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Social Security Finances: Findings of the 2011 Trustees Report

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Summary

In January 2011, 54.2 million people, or about one in six U.S. residents, received Social Security benefits. The benefits are financed by mandatory contributions paid by workers and employers, by income taxes that beneficiaries pay on part of their Social Security benefits, and by interest earned on accumulated trust fund reserves. The 2011 Trustees Report finds that Social Security had an annual surplus – revenue plus interest income in excess of program outgo – of $69 billion in 2010. Annual surpluses are projected to continue for the next 12 years (2011-2022) and reserves are projected to grow to $3.7 trillion by the end of 2022. Beginning in 2023, if Congress takes no action in the meantime, reserves will start to be drawn down to pay benefits. In the very unlikely event that Congress does not act before 2036, the reserves would be depleted and revenue coming into the funds then would cover about 77 percent of scheduled benefits and administrative costs. Social Security is strong in the near term, and relatively modest changes can bring it into long-term balance over the next 50 and 75 years.

What is the Trustees Report?

The Social Security Act establishes a Board of Trustees for the Social Security trust funds and requires the Board to report annually to Congress on the financial and actuarial status of the funds. The Board issues a separate report on the Medicare trust funds. 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 confirmed by the Senate. Charles P. Blahous and Robert D. Reischauer were sworn in as public trustees on October 26, 2010.

The Trustees Report is a tool for Congress and the public to gauge the financial status of the Social Security system and to understand the scope of the program's long-term commitments. Social Security's financial balance is projected over 75 years, longer than almost all other government projections. This reflects the great importance of Social Security. It provides a long lead time for consideration and adoption of changes, if finances are found to be out of balance. The 2011 report is the 71st to be issued and is available on the website of the Office of the Chief Actuary of Social Security at www.ssa.gov/OACT.

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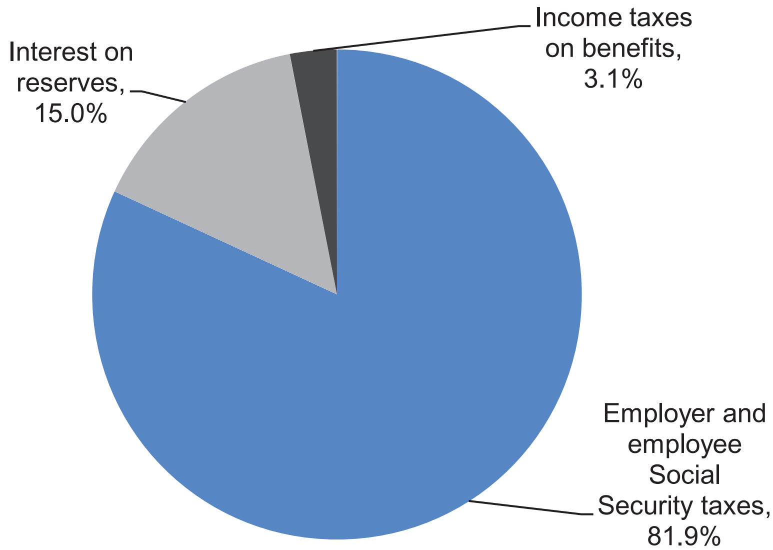
Who pays for Social Security?

Workers and employers pay for Social Security through mandatory contributions (taxes) as called for under the Federal Insurance Contributions Act (FICA). Workers and employers each pay 6.2 percent of earnings up to a cap, which is $106,800 in 2010 and 2011. The combined contribution rate is 12.4 percent. Self-employed workers pay both the employee and the employer share and get a deduction from their taxable personal income for the employer share. In addition, some beneficiaries pay income taxes on part of their benefits, and part of this income-tax revenue goes to the Social Security trust funds and part goes to the Medicare Hospital Insurance fund. Finally, interest earned on accumulated trust fund reserves is a third source of income. In 2010, income from Social Security contributions accounted for 82 percent of trust fund income, while income taxes paid by beneficiaries accounted for 3 percent, and interest on reserves was 15 percent (Figure 1).

Figure 1. Shares of Income to the Trust Funds, 2010



Source: Social Security Administration (SSA), 2011c.

In December, as part of the *Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010*, Congress passed a temporary reduction of 2 percentage points in the employee share of Social Security contributions, calling it a "payroll tax holiday." The reduction from 6.2 to 4.2 percent of earnings is for one year and the $110 billion in lost revenue to the Social Security program is being made up from the government's general fund.

Who receives Social Security?

Social Security pays monthly benefits that replace part of earnings that are lost when a worker retires, becomes disabled, or dies. Benefits are paid to the worker and to family members who had relied on the lost earnings. In January 2011, 54.2 million people, or about one in six Americans, received Social Security benefits.[1] Nearly one family in four receives income from Social Security.[2] Beneficiaries include 34.7 million retired workers, 4.4 million widows and widowers, and 2.5 million spouses. About 8.2 million disabled workers receive benefits, along with 1.0 million adults whose disabilities began in childhood and who were dependents of deceased, disabled or retired parents. Altogether 3.4 million children under age 18 (or under age 19 and still in high school) receive benefits as dependents.[3]

How much does Social Security pay?

The average monthly benefit paid to retired workers was $1,166 (about $14,000 annually) in January 2011 (Table 1). The average benefit was somewhat smaller for disabled workers ($1,050) and for widows and widowers age 60 or older ($1,134). Benefits are higher for families. Widowed mothers with two children received $2,390, on average, or about $28,680 a year, while disabled workers with a young spouse and one or more children received $1,807 a month, on average, or about $21,684 a year. For comparison, the 2011 federal poverty guideline for a family of three is $18,530 a year; for a family of four it is $22,350.[4]

Social Security is the main source of income for most beneficiaries 65 years of age or older. For one in two married couples and seven in ten unmarried beneficiaries over age 65, Social Security accounts for more than half of total income.[5] More information about the role of Social Security in the incomes of beneficiaries is in the Academy's report *Fixing Social Security: Adequate Benefits, Adequate Financing*.[6]

Table 1. Average Monthly Family Benefits, January 2011

Type of Beneficiary	Benefit
Retired worker alone	$1,166
Retired worker and aged spouse	$1,911
Aged widow or widower alone	$1,134
Disabled worker alone	$1,050
Widowed mother and two children	$2,390
Disabled worker, young spouse and one or more children	$1,807

Source: SSA, 2011a and 2011b.

Social Security benefits generally increase each year by a cost-of-living adjustment (COLA) that is based on the consumer price index for urban wage earners (CPI-W). The CPI-W declined after the December 2008 COLA was set and paid in January 2009. Because inflation remained low, no COLA was paid in January 2010 or 2011. A small COLA is projected to be paid in January 2012. Under the law, the cap on earnings that are subject to Social Security contributions does not increase if no COLA is provided. Consequently, the cap remained $106,800 in 2010 and 2011.

How do actuaries project the future?

Each year the Social Security actuaries review the performance of the economy, take into account new laws and regulations, and reassess assumptions about future economic and demographic trends that will affect the Social Security system – such as employment, wage levels, productivity, inflation, interest rates, birth rates, death rates, and immigration.

The actuaries make projections using three scenarios agreed upon by the trustees: low-cost; high-cost; and intermediate. The intermediate scenario is considered the "best estimate" and is most often cited. In general, the low-cost estimate uses a more optimistic set of assumptions (such as higher economic growth, lower unemployment, and lower inflation) whereas the high-cost estimate employs more pessimistic assumptions as they pertain to the trust funds' future financial outlook. For each scenario the Trustees Report projects the status of the funds for the near term and for the next 25, 50 and 75 years.

What do the trustees project for the near term?

In 2011, the Social Security trust funds will receive income of $808 billion and pay out $738 billion, leaving a surplus of $69 billion. Almost all outgo is used to pay benefits; less than 1 percent of outgo is spent on administration. The income is made up of revenues – contributions from workers and employers, general fund reimbursement for the 2011 payroll tax holiday, and income from taxation of benefits – plus interest earned on the trust fund reserves.

By law, the amounts not needed for current outgo are invested in interest-bearing U.S. government securities. The invested assets, or trust fund reserves, are estimated to be $2.7 trillion by the end of 2011. Under the intermediate assumptions, the Social Security trust funds are projected to have surpluses each year until 2023. That is, income from revenues and interest will exceed outgo for benefits and administrative costs and the reserves will continue to grow. By the end of 2022, the reserves are estimated to be $3.7 trillion.

What do the trustees project for the longer term?

The report provides summary measures of program income and outgo over the next 25, 50, and 75 years. The report acknowledges that the reliability of the financial projections declines as the projection period increases. Under intermediate assumptions:

- Over the next 25 years, Social Security is 100 percent solvent – that is, scheduled resources equal obligations.
- Over the next 50 years, Social Security is 90 percent solvent – that is, scheduled resources will cover 90 percent of expected outgo.
- Over the next 75 years, Social Security is 87 percent solvent.

These measures of actuarial solvency illustrate the extent to which the program's assets and income are projected to meet future obligations.[7] The 50- and 75-year projections suggest that remedial actions will be needed to ensure that all legislated benefits will be paid.

The report provides other key dates about future finances:

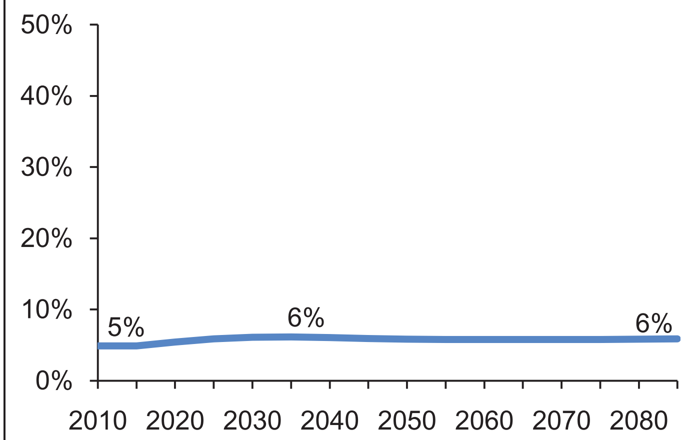
- In 2023, revenues plus interest income will be less than total expenditures for that year. If no action is taken before then, reserves will then start to be drawn down to pay benefits.
- In the very unlikely event that Congress does not act before 2036, the reserves would be depleted and revenue coming into the funds then would cover about 77 percent of scheduled benefits and administrative costs.

The long-range actuarial deficit is 2.22 percent of taxable payroll – that is, 2.22 percent of all earnings subject to Social Security contributions. Closing the 75-year financing gap solely with a contribution rate increase could be accomplished by immediately raising the rate paid by employees and employers each from 6.2 to 7.4 percent.[8] Many options exist to schedule future revenues and/or adjust future benefits to keep the system in balance for 75 years and beyond.[9]

What will Social Security cost as a share of the total economy?

A widely accepted way to assess Social Security's future affordability is to compare benefits scheduled to be paid under current law with the size of the entire economy at the time. Social Security benefits outgo was 4.8 percent of the economy, or gross domestic product (GDP), in 2010 (Figure 2). It is projected to rise to 6.2 percent of the economy by 2035 when all baby boomers are retired and then decline, remaining between 5.9 and 6.0 percent of the economy from 2050 through 2085.

Figure 2. Social Security Outgo as a Percent of the Economy (GDP), 2010-2085



Source: Board of Trustees, 2011: Table VI.F4.

What do the low-cost and high-cost projections show?

Under the trustees' high-cost scenario, the Social Security trust fund reserves would be depleted in 2029 instead of 2036. Under the low-cost scenario, Social Security is solvent through the 75-year projection period and beyond. The difference among estimates reflects the great uncertainty about what the future holds.

Where does the Social Security surplus go?

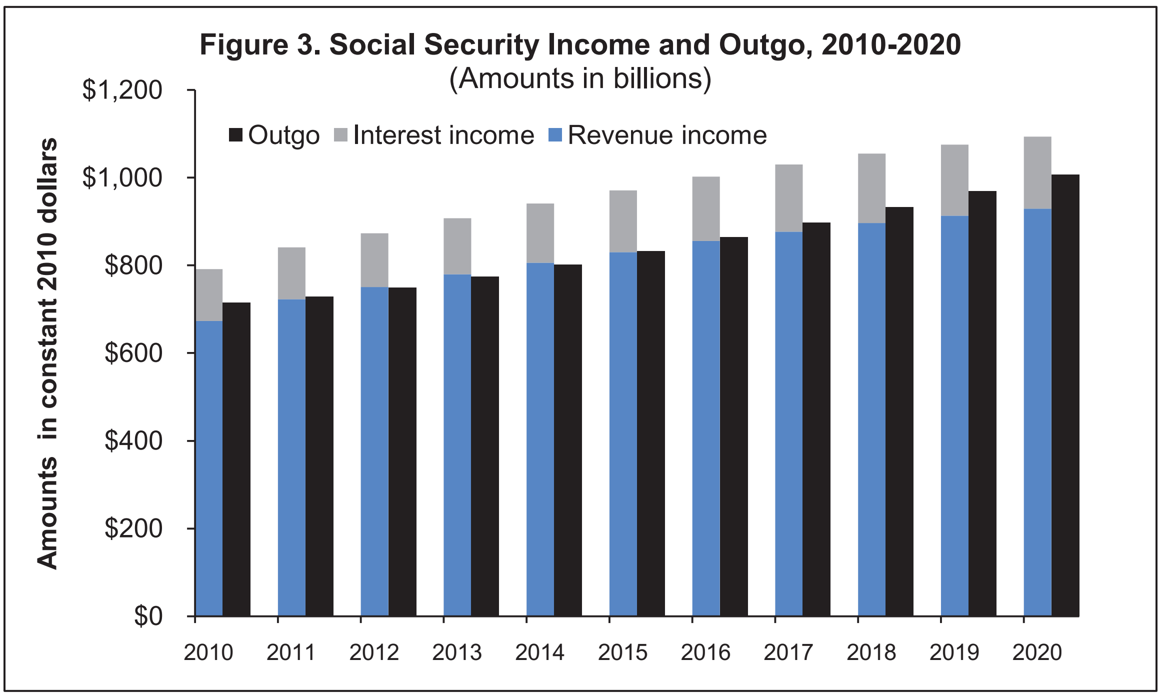
By law, Social Security's surplus funds are invested in interest-bearing securities that are backed by the full faith and credit of the United States government. Currently all trust fund assets are invested in special issue securities, largely U.S. Treasury bonds. These securities earn interest that 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. Private pension funds have large investments in U.S. government bonds, as do many foreign governments.

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 2010, 19 percent of the national debt was owed to the Social Security trust funds; another 15 percent was held by other federal trust funds or accounts.[10]

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; rather, it is an investment of the program's reserves in one of the safest investments available.[11] Regardless of how the government uses the cash, 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. The promise to pay that is embodied in government bonds has never been broken.

What is the Social Security "cash flow" balance?

The "cash flow" balance calculates Social Security's annual income and outgo without counting the interest on trust fund reserves. For example, some media reports announced that "Social Security has gone cash flow negative." In fact, the program had a $69 billion surplus of total income over total outgo in 2010. Figure 3 shows Social Security's annual outgo and its annual income from revenues and from interest each year from 2010 to 2020.



Source: Board of Trustees, 2010: Table VI.F7.

From a budget perspective, the interest owed to Social Security is an outflow from the non-Social Security budget to the Social Security trust fund. From a Social Security financing perspective, the interest is an integral part of the program's income. It is a legal obligation of the federal government.

Social Security's finances are strong over the next ten years. Relatively modest revenue increases in the future, or gradual benefit adjustments, could bring the program into financial balance over the next 75 years and beyond.

Endnotes

[1] Social Security Administration (SSA), 2011a; U.S. Census Bureau, 2010a.
[2] U.S. Census Bureau, 2010b.
[3] SSA, 2011a.
[4] U.S. Department of Health and Human Services, 2011.
[5] SSA, 2010.
[6] Reno and Lavery, 2009.
[7] These measures of actuarial solvency draw on work by Kenneth Buffin (2002). They compare the resources available to the program (beginning balance plus future revenues and interest) over a period of time to scheduled obligations over the same period. For this purpose, obligations do not include a target fund at the end of the period. The estimates are derived from information in Table IV.B4 of the Trustees Report.
[8] The combined increase is slightly higher than the actuarial deficit due to the assumed response of employees and employers to an increase in the contribution rate.
[9] Gregory et al., 2010; Reno and Lavery, 2009.
[10] U.S. Department of the Treasury, 2011: Tables FD-1 and 3.
[11] Van de Water, 2010.

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