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Social Security Finances: Findings of the 2006 Trustees Report

by Virginia P. Reno and Anita Cardwell

Summary

In January 2006, 48.5 million people, or about one in every six U.S. residents, received Social Security benefits. The benefits are financed by dedicated taxes on earnings paid by workers and employers and by income taxes upper income beneficiaries pay on part of their Social Security benefits. According to the 2006 trustees report, the Social Security trust funds will have an annual surplus of $177 billion in 2006. Annual surpluses are projected to continue for the next 10 years and reserves are projected to grow to $4,186 billion by 2015. Beginning in 2017, tax revenues flowing into the trust funds will be less than total expenditures. In 2040, the reserves are projected to be depleted. At that time, tax income coming into the trust funds will cover about 74 percent of benefits and administrative costs at that time, according to the 2006 report of the Social Security trustees.

Social Security taxes are directed to the Social Security trust funds and benefits are paid from the trust funds. The Social Security Act calls for a Board of Trustees to oversee the management and investment of the Social Security trust funds and to report annually to Congress and the public on the financial status of the program. The 2006 report is the 66th to be issued and is available on the website of the Office of the Chief Actuary of Social Security at www.socialsecurity.gov/OACT.

Who pays for Social Security?

Social Security is financed largely by Social Security taxes paid by workers and employers. The tax rate for both workers and employers is 6.2 percent of earnings, up to a cap of $94,200 in 2006. The combined tax rate is 12.4 percent. Self-employed persons pay both the employee and the employer share of the tax and get a deduction from their personal income for half of the total tax. In addition, upper income Social Security beneficiaries pay income taxes on part of their Social Security benefits, and some of this income-tax revenue is dedicated to the Social Security trust funds. Finally, interest earned on accumulated trust fund reserves is a third source of income. According to the 2006 Trustees report, income from Social Security taxes will account for 84 percent of trust fund income in 2006, while income taxes paid by beneficiaries will be 2 percent, and interest on reserves will be 14 percent.

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What is projected for the next 10 years?

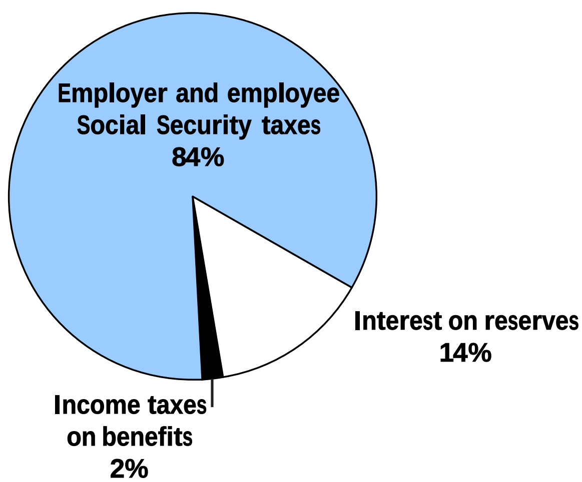
In calendar year 2006, the Social Security trust funds will receive income of $741 billion and pay out $564 billion, leaving an annual surplus of $177 billion.

Almost all outgo is used to pay benefits; less than 1 percent of outgo is spent on administrative costs.

By law, the annual surpluses—amounts not needed for current expenditures—are invested in interest-bearing U.S. government securities. By the end of 2006, the invested assets, or trust fund reserves, are estimated to be $2,035 billion.

Over the next 10 years (2006 through 2015), the Social Security trust funds are projected to continue to have annual surpluses and reserves are projected to grow. By the end of 2015, the reserves are projected to be $4,186 billion.

Income Received
by Social Security Trust Funds
Estimates for Calendar Year 2006



What is projected for the next 75 years?

Current taxes will not produce enough income to cover all scheduled benefits due over the next 75 years. Under the intermediate, or "best estimate" assumptions in the 2006 trustees report:

- In 2017, tax revenues flowing into the trust funds will be less than total expenditures for that year. Interest on the reserves and the assets themselves will be available to supplement tax revenues until 2040.
- In 2040, the reserves will be depleted. Income coming into the funds at that time is expected to cover about 74 percent of the scheduled benefits and administrative costs at that time.
- By 2080, the end of the 75-year projection period, assuming no changes in taxes or benefits, revenues are projected to cover about 70 percent of costs.

The long-range actuarial deficit is 2.02 percent of taxable payroll. This means that to close this gap solely with a tax increase, the Social Security tax rate could be increased by 2.02 percentage points, starting this year. This change would raise the Social Security tax paid by employees (and matched by employers) by 1.01 percentage points, from 6.2 to 7.21 percent. The trustees are not proposing a tax increase. This summary measure simply shows the size of the long-range deficit in relation to taxable earnings that, through the Social Security tax, provide the largest source of income to the system.

Why will Social Security cost more in the future?

Social Security will cost more largely because the number of Americans age 65 and older will grow faster than the number of workers. This will occur for three reasons: the baby boomers will begin to reach age 65 in 2011, people are living longer after age 65, and birthrates are assumed to remain historically low. While costs are projected to rise, the tax rate is constant under current law.

How do the 2006 projections compare to last year's?

Each year the Social Security actuaries review the performance of the economy, take into account new laws and regulations, and reassess the assumptions about future economic and demographic trends that affect the Social Security system (including employment, wage levels, inflation, interest rates, birth rates, death rates, and immigration). Table 1 compares some key results from the 2005 and 2006 reports.

Table 1.
Comparison of Projections in Trustees Reports

	2005 Report	2006 Report
Year when outgo exceeds current tax revenue	2017	2017
Year when trust fund reserves become fully drawn-down	2041	2040
Long-range actuarial deficit (expressed as a percent of taxable payroll)	1.92	2.02
Annual deficit in 2080 (expressed as a percent of taxable payroll)	5.75	5.38

Who receives Social Security?

Social Security pays monthly benefits that replace, in part, income from wages lost when a worker retires, becomes disabled, or dies. Benefits are paid to the worker and to family members who relied on the lost earnings.

In January 2006, 48.5 million people, or about one out of every six Americans, received Social Security benefits. Nearly one household in four receives income from Social Security.

Social Security beneficiaries include 30.6 million retired workers and 4.7 million widows and widowers. About 6.5 million disabled workers received benefits, along with 769,000 severely disabled adult children of deceased, retired, or disabled workers. Another 3.1 million children under age 18 received benefits because their parent had died, become disabled, or retired.

What are typical benefit levels?

The average benefit paid to retired workers was $1,002 in January 2006. The average benefit was somewhat smaller for disabled workers ($938) and for widows and widowers age 60 or older ($967).

For most beneficiaries, Social Security is their major source of income. Social Security accounts for half or more of total income for two out of three recipients who are 65 years of age or older. For all but the highest-income 20 percent of older Americans, Social Security is the largest single source of income.

Table 2.
Average Monthly Benefits Payable as of January 2006

Type of Beneficiary	Average Monthly Benefit
Retired workers	$1,002
Aged widows and widowers (non-disabled)	$967
Disabled workers	$938

Source: Social Security Administration. 2006. Cost-of-Living Adjustments, 2006 Social Security Changes. Office of the Chief Actuary. http://www.ssa.gov/cola/colafacts2006.htm.

What is the Trustees Report?

The Social Security Act established a Board of Trustees for the Social Security trust funds; the Board issues a report to Congress each year on the financial status of the program. The Board also reports on the Medicare trust funds, which are discussed in a separate brief, *Medicare Finances: Findings of the 2006 Trustees Report.*

The Board has six members; the Secretaries of the Treasury; of Labor; and of Health and Human Services; the Commissioner of Social Security; and two trustees representing the public who are from different political parties and are appointed by the President and subject to Senate confirmation.

The report is a tool for Congress and the public to gauge the financial status of the Social Security system and to understand the size of the program's long-term commitments. The report includes detailed projections of the short-range (10 years) and long-range (75 years) actuarial and financial status of the trust funds. It projects revenue, benefit costs, and benefit amounts. The projections are based on assumptions about mortality, fertility, immigration, and the economy. The report shows projections using three different sets of economic and demographic assumptions – a low cost, a high cost, and an intermediate set. All estimates in this *Brief* reflect the intermediate, or "best estimate," assumptions.

Where Does the Social Security Surplus Go?

By law, Social Security's surplus funds are invested in interest bearing securities backed by the full faith and credit of the U.S. government. Currently all trust fund assets are invested in special issue securities, largely U.S. Treasury bonds. These securities earn interest that is credited to the trust funds. The securities can be redeemed whenever needed to pay Social Security costs. In financial markets, Treasury securities (bills, notes and bonds) are considered a very safe investment because they are backed by the full faith and credit of the United States government.

The sum of all Treasury securities makes up the national debt. Most of the debt is held by (or owed to) the public — that is, individuals, corporations, and other investors in the United States and abroad who have loaned money to the government by investing in government securities. At the end of fiscal year 2005, 23 percent of the national debt was owed to the Social Security trust funds. Another 19 percent was held by other federal trust funds or accounts.

Interest on the national debt is a legal obligation of the federal government. In fiscal year 2005, total interest on the debt was $352 billion.

Some people worry when they hear that Social Security annual cash surpluses are loaned to the U.S. Treasury, and the government spends the cash on other activities. This is not a misuse of Social Security funds. The Treasury securities held by the trust funds are a binding legal commitment for the Treasury to redeem the securities with interest when the money is needed to pay Social Security benefits, regardless of how the government uses the cash.

The Social Security surplus helps lower the debt owed to the public. When the rest of the government budget is in deficit, a Social Security annual cash surplus reduces the amount that the government would otherwise have to borrow from the public and in that way slows the growth in the debt held by the public. When the rest of the government budget is balanced or in surplus, a Social Security annual cash surplus results in a reduction of the debt owed to the public. In either case, slowing the growth of (or actually reducing) the debt owed to the public will make it easer to afford Social Security and other activities of government in the future.

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