COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET

Analysis of the Social Security Trustees Report
April 23, 2012

Today, the Social Security and Medicare Trustees released their 2012 report on the financial status of Social Security and Medicare, showing that reforms will be needed soon to make these programs sustainable.

Subsequent analysis will focus on the state of Medicare. Looking at the Social Security Trustees report, we find that:

- Social Security as a whole is on an unsustainable path. The program faces an actuarial imbalance of **0.96 percent of GDP (2.67 percent of payroll)** over 75 years and a deficit of **1.54 percent of GDP (4.5 percent of payroll)** in the 75th year.

- Social Security's financial status has deteriorated significantly since last year's report – when the 75-year shortfall was projected to be 0.8 percent of GDP and 2.22 percent of payroll. This difference is due mainly to changes in economic assumptions resulting in lower income projections.

- As a whole, the Social Security trust funds will be exhausted by **2033** – compared to 2036 in last year's report **–** at which point all beneficiaries will experience a **25 percent** benefit cut.

- Currently, Social Security is adding significantly to unified budget deficits. Not counting the payroll tax holiday this year and last year, the program is projected to run a **$53 billion deficit** in 2012 and **$937 billion** from 2013 through 2022.

- Without changes, Social Security's Disability Insurance trust fund will be exhausted by **2016** at which point all disabled workers would experience over a **20 percent** reduction in benefits.

Given the current state of the program, policymakers should enact a comprehensive plan to increase revenues, slow benefit growth, or do some combination of the two in order to make the program sustainably solvent for generations to come.

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

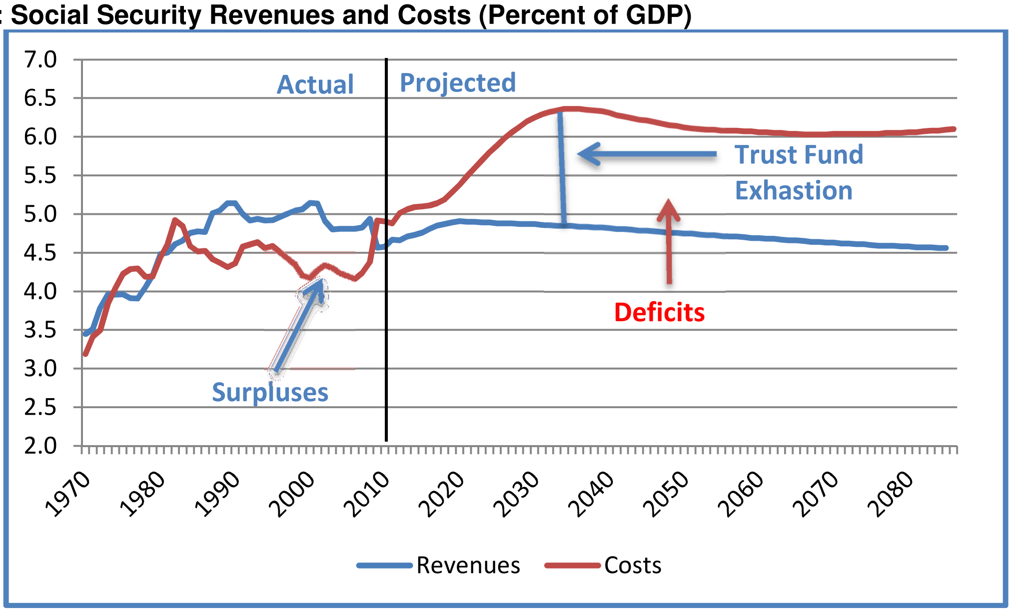
	2012	2020	2040	2060	2080	75-Year
% of GDP	0.34%	0.49%	1.48%	1.37%	1.48%	0.96%
% of Taxable Payroll	0.93%	1.30%	4.07%	3.87%	4.29%	2.67%
Billions of Current Dollars	$53	$115	$854	$1,925	$5,030	$8,600^

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

Social Security Projections

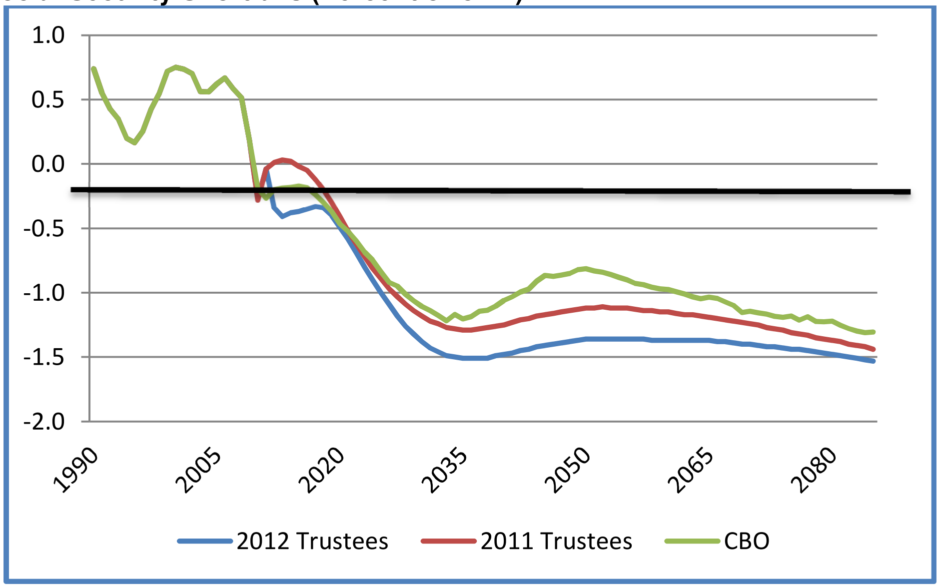
The latest Trustees projections show persistent cash flow deficits in the Social Security program, which will grow significantly over the coming decades. Social Security spending will increase from 5 percent of GDP in 2012 to 6.4 percent by 2035 as the baby boomers retire and life expectancy continues to increase. Meanwhile, revenues will fall short, peaking at 4.9 percent of GDP at the beginning of next decade before falling to below 4.6 percent by 2080.

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



The persistent imbalance between outlays and income for the Social Security system leads to a 0.96 percent of GDP (2.67 percent of taxable payroll) 75-year actuarial shortfall – a significant deterioration from last year's shortfall of 0.8 percent of GDP (2.22 percent of payroll). Closing this gap would require the equivalent of a 21 percent *immediate* increase in payroll taxes or a 16 percent *immediate* cut in benefits. And even under changes of this magnitude, the program would still run out of money shortly beyond the end of the 75-year window. To achieve *sustainable solvency*, a reform plan would also need to eliminate the 1.54 percent of GDP (4.5 percent of payroll) deficit projected in 2086.

Fig. 3: Social Security Shortfalls (Percent of GDP)



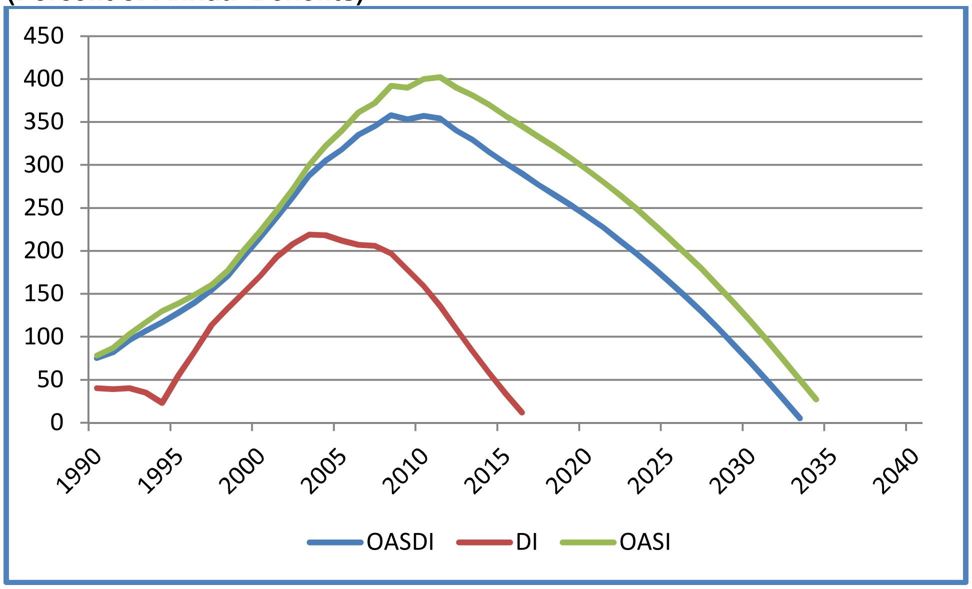
Note: Social Security Trustees numbers reflect calendar year data while CBO uses fiscal year data.

Many experts disagree on the proper way to view the Social Security program in the context of the federal budget – some argue it should be treated as a stand-alone program, while others believe it should be treated as part of the unified budget (see CRFB's analysis on the subject: http://crfb.org/document/social-security-and-budget). In truth – both views lead to the same conclusion – reforms are necessary, and the sooner the better.

Under the unified budget approach, the net effect of Social Security spending and revenues (excluding the effect of the payroll tax holiday) will add $53 billion (0.3 percent of GDP) to the deficit this year, $937 billion (0.4 percent of GDP) over ten years, and $506 billion (1.4 percent of GDP) in 2030 alone.

Under the other view, the Social Security trust funds are on a fast course toward insolvency. If no action is taken on Social Security, the combined OASDI trust fund is projected to be exhausted in 2033, at which point the program could not fully honor all scheduled benefits. Effectively, this would result in a 25 percent immediate cut for all beneficiaries in 2033 – new and current, young and old, and rich and poor alike.

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



If policymakers were to act just before exhaustion to ensure solvency, they would either have to enact a massive general revenue transfer, enact substantial cuts in benefits for *current beneficiaries*, raise revenue by the equivalent of 3.8 percent of payroll (a 30 percent increase from current levels), or some combination thereof. Instead, policymakers should enact gradual and targeted tax and spending changes which allow individuals time to plan and adjust their savings.

Reason for Changes in Projections

The outlook for Social Security has deteriorated substantially since last year, with the 75-year actuarial shortfall growing from 2.22 percent of payroll to 2.67 percent. The largest contributor to this cost increase – about 0.14 percentage points – comes from changes in near-term economic assumptions. Specifically, inflation is higher and wages lower than what the Trustees projected last year. Longer-term economic assumptions, namely a projected decline in average hours worked, contribute an additional 0.07 percent to the shortfall.

Another source of the increased deficits is the shifting in the 75-year window. By including the 4.5 percent of payroll deficit from 2086 in the 75-year window, the shift in the valuation period expands the 75-year actuarial shortfall by 0.05 percent.

Finally, a number of new and changed assumptions on demographics and disability collect, along with other methodological changes, contribute to the worsening financial state of the program.

Fig. 5: Reasons for Change in 75-Year Actuarial Shortfall (Percent of Taxable Payroll)

	Effect on 75-Year Shortfall
75-Year Actuarial Imbalance (2011 Report)	**-2.22%**
Change in Near-Term Economic Assumptions	-0.14%
Change in Long-Term Economic Projections	-0.07%
Change in Demographic and Disability Assumptions	-0.09%
Methodological Changes	-0.08%
Shifting of 75-Year Window	-0.05%
75-Year Actuarial Imbalance (2012 Report)	**-2.67%**

Note: Numbers may not add due to rounding.

Disability Insurance

When considered on its own, the Disability Insurance (DI) program's financial outlook is very dire; in fact it is facing the near-term threat of insolvency. Technically apart from the rest of the OASI trust fund, the DI trust fund is funded by 1.8 percent of the 12.4 percent payroll tax.

Over the past few years, the trust fund has deteriorated as costs have grown from 1.9 percent of payroll in 2005 to 2.5 percent this year. This increase is largely a result of the recession, which has narrowed employment opportunities for disabled individuals and has thus led many to enroll in the disability program. The recession has also reduced revenue coming into the DI program, putting further pressure on the system's finances.

As a result of these and other factors, the DI trust fund exhaustion date has been moved up two years from last year's report to 2016. If no action is taken—either to make the program solvent on its own or to transfer money from the OASI trust fund—benefits will have to be cut by about 20 percent in that year. The Trustees effectively assume a transfer will occur, which would speed up the demise of the OASI trust fund by three years – to 2033 instead of 2036.

Given the looming near-term insolvency, reforming the disability program should be considered an especially high priority. As with the old-age program, some mix of benefit or revenue changes will be necessary – though policymakers could also consider reforms to tighten eligibility criteria, reduce fraud, and help those who are able to return to work.

Conclusion

The Trustees report shows Social Security to be on an unsustainable path and in dire need of reform. As the Trustees explain in the report: "Lawmakers should address the financial challenges facing Social Security and Medicare as soon as possible. Taking action sooner rather than later will leave more options and more time available to phase in changes so that the public has adequate time to prepare."