

SOCIAL SECURITY'S FINANCIAL OUTLOOK: THE 2015 UPDATE IN PERSPECTIVE

BY ALICIA H. MUNNELL*

Introduction

The timing of the release of the Social Security Trustees Report is becoming more unpredictable. It used to come out in the spring, but in the last two years it has been released in late July. It is hard to know whether the delay reflects internal controversy or simply the inability to get six people (the Social Security Commissioner, the Secretaries of Treasury, of Health and Human Services, and of Labor, and two public trustees) in a room at the same time to sign the document. One logical reason for the delay this year is the time required to incorporate the important Medicare legislation passed in April and the desire to release the Social Security and Medicare reports at the same time.

While the release date has become more unpredictable, the message has not. The program faces a 75-year deficit, the Old-Age, Survivors and Disability Insurance (OASDI) program trust funds are scheduled for exhaustion in the early 2030s, and the Disability Insurance trust fund will run out of money next year. The specifics for 2015 show a little improvement: the 75-year deficit declined from 2.88 percent in 2014 to 2.68 percent in 2015 and the date of trust fund exhaustion moved from 2033 to 2034. But the story remains unchanged: the trust funds are going to run out of money, forcing substantial benefit cuts. Congress needs to act both to restore confidence in the nation's major social insurance program and to give people time to adjust to needed changes.

This *brief* updates the numbers and puts the current report in perspective. It also discusses the projected exhaustion of the Disability Insurance Trust Fund in 2016 and replacement rate data that remain missing from the Trustees Report.

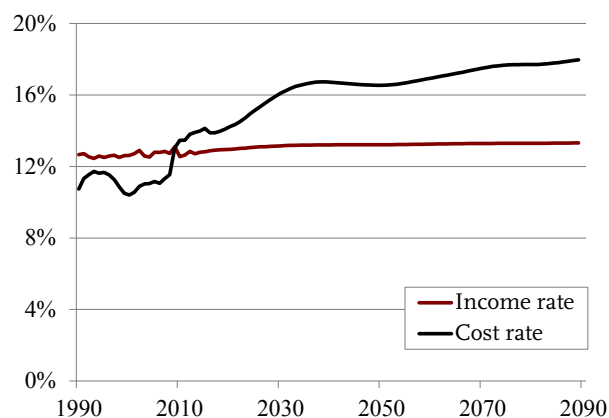
The 2015 Report

The Social Security actuaries project the system's financial outlook over the next 75 years under three sets of assumptions – high cost, low cost, and intermediate. Our focus is on the intermediate assumptions, which show the cost of the program rising rapidly to about 17 percent of taxable payrolls in 2035, where it remains for several decades before drifting up to 18 percent of taxable payrolls (see Figure 1 on the next page).

The increase in costs is driven by the demographics. Since Social Security is financed primarily on a pay-as-you-go basis, the retirement of baby boomers and the decrease in the ratio of workers to retirees from 3:1 to 2:1 raises costs commensurately. This increase is not news; the actuaries have known the whereabouts of the baby boom (those born between 1946 and 1964) for a long time. But the gap between the income and cost rates means that the system is facing a 75-year deficit.

* Alicia H. Munnell is director of the Center for Retirement Research at Boston College and the Peter F. Drucker Professor of Management Sciences at Boston College's Carroll School of Management.

FIGURE 1. PROJECTED SOCIAL SECURITY INCOME AND COST RATES, AS A PERCENTAGE OF TAXABLE PAYROLL, 1990-2089



Source: 2015 Social Security Trustees Report, Table IV.B1.

The 75-year cash flow deficit is mitigated somewhat by the existence of a trust fund, with assets currently equal to roughly three years of benefits. These assets are the result of cash flow surpluses, which began in response to reforms enacted in 1983. Before the Great Recession, these cash flow surpluses were expected to continue for several years, but the recession-induced decline in payroll taxes and uptick in benefit claims caused the cost rate to exceed the income rate in 2010 (see Table 1). This shift from annual surplus to deficit means that Social Security is tapping the interest on trust fund assets to cover benefits sooner than anticipated. And, in 2020, taxes and interest will fall short of annual benefit payments, so the government will be required to draw down trust fund assets to meet benefit commitments. The trust fund will be exhausted in 2034.

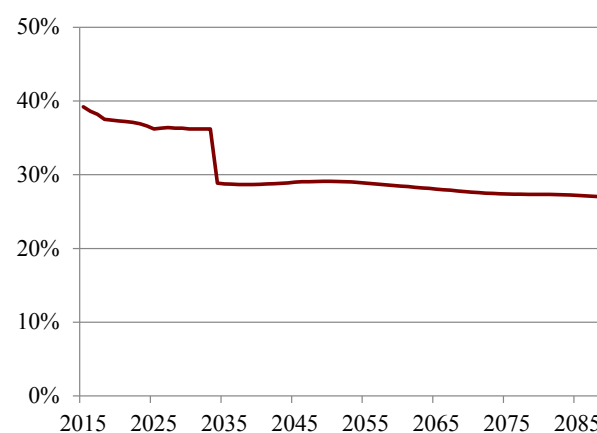
TABLE 1. KEY DATES FOR SOCIAL SECURITY TRUST FUND

Event	Trustees Report				
	2011	2012	2013	2014	2015
First year outgo exceeds income excluding interest	2010	2010	2010	2010	2010
First year outgo exceeds income including interest	2023	2021	2021	2020	2020
Year trust fund assets are exhausted	2036	2033	2033	2033	2034

Source: 2011-2015 Social Security Trustees Reports.

The exhaustion of the trust fund does not mean that Social Security is “bankrupt.” Payroll tax revenues keep rolling in and can cover about 75 percent of currently legislated benefits over the remainder of the projection period. Relying on only current tax revenues, however, means that the replacement rate – benefits relative to pre-retirement earnings – for the typical age-65 worker would drop from 36 percent to 27 percent (see Figure 2) – a level not seen since the 1950s. (Note that the replacement rate for those claiming at age 65 is already scheduled to decline from about 40 percent today to 36 percent because of the ongoing increase in the Full Retirement Age from 65 to 67 that was enacted in 1983.)

FIGURE 2. REPLACEMENT RATE FOR THE MEDIUM EARNER AT AGE 65 FROM EXISTING REVENUES, 2015-2089



Source: 2015 Social Security Trustees Report, Tables IV.B1 and “Annual Scheduled Benefit Amounts with Replacement Rates for Retired Workers with Various Pre-Retirement Earnings Patterns Based on Intermediate Assumptions, Calendar Years 1940-2090.”

Moving from cash flows to the 75-year deficit requires calculating the difference between the present discounted value of scheduled benefits and the present discounted value of future taxes plus the assets in the trust fund. This calculation shows that Social Security’s long-run deficit is projected to equal 2.68 percent of covered payroll earnings. That figure means that if payroll taxes were raised immediately by 2.68 percentage points – 1.34 percentage points each for the employee and the employer – the government would be able to pay the current package of benefits for everyone who reaches retirement age at least through 2089.

At this point in time, solving the 75-year funding gap is not the end of the story in terms of required tax increases. Once the ratio of retirees to workers stabilizes and costs remain relatively constant as a percentage of payroll, any solution that solves the problem for 75 years will more or less solve the problem permanently. But the United States is in a period of transition. The ratio of retirees to workers is rising and the cost rate is increasing. Any package that restores balance only for the next 75 years will show a deficit in the following year as the projection period picks up a year with a large negative balance. Policymakers generally recognize the effect of adding deficit years to the valuation period, and many advocate a solution that involves “sustainable solvency,” in which the ratio of trust fund assets to outlays is either stable or rising in the 76th year. Realistically, eliminating the 75-year shortfall should probably be viewed as the first step toward long-run solvency.

Some commentators report Social Security’s financial shortfall over the next 75 years in terms of dollars – \$10.7 trillion. Although this number appears very large, the economy will also be growing. So dividing this number – plus a one-year reserve cushion – by taxable payroll over the next 75 years brings us back to the 2.68 percent-of-payroll deficit discussed above (see Table 2).

TABLE 2. SOCIAL SECURITY’S FINANCING SHORTFALL

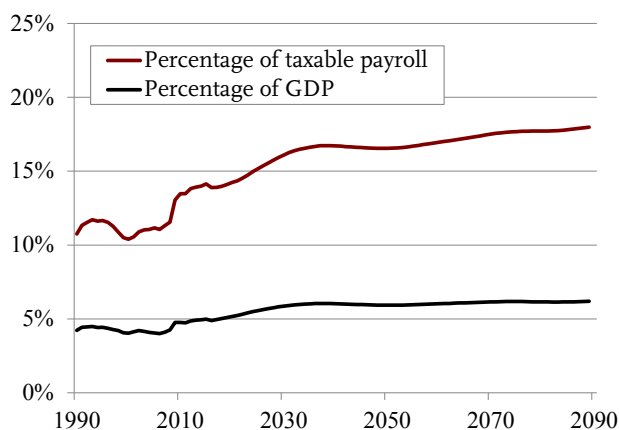
Period	Present value (trillions)	As a percentage of	
		Taxable payroll	GDP
2015-2089	\$10.7*	2.5*	0.9%

* Adding \$633 billion required for a one-year reserve cushion brings the deficit to 2.68 percent.

Source: 2015 Social Security Trustees Report, Table IV.B6.

The Trustees also report Social Security’s shortfall as a percentage of Gross Domestic Product (GDP). The cost of the program is projected to rise from about 5 percent of GDP today to about 6 percent of GDP as the baby boom retires (see Figure 3). The reason why costs as a percentage of GDP more or less stabilize – while costs as a percentage of taxable payroll keep rising – is that taxable payroll is projected to decline as a share of total compensation due to continued growth in health and retirement benefits.

FIGURE 3. SOCIAL SECURITY COSTS AS A PERCENTAGE OF GDP AND TAXABLE PAYROLL, 1990-2089

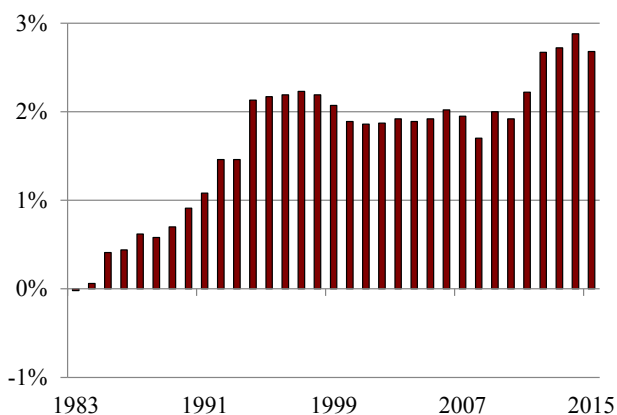


Source: 2015 Social Security Trustees Report, Figures II.D5 and IV.B1.

The 2015 Report in Perspective

The recent shortfall is in sharp contrast to the projection of a 75-year balance in 1983 when Congress enacted the recommendations of the National Commission on Social Security Reform (often referred to as the Greenspan Commission). Almost immediately after the 1983 legislation, deficits appeared and increased markedly in the early 1990s (see Figure 4).

FIGURE 4. SOCIAL SECURITY’S 75-YEAR DEFICIT AS A PERCENTAGE OF TAXABLE PAYROLL, 1983-2015



Source: 2015 Social Security Trustees Report, Table IV.B1.

In the 1983 Report, the Trustees projected a 75-year actuarial surplus of 0.02 percent of taxable payroll; the 2015 Trustees project a deficit of 2.68 percent. Table 3 shows the reasons for this swing of 2.70 percent of taxable payroll. Leading the list is the impact of changing the valuation period. That is, the 1983 Report looked at the system's finances over the period 1983-2057; the projection period for the 2015 Report is 2015-2089. Each time the valuation period moves out one year, it picks up a year with a large negative balance.

TABLE 3. REASONS FOR CHANGE IN THE ACTUARIAL DEFICIT, 1983-2015

Item	Change
Actuarial balance in 1983	0.02%
Changes in actuarial balance due to:	
Valuation period	-1.86
Economic data and assumptions	-0.78
Disability data and assumptions	-0.69
Other factors*	-0.04
Methods and programmatic data	0.28
Demographic data and assumptions	0.23
Legislation/regulation	0.16
Total change in actuarial balance	-2.70
Actuarial balance in 2015	-2.68

* Discrepancies due to rounding.

Source: Author's calculations based on earlier analysis by John Hambor, recreated and updated from *1983-2015 Social Security Trustees Reports*.

A worsening of economic assumptions – primarily a decline in assumed productivity growth and the impact of the recent recession – has also contributed to the increase in the deficit. Another contributor to the increased actuarial deficit over the past 30 years has been persistent increases in disability rolls.

Offsetting the negative factors has been a reduction in the actuarial deficit due to changes in demographic assumptions – primarily higher mortality for women – and methodological changes. Legislative and regulatory changes have also had a positive impact on the system's finances. The passage of health care reform (comprised of the Patient Protection and

Affordable Care Act and the accompanying Health Care and Education Reconciliation Act) in 2010 was assumed to reduce Social Security's 75-year deficit by 0.14 percent, mainly through an expected increase in taxable wages as a number of provisions slow the rate of growth in the cost of employer-sponsored group health insurance.

In the absence of any other changes, the OASDI deficit would have increased by 0.06 percentage points between 2014 and 2015 by including the large negative balance for 2089 in the calculation. But a change in one ultimate economic assumption (an increase in real wage growth from 1.13 percent to 1.17 percent), better near-term economic performance, and some methodological refinements (particularly for projecting the earnings levels for future beneficiaries) reduced the deficit by 0.26 percentage points.

Current Issues

Two issues are worthy of comment this year – the impending exhaustion of the Disability Insurance (DI) program in 2016 and the continued absence of replacement-rate information.

Exhaustion of the Disability Insurance Program

Although the outlook for Social Security is usually reported on a consolidated basis, the program consists of two trust funds – one for Old-Age and Survivors Insurance (OASI) and one for Disability Insurance (DI). Much of the acceleration in the exhaustion date for Social Security has come from the DI portion of the program.

Under the intermediate projections, the DI trust fund will be exhausted in 2016 (see Table 4). Since Social Security is precluded from spending money it does not have, it would have to cut benefits by about

TABLE 4. PROJECTED EXHAUSTION DATES FOR THE SOCIAL SECURITY TRUST FUNDS

Event	2011	2012	2013	2014	2015
OASI trust fund assets are exhausted	2038	2035	2035	2034	2035
DI trust fund assets are exhausted	2018	2016	2016	2016	2016

Source: 2011-2015 Social Security Trustees Reports.

20 percent to accord with DI payroll tax revenues. Congress is unlikely to allow such a circumstance to arise. In 1994, the last time the program was about to run out of money, Congress reallocated 0.6 percentage points of the payroll tax from the OASI program to the DI program.

Such a reallocation could significantly extend the life of the DI trust fund, while not having a serious effect on the retirement portion of the program. More precisely, reallocating taxes to put the two trust funds on an even footing would prolong the DI trust fund by 18 years (from 2016 to 2034), while advancing the OASI fund's depletion date by just one year (from 2035 to 2034). The reason is simple: OASI is much bigger than DI, so a modest reallocation barely dents OASI.

The waters have been muddied a little by a rule adopted in January by the House of Representatives that allows a House member to raise a point of order against the reallocation unless the overall effect of the bill improves the combined 75-year actuarial balance of the OASI and DI trust funds. Of course, at some point, a comprehensive long-term solution is necessary to put both DI and OASI on a strong, sustainable financial footing. But trying to force through a hasty fix when such deep divisions exist between the parties is likely to either fail – and result in draconian benefit cuts to a very vulnerable group – or to produce bad policy. In the end, the most likely result probably will be a “clean” transfer of OASI revenue to DI, with the GOP House members deciding either not to invoke the rule or to override it.

Missing Replacement Rate Data

In the 2014 Report, the Chief Actuary noted in his “Statement of Actuarial Opinion” that the Trustees had eliminated data on benefit replacement rates. The deleted table showed for hypothetical workers at different earnings levels and for different claiming ages both historical and projected benefits adjusted for inflation and benefits as a percentage of pre-retirement earnings. Figure 5 shows a portion of this table from the 2013 Report.

These data are important. First, they are useful to individuals who need to plan for their own retirement and to companies contemplating establishing a plan. Second, they show how changes in the law affect retirement security.

Take the change in the Full Retirement Age as an example. Although raising the Full Retirement Age sounds harmless, it is equivalent to an across-the-board benefit cut. The cut comes in one of two forms. Those who delay claiming from 65 to 67 receive two fewer years of benefits. Those who continue to claim at 65 receive actuarially reduced benefits and lower replacement rates. If the only numbers provided to policymakers are the rising dollar amounts of benefits (as done in the 2014 and 2015 Reports) – without any reference to the earnings these benefits are replacing – policymakers will be led to believe that raising the Full Retirement Age would not harm retirement security for those unable to work longer.

The Trustees did not restore the replacement rate data in the 2015 Report.

FIGURE 5. PORTION OF REPLACEMENT RATE TABLE IN 2013 TRUSTEES REPORT

Table V.C7.—Annual Scheduled Benefit Amounts for Retired Workers
With Various Pre-Retirement Earnings Patterns
Based on Intermediate Assumptions, Calendar Years 2013-90

Year attain age 65	Retirement at normal retirement age			Retirement at age 65		
	Age at retirement	CPI-indexed 2013 dollars	Percent of earnings	Age at retirement	CPI-indexed 2013 dollars	Percent of earnings
Scaled medium earnings:						
2015	66:0	18,935	41.2	65:0	17,668	39.5
2020	66:2	20,198	39.6	65:0	18,622	37.1
2030	67:0	23,538	40.9	65:0	20,400	36.3
2040	67:0	26,404	41.0	65:0	22,885	36.3
2050	67:0	29,497	41.1	65:0	25,561	36.4
2060	67:0	32,835	41.1	65:0	28,456	36.4
2070	67:0	36,500	41.1	65:0	31,634	36.4
2080	67:0	40,589	41.0	65:0	35,177	36.4
2090	67:0	45,274	41.0	65:0	39,236	36.3

Source: 2013 Social Security Trustees Report, Table V.C7.

Conclusion

The 2015 Trustees Report confirms what has been evident for two decades – namely, Social Security is facing a long-term financing shortfall which now equals about 1 percent of GDP. The changes required to fix the system are well within the bounds of fluctuations in spending on other programs. For example, defense outlays went down by 2.2 percent of GDP between 1990 and 2000 and up by 1.8 percent of GDP between 2000 and 2010.

While Social Security's shortfall is manageable, it is also real. The long-run deficit can be eliminated only by putting more money into the system or by cutting benefits. There is no silver bullet. Despite the political challenge, stabilizing the system's finances should be a high priority to restore confidence in our ability to manage our fiscal policy and to assure working Americans that they will receive the income they need in retirement.

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Urban Institute

Contact Information

Center for Retirement Research
Boston College
Hovey House
140 Commonwealth Avenue
Chestnut Hill, MA 02467-3808
Phone: (617) 552-1762
Fax: (617) 552-0191
E-mail: crr@bc.edu
Website: <http://crr.bc.edu>

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