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2010 Social Security Trustees Report Continues to Show 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 2010 Social Security Trustees Report was released on August 5. This paper 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 2010 Trustees Report shows that the program faces massive permanent annual deficits starting in just five years. Now is the time to focus on solutions. Instead of just blindly defending the current program, both Congress and the Administration 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 $7.9 trillion more in benefits than it will receive in taxes. The 2010 number consists of $2.5 trillion to repay the special issue bonds in the trust fund and $5.4 trillion to pay benefits after the trust fund is 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 fund is exhausted would have risen to about $5.7 trillion, mainly due to adding 2084—a year in which the system 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 on its finances. The recession increases the amount of benefits paid out by Social Security as older workers who have lost their jobs choose to 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 who suffer a drop in their

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income pay lower amounts. This will have the effect of reducing the revenues that go to the trust fund. Although this year's report predicts that Social Security will subsequently have cash-flow surpluses of between $2 billion to $5 billion in 2012–2014, 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's perpetual projection extends beyond the usual 75-year planning horizon. In net present value terms, the perpetual projection is $16.1 trillion, including money necessary to repay bonds in the trust fund. Last year's number was $15.1 trillion. If the 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 net present value deficit of Social Security 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 just eliminates deficits over the 75-year window will not be sufficient to solve the program's problems.

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 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 improved very slightly from a 75-year deficit of 2.0 percent of taxable payroll in last year's report to a deficit of 1.92 percent.

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 come 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.

Is the Important Year to Consider 2037, 2015, or 2010? The year when Social Security begins to permanently spend more than it takes in, 2015, 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 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 or require large and growing tax increases.

A second important year is 2010—this year. Starting now, the annual Social Security surpluses that Congress has been borrowing and spending on other programs will disappear. Because the recession has both reduced Social Security payroll tax revenues and increased benefit payments, Congress will have to either find other sources to replace the money that it borrows from Social Security or shrink spending.

This year, Social Security will actually have a cash-flow deficit of about $41 billion, followed by a predicted deficit in 2011 of $7 billion, and although it is predicted to have 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 these two dates, 2037—the year that the Social Security trust fund is projected to run out of its special issue bonds—is of 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 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.

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 in last year's report. The year the "trust fund" is exhausted is 2037, the same as in last year's report.

What Are the Old Age Survivors' Insurance 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 2009, the Old-Age and Survivors 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 Does It All Mean?

Good News for Seniors. The benefits of 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 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 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 but receiving only 78 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 2037.

Improving Retirement Savings Is a Must. 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 for retirement income and enable them to increase retirement security.

The Crisis Is Here Now. It takes about 22 years to grow a taxpayer. Almost every new taxpayer who will begin a career after graduating from college in 2032 is living today and can be counted. Similarly, all people who will receive Social Security retirement benefits in the year 2040 are alive now, 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.

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