The Concord Coalition

Lessons from the 2003 Social Security Trustees Report

May 20, 2003

The latest Trustees report on Social Security's financial condition shows that its cash income, mostly from payroll taxes, will cover expenses until 2018, one year later than last year's projection. It also shows that Social Security's trust funds will be depleted in 2042, also one year later than projected last year. At first glance, these new projections might suggest that the need for reform is less urgent. Indeed, release of the Trustees report was greeted with an Alfred. E. Neuman chorus of status quoists singing, "What, me worry?" But those willing to scratch below the surface will find a more unsettling message in the very same document.

A careful reading of the Trustees report reveals that Social Security, as currently designed and financed, cannot be sustained in the long run.

Far from providing a politically convenient excuse to delay reform, the Social Security Trustees report demonstrates that major changes must be made to protect future generations from deep benefit cuts, steep tax increases or crushing debt. The case for reform is not a matter of ideology. It is a matter of simple arithmetic.

Regardless of how Americans feel about specific reform proposals – and there is certainly plenty of room for discussion – we must not ignore the incontrovertible facts:

(1) Social Security's problems begin long before its trust funds become insolvent. While the additional year of trust fund solvency was hailed as "good news" in most media reports, solvency is a very misleading measure of Social Security's long-term fiscal sustainability. The trust funds do not represent a pool of savings that can be drawn down to make benefit payments. They are simply bookkeeping devices and the special issue U.S. Treasury bonds they contain represent nothing more than a promise from one arm of government (Treasury) to pay off IOUs held by another arm of government (Social Security.) Thus, when the Trustees say that Social Security is "solvent" until 2042 they are only saying that the program will have sufficient claims on the Treasury (i.e., taxpayers) to pay full benefits until that date. The more important issue is how much paying off the IOUs is going to cost and whether it is affordable. In 2041, the last year Social Security's trust funds are still projected to be "solvent," the new Trustees report shows that there will be a $366 billion gap between what the government has promised beneficiaries in that year and what it expects to collect in Social Security taxes.[1] To put this in perspective, the cash shortfall in 2041 is projected to be roughly the size of today's entire defense budget. The further out you go, the bigger the deficits become.

What matters in the real world is not some official "solvency" measure but Social Security's operating balance — that is, the annual difference between cash in and cash out. According to the Trustees report, by 2018 Social Security's cash in will no longer exceed the cash out. At that point, the trust fund bonds will need to be converted into cash to pay promised benefits. To do so, Congress will need to cut spending for other programs, borrow from the public, or raise taxes (or some combination of all three.) The key point is that the trust fund assets are also taxpayer liabilities. Their existence does not ease the fiscal challenge of paying future benefits and the addition of another year to the solvency date does not mean that reform is any less urgent.

(2) Long-term deficits far outweigh near-term surpluses. Social Security is generating annual surpluses now, but large and growing deficits loom in the not-too-distant future. Between now and 2018, the program is projected to generate a $1.1 trillion cash surplus. But from 2018 through 2077, the end of the Trustees' 75-year evaluation period, Social Security faces a cumulative cash deficit of $26 trillion. This cumulative cash deficit has been growing, primarily because each new report adds another big deficit year to the end of the 75-year projection. Measured as a share of the U.S economy, (gross domestic product, or "GDP"), the

1 All dollar figures in this brief are measured in constant 2003 dollars unless otherwise noted.

Trustees project that Social Security's annual cash surplus will peak in 2007, the year before the first of the Baby Boomers qualify for early retirement benefits at age 62. Although Social Security's cash flow shortfall is triggered by the Baby Boomers' retirement, it is not a temporary problem that will ease after the last Boomers pass away. Indeed, once Social Security's cash balance starts falling, the Trustees project that it will continue to fall throughout their 75-year projection horizon and beyond.

(3) Doing nothing leads to harsh consequences for future generations. Given the magnitude of the projected Social Security deficits, it is clear that the failure of our nation's lawmakers to enact reforms will have dire consequences for future generations. And yet, the most popular reform plan in Washington seems to be the "Do Nothing Plan." According to the Trustees, doing nothing would result in a 26 percent across-the-board cut in benefits by 2042, or a 34 percent increase in taxes. Borrowing the money to pay benefits would add roughly $7 trillion to the publicly held debt by 2042 and $52 trillion by 2077, including interest. This is an untenable and irresponsible legacy to leave our children.

(4) Social Security is growing faster than the underlying economy. Today, the size of the Social Security program equals approximately 4.4 percent of the U.S. economy (GDP). Without reform, Social Security will consume 6.6 percent of GDP in 2040, an increase of about 50 percent. This growth is due to the rapid aging of America's population. Low birthrates are reducing the relative number of taxpaying workers even as longer life spans are increasing the relative number of beneficiaries. This underlying demographic transformation will soon be accelerated by the retirement of the huge Baby Boom generation.

(5) Social Security is only one part of a much larger fiscal challenge. It is important to consider the Trustees report within the broader context of an aging population. The major demographic transformation that is fast approaching will have profound fiscal and economic consequences that reach far beyond Social Security alone. Between 2000 and 2040, the cost of the three major senior benefit programs (Social Security, Medicare and Medicaid) is due to double relative to the size of the economy, from 7.6 to 15.5 percent of GDP. To get an idea of the magnitude of this number, consider that 15.5 percent of GDP is about three-quarters of what we now devote to the entire budget. Absent reform, all other government spending will have to be slashed or taxes will have to be raised to unprecedented levels. What, me worry?

(6) The unfunded portion of Social Security promises made to current participants equals roughly the size of the U.S. economy. The Trustees report includes a first-time ever official statistic, called the "closed group unfunded liability." This is the one-time lump-sum that the federal government would need to set aside today (and earn interest on) to cover the shortfall between taxes due to be collected from, and benefits due to be distributed to, current Social Security participants—including both those now receiving benefits and those now paying into the program. It measures the burden that paying full benefits to today's adults would place on future generations.

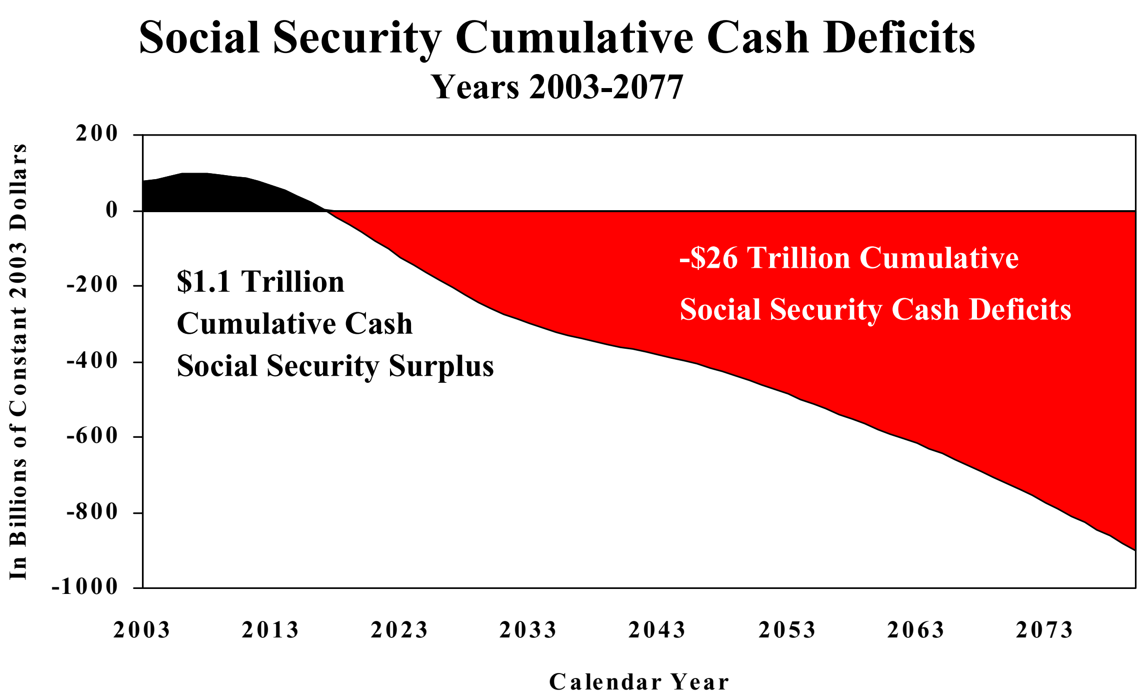
The Trustees estimate that the current closed group unfunded liability is a staggering $10.5 trillion. This is roughly equivalent to the size of the entire U.S. economy. Phrased differently, in order to fulfill all future Social Security promises for current workers and retirees, the federal government would need to dedicate 100 percent of this year's national economic resources—public and private—to the Social Security program. What, me worry?

(7) Procrastination is costly. The Trustees include another new statistic in this year's report: the projected shortfall between Social Security taxes and benefits assuming that the program continues for the indefinite future. This differs from the traditional 75-year actuarial deficit, which looks at the program as if all obligations abruptly cease in 75 years. The Trustees calculate that an immediate and permanent 23-percent across-the-board reduction in benefits would be required to eliminate Social Security's open-group liability — and this assumes that the trust funds represent genuine savings, not unfunded inter-governmental IOUs. Delaying any reform just seven years, however, would require even larger benefit cuts: a nearly 28-percent reduction in benefits for everyone retiring in 2010 or later.

Similarly, an additional 3.8 percentage point increase in the payroll tax rate (from 12.4 percent to 16.2 percent) would eliminate Social Security's open group liability. Deferring any action until 2010, however, would necessitate an increase in the payroll tax rate to 16.6 percent – a 33 percent increase. The lesson to be learned from this is that the longer reforms are delayed the more the burden of reform is shifted to future workers and retirees

(8) The window of opportunity is closing fast. There are just two ways to close Social Security's financing gap without burdening tomorrow's workers and taxpayers: Reduce Social Security's long-term cost, or make the cost more bearable by increasing national savings and hence the size of the economy. A workable plan must do both. Unfortunately, the window of opportunity to gradually phase-in cost saving reforms and prefund a portion of future benefit promises is rapidly closing shut. The obvious way to begin prefunding Social Security is to translate its significant near-term cash surpluses into genuine savings. One possibility is to set up a reserve administered by an independent trustee and invested in marketable securities. Alternatively, Congress could allocate Social Security surpluses to a new system of personally owned worker retirement accounts. Either option would better safeguard the Social Security surplus than a government "lockbox" for which politicians always hold the key. However, if Congress makes up for the foregone revenue by running up the deficit national savings will not rise. Fiscal respons-ibility and Social Security reform are thus intimately linked and cannot be addressed on separate tracks. Moreover, while saving the surpluses can help ease Social Security's burden on the budget and the economy, it is not a magic bullet. Congress will still need to enact reforms that reduce projected benefits or increase dedicated revenues. Instead of using the Trustees report as an excuse to delay reform, policymakers should use it as an opportunity to rally public support for the hard choices needed to place Social Security on a fiscally sustainable path for future beneficiaries and taxpayers alike.

As the non-partisan Trustees of the Social Security Administration state in their report: "The trust fund deficits projected for the longer run should be addressedin a timely way to allow for a gradual phasing in of any necessary changes and to provide advance notice so that workers can adjust their plans to take account of those changes. The sooner adjustments are made, the smaller and less abrupt they will have to be. With informed public discussion and timely legislative action, Social Security will continue to play an important role in the life of virtually every American."



Source: Social Security Trustees