 17.1 percent of payroll (6.2 percent of GDP) by 2035, dip slightly, then reach 18.2 percent of payroll (6.1 percent of GDP) by 2088.

Meanwhile, revenues will fail to keep up – growing slightly as a percent of payroll from 12.7 percent today to 13.3 percent in 2088, while actually falling slightly as a percent of GDP after the 2020s from 4.8 percent in 2030 to 4.5 percent by 2088.

Fig. 1: Social Security Revenue and Benefits (Percent of Payroll)

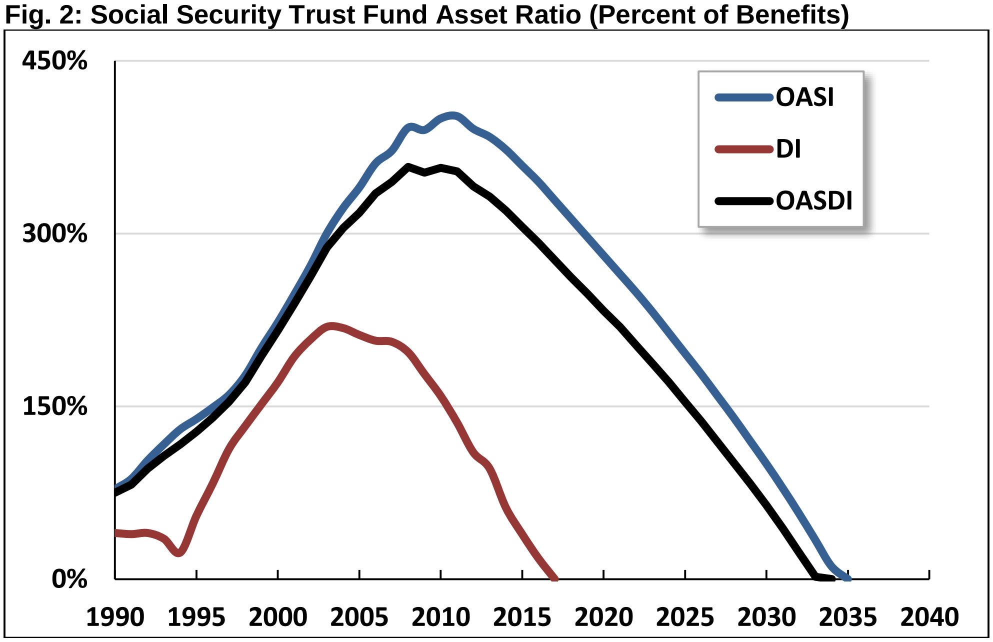


Source: Social Security Administration

Over 75 years, the actuarial imbalance – the present value of program's 75-year trust fund shortfall – is estimated to total 2.88 percent of payroll (1.02 percent of GDP) – which is slightly larger than last year's estimate of a 2.72 percent of payroll (0.98 percent of GDP) shortfall. Thought of another way, keeping Social Security solvent would require an immediate payroll tax rate increase of about 2.9 percentage points[1], an immediate 17 percent benefit cut, or some combination of the two. Importantly, though, even an adjustment this size – unless it grew over time – would leave cash-flow deficits from 2028 onward, bringing into question the program's long-term sustainability. Moreover, the necessary cuts and increases only become larger the longer that policymakers delay action (see CRFB's report, *Social Security Reform and the Cost of Delay*).

Because of this shortfall, the Social Security trust funds are projected to run out of reserves. The Old Age and Survivors' Insurance (OASI) trust fund is projected to be exhausted in 2034, while the Disability Insurance (DI) trust fund is pegged for a 2016 exhaustion date. On a combined basis, OASDI trust funds will be exhausted date of 2033, meaning that if lawmakers transfer money from OASI to DI rather than addressing DI's shortfall on its own, it will shorten the life of the old age fund by one year.

Fig. 2: Social Security Trust Fund Asset Ratio (Percent of Benefits)



Source: Social Security Administration

Assuming this transfer happens, when the OASDI trust fund is exhausted, beneficiaries will face an across-the-board 23 percent benefit cut. This cut would be immediate and would affect all beneficiaries regardless of age, income, or disability status. Preventing such a cut would require a 3.8 to 4.0 point increase in the payroll tax rate or an equivalent change to taxes and benefits. Alternatively, lawmakers could allow a general revenue transfer of 1.4 percent of GDP, which is currently more than we spending on all income security spending programs combined.[2] A much smarter course of action would be to begin changes much earlier so they can be shared among more individuals and phased in more gradually.

[1] To maintain a trust fund ratio above 100 percent would actually require a 2.99 percentage point payroll tax rate increase, which is higher than the shortfall of 2.88 percent due to behavioral responses to the tax increase. However, targeting only a positive trust fund balance would require a rate increase of only 2.83 percentage points.
[2] Includes food stamps (SNAP), Supplemental Security Income (SSI), unemployment insurance (UI), child nutrition, and family support and foster care.

Importantly, policymakers should look beyond simply keeping the program solvent for 75 years and pursue "sustainable solvency" which ensures the program does not remain in deficits and does not run out of trust fund assets in the 76th year. To achieve this goal, any reform plan should close the program's deficit in the 75th year of 4.9 percent of payroll and 1.7 percent of GDP.

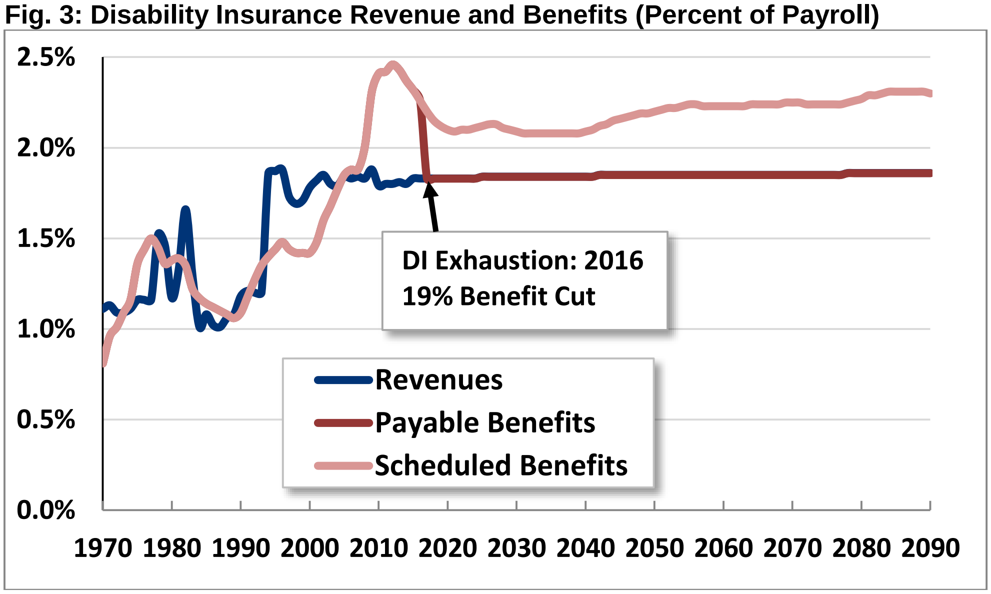
Social Security Disability Insurance Projections

While the impending depletion of the combined OASDI program highlights the need for action to reform Social Security sooner rather than later, this is especially true for the disability insurance program. The Social Security Disability Insurance (SSDI) trust fund is scheduled to run out of reserves in only two years. At that point, all disabled workers and their dependents on the program would receive an immediate 19 percent cut in their benefits.

Though lawmakers could avert this outcome by transferring or reallocating funds from the OASI trust fund, doing so would hasten the insolvency date of the OASI program. Alternatively, lawmakers could authorize temporary interfund borrowing from the OASI trust fund, though this too would likely hasten depletion of the OASI trust fund, depending on the design. Although some (possibly temporary) reallocation or interfund borrowing may ultimately be necessary to respond to imminent depletion of the DI trust fund, relying solely on transferring or reallocating funds to address the shortfall would represent a missed opportunity to fix the financial and structural issues facing the DI program which would remain even with reallocation.

Spending on SSDI has increased significantly in recent years, from 1.1 percent of payroll in 1990 to 2.4 percent today. This growth is driven largely by increases in the number of disabled workers receiving benefits – which have doubled since 1995 and tripled since 1980. This increase has been driven by a number of factors, including the recession, an aging population, an increased number of women in the workforce, and the scheduled increase in the normal retirement age. As some of these factors are temporary, the Trustees project SSDI spending to subside some in future years.

Fig. 3: Disability Insurance Revenue and Benefits (Percent of Payroll)



Source: Social Security Administration

Importantly, even if SSDI spending falls from its current levels, it is projected to remain above its dedicated revenue stream. Over 75 years, the Trustees project an SSDI shortfall of 0.3 percent of payroll, which is about 15 percent of benefits. By the end of the 75-year window, the shortfall would total 20 percent of benefits. Moreover, experts from across the ideological spectrum have identified a number of important structural concerns with even a fully-funded SSDI program and its ability to effectively serve disabled workers.

The disability program shortfalls would best be addressed in the context of comprehensive Social Security reform, which policymakers should pursue sooner rather than later. Absent such wholesale reform, policymakers should view the 2016 insolvency date as an opportunity to make improvements to the SSDI program so that it is not only more financial sound, but better equipped to serve workers with disabilities. Time is running short to develop and debate thoughtful improvements to the SSDI program; policymakers should start now.

Changes in Projections

Social Security's outlook is quite similar to last year's projections, though it has worsened somewhat. The 75-year shortfall has increased from 2.72 percent of taxable payroll to 2.88 percent of taxable payroll and from 0.98 percent of GDP to 1.02 percent. Meanwhile the shortfall in 2088 has grown from 4.8 percent of payroll to 4.9 percent of payroll (both 1.7 percent of GDP).

The largest contributor to the increased shortfall is economic assumptions, with those contributing 0.1 of the 0.16 percentage point change in the shortfall. Specifically, the Trustees expect GDP to be about one percent lower over the long-run, as well as other changes related to the growth in covered wages.

Fig. 4: Reasons for Change in 75-Year Actuarial Shortfall (Percent of Taxable Payroll)

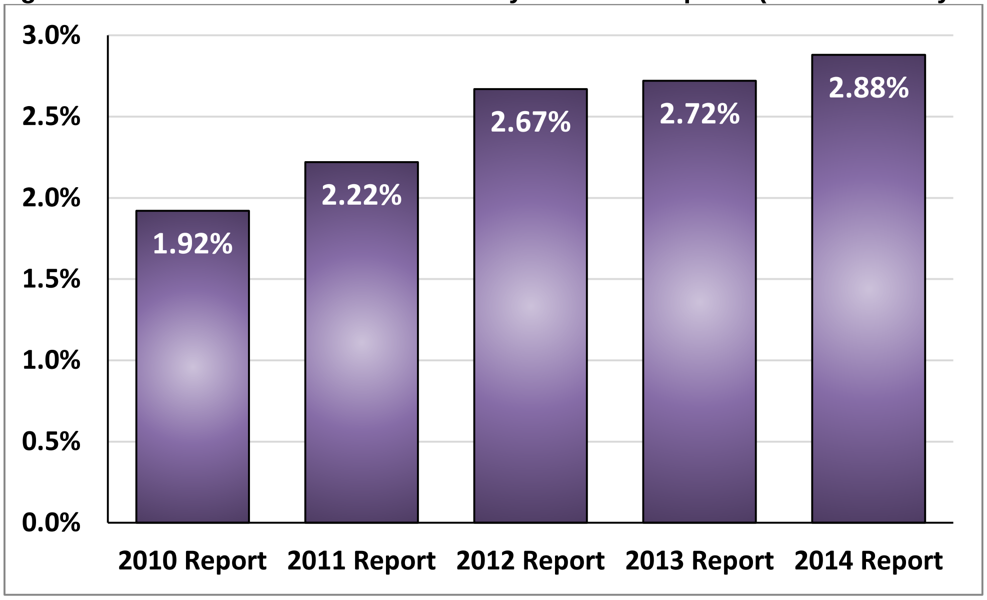
	Effect on 75-Year Shortfall
75-Year Actuarial Imbalance (2013 Report)	**-2.72%**
Change in Legislation and Regulation	-0.01%
Change in Economic Assumptions	-0.10%
Change in Demographic and Disability Assumptions	+0.06%
Methodological Changes	-0.05%
Shifting of 75-Year Window	-0.06%
75-Year Actuarial Imbalance (2014 Report)	**-2.88%**

Source: Social Security Administration

The remaining 0.6 percentage point change comes from the 75-year period shifting one year later, since there is a relatively large deficit at the end of the window. The rest of the changes largely cancel each other out, including a slight increase from Social Security benefits to now federally-recognized same-sex couples, a 0.1 percent decrease in the long-term CPI, and the incorporation of more information about birth and divorce rates.

Notably, the 75-year actuarial shortfall has continuously increased since the 2010 Trustees report. That year, the shortfall was 1.92 percent, but it has since risen to 2.22 percent in the 2011 report, 2.67 percent in the 2012 report, 2.72 percent in the 2013 report, and 2.88 percent this year.

Fig. 5: 75-Year Shortfall in Social Security Trustees Reports (Percent of Payroll)



Source: Social Security Administration

Conclusion

The Social Security Trustees report makes it crystal clear that programmatic reforms are necessary. In only two years, the Social Security Disability Insurance fund will run out of money, leading to deep immediate cuts in benefits. And while these cuts could be prevented through reallocation from the old age fund, the Trustees point out that a clean reallocation "might delay DI reforms and much needed corrections for OASDI as a whole."

Regardless of whether reallocation occurs, both Social Security trust funds will run out of money within two decades – when today's 48-year-olds are just reaching the normal retirement age. Failure to identify sufficient revenue or spending adjustments to prevent insolvency will mean a 23 percent across-the-board benefit cut for every person in the program.

Fortunately, the program's shortfall can still be closed without making drastic tax or benefit changes. If lawmakers are willing to take action soon, they can design a plan that strengthens the program's finances while phasing in changes gradually to give workers time to plan, protects vulnerable beneficiaries, improves the program for much of the disabled population, and promotes long-term economic growth. The ability to make targeted and gradual changes will dwindle over time, however. As the Trustees explain:

> If substantial actions are deferred for several years, the changes necessary to maintain Social Security solvency would be concentrated on fewer years and fewer generations. Much larger changes would be necessary if action is deferred until the combined trust fund reserves become depleted in 2033.

Policymakers should not waste the opportunity they have now to make thoughtful changes well in advance of the insolvency date. The luxury of time is still on our side, but just barely.