SOCIAL SECURITY’S FINANCIAL OUTLOOK:
THE 2019 UPDATE IN PERSPECTIVE

By Alicia H. Munnell*

Introduction

Contrary to media reports, the 2019 Trustees Report contains no real news. The program continues to run a 75-year deficit between 2 and 3 percent of taxable payrolls, and the trust fund will be exhausted in the early 2030s, after which the program can pay only about three quarters of benefits.

If anything, the 2019 report shows a slight improvement in the program’s 75-year finances: the deficit is projected at 2.78 percent of taxable payrolls in 2019 compared to 2.84 percent in 2018. Similarly, the trust fund is scheduled to run out of money one year later – 2035 rather than 2034, as reported last year. The improvement, after accounting for various offsetting changes, is almost entirely due to a more favorable outlook for the Disability Insurance (DI) program.

On the administrative side, the timing of the Trustees Report has returned to April, after several years of June or July releases. A more noteworthy issue is that this report once again reflects the continuing absence of public trustees. These slots should be filled. Public trustees play an important role in overseeing the program and communicating its status to the public. Their continued absence reflects a failure with the political process, not with the program itself.

This brief updates the numbers for 2019 and puts the current report in perspective. It also briefly discusses recent developments on the disability front. The bottom line is that Social Security’s finances remain steady. Social Security’s shortfall over the next 75 years, which has been evident for the last three decades, should be addressed sooner rather than later in order to share the burden more equitably across cohorts, restore confidence in the nation’s major retirement program, and give people time to adjust to needed changes.

The 2019 Report

The Social Security actuaries project the system’s financial outlook over the next 75 years under three sets of cost assumptions – high, low, 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 2040, at which point it declines slightly for a decade before drifting up toward 18 percent of taxable payrolls (see Figure 1 on the next page).

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The increase in costs is driven by the demographics, specifically the drop in the total fertility rate after the baby-boom period. A woman of childbearing age in 1964 could expect to have 3.2 children; by 1974 that expectation had dropped to 1.8. The combined effects of the retirement of baby boomers (those born between 1946 and 1964) and a slow-growing labor force from the drop in fertility reduce the ratio of workers to retirees from about 3:1 to 2:1 and raise costs commensurately. In addition, the long-term increase in life expectancies at the individual level causes costs to continue to increase even after the ratio of workers to retirees stabilizes. The increasing gap between the income and cost rates means that the system is facing a 75-year deficit.

The 75-year cash flow deficit is mitigated somewhat in the short term 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 that 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 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 has been tapping the interest on trust fund assets to cover benefits sooner than anticipated. And, in 2020, taxes and interest are expected to fall short of annual benefit payments, which requires the government to begin drawing down trust fund assets to meet benefit commitments. The trust fund is then projected to be depleted in 2035, one year later than projected in the last Trustees Report.

The depletion of the trust fund does not mean that Social Security is “bankrupt.” Payroll tax revenues keep rolling in and can cover 80 percent of currently legislated benefits initially, declining to 75 percent by the end of the projection period. Relying only on 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 about 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 39 percent today to 36 percent because of the ongoing increase in the Full Retirement Age.)
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 2.78 percent of covered payroll earnings. That figure means that if payroll taxes were raised immediately by 2.78 percentage points – 1.39 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 through 2093, with a one-year reserve at the end.

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, during this period of transition, 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. Thus, eliminating the 75-year shortfall should be viewed as the first step toward long-run solvency.

Some commentators cite Social Security’s financial shortfall over the next 75 years in terms of dollars – $13.9 trillion (see Table 2). Although this number appears very large, the economy will also be growing. So dividing this number – plus a one-year reserve – by taxable payroll over the next 75 years brings us back to the 2.78 percent-of-payroll deficit discussed above.

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 boomers retire (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, 1990-2093

![Graph showing Social Security costs as a percentage of GDP and taxable payroll, 1990-2093](source: 2019 Social Security Trustees Report, Figures II.D4 and IV.B1.)

### 2019 Report in Perspective

The continued 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, however, deficits appeared and increased markedly in the early 1990s (see Figure 4 on the next page).

### Table 2. Social Security’s Financing Shortfall, 2019-2093

<table>
<thead>
<tr>
<th>Period</th>
<th>Present value (trillions)</th>
<th>As a percentage of</th>
<th>Taxable payroll</th>
<th>GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019-2093</td>
<td>$13.9*</td>
<td>2.6%</td>
<td>0.9%</td>
<td></td>
</tr>
</tbody>
</table>

* Adding $923 billion required for a one-year reserve cushion brings the deficit to 2.78 percent.

*Source: 2019 Social Security Trustees Report, Table IV.B6.*
In the 1983 Report, the Trustees projected a 75-year actuarial surplus of 0.02 percent of taxable payroll; the 2019 Trustees project a deficit of 2.78 percent. Table 3 shows the reasons for this swing. 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 2019 Report is 2019-2093. Each time the valuation period moves out one year, it picks up a year with a large negative balance.

A worsening of economic assumptions – primarily a decline in assumed productivity growth and the impact of the Great Recession – has also contributed to the increase in the deficit. Another contributor to the increased actuarial deficit over the past 35 years has been increases in disability rolls although, as discussed later, that picture has changed dramatically.

Offsetting the negative factors has been a reduction in the actuarial deficit due to changes in demographic assumptions – primarily higher mortality for women. Legislative and regulatory changes have also had a positive impact on the system’s finances. For example, the passage of the Affordable Care 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 by slowing the growth in the cost of employer-sponsored health insurance. Methodological improvements had the largest positive effect on the 75-year outlook.

In the short term, between 2018 and 2019, in the absence of any other changes, the Social Security deficit would have increased by 0.05 percentage points as a result of including the large negative balance for 2093 in the calculation (see Table 4). This increase was more than offset by a 0.07-percentage-point savings from other factors.

Table 3. Reasons for Change in the Actuarial Deficit 1983-2019

<table>
<thead>
<tr>
<th>Item</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Actuarial balance in 1983</td>
<td>0.02%</td>
</tr>
<tr>
<td>Changes in actuarial balance due to:</td>
<td></td>
</tr>
<tr>
<td>Valuation period</td>
<td>-2.08</td>
</tr>
<tr>
<td>Economic data and assumptions</td>
<td>-0.98</td>
</tr>
<tr>
<td>Disability data and assumptions</td>
<td>-0.58</td>
</tr>
<tr>
<td>Legislation/regulation</td>
<td>0.19</td>
</tr>
<tr>
<td>Demographic data and assumptions</td>
<td>0.25</td>
</tr>
<tr>
<td>Methods and programmatic data</td>
<td>0.41</td>
</tr>
</tbody>
</table>

| Total change in actuarial balance   | -2.80  |
| Actuarial balance in 2019           | -2.78  |

Note: Subtotals do not add to total due to rounding.
Sources: Author’s calculations based on earlier analysis by John Hambor, recreated and updated from 1983-2019 Social Security Trustees Reports.

Table 4. Principal Reasons for the Change in Actuarial Balance from 2018 to 2019

<table>
<thead>
<tr>
<th>Reason</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total change for all reasons</td>
<td>+0.06%</td>
</tr>
<tr>
<td>Valuation period</td>
<td>-0.05</td>
</tr>
<tr>
<td>Economic data and assumptions</td>
<td>-0.04</td>
</tr>
<tr>
<td>Lower rate of productivity growth</td>
<td>-0.09</td>
</tr>
<tr>
<td>Lower real interest rate</td>
<td>-0.08</td>
</tr>
<tr>
<td>Lower assumed price differential</td>
<td>+0.09</td>
</tr>
<tr>
<td>Higher real wage differential and starting values</td>
<td>+0.04</td>
</tr>
<tr>
<td>Lower disability incidence</td>
<td>+0.07</td>
</tr>
<tr>
<td>Demographic data and assumptions</td>
<td>+0.06</td>
</tr>
<tr>
<td>Lower assumed near-term fertility</td>
<td>-0.02</td>
</tr>
<tr>
<td>Higher recent mortality</td>
<td>+0.09</td>
</tr>
<tr>
<td>Lower immigration</td>
<td>-0.01</td>
</tr>
<tr>
<td>Methods and programmatic data</td>
<td>+0.01</td>
</tr>
</tbody>
</table>

Note: Subtotals do not add to total due to rounding.
Source: U.S. Social Security Administration (2019).
ing through a reduction in the assumed near term and ultimate rate in disability incidence. In addition, demographic developments (people dying earlier) reduced costs (0.06 percentage points), while offsetting changes in economic assumptions increased projected costs (0.04 percentage points).

**Current Issue – The Improved Outlook for DI**

The most newsworthy part of the most recent Trustees report is the recognition of the improving disability landscape.

For most of the last 35 years, the disability rolls have been soaring. Three factors explain the steady increase. First, legislation passed in 1984 broadened the definition of disability and provided applicants and medical providers with greater opportunity to influence the decision process. Second, the population was aging, and the baby boom generation ‘aged into’ the higher incidence rates following the 1984 Congressional reforms. Third, the secular rise in women’s labor force participation increased the fraction of women eligible by their work history for disability benefits, and they too aged into the higher incidence rates.

These three factors that led to the increase in the disability rolls over the 35 years are not likely to occur again. Further liberalizing of the program is unlikely. The aging of the workforce has slowed with the baby boom moving into retirement, and women’s labor force participation has levelled off.

Indeed, two recent developments suggest that the trajectory of the program is shifting rapidly. First, in 2018 the stock of beneficiaries declined for the fourth year in a row – a sea change in the program’s development (see Figure 5).

Second, since 2001 the DI allowance rate – the fraction of all DI applicants who are ultimately allowed benefits – has declined (see Figure 6). While this decline may in part reflect the impact of the Great Recession (since DI application rates typically rise and allowance rates typically fall during an economic downturn), a regime shift in the adjudication process also may be underway.
Because of these shifts and other considerations, the Social Security Trustees have changed their key assumption regarding DI – namely, the incidence rate (the fraction of individuals insured by DI who are awarded benefits). As shown in Figure 7, the incidence rate is dramatically lower than previously assumed in the short run, and the ultimate assumption has been lowered from 5.4 percent to 5.2 percent. This changing picture contributed to the improvement in the 75-year outlook.

Conclusion

The 2019 Trustees Report confirms what has been evident for almost three decades – namely, Social Security is facing a long-term financing shortfall which equals 1 percent of GDP. The changes required to fix the system are well within the bounds of fluctuations in spending on other programs in the past.

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. The long-run deficit can be eliminated only by putting more money into the system or by cutting benefits. There is no silver bullet.

Figure 7. Disability Insurance Incidence Rates and Assumptions for 2012, 2015, and 2019 Trustees Reports

Sources: 2012, 2015, 2019 Social Security Trustees Reports.
References


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