Committee for a Responsible Federal Budget

Analysis of the 2015 Social Security Trustees' Report

July 22, 2015

Today, the Social Security and Medicare Trustees released their annual reports on the financial health of the programs. Although these projections show some improvements relative to last year, they nonetheless show both programs continue to face large shortfalls that will grow over time. With regards to Social Security, the Trustees show that:

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

- On a combined basis, or assuming reallocation or interfund borrowing, the Old Age, Survivors, and Disability Insurance (OASDI) trust funds are projected to be exhausted in 2034. At that point, all beneficiaries would face an immediate 21 percent across-the-board benefit cut, which would grow to more than 27 percent by 2090.

- Over 75 years, Social Security's actuarial imbalance totals **2.68 percent of taxable payroll**, or about **0.96 percent of GDP**.

- The gap between Social Security spending and revenues is projected to grow from 1.3 percent of payroll (0.46 percent of GDP) this year to 3.5 percent of payroll (1.26 percent of GDP) by 2040 and 4.7 percent of payroll (1.62 percent of GDP) by 2090.

- Overall, this year's report represents an improvement over last year's, which showed a combined trust fund exhaustion date of 2033 (one year sooner) and a 75-year actuarial imbalance of 2.88 percent of payroll (0.20 percentage points higher).

Although the projections have slightly improved, Social Security's long-term outlook is fundamentally unchanged. The SSDI trust fund will be depleted next year, and the combined trust funds by the time today's 48-year-olds reach the normal retirement age – or when today's newest retirees turn 81.

Policymakers must act quickly to put Social Security on a path toward solvency. As time goes on, it will be more difficult to secure the Social Security programs for current and future generations with thoughtful changes instead of abrupt benefit cuts or tax increases.

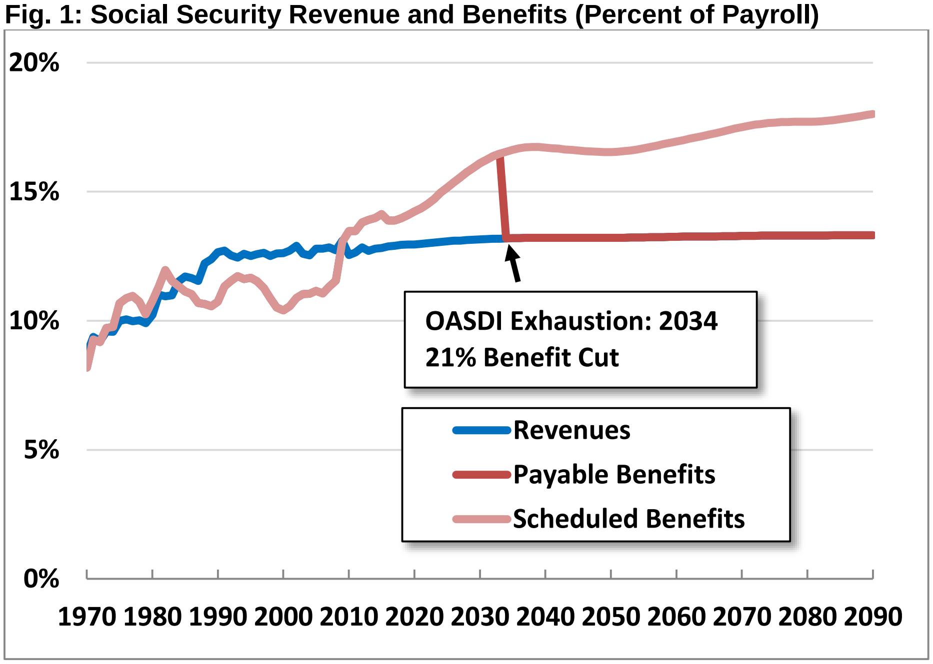
Social Security Projections

As in past years, the Social Security Trustees warn that the program is currently financially unsound. They project the combined programs to run cash flow deficits for the foreseeable future. This year, those deficits total about $85 billion, which is 1.3 percent of payroll and 0.46 percent of GDP. They are projected to reach 2.1 percent of payroll (0.8 percent of GDP) by 2025, 3.5 percent of payroll (1.3 percent of GDP) by 2040, and 4.7 percent of payroll (1.6 percent of GDP) by 2090.

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 14.1 percent of payroll (5.0 percent of GDP) today. The Trustees project they will continue to grow to 16.7 percent of payroll (6.0 percent of GDP) by 2040, dip slightly, and then grow to 18.0 percent of payroll (6.2 percent of GDP) by 2090.

Meanwhile, revenues will fail to keep up – growing slightly as a percent of payroll from 12.8 percent today to 13.3 percent in 2090, while actually falling slightly as a percent of GDP after the 2020s from 4.8 percent in 2030 to 4.6 percent by 2090.

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



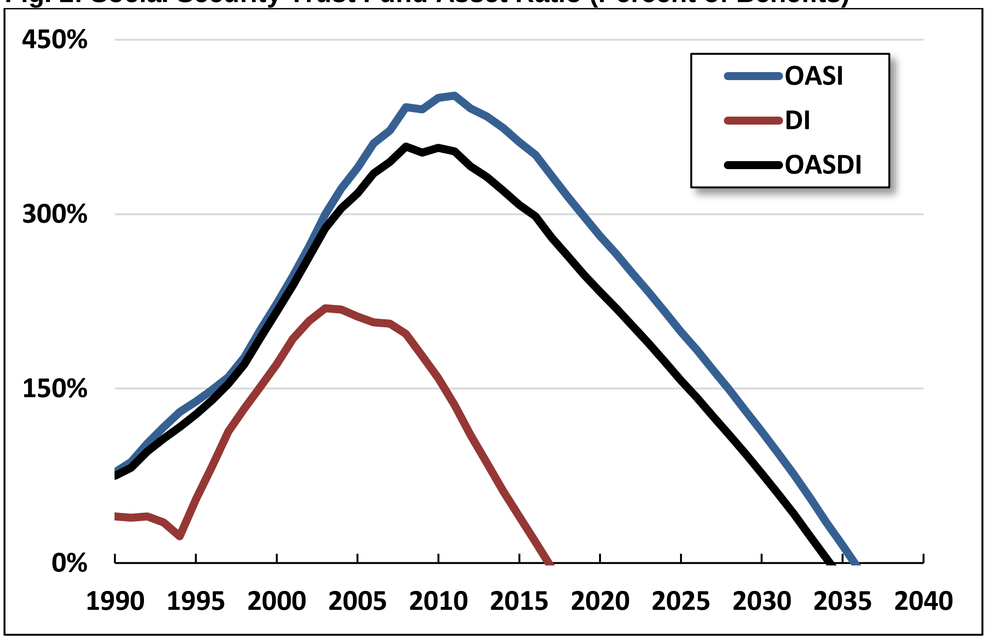
Source: Social Security Administration

Over 75 years, the actuarial imbalance – present value of the program's 75-year trust fund shortfall – is estimated to total 2.68 percent of payroll (0.96 percent of GDP) – which is somewhat smaller than last year's estimate of a 2.88 percent of payroll (1.02 percent of GDP) shortfall. Thought of another way, keeping Social Security solvent would require increasing payroll taxes by over one-fifth to about 15 percent, reducing benefits for all current and future beneficiaries by about one-sixth, or some combination of the two.

Importantly, even with an immediate payroll tax increase large enough to make the program solvent, cash-flow deficits would return before 2030 – meaning more would need to be done over the long-term. 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*).

As benefits continue to exceed dedicated revenue, 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 2035, while the Disability Insurance (DI) trust fund is pegged to deplete its reserves in the fourth quarter of 2016. On a combined basis, the Social Security trust funds would run out of reserves by 2034, meaning that if lawmakers somehow 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 – through reallocation, interfund borrowing, or some other means – when the OASDI trust fund is exhausted, beneficiaries will face an across-the-board 21 percent benefit cut. This cut would be immediate and would affect all beneficiaries regardless of age, income, or health and wellbeing. The size of the cut would also grow over time, to more than 27 percent by 2090.

Even if policymakers wanted to exempt current beneficiaries from cuts in 2034, eliminating benefits for only new beneficiaries would not avoid insolvency. Cuts could be prevented with an immediate 3.7 point increase in the payroll tax rate – the equivalent of a sudden $2,000 per worker tax increase in today's dollars. 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.

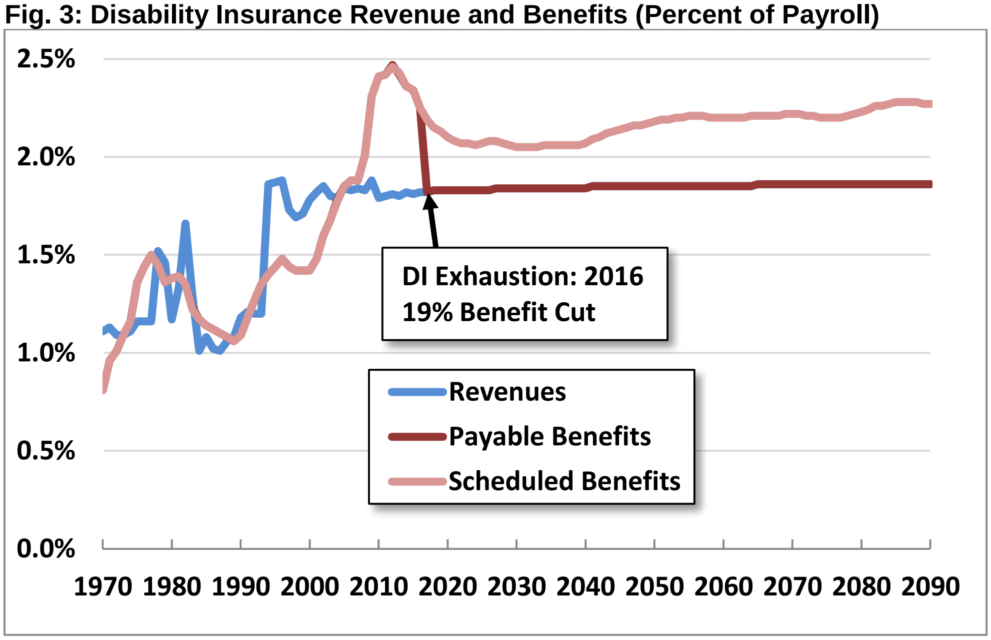
Importantly, policymakers should look beyond simply keeping the program solvent for 75 years and pursue "sustainable solvency" which ensures the program raises about as much as it pays out over the long-run and requires savings equivalent to 4.7 percent of payroll (1.6 percent of GDP) by 2090.

Social Security Disability Insurance Projections

While the projected depletion of the combined OASDI program highlights the need for action to reform Social Security sooner rather than later, the Social Security Disability Insurance (SSDI) trust fund faces a much more immediate problem.

Spending on SSDI has increased significantly in recent years, from less than 1.1 percent of payroll in 1990 to more than 2.3 percent today – while dedicated revenue covers only about 1.8 percent of payroll. Although the Trustees project SSDI spending to subside in the coming years, they project costs will continue to exceed benefits, resulting in a 75-year shortfall of 0.31 percent of payroll.

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



Source: Social Security Administration

As a result, the SSDI trust fund is scheduled to run out of reserves toward the end of next year, at which point all SSDI beneficiaries would receive an immediate 19 percent cut in their benefits.

Lawmakers could delay the depletion of the SSDI trust fund by reallocating, transferring, or lending money from the old-age trust fund. Indeed, failure to address SSDI's financial shortfall in a timely manner before now makes an adjustment like this virtually inevitable. At the same time, relying *solely* on transferring or reallocating resources to address the shortfall would represent a missed opportunity to fix financial and structural issues facing the SSDI program, or make improvements to that program. Furthermore, a rule adopted by the House this year requires any sort of reallocation legislation to be accompanied by measures that would improve the overall financial health of the Social Security program.

Ideally, lawmakers would address the disability program shortfalls in the context of comprehensive Social Security reform that made the combined trust funds solvent for the foreseeable future and appropriately addressed the many interactions and common features of the two programs. 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 financially sound, but also better equipped to serve workers with disabilities. Some ideas have already been generated through the McCrery-Pomeroy SSDI Solutions Initiative, a project dedicated to identifying practical policy changes to improve the SSDI program, but time is running short to develop such improvements.

Changes in Projections

The Social Security Trustees project a similar but somewhat improved outlook relative to last year's. Specifically, the Trustees project a combined trust fund exhaustion date of 2034 instead of 2033, smaller deficits throughout the projection window, and a 75-year actuarial shortfall of 2.68 percent of payroll as opposed to 2.88 percent of payroll last year.

The largest contributors to these improvements include more optimistic short-term economic assumptions and changes in estimating methodology. Specifically, the Trustees expect that slower growth in health insurance premiums will mean that employers will give out less compensation in the form of health insurance and more in the form of taxable wages. They also partially reverse one of the economic changes they made last year dealing with the growth of average wages.

Methodologically, the Trustees have improved their collection of data and projection methods involving the earnings of older workers, Social Security coverage of certain immigrants, and taxation of benefits. They also incorporate legislative and regulatory changes, most notably President Obama's recent executive order on immigration.

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

	Effect on 75-Year Shortfall
75-Year Actuarial Imbalance (2014 Report)	**-2.88%**
Change in Legislation and Regulation	+0.02%
Change in Economic Assumptions	+0.10%
Change in Demographic Assumptions	-0.03%
Methodological Changes	+0.17%
Shifting of 75-Year Window	-0.06%
75-Year Actuarial Imbalance (2015 Report)	**-2.68%**

Source: Social Security Administration

Partially offsetting these improvements, the Trustees updated near-term data for fertility, mortality, and immigration rates and incorporated one more future year into the 75-year projection window.

Although the projected financial state of the program has improved since last year, the shortfall remains at about the levels projected in 2012 and 2013 and about forty percent higher than the shortfall projected in 2010.

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

Source: Social Security Administration

Conclusion

The Social Security Trustees highlight the importance of reforming Social Security soon. The SSDI program will run out of reserves next year, leading to deep immediate cuts in benefits. And while these cuts could be prevented by diverting resources from the old-age fund, the Trustees point out that reallocation without reform could "serve to delay DI reforms and much needed corrections for OASDI as a whole."

Yet even setting aside the immediate issues facing the SSDI fund, 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 21 percent across-the-board benefit cut for every person in the program, with that cut growing deeper over time.

Fortunately, the Social Security's finances can still be fixed without making drastic tax or benefit changes. If policymakers are willing to act soon, they can create a plan that strengthens the program's finances while phasing in changes gradually to give workers time to plan, protecting vulnerable beneficiaries, improving the program for much of the disabled population, and promoting long-term economic growth. However the cost of delay is substantial and could even be detrimental. 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 theoretical combined trust fund reserves become depleted in 2034…[and] some strategies for achieving solvency would not be feasible.

Lawmakers should not waste any time to make policy changes and reforms well in advance of the insolvency date. The window to act in a rational, reasonable and measured manner is closing.