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WHAT THE 2008 TRUSTEES' REPORT SHOWS ABOUT SOCIAL SECURITY

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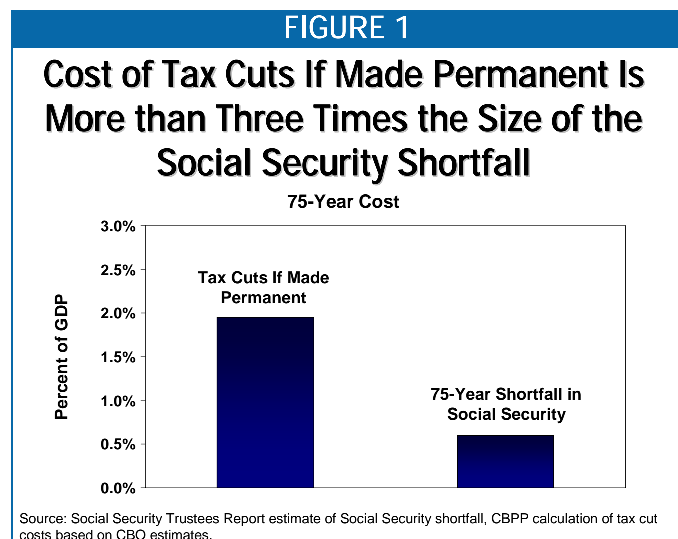
Executive Summary

On March 25, the Social Security Board of Trustees released the 68th annual report on the program's financial and actuarial status. The report projects that Social Security's trust fund reserves will be exhausted in 2041, the same as projected last year. In 2041, Social Security will be able to pay 78 percent of scheduled benefits, rather than full benefits.

This analysis highlights several points about the trustees' report:

- The trustees' report reaffirms that Social Security does not face a near-term crisis and can continue to pay full benefits for more than three decades but will eventually face a significant imbalance. A sizeable shortfall between Social Security income and Social Security benefits should not be acceptable to the public or policymakers, and action is needed to restore the program's long-term solvency.

- The trustees' report finds some improvement from last year's projections in Social Security's financial status, largely as a result of changes in the methods used to project immigration. The year that the trust fund will be exhausted remains 2041, but the actuarial shortfall has declined significantly to 1.70 percent of taxable payroll, compared with 1.95 percent in last year's projections. This is the largest decline since 1983 and is the smallest shortfall that has been projected since the trustees' 1993 report.



Source: Social Security Trustees Report estimate of Social Security shortfall, CBPP calculation of tax cut costs based on CBO estimates.

The program will be able to pay 78 percent of full benefits when the trust fund is exhausted in 2041 (compared with 75 percent under last year's projections). At the end of the 75-year

projection window in 2082, Social Security will still be able to pay 75 percent of full benefits.

- Anyone concerned about Social Security's long-term shortfall ought to be equally (if not more) concerned about the long-term fiscal impact of extending the 2001 and 2003 tax cuts. Making the tax cuts permanent will cost more than *three times* as much, over the next 75 years, as the 75-year shortfall in Social Security (see Figure 1). Any attempt to address the looming fiscal challenges should include Social Security, Medicare and the U.S. health care system as a whole, *and* overall government revenues.

An Overview of the Projections in the New Trustees' Report

The new trustees' report contains several key figures that document the challenge Social Security faces:

- The trustees project that in 2017, benefit payments will begin to exceed Social Security's *tax* revenues. At this point, Social Security will start using some of the interest it earns on its trust fund bonds to pay benefits. Nevertheless, the trustees project that in 2017, the trust fund will have $4.5 trillion in assets and that these assets will increase by another $1 trillion over the following nine years.[1] (See the box on page 6 for a discussion of the soundness of the assets in the trust fund.)

- The balances in the trust fund are projected to peak in 2026. After that date, Social Security will start redeeming the bonds in the trust fund to raise the additional funds needed to pay full benefits. The combination of tax revenues, interest earnings, and proceeds from redeeming Treasury bonds will be sufficient for Social Security to pay full benefits for 14 more years after 2026.

- The trustees project that there will be no more bonds left to redeem — and the Trust Fund will be exhausted — in 2041. After that, the trust fund will continue to receive annual revenues from payroll taxes and from the partial taxation of the Social Security benefits that higher-income beneficiaries receive. That revenue, however, will not be sufficient to pay full benefits.

- After the trust fund is exhausted in 2041, Social Security's tax revenue will be sufficient to pay 78 percent of promised benefits. This percentage will fall gradually to 75 percent of benefits in 2082.

- The new report places the amount of the 75-year shortfall — that is, the amount by which the trust fund's income and revenues over the next 75 years will fall short of what is needed to pay full benefits over the period — at $4.3 trillion in net present value,[2] or 0.6 percent of GDP.

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[1] Technically, Social Security has two distinct trust funds: one for old-age and survivors benefits and one for disability benefits. This report follows the standard convention in referring to the combined balance as "the Social Security trust fund."

[2] Net present value is the equivalent amount that today, with interest, would exactly cover the future shortfall.

The shortfall also is equal to 1.70 percent of taxable payroll.[3]

- The new report places the "infinite horizon" (i.e., through eternity) shortfall at 1.1 percent of GDP and 3.2 percent of taxable payroll, which is down from last year's estimate of 3.5 percent as a result of the same changes in methods and assumptions that produced the improvement in some measures of Social Security's financial condition.

  The infinite horizon measure, which was first included in the 2003 report, has been strongly criticized as a highly speculative and misleading measure by the American Academy of Actuaries and other Social Security analysts.[4] Changes in the dollar value of the infinite horizon deficit — or in the dollar value of the 75-year deficit, for that matter — are particularly misleading because they can be large even when there is no meaningful change in the real financial condition of the program; likewise, the real condition can change without changing the large dollar value of the deficit.[5] In addition, over two-thirds of the infinite horizon deficit would be incurred after 2082, making it very sensitive to small changes in assumptions and consequently of very limited reliability for policymakers.

How the Projections Compare with Those Made In Previous Years

In general, the key dates and the overall financial picture in the 2008 trustees' report represent an improvement over each of the 1997-2001 trustees' reports and a more modest change from the 2002-2007 reports (see Table 1). The long-term deficit in Social Security declined from 2.23 percent of taxable payroll in the 1997 report to 1.89 percent in the 2000 report and, after drifting up slightly for several years, fell to 1.70 percent in 2008. The date by which the trust fund is projected to be exhausted has moved farther into the future — from 2029, as forecast in 1997, to 2041 as projected in the current report. In other words, Social Security has a long-run financing shortfall that must be addressed. Over the past decade, the magnitude of the challenge has eased modestly but not dramatically.

The principal reason that Social Security's underlying financial outlook changes over time is that the trustees revise their assumptions about future economic and demographic variables and their projection methodologies. Those changes interact with the purely technical fact that the mere passage of time has the effect of worsening some measures of the program's financial condition.

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[3] Note that, per the trustees' convention, the shortfall as a share of taxable payroll includes the cost of a "target fund" — that is, a trust fund balance at the end of 2081 that would be sufficient to pay full benefits in 2082 even in the absence of any trust fund income.

[4] See, Letter from the American Academy of Actuaries to the Trustees of the Social Security System, December 19, 2003, available at http://www.actuary.org/pdf/socialsecurity/tech_dec03.pdf.

[5] Illustrating the potentially misleading nature of dollar estimates, the infinite horizon estimate remained essentially unchanged in dollar terms this year even though it dropped as a percentage of GDP and as a percentage of taxable payroll. For a discussion of the pitfalls in using the infinite horizon measure, see Richard Kogan, Robert Greenstein, and Jason Furman, "Will the Administration Claim the Cost of Fixing Social Security Rose $700 Billion Because Congress Did Not Act Last Year?" Center on Budget and Policy Priorities, April 28, 2006.

TABLE 1: History of Social Security Trustees' Estimates			
Report Year	**75-year Deficit as a Percent of Taxable Payroll**	**Year When Costs First Exceed Total Revenues**	**Year When Trust Fund is Exhausted**
1997	2.23%	2019	2029
1998	2.19%	2021	2032
1999	2.07%	2022	2034
2000	1.89%	2025	2037
2001	1.86%	2025	2038
2002	1.87%	2027	2041
2003	1.92%	2028	2042
2004	1.89%	2028	2042
2005	1.92%	2027	2041
2006	2.02%	2026	2040
2007	1.95%	2027	2041
2008	1.70%	2027	2041

Source: Trustees Reports, various years.

The passage of time affects the 75-year deficit, for example, by bringing in another year with a relatively large deficit. Thus, in going from the 2007 to the 2008 projection, the relatively large deficit for 2082 was added. An analogous effect happens with the infinite-horizon shortfall.[6]

In this year's report, the reduction in the Social Security shortfall due to changes in the methods and assumptions used to project immigration was large enough to more than offset the increase in the shortfall due to the passage of time. In brief, the new methods for projecting immigration "result in a substantial increase in the number of working-age individuals contributing payroll taxes, but a relatively smaller increase in the number of retirement-age individuals receiving benefits in the latter half of the long-range period.[7]

As a net result of these changes, the key indicators in 2008 continue to look roughly as they did in 2002-2007. That the outlook for Social Security has been relatively stable does not negate the fact that the program faces large deficits down the road, reflecting, among other things, the retirement of the baby-boom generation. But it does mean that the magnitude of the challenge we face to put the program on a sound long-term basis is not becoming unmanageable. That is especially evident when looking at measures that express the long-term shortfall as a percentage of GDP or taxable payroll (that is, relative to the resources available to meet the challenge), rather than simply in dollar terms.

[6] In moving from 2007 to 2008, every future year's balance is discounted by one less year, which increases the size of that year's balance in the present-value calculation.

[7] The 2008 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, p. 69.

Social Security's Imbalances Are Dwarfed by the Cost of the Tax Cuts

The Social Security shortfall contributes to the government's long-term fiscal challenge, but it is by no means the primary source of this challenge. Eliminating Social Security's shortfall would nevertheless be an important step in addressing America's overall fiscal problems.

Over the next 75 years, the Social Security shortfall amounts to 0.6 percent of GDP, a relatively modest share of the total federal budget shortfall projected for this period. Recently enacted policies, particularly the tax cuts (if made permanent), will have a larger impact on the long-term fiscal deficit.

- Extending the 2001 and 2003 tax cuts and other tax provisions scheduled to expire in coming years would cost 1.9 percent of GDP over the next 75 years, or $15.0 trillion in net present value.[8]
- This is more than three times as great as the Social Security trustees' estimate of the Social Security shortfall (see Table 2).
- In fact, the cost of extending only the tax cuts for the top 1 percent of Americans, those currently making more than $450,000, is about as large as the trustees' estimate of the 75-year Social Security shortfall.

TABLE 2: The Shortfall in the Social Security Trust Fund Compared to Other Sources of Deficits

	Shortfall or cost as a percent of GDP through 2082	In trillions of dollars through 2082[a]
Shortfall, Social Security Trust Fund (Trustees estimate)[b]	0.6%	$4.3 trillion
Shortfall, Medicare Hospital Insurance Trust Fund	1.6%	$12.4 trillion
Cost of extending recent tax cuts[c]	1.9%	$15.0 trillion
Cost of extending tax cuts for top 1 percent[d]	0.6%	$4.6 trillion

a. Measured in present value in 2008 dollars.

b. Source: Calculations from the Trustees' report, 2008 Annual Report of the Old-Age and Survivors Insurance And Disability Insurance Trust Funds.

c. Source: Center on Budget and Policy Priorities. The estimate of the cost of extending recent tax cuts is based on estimates issued by CBO. For details, see footnote 6.

d. Source: Center on Budget and Policy Priorities. The estimate is based on the cost of the tax cuts, estimated as noted above, and distributional estimates from the Urban-Brookings Tax Policy Center. In 2008, the top 1 percent of households are those with incomes above $450,000.

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[6] These estimates reflect the cost of extending the 2001 and 2003 tax cuts (including the portion of the cost of AMT relief created by the tax cuts). To compare these costs with the Social Security shortfall, we measure the (present-value) cost of extending expiring tax provisions and display this cost as a share of the present value of total GDP, 2008-2082. Through the first ten years, we base our estimates on CBO and Urban Institute-Brookings Institution Tax Policy Center data. Thereafter, we assume that the cost of the tax cuts remains constant as a share of GDP.

The Social Security Trust Fund Has Not Been "Raided"

The Social Security reforms enacted in 1983 envisioned a process in which the program would first build up the trust fund by running surpluses in the decades prior to the retirement of the baby-boom generation and then draw on that trust fund to supplement Social Security tax revenues as promised benefits began to exceed those revenues. This use of the trust fund allows full benefits to be paid from 2017 through 2040 in the current projections even though annual tax revenues are expected to be less than promised benefits after 2016.

There is a popular misconception that the surpluses accumulated in the Social Security trust fund will not be there to fulfill this role because the fund has already been "raided" to pay for other programs over the years. This misconception may arise from the false picture of a surplus that has been placed in a vault somewhere, but with the door unlocked so that the funds could be removed. In fact, just as a bank does not keep all of its deposits in its vaults but rather lends them out at interest, so, too, are the moneys deposited into the trust fund invested in interest-bearing U.S. Treasury securities, which are rock-solid assets backed by the full faith and credit of the U.S. government. The Treasury is bound by law to pay interest on those securities and to redeem the securities when needed to pay full Social Security benefits.

In the late 1990s when the non-Social Security part of the federal budget was itself in surplus, the surplus funds that the Social Security trust fund loaned to the Treasury allowed the Treasury to pay down debt owed to the public. In this decade, when large federal budget deficits have re-emerged, the funds loaned to the Treasury have reduced the amount of debt that the Treasury has had to borrow from the public to finance those deficits. The Social Security trust fund's assets remained sound in both cases. In short, there has been no raid on the trust fund, and Social Security's long-term financing gap is the result of demographic pressures not some mythical "raid."

Conclusion

The new trustees' report is consistent with previous reports. It shows that Social Security faces a significant but manageable challenge. Acting sooner rather than later will help reduce the size of the eventual adjustments, but the trustees' report indicates that Social Security does not face a deep structural crisis requiring drastic changes.

Putting the trustees' report in a broader fiscal context suggests that the sources of the future large imbalances in the federal budget as a whole need to be addressed. The sources of these imbalances include not only Medicare (primarily as a result of rising health care costs throughout the U.S. health care system) and Social Security, but revenues as well. If the 2001 and 2003 tax cuts are made permanent, they will contribute far more to budget deficits than Social Security will.

In 1983, Congress and President Reagan acted on recommendations made by the Greenspan Commission and strengthened Social Security's financial status through a combination of benefit and revenue measures. Various combinations of modest benefit reductions and revenue increases have been proposed by economists Peter Diamond and Peter Orszag, economists Henry Aaron and Robert Reischauer, the late Robert Ball (who served as Social Security Commissioner under presidents of both parties), and the AARP. Such steps could restore Social Security solvency while beginning to reduce federal budget deficits and debt.