WebMemo
Published by The Heritage Foundation

No. 1429
April 24, 2007

2007 Social Security Trustees Report Shows the Urgency of Reform

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"There are risks and costs to action. But they are far less than the long range risks of comfortable inaction."

—John F. Kennedy

"We are increasingly concerned about inaction on the financial challenges facing the Social Security and Medicare programs. The longer we wait to address these challenges, the more limited will be the options available, the greater will be the required adjustments, and the more severe the potential detrimental economic impact on our nation."

—2007 Trustees Report

The 2007 Social Security Trustees Report was released on April 23. This briefing explains the important facts and answers the frequently asked questions about Social Security's financial outlook.

How will this report affect the Social Security debate?

The debate about whether Social Security faces a problem and needs to be fixed is over. The 2007 Trustees Report shows that the program faces massive annual deficits starting in just 10 years. Now is the time to focus on solutions. Several plans to establish personal retirement accounts have been shown to fix Social Security. Instead of just criticizing these plans, personal account opponents need to propose comprehensive programs that permanently fix Social Security. Opposing a potential solution is not the same thing as coming up with a plan.

Has the size of the Social Security problem changed over the last year?

- In net present value terms, Social Security owes $6.8 trillion dollars more in benefits than it will receive in taxes. That number includes $2.0 trillion, in net present value terms, to repay the bonds in Social Security's trust fund. This $300 billion increase is almost 4.5 percent higher than last year's $6.5 trillion number. The 2007 number consists of $2.0 trillion to repay the special issue bonds in the trust fund and $4.8 trillion to pay benefits after the trust fund is exhausted in 2041.

  Net present value measures the amount of money that would have to be invested today in order to have enough money on hand to pay deficits in the future. In other words, Congress would have to invest $6.8 trillion today in order to have enough money to pay all of Social Security's promised benefits between 2017 and 2081. This money would be in addition to what Social Security receives during those years from its payroll taxes.
- The Trustee Report's perpetual projection extends beyond the usual 75-year planning hori-

This paper, in its entirety, can be found at:
www.heritage.org/research/SocialSecurity/wm1429.cfm

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

Published by The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002–4999
(202) 546-4400 • heritage.org

zon. In net present value terms, the perpetual projection is $13.6 trillion, including money necessary to repay bonds in the trust fund. Last year's number was $13.4 trillion. This means that the net present value deficit of Social Security after 2081 is $8.9 trillion. These projections show that Social Security's total deficit continues to grow well beyond the 75-year projection period. Any reform that just eliminates deficits over the 75-year window will not be sufficient to solve the program's problems.

This is important because many opponents of reform claim that raising payroll taxes by about 2 percent, the average percentage difference between revenues and outlays over the 75-year period, would solve Social Security's problems. The reality, however, is that the program's future deficits are projected to be large *and* growing so that this tax increase would still leave a huge shortfall. These new projections should end the claims that Social Security's impending financial crisis can be resolved with modest changes to the current system.

- In actuarial terms, Social Security's long term financing appears to have improved from a 75-year deficit of 2.01 percent of taxable payroll in last year's report to a deficit of 1.95 percent. However, a closer examination shows that almost all of that improvement comes from changes in the Disability Insurance program. The actuarial deficit of Social Security's retirement and survivors program actually worsened, going from a 1.68 percent deficit to a 1.69 percent deficit.
- Social Security spending will exceed projected tax collections in 2017. These deficits will quickly balloon to alarming proportions. After adjusting for inflation, annual deficits will reach $67.8 billion in 2020, $266.5 billion in 2030, and $330.9 billion in 2035.

Is the important year to consider 2041, 2017, or 2009?

The year when Social Security begins to spend more than it takes in, 2017, is by far the most important year. From that point on, Social Security will require large and growing amounts of general revenue money in order to pay all of its promised benefits. Even though this money will technically come from cashing in the special issue bonds in the trust fund, the money to repay them will come from other tax collections or borrowing. The billions that go to Social Security each year will make it harder to find money for other government programs or require large and growing tax increases.

A second important year is 2009. Starting in just two years, the annual Social Security surpluses that Congress has been borrowing and spending on other programs will begin to shrink. From that point on, Congress will have to find other sources to replace the money that it borrows from Social Security or shrink spending. By 2017, Congress will have about $100 billion less to spend annually.

Compared to these two dates, 2041—the year that the Social Security trust fund runs out of its special issue bonds—has little importance. Even though the end of those bonds will require a 25 percent benefit reduction, Congress would have been paying over $300 billion a year (in 2007 dollars) to repay those bonds for about 7 years by the time the trust fund runs out. Congress will have to do this through some combination of other spending cuts, new taxes, or additional borrowing. These are the same choices Congress would face without the trust fund.

Did politics influence the trustees report?

No. Social Security Administration Chief Actuary Stephen Goss and his staff of non-partisan experts produce the numbers in the Trustees Report. They are respected professionals who never have been, and are not, subject to political pressure. Goss has been at SSA since 1973 and is internationally respected. Although members of the President's cabinet serve as trustees, they have little influence over the numbers. The 2007 numbers are substantially similar to those in the Trustees Reports issued during the Clinton Administration.

When will Social Security begin to run a cash-flow deficit?

According to the 2007 Trustees Report, the year that Social Security will begin to spend more in benefits than it receives in payroll taxes remains at 2017—the same as in last year's report. The year the "trust fund" is exhausted also moves back a year to 2041 from last year's 2040, but this change has little significance to the program's unsustainability.

What are the operating numbers from the current year?

The Trustees Report includes detailed information about the aggregate amount of payroll taxes paid in the previous calendar year and the aggregate amount of benefits paid in that year. It also includes data on operating expenses. In 2006, the Old-Age and Survivors Trust Fund, which pays for retirement and survivors' benefits, took in $642.2 billion and paid out $461.0 billion. Its annual surplus was $181.3 billion, but only $89.5 billion of that came from payroll tax receipts. The remaining $91.8 billion of the surplus came from a paper transaction that credited interest to the trust fund.

What does it all mean?

- **Good news for seniors.** The benefits of current retirees and those close to retirement remain completely safe. The 2007 report shows that the program will have enough resources to pay full benefits until 2017. Despite political scare tactics, seniors can rest assured that their benefits are safe and that they will receive every cent that they are due, including an annual cost-of-living increase.
- **Bad news for younger workers.** Unfortunately, younger workers have a great deal to worry about. Even though their parents' and grandparents' benefits are safe, theirs are not. Any worker born after 1974 will reach full retirement age after the trust fund is exhausted. Unless Congress acts soon, younger workers can look forward to paying full Social Security taxes throughout their careers but only receiving 75 percent or less of the benefits that have been promised to them. In addition, they will have to repay the Social Security trust fund, an expense that will total almost $6 trillion by the time the trust fund is exhausted in 2041.
- **Social Security must be reformed.** Today's Social Security cannot last. The report shows that there is a 95 percent chance that Social Security will run multi-billion-dollar annual deficits starting in about 2017. The system has promised trillions of dollars (in 2007 dollars) more in benefits than it will have the ability to pay. Just repaying Social Security's trust fund will cost about $6 trillion by the time the trust fund is exhausted in 2041.
- **Delay makes it even harder to reform Social Security.** Every year, there is one less year of surplus and one more year of deficit. Once those deficits start in 2017, the Trustees Report shows that they will never end. Each year, with the disappearance of another year of surplus, reforming Social Security gets more expensive.
- **Delay will make it harder to run the rest of the government.** If Social Security is not reformed, by 2041 it will require about 13 percent of all income taxes collected that year, in addition to what the program would receive from its payroll taxes, to pay all promised benefits, and its draw on the general budget will continue to grow. This will make it much harder for our children and grandchildren to pay for government programs dealing with national security, health, education, and the environment.
- **Delay makes massive tax increases much more likely.** The 2007 report shows that Social Security will begin to run cash flow deficits in about 10 years. However, of the three general ways to fix Social Security, two, changing benefits and establishing Social Security accounts, will take years to have a real effect. Accounts of any size need to grow for about 20 to 25 years before they are large enough to pay much in the way of retirement benefits. Benefit changes are politically feasible only if current retirees and those close to retirement are not affected, which means that it would be at least 10 years or more before changes start to take effect. On the other hand, some prefer tax increases because they would immediately pump money into Social Security. But that band-aid would just delay the start of real long-term reform and make it much more likely that Congress would keep taking the easy way out by raising taxes.
- **Include a personal savings element.** Allowing American workers to save and invest a portion of their income in accounts that they would own is the lowest cost way to ensure that they have an

adequate retirement income. The alternative is a combination of benefit cuts and tax increases. Without personal retirement accounts, workers will end up paying more taxes for less benefits.

False lessons that should be avoided

- **Social Security's problems are so far in the future that we don't need to worry about them.** It takes about 22 years to grow a taxpayer. Almost every new taxpayer who will begin a career after graduating from college in 2025 is living today and can be counted. Similarly, everyone who will receive Social Security retirement benefits in the year 2040 is alive, and most of them are paying taxes. Social Security's problems are based on demographics, which do not change from year to year. The people who will be hurt if nothing is done to fix Social Security are not unknown people of the future. They are our children and grandchildren of today.
- **Repealing President Bush's tax cuts will make it easier to pay for Social Security.** Repealing tax cuts today will not make it easier to pay for Social Security in the future. Social Security does not need any additional cash to pay benefits for about another 10 years. During the interim, Congress would just spend the additional money on new programs, and by the time it might be used to pay benefits, every dollar would be committed to new "essential" programs that cannot be cut.

Background Information

What is the Trustees Report?

The Social Security Act requires the Trustees of the Social Security trust funds to issue an annual report on the financial status of those trust funds. This report includes not only current financial information, but also projections about the funds' ability to finance promised benefit payments in the future. If the report shows that the trust funds will be unable to finance all of these payments (as all recent reports have), the law requires the Trustees to recommend ways to make up the shortfall. However, this requirement is regularly ignored.

The Trustees include the Secretaries of Treasury, Labor, and Health and Human Services, the Social Security Administration Commissioner and Deputy Commissioner, and two public trustees appointed by the President and confirmed by the Senate. The public trustees are Thomas R. Saving of Texas A & M University and John L. Palmer of Syracuse University. They were nominated to a four-year term by former President Bill Clinton in 2000 and approved by the Senate later that year. Both public trustees were nominated for a second term, but after the Senate refused to consider the nominations, President Bush gave them both recess appointments that extended their terms until December of this year.

The 2007 report is the sixth to include the full input of these public trustees and continues to include a great deal of additional information that was not available in previous reports. Both trustees have spoken about the need to include more and clearer information so that the public can fully understand the state of the Social Security trust fund and the financial challenges that lie ahead. This year's report again shows the value of their efforts.

Social Security's three scenarios for the future

The Trustees use three scenarios to project Social Security's financial future. The middle scenario, called the "intermediate projection," is the most likely to occur. That is the reason that it is usually cited. The Trustees also include both a more optimistic projection and a more pessimistic projection. Although all three are listed, it is not correct to assume that there is an equal chance that each might occur. In fact, there is a less than five percent chance that either of the other two scenarios will occur.

What's missing from the report?

- **A measure of workers' rate of return.** The Trustees Report does not include any measure of what workers actually receive for their payroll taxes. The best way to accomplish this would be to include a chart that plots implicit rates of return by birth year. Similar to a chart found in the Government Accountability Office's August 1999 report on Social Security's rate of return, this chart would illustrate to Americans that the rate of return from Social Security has steadily and dramatically decreased. For instance, GAO's chart shows that a worker born around 1920 could expect a rate of return from Social Security taxes of about 7 percent after inflation. A worker born in mid-1980s, however, could expect a return of less than 2 percent. If they were provided with these figures, workers would see that, unless the current system is reformed, they can expect lower returns on their taxes than their parents and grandparents received. More important, they would see that their children and grandchildren will receive even less from Social Security.

- **Information on the nature of its trust funds and how they differ from private-sector trust funds.** The Office of Management and Budget explained in its fiscal year 2000 budget document that the Social Security "trust funds" do not contain stocks, bonds, or other assets that could be sold directly for cash. Unlike private-sector trust funds, the Social Security trust funds contain only IOUs that will have to be paid back with future taxes. As OMB noted,

> These balances are available to finance future benefit payments...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.

How does Social Security operate?

For a briefing on how Social Security operates, how the trust fund works, how benefits are calculated, and other features of the current system and reform options, see The Heritage Foundation *WebMemo* No. 143 "Social Security Basics" at *www.heritage.org/Research/SocialSecurity/wm143.cfm*.

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