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2010 Social Security Trustees Report: Reform Needed Now

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Abstract: *The 2010 annual report by the Social Security trustees has been released. It comes as no surprise that the Trustees Report predicts massive—and permanent—yearly deficits if the Social Security system is not reformed. Though the report shows that Social Security payments are secure for another five years, Social Security already owes $7.9 trillion more in benefits this year than it will receive in tax revenues. The time for reform is now—delay will only make each challenge and problem harder to fix. Heritage Foundation financial and pension expert David C. John examines the findings of the new Trustees Report—and explains what they mean for Americans.*

The debate about whether Social Security needs to be fixed is over. The 2010 Social Security Trustees Report, released on August 5, shows that the program faces massive permanent annual deficits starting in just five years. Now is the time to focus on solutions. Instead of blindly defending the current program,[1] both Congress and the Administration need to propose comprehensive programs that fix Social Security—permanently. (Opposing a potential solution is not the same as coming up with a plan.)

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. The report includes not only current financial information but also projections about the funds' ability to finance

Talking Points

- Social Security will run cash-flow deficits this year and in 2011 due to the effects of the recession.
- Starting in 2015, the program will begin to run permanent deficits that will require hundreds of billions of dollars from general revenues to fill. Social Security's trust funds will enable it to pay full benefits until 2037, but that money must come from general revenues.
- Over the next 75 years, Social Security owes about $7.9 trillion more than it will receive from payroll taxes.
- The longer Congress delays fixing Social Security, the more expensive the reforms will be, and the higher the probability that Congress will simply raise taxes to cover the program's deficits.
- If younger workers are to be served by Social Security in the same manner as their parents and grandparents, Congress must fix Social Security now.

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promised benefit payments in the future. If the report shows that the trust funds will be unable to finance all of these payments (which is the case in all recent reports), 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 the 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. Currently, the two public trustee spots are vacant, but President Obama has nominated Charles P. Blahous III and Robert D. Reischauer for the positions.

Three Scenarios for the Future of Social Security. The trustees use three scenarios based on differing assumptions about the economy and other factors to predict Social Security's financial future. The middle scenario, called the "intermediate projection," is the most likely to occur, and is usually cited when discussing the future of Social Security. Although the trustees also include a more optimistic projection and a more pessimistic projection, there is a 95 percent chance that the intermediate projection will occur.

Changes Since 2009

The 2010 report shows that over the next 75 years, Social Security owes $7.9 trillion more in benefits than it will receive in tax revenues. The 2010 number consists of $2.5 trillion to repay the special issue bonds in the trust funds and $5.4 trillion to pay benefits after the trust funds are exhausted in 2037. This is an increase of $0.1 trillion from last year's report, but that number reflects several changes to assumptions and methodology. Otherwise, the unfunded liability for benefit payments after the trust funds are exhausted would have risen to about $5.7 trillion, mainly due to adding the year 2084, in which the program is predicted to run a massive deficit, into the calculation period.

A key change in this year's report is that Social Security is predicted to run cash-flow deficits in both 2010 and 2011 due to the effects of the recession. The recession has increased the amount of benefits paid out by Social Security as older workers who have lost their jobs file for benefits earlier than they might have otherwise. At the same time, both they and younger unemployed workers are unable to pay Social Security taxes, while workers

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who suffer a drop in their income will pay lower amounts. The 2010 and 2011 cash-flow deficits will have the effect of reducing the revenues that are paid into the trust funds. Although this year's report predicts that Social Security will subsequently have cash-flow surpluses of between $2 billion and $5 billion from 2012 to 2014, if the heightened unemployment continues, those surpluses may not materialize.

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 $7.9 trillion today in order to have enough money to pay all of Social Security's promised benefits between 2015 and 2084. This money would be *in addition* to what Social Security receives during those years from its payroll taxes.

The Trustees Report also includes a perpetual projection that extends well beyond the usual 75-year planning horizon. In net present value terms, the perpetual projected unfunded liability is $16.1 trillion, including money necessary to repay bonds in the trust fund. Last year's number was $15.1 trillion. If the same assumptions and other details were the same as last year, this year's number would still have grown to $15.9 trillion. This means that the

1. For a briefing on how Social Security operates, how the trust funds work, how benefits are calculated, and other features of the current system and reform options, see "Social Security Basics," Heritage Foundation *WebMemo* No. 143, September 12, 2002, at *http://www.heritage.org/Research/Reports/2002/09/Social-Security-Basics*.

net present value of Social Security's unfunded liability after 2084 is $8.2 trillion. These projections show that Social Security's total deficit continues to grow well beyond the 75-year projection period. Any reform that eliminates deficits only for the 75-year window will not be sufficient to solve the program's fiscal problems.

In actuarial terms, Social Security's long-term financing improved slightly from a 75-year deficit of 2 percent of taxable payroll in last year's report to a deficit of 1.92 percent. Many opponents of reform claim that raising payroll taxes by about 2 percent (which in theory would close 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 this tax increase would still leave a massive 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.

Social Security spending will exceed projected tax collections in 2015. These deficits will quickly balloon to alarming proportions. After adjusting for inflation, annual deficits will reach $78.3 billion in 2020, $267.5 billion in 2030, and $317.3 billion in 2035.

Because a significant proportion of the deficits that Social Security is predicted to run in 2010 and 2011 stem from the effects of the recession, the system is likely to return to small surpluses once the economy begins to recover. Although at that point, some will claim that the improvement "proves" the viability of the current system, the reality is that Social Security's outlook remains clouded by perpetual deficits that will begin about 2015.

Which Year Counts Most—2010, 2015, or 2037?

The year when Social Security begins to permanently spend more than it takes in—2015—is the crucial 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 funds, the money to repay those bonds 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, thus requiring large and growing tax increases.

Projections show that Social Security's total deficit will continue to grow well beyond the 75-year projection period.

The second-most important year is 2010. Beginning this year, the annual Social Security surpluses that Congress has been borrowing in order to spend on other programs will disappear. Because the recession has both reduced Social Security payroll tax revenues and increased the amount of payments, Congress will have to either find other sources to replace the money that it borrows from Social Security, or scale back spending. This year, Social Security will have a cash-flow deficit of about $41 billion, followed with a predicted deficit of $7 billion next year. Although the Trustees Report predicts small surpluses for 2012 through 2014 as the economy recovers, Social Security surpluses can no longer be used to mask the real size of the deficit and finance other spending.

Compared to 2010 and 2015, 2037—the year in which the Social Security trust funds run out of special issue bonds—has little importance. Even though the end of those bonds will require a 22 percent benefit reduction, Congress would have been paying about $250 billion a year (in 2010 dollars) to repay those bonds for about seven years by the time the trust funds run 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 existence of the trust funds.

Do Politics Influence the Trustees Report?

No. Social Security Administration (SSA) Chief Actuary Stephen Goss and his staff of non-partisan experts are the source for the data in the Trustees Report. They are respected professionals who never were, and are not now, subject to political pressure.

Goss has been at SSA since 1973 and is internationally renowned. Although members of the President's Cabinet serve as trustees, they have little influence over the numbers. The 2010 numbers are substantially similar to those in the Trustees Reports issued during the Clinton and both Bush Administrations.

When Will Social Security Begin to Run a Cash-Flow Deficit?

According to the 2010 Trustees Report, the year that Social Security will begin to spend more in benefits than it receives in payroll taxes is 2015—one year sooner than predicted in last year's report. The year the "trust funds" are exhausted remains at 2037, the same as in last year's report.

OASI Operating Numbers for 2010

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 2009, the Old-Age and Survivors Insurance (OASI) Trust Fund, which pays for retirement and survivors' benefits, took in $698.2 billion and paid out $564.3 billion. Its annual surplus was $133.9 billion, but only $26 billion of that came from payroll tax receipts. The remaining $107.9 billion of the surplus came from a paper transaction that credited interest to the trust fund.

What It All Means

- **Good news for seniors.** The benefits for current retirees and those close to retirement remain completely safe. Even allowing for the predicted cash-flow deficits this year and next, the 2010 report shows that the program will have enough resources to pay full benefits until 2015. Despite political scare tactics, seniors can rest assured that their benefits are safe for five more years 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. Any worker born after 1970 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 only to receive 78 percent or less of the benefits that have been promised to them. In addition, younger workers will have to pay to re-fund the surpluses that have been borrowed from the Social Security trust fund, an expense that will total almost $6 trillion by the time the trust fund is exhausted in 2037.
- **Social Security must be reformed—now.** Today's Social Security program cannot last. The report shows that there is a 95 percent chance that Social Security will run permanent annual multi-billion-dollar deficits starting around 2015. The system has promised trillions of dollars more in benefits than it will have the ability to pay.
- **Delay makes reform harder.** Every year, there is one year less of surplus and one year more of deficit. The Trustees Report demonstrates that once those permanent deficits start in 2015, they will never end. Each year, reforming Social Security becomes more expensive.
- **Delay makes running the rest of the government harder.** If Social Security is not reformed, by 2037 Social Security will require more than 10 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 hikes much more likely.** The 2010 report shows that Social Security will begin to run permanent cash-flow deficits in about five years. However, of the three general ways to fix Social Security, two (changing benefits and establishing Social Security personal retirement 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 before changes take effect. While tax increases would immediately pump money into Social Security, that Band-Aid

would just delay the start of real long-term reform and make it much easier for Congress to continue taking the easy way out.

- **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. Increasing the ability of workers to save for retirement will reduce their dependence on Social Security and allow them to increase retirement security.

Social Security Myths

- **Social Security's problems are so far in the future that Americans need not 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 2031 is living today and can be counted. Similarly, all Americans who will receive Social Security retirement benefits in the year 2040 are alive now, and most of them are paying taxes. Social Security's funding 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 strangers in the future: They are our children and grandchildren.
- **Letting the 2001 and 2003 tax cuts expire will make it easier to pay for Social Security.** Allowing those tax cuts to expire 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 five 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.

What Is 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 such a measurement 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 (GAO) 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, the GAO 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 the mid-1980s, however, could expect a return of less than 2 percent. If 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 the Social Security trust funds and how they differ from private-sector trust funds.** The Office of Management and Budget (OMB) 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.[2]

Conclusion

Social Security has served past generations well, and helped to significantly reduce the number of retirees forced to live in poverty. But its pending deficits mean that younger workers cannot receive

2. Office of Management and Budget, *Analytical Perspectives, Budget of the United States Government, Fiscal Year 2000* (Washington, D.C.: U.S. Government Printing Office, 1999), p. 337.

the same level of benefits as their parents and grandparents did. Congress must fix Social Security now. Delay will only raise the cost of reforms and make it much more likely that Congress will resort to tax increases instead of the kind of fundamental reforms that are needed to enable Social Security to serve younger workers as well as it served older generations.

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