



# COMMITTEE on WAYS and MEANS

## Social Security Watch

### A Guide to the 2013 Social Security Trustees Report By Charles Blahous

Friday, June 07, 2013

Like

8 people like this. [Sign Up](#) to see what your friends like.



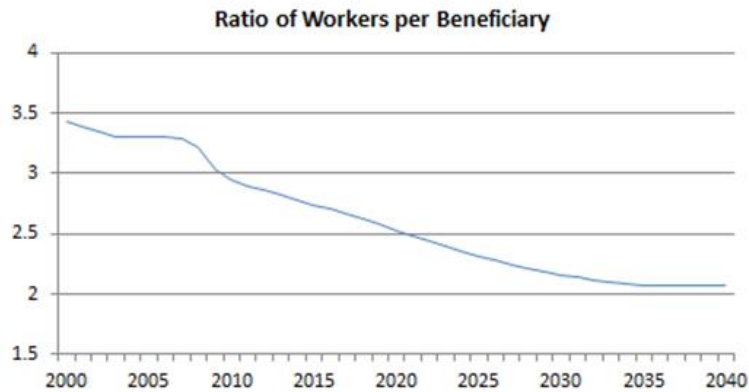
The Social Security and Medicare trustees released our [annual reports](#) last Friday, May 31. These reports set forth the state of program finances as required under the [Social Security Act](#). There are six trustees; four of them (the Secretaries of Treasury, HHS and Labor as well as the Social Security Commissioner) serve by virtue of their government offices. The other two, of which am I one, are members of the public nominated by the President and confirmed by the US Senate. I have adopted the custom of publishing a short summary of each report just after it is released. This year's Social Security report summary will roughly follow the format of [last year's](#), condensing the report's fuller information into a few critical points.

*Social Security faces a large and increasingly immediate financing shortfall necessitating prompt legislative corrections*. Social Security holds two trust funds. Its Old-Age and Survivors (OASI) Trust Fund finances what we generally think of as retirement benefits (as well as benefits for so-called non-working spouses, widowed spouses and surviving children); the Disability Insurance (DI) Trust Fund finances disability benefit payments. Although it has become common practice to reference Social Security's finances as a combined whole, under [law](#) benefits in each portion of the program can only be paid from its respective trust fund. Each trust fund must maintain a positive balance of reserves to avoid an interruption in benefit payments.

Under our current projections the DI Trust Fund will be depleted in 2016. We estimate that at the point of depletion, there will only be sufficient funds to pay 80% of disability benefits. 2016 was also our projection last year, but a critical difference in this year's report is that we have lost a good portion of our remaining time to deal with the problem. In the absence of legislation, payments for the disabled will be cut by an estimated 20% in three years.

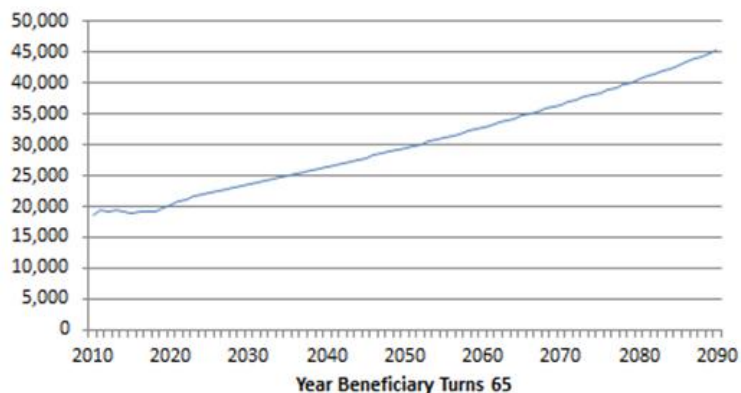
*The shortfall facing Social Security as a whole arises primarily from demographic factors interacting with the program's benefit formula and financing method*. Zooming out from the DI Trust Fund to Social Security as a whole, there are three factors that drive its shortfall. The first is demographic; the number of beneficiaries is growing rapidly relative to the number of taxpaying workers.

## Demographics: Fewer Workers to Support Each Beneficiary



Second, real per-capita program payments are rising under current benefit formulas.

## Per-Capita Payments Rising Under Current Benefit Formula (Scaled Medium Earner, Initial Annual Retirement Benefit in \$2013)



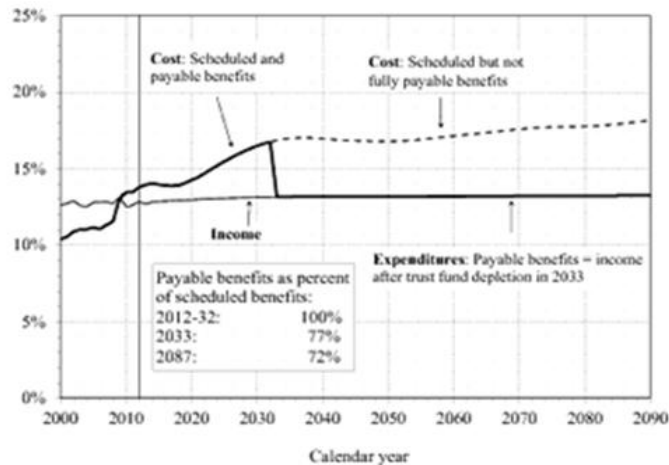
And third, the program is financed on a pay-as-you-go basis, meaning that each generation's benefits are paid for the most part from the tax contributions of the following generation, rather than saving those contributions to finance future payments. Such a financing method is very sensitive to changes in the ratio of taxpaying workers to recipient beneficiaries.

If any of these three factors were absent we would not now face a shortfall. The program's current benefit formula and financing method would both be sustainable with a stable tax rate were it not for the increase in the number of beneficiaries relative to taxpayers. Similarly, even with our current demographics and financing methods, Social Security would not now face a shortfall had not a significant benefit expansion and new indexation method been introduced in the 1970s. And finally, even with our current tax rates, benefit schedules and demographics, the system would be sustainable if individuals' tax contributions were saved to finance their own future retirements, rather than tapped to pay benefits previously promised to older generations. It's the collision of demographics, benefit growth and program financing methods that has put us where we are.

The following graph from the trustees' report shows projected operations for Social Security if viewed as a combined trust fund. The growth depicted in the cost line looks like an upside-down version of the earlier graph showing the declining ratio of workers to beneficiaries, highlighting the critical role of demographics.

## Social Security Tax Income and Expenditures

(Hypothetical Combined Trust Funds, as % of Taxable Worker Wages)



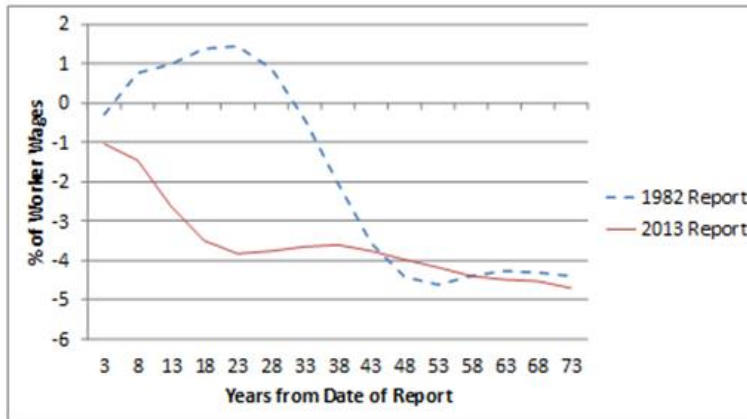
*We are running out of time to fix Social Security's finances without abandoning its historical financing structure.* Continuing Social Security's historical "earned benefit" construct and self-financing structure is only possible if lawmakers are willing to assess payroll taxes at levels sufficient to finance scheduled benefits. If they aren't willing to do that then another financing mechanism will need to be found, such as doing away with the program's contribution-benefit link altogether and directly subsidizing the program with income taxes from the general fund.

We are already at the point where it is open to serious question whether Congress and the President will prove willing to balance the program's books without turning to such changes. If and when such changes occur, Social Security [will no longer be](#) quite the same program it has been; instead of one in which it is perceived that workers in the aggregate have paid for their benefits, it would more likely become a means-tested program, as are other general revenue-financed programs such as welfare and parts of Medicare.

For perspective, consider that the current Social Security shortfall is now much larger than the one addressed in 1983. To resolve the 1983 crisis, legislators had to do many difficult things, including: delay COLAs by six months, expose benefits to taxation for the first time, bring newly hired federal employees into the system, raise the retirement age, and accelerate a previously-enacted increase in the payroll tax. A solution enacted today would need to allocate nearly twice as much pain among beneficiaries and taxpayers; a solution much further delayed would have to allocate still more.

## Social Security's Current Shortfall Is Nearly Twice as Large as during 1982-83 Crisis

(Projected annual balances, 2013 vs. 1982 reports)



The Trustees' Report explains how the problem will essentially become insoluble if lawmakers wait until 2033 draws near to address it. By 2033, scheduled benefits could only be paid by raising tax revenues by the equivalent of an increase in the current tax rate from 12.4% to 16.5% – an increase of nearly one-third in worker tax burdens. Avoiding a tax increase would require cutting costs by the equivalent of a 23% across-the-board benefit reduction – one that would apply regardless of the beneficiary's income level or whether she had been already been dependent on benefits for decades. If alternatively Congress does not want to slash benefits for everyone already receiving them, even 100% elimination of benefits for those newly eligible in 2033 would be insufficient to close that year's shortfall. In sum, by 2033 the game is basically over. The window of opportunity to deal realistically with Social Security finances is actually in the process of closing now.

That the situation will become untenable with too much further delay is well understood by Social Security experts in both parties, and is one reason why all six trustees again joined this year in stating that lawmakers should correct this situation “[as soon as possible](#).” Occasionally, however, one sees expressions of mock ignorance from commentators who profess not to understand these consequences of delay. One such [columnist](#) recently wrote:

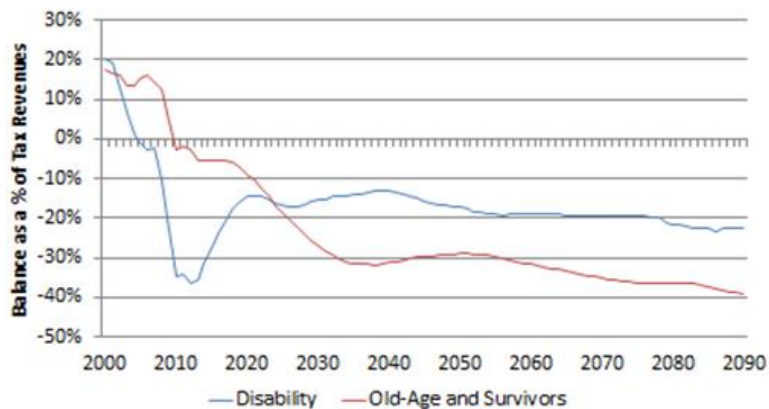
“the usual suspects insist that we must move right now to reduce scheduled benefits. But I’ve never understood the logic of this demand. The risk is that we might, at some point in the future, have to cut benefits; to avoid this risk of future benefit cuts, we are supposed to act pre-emptively by...cutting future benefits. What problem, exactly, are we solving here?”

This issue is actually not that difficult to understand; if we spread a certain amount of required savings over twenty more years' worth of retiree and taxpayer cohorts, each will be affected less than if we try to load the entire financing burden onto the unlucky system participants of 2033. As our report summary notes, moving sooner would allow us to “ameliorate any adverse impacts on vulnerable populations, including lower-income workers and people already dependent on program benefits.” If we continue to delay, such protections won't be possible.

*Simply reallocating taxes from Social Security's OASI trust fund to its DI trust fund is a sub-optimal response to DI's projected depletion in 2016 . [Some](#) have argued that DI's projected 2016 depletion need not require any near-term response stronger than simply moving some tax revenue from Social Security's OASI fund to its DI fund.*

Reallocating the taxes between the two trust funds would indeed make perfect sense if the OASI fund were on better long-term footing than the DI fund, but it's not. Under our projections OASI actually faces the larger long-term deficit, even relative to its larger tax base.

**Even Relative to its Larger Size, the OASI (Retirement)  
Trust Fund's Long-term Shortfall Is Larger**  
(Annual cash balances as a % of tax revenues)



The DI trust fund's shortfall is more immediate primarily because the baby boomers hit the disability rolls before they hit the retirement rolls. As boomers age, more of them are automatically being converted by law from disability beneficiaries into retirement beneficiaries. Thus moving tax revenue from OASI to DI would deprive the retirement side of tax revenue at the precise moment that the boomers are moving onto it in droves. The best answer is to shore up both the disability and old-age trust funds simultaneously so that Social Security's largest trust fund is not weakened in the process.

Political advice is out of my lane, but I also believe that the politics of a tax reallocation are likely to be more difficult than some assume. Americans are generally aware that Social Security faces a financial shortfall. At the same time there is a widely-shared sense, accurate or not, that Social Security retirees have in some way individually earned or paid for their benefits while Social Security's disability benefit is more of a true insurance program. Taking tax revenue away from the retirement side of Social Security, even to finance benefits for a sympathetic disabled population, automatically reduces the "earned" benefits retirees get back for their contributions, a step warranting caution.

**Conclusion :** The Social Security financing shortfall has ceased to be a long-term issue and has become a near-term problem. Its most immediate manifestation is the threat of 20% reductions in disability payments within just three years. Social Security's total financing shortfall is now larger than it has been at any point since the 1983 reforms, and indeed now requires legislative corrections more severe than those enacted at that time. As legislators address this problem, they should be wary of sidestepping problems in Social Security's disability trust fund by further weakening the financial condition of its retirement trust fund.

*Charles Blahous is a research fellow with the Hoover Institution, a senior research fellow with the Mercatus Center, and the author of [Social Security: The Unfinished Work](#).*

###

