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What the 2016 Trustees' Report Shows About Social Security

By Kathleen Romig

Social Security can pay full benefits for close to two decades, the trustees' latest annual report shows, but will then face a significant, though manageable, funding shortfall that policymakers should address in the near future. Doing so would permit changes that are gradual rather than sudden and allow people to plan their work, savings, and retirement with greater certainty.

Several key points emerge from the report:

- The 2015 bipartisan budget agreement extended the solvency of the Disability Insurance (DI) trust fund through 2023 by reallocating payroll taxes between the DI and Old-Age and Survivors Insurance (OASI) trust funds. Policymakers will have to revisit DI financing within the next seven years, ideally as part of a comprehensive Social Security solvency package.
- The trustees estimate that, if policymakers took no further action, Social Security's combined Old-Age and Survivors Insurance (OASI) and DI trust funds will be exhausted in 2034 — same as last year's report.
- After 2034, Social Security could still pay three-fourths of scheduled benefits using its tax income even if policymakers took no steps to shore up the program. Those who claim that Social Security won't be around at all when today's young adults retire and that young workers will receive no benefits misunderstand or misrepresent the trustees' projections.
- The program's shortfall amounts to 1 percent of gross domestic product (GDP) over the next 75 years (and 1.5 percent of GDP in 2090, the 75th year).

A mix of tax increases and benefit modifications, carefully crafted to shield beneficiaries with limited means and to give ample notice to all participants, could put the program on a sound footing indefinitely. There is some room to trim Social Security benefits for high earners — and to strengthen benefits for particularly vulnerable groups. But Social Security will necessarily require an increasing share of our nation's resources in the coming decades as the population ages, and polls show a widespread willingness to support it through higher tax contributions.

Report Holds Few Surprises

The outlook in the 2016 trustees' report changed very little from last year's. The report focuses on the next 75 years — a horizon that spans the lifetime of just about everybody now old enough to work.[1] With no tax increases scheduled, the trustees project that the program's tax income will remain around 13 percent of taxable payroll.[2] (Taxable payroll — the wages and self-employment income up to Social Security's taxable maximum, currently $118,500 a year — represents slightly over one-third of GDP.) Meanwhile, program costs are expected to climb faster, largely due to the aging of the population. Costs will grow more steeply for the next 15 years and then moderate, rising from 14 percent of taxable payroll to roughly 18 percent in 2090. Interest earnings, long an important component of the trust funds' income, will shrink after the mid-2020s and eventually disappear.

Over the entire 75-year period, the trustees put the Social Security shortfall at 2.66 percent of taxable payroll; the shortfall is concentrated in the later decades of the projection. Expressed as a share of the nation's economy, the 75-year shortfall equals 1.0 percent of GDP.

While Social Security provides a safety net to people of *all* ages — young children and their surviving parents who have lost a family breadwinner, working-age adults who have suffered a serious disability, and retired workers and elderly widows and widowers — about three-fourths of its benefits go to the elderly. The elderly share of the population will climb steeply over the next 20 years, from one in seven Americans to one in five, and then inch up thereafter. The rise in Social Security's cost as a percentage of GDP lags slightly *behind* that growth due to already enacted increases in the age for full retirement benefits (previously 65, now 66, and eventually 67), which dampen the rise in benefit costs.[3] (See Figure 1.) These facts reinforce the point that Social Security's fundamental challenge is demographic, traceable to a rising number of beneficiaries rather than to escalating costs per beneficiary.

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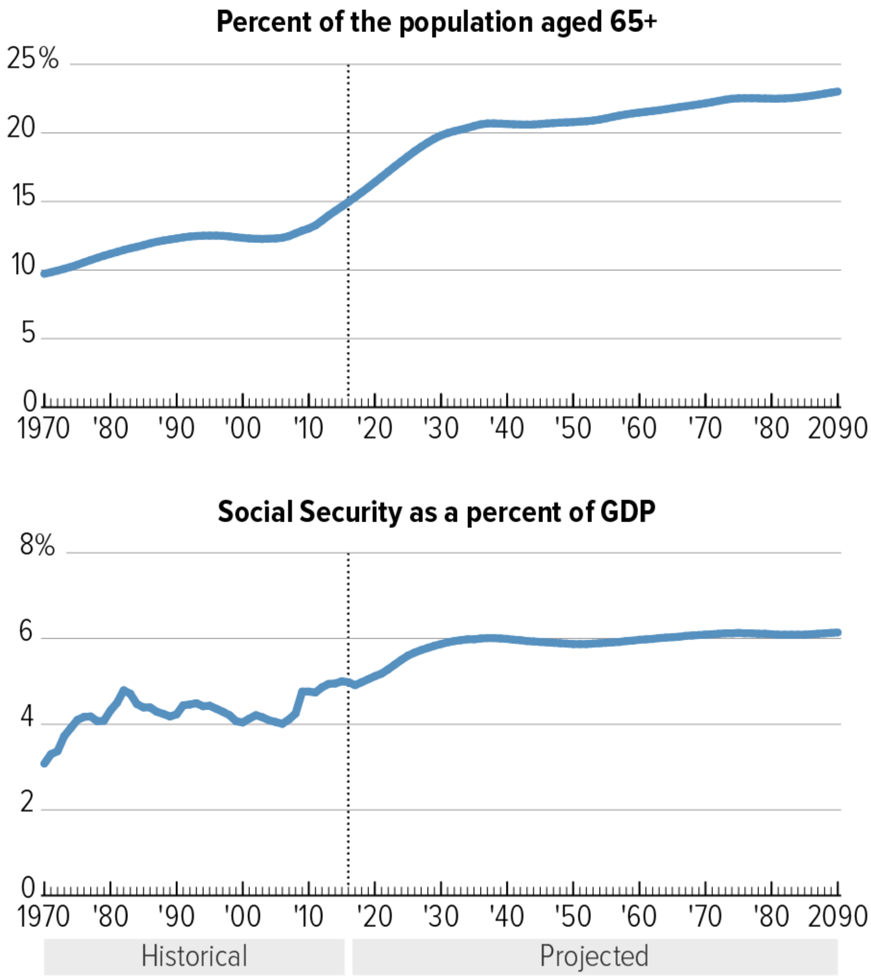
[1] *The 2016 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, June 2016, https://www.ssa.gov/OACT/TR/2016/index.html.

[2] See Table IV.B1, "Annual Income Rates, Cost Rates, and Balances," https://www.ssa.gov/OACT/TR/2016/lrIndex.html. Payroll taxes equal 12.4 percent of taxable payroll, while dedicated income taxes that higher-income beneficiaries pay on a portion of their Social Security benefits contribute a gradually rising percentage of taxable payroll.

[3] The scheduled rise in the full retirement age from 66 to 67, to be phased in between 2017 and 2022, causes the growth of program costs to be less than it otherwise would be, as the previous rise from 65 to 66 also did. For an explanation, see the box, "Why Does Raising the Retirement Age Reduce Benefits?" in Kathy Ruffing and Paul N. Van de Water, *Social Security Benefits Are Modest*, Center on Budget and Policy Priorities, updated December 11, 2015, http://www.cbpp.org/research/social-security/social-security-benefits-are-modest.

FIGURE 1

Social Security's Growth Roughly Tracks Population's Aging



Note: Social Security's age for full retirement benefits rose from 65 to 66 between 2000 and 2005, and it will climb from 66 to 67 between 2017 and 2022. That change dampens the rise in Social Security benefit costs. GDP = gross domestic product.

Source: Social Security Administration

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At first blush, the projected deficit — 2.66 percent of taxable payroll — appears larger than past projections. Those figures are not, however, comparable, because the period covered by the reports has shifted. Each one-year shift in the valuation period moves the 75-year balance further into the red by a small amount. Unlike the program's deficit, the date of trust-fund exhaustion is not affected by the 75-year valuation period, and it has ranged between 2029 and 2042.

TABLE 1

Trustees' Estimates Have Fluctuated But Tell a Consistent Story

Year of report	Change in actuarial balance (as percentage of taxable payroll over 75 years) since previous report due to… Legislation and regulations	Change in valuation period	All other*	Total change	Actuarial balance	Year of exhaustion
1997	0.03	-0.08	0.02	-0.03	-2.23	2029
1998	0.00	-0.08	0.12	0.04	-2.19	2032
1999	0.00	-0.08	0.20	0.12	-2.07	2034
2000	0.00	-0.07	0.24	0.17	-1.89	2037
2001	0.00	-0.07	0.10	0.03	-1.86	2038
2002	0.00	-0.07	0.06	-0.01	-1.87	2041
2003	0.00	-0.07	0.03	-0.04	-1.92	2042
2004	0.00	-0.07	0.10	0.03	-1.89	2042
2005	0.00	-0.07	0.03	-0.04	-1.92	2041
2006	0.00	-0.06	-0.03	-0.09	-2.02	2040
2007	0.00	-0.06	0.13	0.06	-1.95	2041
2008	0.00	-0.06	0.32	0.26	-1.70	2041
2009	0.00	-0.05	-0.25	-0.30	-2.00	2037
2010	0.14	-0.06	0.00	0.08	-1.92	2037
2011	0.00	-0.05	-0.25	-0.30	-2.22	2036
2012	0.00	-0.05	-0.39	-0.44	-2.67	2033
2013	-0.15	-0.06	0.16	-0.05	-2.72	2033
2014	-0.01	-0.06	-0.09	-0.16	-2.88	2033
2015	0.02	-0.06	0.24	0.20	-2.68	2034
2016	0.03	-0.06	0.04	0.02	-2.66	2034

* "All other" changes include effects of economic, demographic, and disability assumptions and any changes in the actuaries' methods and models.

Note: Details may not add to totals due to rounding. Data are for the combined Old-Age and Survivors Insurance and Disability Insurance trust funds.

Source: Sharon Chu and Seung H. An, "Disaggregation of the Long-Range Actuarial Balance for the Old-Age, Survivors, and Disability Insurance (OASDI) Program Since 1983," Actuarial Note 2016.8, June 2016, https://www.ssa.gov/OACT/NOTES/ran8/an2016-8.pdf.

Some commentators cite huge dollar figures that appear in the trustees' report, such as the $11.4 trillion shortfall through 2090 (or even the $32.1 trillion shortfall through eternity, a figure whose validity many experts question[4]). Except over relatively short periods, however, it is not useful to express Social Security's income, expenditures, or funding gap in dollar terms, which does not

[4] See letter from the American Academy of Actuaries to the Trustees of the Social Security System and the Social Security Advisory Board, December 19, 2003, http://www.actuary.org/pdf/socialsecurity/tech_dec03.pdf. See also Kathy Ruffing, Paul N. Van de Water, and Richard Kogan, "*Generational Accounting" Is Complex, Confusing, and Uninformative*, Center on Budget and Policy Priorities, February 6, 2014, http://www.cbpp.org/research/generational-accounting-is-complex-confusing-and-uninformative.

convey a sense of the economy's ability to support the program. Expressing them in relation to taxable payroll or GDP, in contrast, puts them in proper perspective. Over the next 75 years, for example, taxable payroll — discounted to today's dollars just as the $11.4 trillion shortfall figure is — will be nearly $460 trillion, and GDP will exceed *$1,200 trillion*. Thus, the shortfall over the next 75 years equals about 2.5 percent of taxable payroll and 1.0 percent of GDP.[5]

Key Dates and What They Mean

2034 is the "headline date" in the trustees' report, because that is when the combined Social Security trust funds are expected to run out of Treasury bonds to cash in. At that point, if nothing else is done, the program could then pay 79 percent of scheduled benefits, a figure that would slip to 74 percent by 2090. Contrary to popular misconception, benefits would not stop.[6]

Although the exhaustion date attracts keen attention, the trustees caution that their projections are uncertain. For example, while 2034 is their best estimate of when the trust funds will be depleted, they judge there is an 80 percent probability that trust fund exhaustion will occur sometime between 2030 and 2040.[7] Chiefly because it assumes slightly faster improvements in mortality, the Congressional Budget Office (CBO) expects the combined trust funds to be exhausted in 2029, with an 80 percent probability that the combined trust funds would be exhausted between 2026 and 2033.[8] In short, all reasonable estimates show a long-run problem that needs to be addressed but not an immediate crisis.

Two other, earlier dates also receive attention but have little significance for Social Security financing:

- 2010 marked the first year since 1983 in which the program's total expenses exceeded its *tax* income (from payroll taxes and income taxes that higher-income beneficiaries pay on a portion of their Social Security benefits). The trust funds are nevertheless still growing because of the *interest* income they receive on their Treasury bonds. In 2015, for example, Social Security's interest income of $93 billion more than offset its so-called cash deficit of $70 billion, leading the trust funds to grow by $23 billion.[9]
- 2020 will be the first year in which the program's expenses exceed its *total* income, including its interest income. At that point, the trust funds — after peaking at nearly $2.9 trillion — will start to shrink as Social Security redeems its Treasury bonds to pay benefits.

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[5] *Trustees' Report*, Tables IV.B5 and VI.F1. The more prominent 75-year figures — 2.66 percent of taxable payroll (and 1 percent of GDP) — include an extra margin for a target trust-fund balance at the end of 2090. Without that buffer, which is set at 100 percent of the next year's estimated Social Security outlays, the shortfall is 2.49 percent of taxable payroll (and 0.9 percent of GDP) over 75 years.

[6] Noah P. Meyerson, "Social Security: What Would Happen If the Trust Funds Ran Out?" Congressional Research Service, August 28, 2014, https://www.fas.org/sgp/crs/misc/RL33514.pdf.

[7] *Trustees' Report*, Table VI.E1.

[8] *The 2015 Long-Term Projections for Social Security: Additional Information*, December 16, 2015, http://www.cbo.gov/publication/51047.

[9] *Trustees' Report*, Table VI.G8.

Neither of these dates affects Social Security beneficiaries. From 1984 through 2009, Social Security collected more in taxes each year than it paid out in benefits, lent the excess revenue to the Treasury, and received Treasury bonds in return. Together with compound interest, that accounts for the $2.8 trillion in Treasury bonds that the trust funds hold today.

Following the 1983 Social Security amendments, the trust funds increased dramatically, which has helped to finance the retirement of the baby boom. The principal and interest from the trust funds' bonds will enable Social Security to keep paying full benefits until 2034. The bonds have the full faith and credit of the United States government, and — as long as the solvency of the federal government itself is not called into question — Social Security will be able to redeem its bonds just as any private investor might do.[10] When Social Security needs to start cashing bonds to pay benefits, the federal government will have to increase its borrowing from the public, raise taxes, or spend less. That will be a concern for the Treasury — but not for Social Security.

Bipartisan Budget Deal Improved DI Solvency

In order to avoid imminent exhaustion of the DI trust fund, the 2015 bipartisan budget agreement extended DI solvency through 2023 by reallocating payroll taxes between the DI and OASI trust funds.[11] In addition, the agreement renewed the Social Security Administration's (SSA) authority to conduct demonstration projects to encourage work among DI beneficiaries, and provides more funding to SSA for program integrity. The agreement did not affect the projected exhaustion year of the OASI fund.

Policymakers will have to revisit DI solvency within the next seven years, ideally as part of a comprehensive Social Security solvency package. The budget deal reallocated tax rates for just three years, far too short to rebalance the two trust funds after years of shortchanging DI.[12] The trustees show the number of DI beneficiaries will rise over the next seven years — but that's largely because Social Security's full retirement age will gradually rise from 66 to 67 over that period. DI beneficiaries are automatically converted to retirement beneficiaries when they reach retirement age, so this long-planned change in the retirement age will increase the number of beneficiaries who are classified as "disabled" rather than "retired" — and make it look as if disability enrollment is rising.

DI and OASI are closely related, so policymakers should strengthen both by addressing overall Social Security solvency. Both components of Social Security face fairly similar long-run shortfalls, and key features — including the tax base, the work history required to become insured for benefits, the benefit formula, and cost-of-living adjustments — are similar or identical for the two programs. In addition, most DI beneficiaries are close to or past Social Security's early retirement age of 62.

[10] Paul N. Van de Water, *Understanding the Social Security Trust Funds*, Center on Budget and Policy Priorities, updated August 18, 2014, http://www.cbpp.org/research/social-security/understanding-the-social-security-trust-funds.

[11] Robert Greenstein, "Budget Deal, Though Imperfect, Represents Significant Accomplishment and Merits Support," Center on Budget and Policy Priorities, October 27, 2015, http://www.cbpp.org/press/statements/greenstein-budget-deal-though-imperfect-represents-significant-accomplishment-and.

[12] Kathy Ruffing and Paul N. Van de Water, *Boosting Disability Insurance Share of Social Security Payroll Tax Would Not Harm Retirees*, Center on Budget and Policy Priorities, December 2, 2014, http://www.cbpp.org/research/boosting-disability-insurance-share-of-social-security-payroll-tax-would-not-harm-retirees.

Tackling DI in isolation would leave policymakers with few — and unduly harsh — options and require them to ignore the strong interactions between Social Security's disability and retirement components.

Small Cost-of-Living Adjustment Expected in 2017

The Social Security trustees expect that there will be a small cost-of-living adjustment (COLA) in benefits next January. They do not rule out the possibility of a second year of no COLA. If they're right — which we won't know until late October — that has several consequences for beneficiaries and covered workers.

Since COLAs' purpose is to preserve beneficiaries' purchasing power, very low (or no) price growth means that beneficiaries would not need much (or any) COLA to keep up with inflation. And the Social Security Act provides that there are no negative COLAs, so when prices fall, benefits can't be reduced. This protected beneficiaries in 2010, 2011, and 2016 and could do so again.

If Social Security's COLA is small (or zero), it will affect Medicare Part B premiums. Most Social Security beneficiaries enroll in Medicare Part B for doctor and outpatient services and have the premium — currently $104.90 a month — deducted from their checks. By law, in most cases, their *net* Social Security check can't fall when Medicare premiums go up. If there's no COLA, or if the COLA is small, this provision will shield up to 70 percent of enrollees from a premium hike — but because premiums must, by law, cover one-fourth of total Part B spending, it means that the other 30 percent, including people newly signing up for Medicare at 65, will pay disproportionately more. The smaller the COLA, the more beneficiaries are held harmless — and the more costs beneficiaries not held harmless must cover.

As part of the 2015 bipartisan budget agreement, lawmakers limited the premium increase faced by the 30 percent of beneficiaries who would otherwise have faced a huge premium jump in 2016 — and an increase in the Part B deductible — to the normal amounts by which the premiums and the deductible would rise in 2016 if there were no premium freeze for other beneficiaries. The deal then raises the premium by an extra $3 a month for about six years for the beneficiaries who would have faced steep premium hikes in 2016. In essence, the deal smooths out the premium increase over a number of years, while keeping Medicare's trust fund from facing a financial loss in the process. This provision will apply again in 2017 if there is no COLA — but not if there is a small COLA.

A zero COLA also freezes Social Security's "taxable maximum," or the maximum wage on which workers and their employers pay Social Security payroll taxes, which is currently $118,500. The link between the COLA (which is based on prices) and the taxable maximum (which is based on wages) is unnecessary and costs Social Security money. If there is a COLA in 2017, the taxable maximum will rise again. Regardless, Congress should de-link the taxable maximum from the COLA and let it rise with wages as it normally does, whether or not there's a COLA that year.

For more information see *The 2016 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, July 2016, Tables V.C1 and V.C2; Robert Greenstein, "Budget Deal, Though Imperfect, Represents Significant Accomplishment and Merits Support," Center on Budget and Policy Priorities, October 27, 2015, http://www.cbpp.org/press/statements/greenstein-budget-deal-though-imperfect-represents-significant-accomplishment-and; and Kathleen Romig, "No COLA for 2016 Will Affect Medicare Premiums and Social Security Finances," Center on Budget and Policy Priorities, October 15, 2015, http://www.cbpp.org/blog/no-cola-for-2016-will-affect-medicare-premiums-and-social-security-finances.

Getting Social Security Solvency Right

Policymakers need to get Social Security reform right. Nearly every American participates in Social Security, first as a worker and eventually as a beneficiary. The program's benefits are the foundation of income security in old age, though they are modest both in dollar terms (elderly retirees receive an average Social Security benefit of about $16,000 a year, widows and disabled workers even less) and compared with benefits in other countries (Social Security benefits replace a smaller share of pre-retirement earnings than comparable programs in most other developed nations).[13] Millions of beneficiaries have no income other than Social Security.[14]

Because Social Security benefits are so modest and make up the principal source of income for most beneficiaries, policymakers should restore solvency through a mix of revenue increases and benefit changes, with increased revenues contributing a majority of the savings. Revenues could come from raising the maximum amount of wages subject to the payroll tax (which now encompasses only about 81 percent of covered earnings, well short of the 90 percent figure envisioned in the 1977 Social Security amendments); broadening the tax base by subjecting voluntary salary-reduction plans, such as cafeteria plans and health care Flexible Spending Accounts, to the payroll tax (as 401(k) plans and similar retirement accounts are); and raising the payroll tax rate by small steps starting at some point in the future.

Future workers are expected to be more prosperous than today's. Under the trustees' assumptions, the average worker will be about 33 percent better off — in real terms — in 2034 than in 2016, and twice as well off by 2080. It is appropriate to devote a small portion of those gains to the payroll tax, while still leaving future workers with much higher take-home pay. Social Security is a popular program, and poll respondents of all ages and incomes express a willingness to support it through higher taxes.[15]

Policymakers need to design reforms judiciously so that Social Security remains the most effective and successful income security program in the nation's history.

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13 Kathy A. Ruffing and Paul N. Van de Water, *Social Security Benefits Are Modest*, updated December 11, 2015, http://www.cbpp.org/research/social-security/social-security-benefits-are-modest.

14 Center on Budget and Policy Priorities, *Policy Basics: Top Ten Facts About Social Security*, updated August 13, 2015, http://www.cbpp.org/research/social-security/policy-basics-top-ten-facts-about-social-security.

15 Elisa A. Walker, Virginia P. Reno, and Thomas N. Bethell, *Americans Make Hard Choices on Social Security: A Survey with Trade-Off Analysis*, National Academy of Social Insurance, October 2014, https://www.nasi.org/research/2014/report-americans-make-hard-choices-social-security-survey-tr. Another report about polarization among Americans on many issues nevertheless found strong support for maintaining and even enhancing Social Security benefits; see Matthew Yglesias, "Americans are divided on everything, except their love of Social Security," Vox, June 12, 2014, http://www.vox.com/2014/6/12/5803160/americans-are-divided-on-everything-except-their-love-of-social.