COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET

Analysis of the Social Security Trustees Report
May 31, 2013

Today, the Social Security and Medicare Trustees released their 2013 reports on the state of the Social Security and Medicare Trust Funds, further making the case for reforms to make these programs sustainably solvent. Looking at the Social Security Trustees report alone, we find that:

- Social Security is projected to become insolvent in **two** decades. The combined OASDI trust fund will be exhausted by **2033**, the same as it was projected in last year's report. Absent legislative action, all beneficiaries would face an immediate 23 percent benefit cut in that year.

- Social Security has an actuarial imbalance of **0.98 percent of GDP (2.72 percent of payroll)** over 75 years while the deficit in the 75th year is projected to be 1.64 percent of GDP (4.77 percent of payroll).

- Last year's Social Security Trustee report presented a similar financial picture for Social Security, the slight increase in the deficit due primarily to shifting the projection window out a year. In 2012, the 75-year shortfall was projected to be 0.96 percent of GDP and 2.67 percent of payroll.

- The Social Security Disability Insurance program is in desperate need of reform. The disability trust fund is projected to be exhausted in **2016**, at which point disabled workers will experience an immediate across-the-board **20 percent** reduction in benefits.

The financial state of the Social Security program should not be ignored. The longer policymakers wait to address its structural imbalance, the greater the required changes will need to be to ensure the 75-year solvency of the program. By enacting reforms in a comprehensive plan, policymakers can strengthen Social Security and ensure that it will be fully available for future generations.

1899 L Street NW • Suite 400 • Washington, DC 20036 • Phone: 202-986-2700 • Fax: 202-986-3696 • www.crfb.org

Social Security Projections

The 2013 projections present a similar takeaway from past Trustee reports – the Social Security program is in need of reform. As was the case in the 2012 and 2011 reports, projections show that cash flow deficits will continue indefinitely. Spending will continue to rise from 4.2 percent of GDP (10.4 percent of payroll) in 2000 to 5.1 percent of GDP (14 percent of payroll) in 2013, 5.3 percent of GDP (14.3 percent of payroll) in 2020, and 6.2 percent of GDP (17 percent of payroll) in 2040 as the retirement of the baby boomers increases benefit payouts. Non-interest revenues will continue to rise with the economic recovery from 4.6 percent of GDP in 2013 to 4.8 percent of GDP by 2020, but will level off and begin to decline slowly thereafter to 4.6 percent of GDP by 2080.

The result is continuous and growing deficits projected over the next 75 years. 2013 programmatic deficits of 0.46 percent of GDP (1.26 percent of payroll), will grow slightly to 0.48 percent of GDP (1.29 percent of payroll) by 2020, then jump to 1.38 percent of GDP (3.79 percent of payroll) by 2040, and 1.57 percent of GDP (4.53 percent of payroll) by 2080.

Over the 75-year period, the total actuarial shortfall is projected to be nearly 1 percent of GDP (2.72 percent of taxable payroll), compared to 0.96 percent of GDP (2.67 percent of payroll) last year. Put differently, keeping Social Security solvent over the next 75 years would require the equivalent of an immediate 2.66 point increase in the payroll tax or an immediate 16.5 percent benefit cut.

Fig. 1: Current and Projected Social Security Cash Flow Deficits

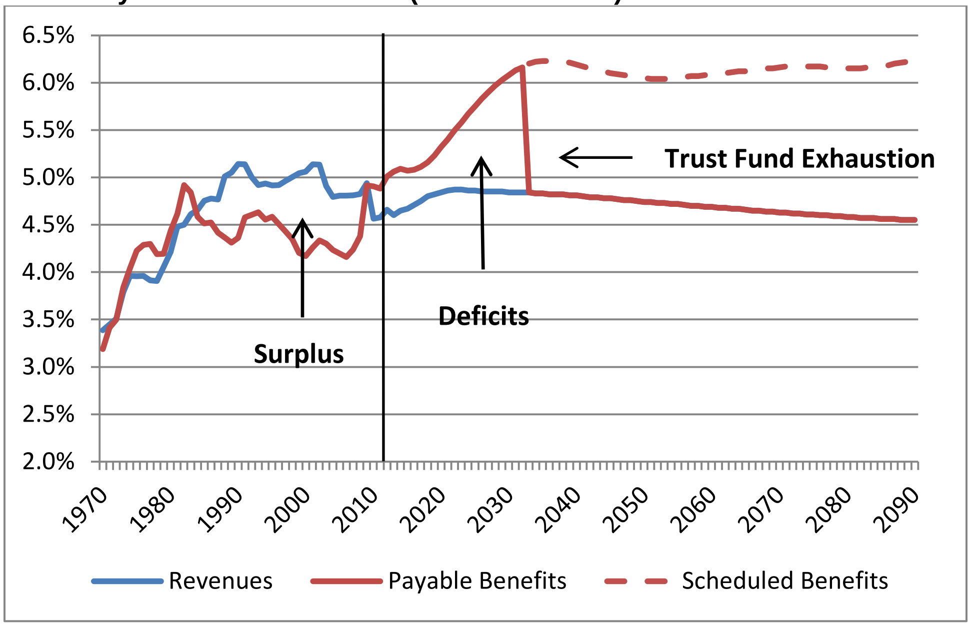
	2013	2020	2040	2060	2080	75-Year
% of GDP	0.46%	0.48%	1.38%	1.40%	1.57%	0.98%
% of Taxable Payroll	1.26%	1.29%	3.79%	3.95%	4.53%	2.72%
Billions of Current Dollars	$75	$114	$805	$1,993	$5,401	$9,600^

^Present-value estimate of the 75-year unfunded obligation.

Some experts argue that Social Security should be viewed as a stand-alone program, while others take a unified view of the budget and argue the program currently adds to the deficit. Both approaches have merit, but neither suggests that Social Security's finances should be ignored. Under the unified budget approach, Social Security will add $75 billion (0.5 percent of GDP) to the deficit this year and $1.1 trillion over the next ten years (0.5 percent of GDP). With total projected deficits at $6.8 trillion over the next decade, this represents a significant proportion.

Under the trust fund view, the OASDI trust fund is projected to be exhausted by 2033. If no action is taken, outlays will need to fall in order to meet revenues. As a result, benefits would be cut automatically by 23 percent across the board affecting beneficiaries at all ages and income levels. Preventing that benefit cut would require a large transfer from general revenues or an abrupt one-third increase in the payroll tax in that year.

Fig 2: Social Security Revenues and Costs (Percent of GDP)



Alternatively, a combination of tax and spending changes could be phased in gradually, spreading the burden over multiple generations and allowing beneficiaries time to plan and adjust. Under the trust fund view, making gradual changes now is preferable, since they would extend the life of the trust fund longer compared to similar-sized changes made later as interest accrues.

The ultimate goal for Social Security's finances should be sustainable solvency, bringing Social Security's revenues and spending into balance for the duration of the 75 year window and ensuring the program will not fall back into deficit over the longer run. This would require lawmakers to close the 1.64 percent of GDP (4.77 percent of payroll) deficit projected in 2087. Even if solvency is achieved, failing to reach sustainable solvency will require additional reforms further down the road.

As lawmakers move closer and closer to the exhaustion date of the Social Security Trust Fund, the gap that must be made up grows larger and larger. Waiting to make changes is counterproductive, as the costs of fixing Social Security for the long run will never be lower.

Reason for Changes in Projections

Overall, the Trustees' projections of the 75-year actuarial shortfall are similar to last year – 2.72 percent of payroll instead of 2.67 percent. The main reason for the slight increase in the deficit is the shift in the 75-year projection window, which adds the relatively high deficit from 2087 to the total.

Other changes to the outlook largely cancel each other out. The American Taxpayer Relief Act added 0.15 percent of payroll to the shortfall because the lowering of marginal tax rates relative to current law reduces taxation of benefits. Changes to demographic assumptions, mainly due to the incorporation of more recent data, added 0.17 percent to the 75-year deficit. Changes in immigration and economic assumptions had a more minor impact. Methodological changes are the main offsetting factor, reducing the deficit by 0.35 percent.

Fig. 3: Reasons for Change in 75-Year Actuarial Shortfall (Percent of Taxable Payroll)

	Effect on 75-Year Shortfall
75-Year Actuarial Imbalance (2012 Report)	**-2.67%**
Change in Legislation and Regulation	-0.15%
Change in Economic Assumptions	-0.03%
Change in Demographic and Disability Assumptions	-0.16%
Methodological Changes	0.35%
Shifting of 75-Year Window	-0.06%
75-Year Actuarial Imbalance (2013 Report)	**-2.72%**

Note: Numbers may not add due to rounding.

Disability Insurance

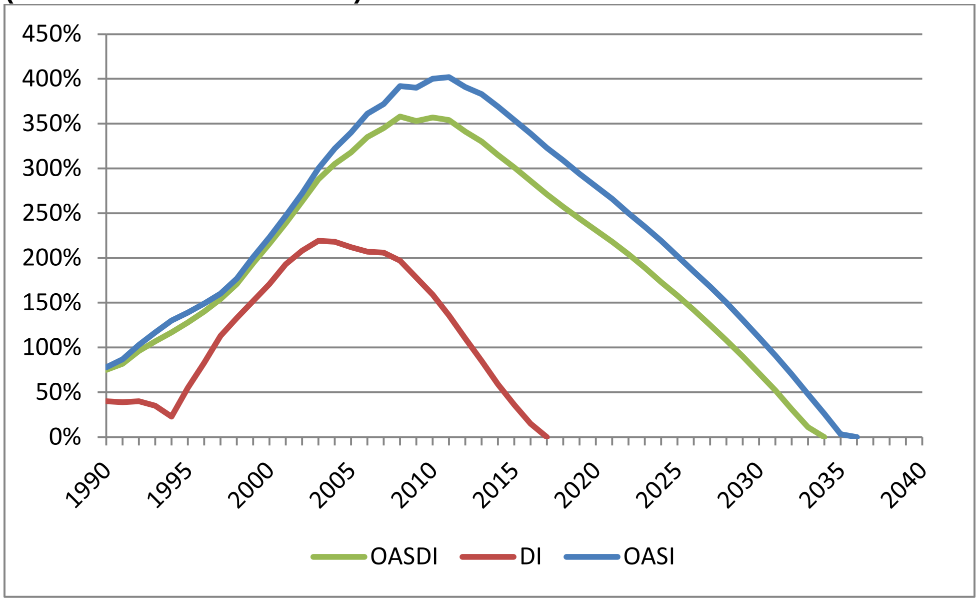
While the Social Security program on the whole is on a path toward insolvency, the financial outlook for disability insurance program is in urgent need of addressing; indeed the trust fund is projected to run out of money in only **three** years. The Disability Insurance (DI) program, which is technically separate from the OASI trust fund, relies on revenue from 1.8 percent of the 12.4 percent Social Security payroll tax. Especially since the recession hit, this revenue has been unable to meet rising costs. The DI program will spend 2.4 percent of payroll in 2013, up from 1.7 percent a decade ago.

This divergence between outlays and dedicated revenues leads to the DI trust fund's projected insolvency in 2016. At that time, if no reforms are enacted, funds will either need to be transferred from the OASI trust fund or benefits will automatically be cut across the board by 20 percent. Transferring funds from the OASI trust fund would shorten the projected life of the OASI trust fund from 2035 to 2033 and require even greater reforms to ensure solvency.

The recession has played some role in the deterioration of the DI program's finances, as those unable to find work turn to the program as an alternative. Last year's report moved the date of the DI trust fund exhaustion up from 2018 to 2016 where it remains in the 2013 projections. However, shortcomings in the DI program have been apparent for some time and reform offers an opportunity to strengthen the program.

Intelligent reforms to the disability program offer many potential benefits. Implementing policies that reward those who are able to work to return to old jobs or find new ones would lead to a larger labor force and a better standard of living for those who re-enter the labor force. Reducing fraud and abuse along with simplifying the appeals process could allow for the program to be more efficient and effective. Combining these policies along with other options could shore up the finances of the DI program and improve its performance at the same time. And of course, these changes should be made in concert with reforms to the old-age system given its financial condition and the large interactions between the programs.

Fig. 4: Social Security's Old Age and Survivors, Disability, and Combined Trust Fund Assets (Percent of Annual Benefits)



Conclusion

While the finances of Social Security are a clear cause for concern, identifying fixes to the problem is relatively straightforward if lawmakers are willing to put everything on the table and act now rather than waiting. Next week, CRFB will be releasing *The Reformer,* an interactive calculator that allows users to design their own reform plan. The calculator shows that a modest combination of policies can make the system sustainably solvent while giving future retirees plenty of time to plan and adjust.

Such a plan, if enacted today, could be designed to protect current beneficiaries, enhance benefits for the most vulnerable, and keep taxes relatively low. Unfortunately, even common-sense changes such as measuring inflation more accurately have received substantial backlash. If policymakers are not willing to pursue changes like that today, the future necessary adjustments to avoid an across-the-board 23 percent cut in benefits will be far more drastic and immediate.

The real time to act to reform Social Security was two decades ago. But there is still an opportunity to act now. Policymakers should not squander it.