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Social Security Finances: Findings of the 2012 Trustees Report

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Summary

The 2012 Trustees Report shows that Social Security is 100 percent solvent until 2033, but faces a moderate long-term shortfall. In 2011, Social Security had a surplus – revenue plus interest income in excess of outgo – of $69 billion. Reserves are projected to grow to $3.1 trillion by the end of 2020. Then, if Congress takes no action in the meantime, reserves would start to be drawn down to pay benefits. In the highly unlikely event that Congress does not act before 2033, the reserves would be depleted and revenue coming into the trust funds from workers' and employers' contributions would cover about 75 percent of scheduled benefits (and administrative costs, which are less than 1 percent of outgo). While the trustees' projections indicate that major changes are not needed, modest changes should be made in a timely manner and can bring Social Security into long-term balance.

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.

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 virtually all other government projections. This reflects the great importance of Social Security. Although 75-year projections are inherently uncertain, they provide a long lead time for consideration and adoption of changes that may be needed to maintain long-term balance. The 2012 report is the 72nd to be issued and is available on the Office of the Chief Actuary of Social Security website: www.ssa.gov/OACT.

Who pays for Social Security?

Workers and employers pay for Social Security through mandatory contributions as called for under the Federal Insurance Contributions Act (FICA). Contributions are levied on earnings up to an annual cap, which is $110,100 in 2012. Workers currently pay 4.2 percent of their earnings – temporarily reduced from 6.2 percent under the "payroll tax holiday" enacted in 2010 and extended through 2012 – and employers pay an additional 6.2 percent. Self-employed workers pay both the employee and the employer share but are allowed to deduct the employer share from their taxable personal income. In addition, some beneficiaries pay income taxes on part of their benefits, with part of this income-tax revenue going to the Social Security trust funds and part going to the Medicare Hospital Insurance fund. Interest earned on accumulated trust fund reserves is a third source of income.

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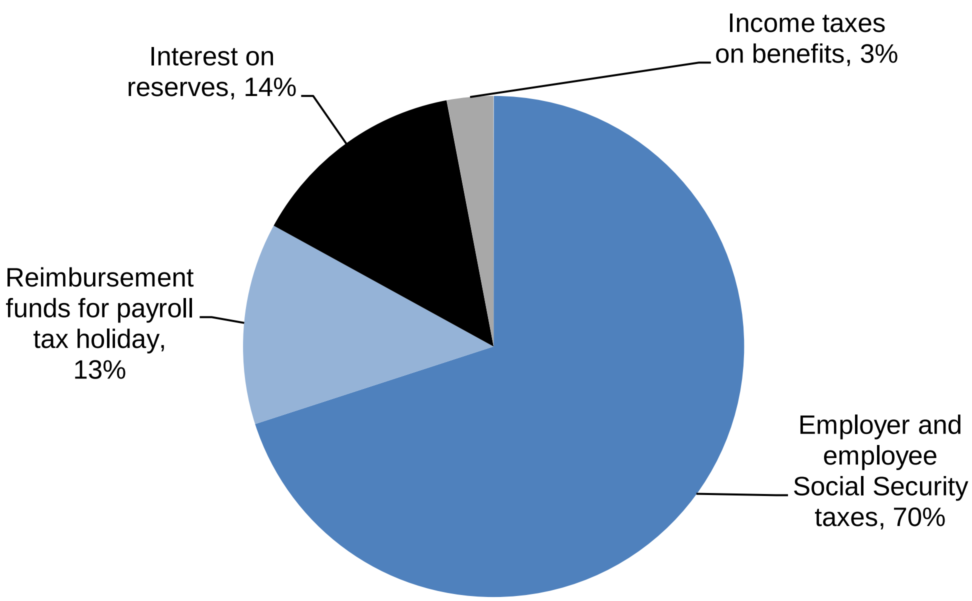
The “payroll tax holiday” that temporarily reduces workers’ contribution rates adds a fourth source of dedicated income to Social Security: reimbursement funds from general revenues, replacing dollar-for-dollar all of the reduction in revenue caused by the payroll tax holiday.[1] In 2011, these reimbursement funds made up 13 percent of Social Security’s income that otherwise would have come from workers’ contributions. Income from worker and employer contributions accounted for 70 percent of trust fund income, while income taxes paid by beneficiaries accounted for 3 percent, and interest on reserves was 14 percent (Figure 1).

Figure 1. Shares of Income to the Trust Funds, 2011



Who receives Social Security?

Social Security pays monthly benefits that replace part of the 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 2012, 55.6 million people, or more than one in six Americans, received Social Security benefits.[2] One family in four receives income from Social Security.[3] Beneficiaries include 35.8 million retired workers, 4.4 million widows and widowers, and 2.5 million spouses. About 8.6 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. About 3.4 million children under age 18 (or under age 19 and still in high school) receive benefits as dependents.[4]

How much does Social Security pay?

The average monthly benefit paid to all retired workers in January 2012 was $1,230, or about $14,760 annually (Table 1).[5] The average benefit was somewhat smaller for disabled workers ($1,110) and for widows and widowers age 60 or older ($1,185). Benefits are higher for families. Widowed mothers or fathers with two children received $2,487, on average, or about $29,840 a year, while disabled workers with a young spouse and one or more children received $1,878 a month, on average, or about $22,540 a year. For comparison, the 2012 federal poverty guideline for a family of three is $19,090 a year; for a family of four it is $23,050.[6]

Table 1. Average Monthly Benefits, January 2012	
By Beneficiary Type:	**Benefit**
Retired workers	$1,230
Disabled workers	$1,110
Aged widows or widowers	$1,185
By Family Type:	**Benefit**
Retired worker and aged spouse	$1,997
Widowed parent and two children	$2,487
Disabled worker, young spouse and one or more children	$1,878

Source: SSA, 2012b; SSA, 2012c.

Social Security is the main source of income for most people 65 years of age and older. For nearly one in two married couples and two in three unmarried individuals over age 65, Social Security accounts for more than half of total income.[7] 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.*[8]

Social Security benefits are generally increased each year by a cost-of-living adjustment (COLA) that is based on the consumer price index for urban wage earners (CPI-W). A 3.6 percent COLA took effect in December 2011, increasing benefits paid in January 2012 and thereafter.

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) while the high-cost estimate is based on more pessimistic assumptions. For each scenario the Trustees Report projects the status of the funds for the short and long term.

What do the trustees project for the near term?

In 2012, the Social Security trust funds are projected to collect $846.0 billion and pay out $788.7 billion, leaving a surplus of $57.3 billion (Table 2). Almost all outgo will be used to pay benefits; less than 1 percent of outgo will be spent on administration. Income consists of revenues – contributions from workers and employers, general fund reimbursement for the 2011-2012 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, and these invested assets make up the trust fund reserves. Since 1935, Social Security has collected $15.5 trillion and spent $12.8 trillion, leaving a balance of approximately $2.7 trillion in its trust funds at the end of 2011. Under the intermediate assumptions, the Social Security trust funds are projected to have surpluses each year until 2021. 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 2020, the reserves are estimated to be $3.1 trillion.

Table 2. Social Security at a Glance, 2010-2012			
	2010	2011	2012 projected
Income (in billions)	$781.1	$805.1	$846.0
Outgo (in billions)	$712.5	$736.1	$788.7
Surplus (in billions)	$68.6	$69.0	$57.3
Trust fund balance (in billions)	$2,609.0	$2,677.9	$2,735.2
Covered workers (in thousands)	156,978	157,736	159,393
Beneficiaries (in thousands)	53,398	54,816	56,345
COLA[a]	0.0%	0.0%	[b] 3.6%
Taxable maximum	$106,800	$106,800	[b] $110,100

Source: Board of Trustees, 2012.
[a] COLAs shown are effective beginning with benefits paid in January of the year indicated.
[b] Actual.

What do the trustees project for the longer term?

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

- Over the next 21 years, Social Security is projected to be 100 percent solvent – that is, its income and trust fund reserves can cover all scheduled payments.
- Over the next 25 years, Social Security is projected to be 96 percent solvent – that is, scheduled resources are expected to cover 96 percent of expected outgo.
- Over the next 50 years, Social Security is projected to be 88 percent solvent.
- Over the next 75 years, Social Security is projected to be 85 percent solvent.

These measures of actuarial solvency illustrate the extent to which the program's assets and income are projected to meet future obligations.[9] The 25-, 50-, and 75-year projections indicate that remedial actions will be needed to ensure that all legislated benefits will be paid.

The report highlights other key dates about Social Security's future finances:

- In 2021, revenues plus interest income are expected to be less than total outgo for that year. If no action is taken before then, reserves would then start to be drawn down to pay benefits.
- In the highly unlikely event that Congress does not act before 2033, the reserves are expected to be depleted, and revenue coming into the funds then would cover about 75 percent of scheduled benefits and administrative costs.

The long-range actuarial shortfall is projected to be 2.67 percent of taxable payroll – that is, 2.67 percent of all earnings subject to Social Security contributions. To put this in perspective, that projected shortfall could be eliminated by immediately raising the contribution rate paid by employees and employers from 6.2 percent to 7.6 percent for each.[10] Many options exist to schedule future revenues and/or adjust future benefits to keep the system in balance for the entire 75-year estimating period.[11]

Disability insurance trust fund needs attention soon

Social Security has a separate trust fund to finance benefits for disabled workers and their families. Of the 6.2 percent of earnings that workers and employers each normally pay for Social Security, 0.9 percent is for the Disability Insurance (DI) trust fund, and the remaining 5.3 percent goes to the Old-Age and Survivors Insurance (OASI) trust fund. Often the two funds are considered together as the OASDI, or Social Security, trust funds, but by law they are separate and cannot borrow from each other. Viewed separately, the DI fund can cover promised benefits until 2016 and the OASI fund can do so until 2035. Congress could authorize inter-fund borrowing or reallocate the 6.2 percent contribution rate to equalize the solvency of the two funds, as has been done many times before. The most recent reallocation in 1994 was expected to keep DI in balance until 2016. Despite the great uncertainty of long-range projections, that estimate is strikingly on the mark 18 years later. Lawmakers could act in the next few years to reallocate the rate so that both funds would cover all benefits until 2033 and revenues would cover about 75 percent of benefits due from both funds thereafter. Another option is to allocate additional resources to the program – beyond the current Social Security contributions – sufficient to keep the DI trust fund solvent for the long term.

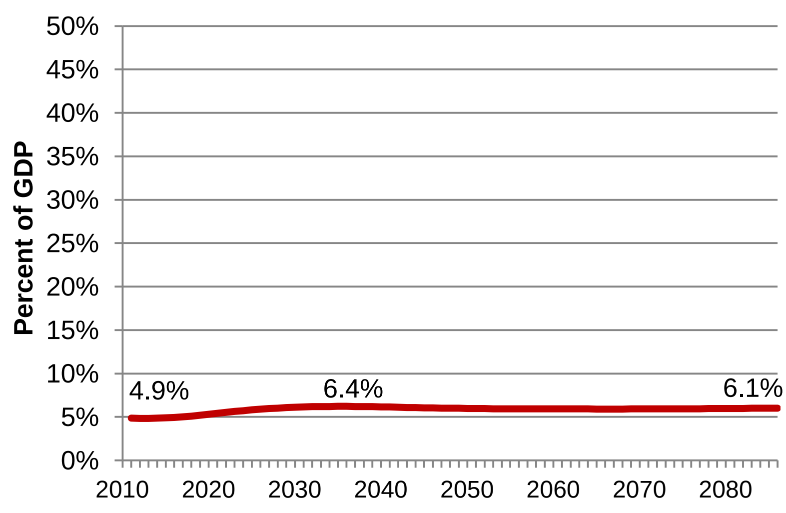
What do the low-cost and high-cost projections show?

Under the trustees' high-cost scenario, the Social Security trust fund reserves would be depleted in 2027 instead of 2033. Under the low-cost scenario, Social Security would be fully financed through the 75-year projection period and beyond. The difference among estimates reflects the great uncertainty about what the distant future holds.

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. In 2011, Social Security outgo was 4.9 percent of the economy, or gross domestic product (GDP). It is projected to rise to 6.4 percent of the economy by 2035, when all baby boomers will be retired, and then to decline, remaining between 6.0 and 6.1 percent of the economy from 2050 through 2086 (Figure 2).

Figure 2. Social Security Outgo as a Percent of the Economy (GDP), 2011-2086



Source: Board of Trustees, 2012: Table VI.F4.

What has changed since last year's projections?

The projected long-term revenue shortfall increased from 2.22 percent of payroll in 2011 to 2.67 in the 2012 Trustees Report. In the absence of congressional action, the year in which trust funds would be fully drawn down shifted from 2036 to 2033. What has caused this decline in Social Security balances?

Year-to-year changes in the estimates are to be expected, particularly in a volatile economy. Key reasons for the changes between the 2011 and 2012 projections include:

- **Higher than expected inflation** in 2011, which brought a higher cost-of-living adjustment in January 2012 than was expected a year ago (3.6 percent instead of 0.7 percent), thereby increasing outgo in 2012 and beyond; and

- **Slower than expected recovery** from the Great Recession, which resulted in somewhat less income due to slower growth in taxable earnings and lower interest on trust fund reserves. Changed economic assumptions also result in slower long-term revenue gains.

The increase in the projected shortfall is evidence that Social Security has been serving its purpose in mitigating the impact of the Great Recession by keeping benefits up with inflation and weathering slow growth in taxable earnings during the sluggish recovery.

Where does the Social Security surplus go?

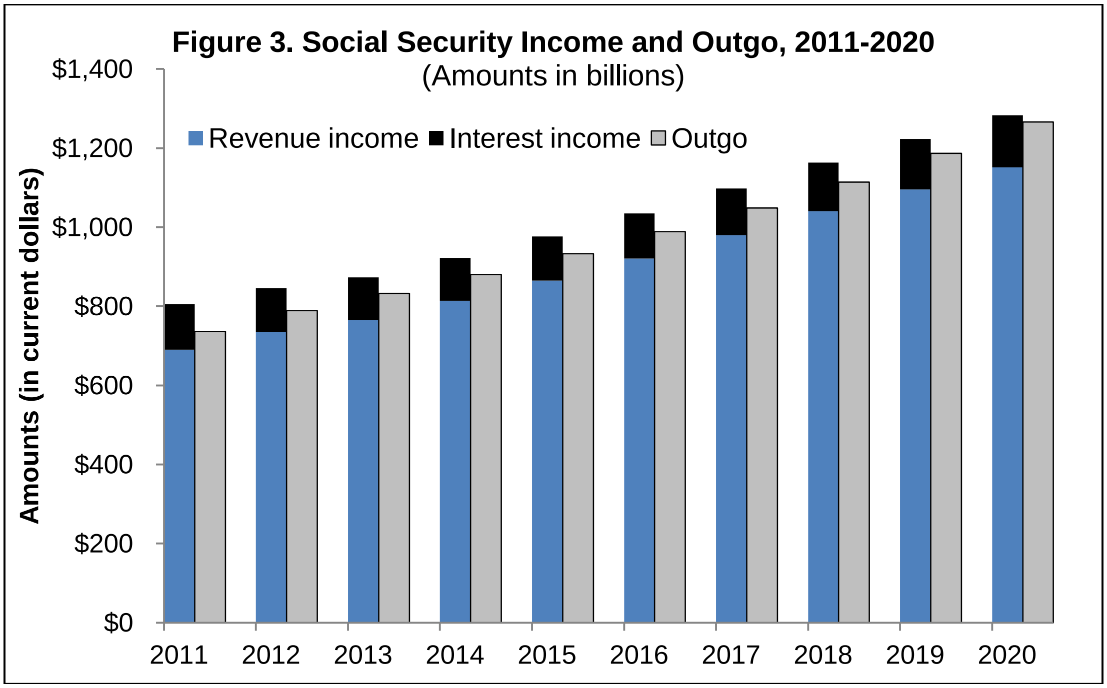
By law, Social Security's surplus funds are invested in interest-bearing securities that are backed by the full faith and credit of the United States government. Currently all trust fund assets are invested in special issue securities, largely U.S. Treasury bonds. These securities earn interest that 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 an extremely 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 2011, 18 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.[12]

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 precisely the procedure that has been required by law since the inception of the program. This procedure has the advantage of investing the program's reserves in one of the safest financial instruments available.[13] 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?

Discussions of "cash flow" balance calculate Social Security's annual income and outgo without counting the interest on trust fund reserves. For example, in 2011 some media reports stated that "Social Security has gone cash flow negative." In fact, the program had a $69 billion surplus of total income over total outgo in 2011. Figure 3 shows Social Security's annual outgo and its annual income from revenues and from interest for 2011 and as projected for each year until 2020.



Source: Board of Trustees, 2012: Table VI.F8.

From a unified federal 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.

Conclusion

Social Security's finances are strong but require moderate adjustment for the long run. Timely revenue increases and/or gradual benefit adjustments can bring the program into long-term balance and extend the solvency of the disability insurance trust fund.

Endnotes

[1] Walker, Bethell, and Reno, 2012.
[2] Social Security Administration (SSA), 2012b; U.S. Census Bureau, 2011a.
[3] U.S. Census Bureau, 2011b.
[4] SSA, 2012b.
[5] SSA, 2012b.
[6] U.S. Department of Health and Human Services, 2012.
[7] SSA, 2012d.
[8] Reno and Lavery, 2009.
[9] 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.

NATIONAL ACADEMY OF•SOCIAL INSURANCE

[10] 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.
[11] Gregory et al., 2010; Reno and Lavery, 2009.
[12] U.S. Department of the Treasury, 2012: Tables FD-1 and 3.
[13] Van de Water, 2010.

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