No. 666

April 4, 2000

SOCIAL SECURITY'S TRUSTEES' REPORT SHOWS BIGGER LONG-RUN DEFICIT

DANIEL J. MITCHELL, PH.D.

The just-released annual report of the Social Security Trust Fund's Board of Trustees contains good short-term news but bleak long-term news. On the positive side, the trustees estimate that the program will not begin running annual deficits until 2015, compared with the 2014 estimate in last year's report. They also estimate that the trust fund will accumulate enough government bonds to pay Social Security Old-Age and Survivors and Disability Insurance (OASDI) benefits through 2037—assuming, of course, that future lawmakers are willing to redeem those IOUs by raising taxes, cutting benefits, or issuing new debt.

Unfortunately, the improvement in Social Security's short-term outlook is offset by the continued deterioration of its long-term forecast. Most important, the inflation-adjusted cumulative deficit between 2015 and 2075 is now projected to be $21.6 trillion, up nearly 7 percent compared with last year's projection. More specifically, the new report shows higher deficits every year beginning in 2029.

If lawmakers do not move quickly to modernize the program, Social Security's staggeringly large long-term deficit will require draconian changes in public policy. To pay promised benefits, the OASDI payroll tax rate eventually would need to climb to 18.6 percentage points—49.8 percent higher than the current level. Alternatively, benefits would have to be cut by 32 percent to keep the system in balance during the next 75 years.

Opponents of needed reforms claim that Social Security is in good shape, since the bonds in the trust fund will enable all benefits to be paid until 2037. In reality, however, the trust fund contains nothing but IOUs. As the Clinton Administration explained last year in the fiscal year 2000 budget's *Analytical Perspectives*:

> These [trust fund] balances are available to finance future benefits and other trust fund expenditures—but only in a bookkeeping sense.... They do not consist of real economic assets that can be drawn down in the future to fund benefits. Instead, they are claims on the Treasury, that, when redeemed, will have to be financed by raising taxes, borrowing from the public, or reducing benefits or other expenditures.

Produced by the
Thomas A. Roe Institute
for Economic Policy Studies

Published by
The Heritage Foundation
214 Massachusetts Ave., N.E.
Washington, D.C.
20002–4999
(202) 546-4400
http://www.heritage.org

This paper, in its entirety, can be found at: *www.heritage.org/library/execmemo/em666.html*

What the Report Really Says. Notwithstanding Pollyanna assertions that Social Security is structurally sound, the trustees' report is a combination of distressing statistics and ominous numbers. For instance:

- Social Security spending will exceed projected tax collections in 2015. These deficits will quickly balloon to alarming proportions. Even after adjusting for inflation, annual deficits will reach $100 billion in 2021, $200 billion in 2026, and $300 billion in 2034.

- Between 2015 and 2075, the cumulative unfunded liability in today's dollars is projected to be $21.6 trillion. This is more than six times larger than the national debt and 7 percent larger than last year's estimate. (In nominal terms, the long-run deficit is a stunning $134 trillion.)

- Comparing this year's and last year's reports, the estimated inflation-adjusted deficit in 2075 alone has jumped from $575 billion to $651 billion—an increase of more than 13 percent.

- The real long-term deficit would be even larger than $21.6 trillion if the trustees' report included estimates for the annual deficits after 2075. Between 2065 and 2075, annual inflation-adjusted deficits will climb from $530 billion to $651 billion. Demographic data suggest that the upward trend will continue after 2075.

- According to independent experts, the cumulative shortfall is about $2 trillion worse than the above numbers suggest, since the trustees count the payroll taxes of federal employees as real revenue flows. In reality, no money changes hands. The government simply creates an accounting entry within Social Security that is offset by accounting debits across the federal workforce.

What the Report Means. One thing is clear: Doing nothing is not a responsible option if Social Security is to be preserved for future generations. Delay will simply make the problem worse. To keep the current system afloat without reform, politicians would have to choose from the following unpleasant options:

- Boost the payroll tax by nearly 50 percent, which would mean the burden on workers would rise from 12.4 percent today to nearly 18.6 percent in the future.

- Reduce promised benefits by nearly one-third, cutting future retirement checks by 32 percent.

- Sharply increase the retirement age, forcing workers to pay into the system—and defer collecting full benefits—until they are into their seventies.

None of these options is attractive. Higher tax rates would have an adverse impact on the economy, and benefit reductions would punish those who assume the government would keep its side of the retirement benefits contract. (The Supreme Court has ruled that workers have no right to promised Social Security benefits.) Perhaps more important, while all of these options—at least on paper—could solve Social Security's looming financial crisis, they all would exacerbate its other crisis by making the program an even worse deal for workers. More specifically, raising taxes or cutting benefits means that Social Security's already meager "rate of return" would decline further. For some groups that are already disadvantaged by the current system because of shorter life expectancies, such as African–Americans, the return on payroll taxes would drop well below zero.

The only way to solve Social Security's two crises simultaneously is to allow workers to shift some portion of their payroll taxes into personal accounts. This would reduce the program's long-run deficit, since workers would be able to retire using the funds they accumulate in their private accounts. And since these accounts would take advantage of the compounding returns of private investment, workers would enjoy a safer and more comfortable retirement. The trustees' report shows that only structural reform of this kind can save the program.

—Daniel J. Mitchell, Ph.D., is McKenna Senior Fellow in Political Economy in the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation.

NOTE: Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.