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Social Security Finances: Findings of the 2013 Trustees Report

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Summary

The 2013 Trustees Report updates projections about the future finances of Social Security's two trust funds. The Disability Insurance (DI) trust fund, which is legally separate from the Old-Age and Survivors Insurance (OASI) trust fund, requires legislative action soon to ensure that all scheduled benefits for disabled workers and their families can be paid in 2016 and beyond. Of the 6.2 percent of earnings that workers and employers each pay into Social Security, 5.3 percent goes to the OASI trust fund and 0.9 percent goes to the DI trust fund. A temporary reallocation of that rate could strengthen DI while only slightly changing the trustees' OASI financial forecast.

On a combined OASDI basis, Social Security is fully funded until 2033, but faces a long-term shortfall thereafter. In 2012, Social Security revenue plus interest income exceeded outgo by $54 billion, leaving a surplus. Reserves, now at $2.7 trillion, are projected to grow to $2.9 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 continuing to come into the trust funds from workers' and employers' contributions and taxation of benefits would cover about 77 percent of scheduled benefits (and administrative costs, which are less than 1 percent of outgo). Timely revenue increases and/or gradual benefit reductions can bring the program into balance over the long term.

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 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 must be 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 almost all other government or private projections. This reflects the great importance of Social Security and the fact that its commitments are very long-term. A high degree of stability and predictability is a valued part of the Social Security tradition. Although 75-year projections are inherently uncertain, they provide a long lead time for policymakers to consider, and for citizens to express their views on, changes that achieve long-term balance. The 2013 report is the 73rd to be issued and is available on the website of the Office of the Chief Actuary of Social Security: www.ssa.gov/OACT.

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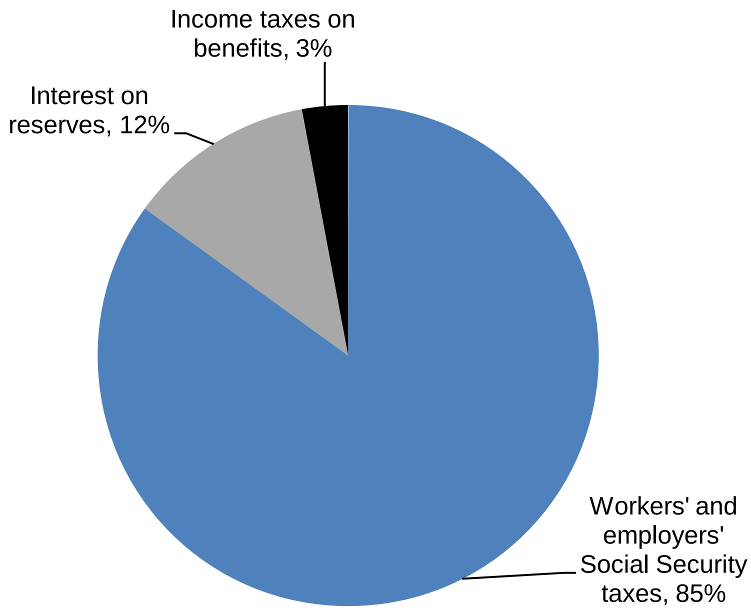
Who pays for Social Security?

Workers and employers pay for Social Security through mandatory contributions under the Federal Insurance Contributions Act (FICA). Workers and employers each pay 6.2 percent of earnings up to an annual cap, which is $113,700 in 2013.[1] Self-employed workers pay both the employee and the employer share and can deduct the employer share from their taxable personal income. Upper-income beneficiaries pay income taxes on part of their benefits; part of this income-tax revenue goes to the Social Security trust funds and part goes to the Medicare Hospital Insurance trust fund. Social Security's surpluses are invested in U.S. Treasury bonds, and interest earned on accumulated Social Security trust fund reserves is a third source of program income. Income from worker and employer contributions is projected to account for 85 percent of trust fund income in 2013, while income taxes paid by beneficiaries will account for 3 percent, and interest on reserves will be 12 percent (Figure 1).[2]

Figure 1. Shares of Income to the Trust Funds, 2013



Source: Board of Trustees, 2013: Table IV.A3.

Who receives Social Security?

Social Security pays monthly benefits that replace part of the earnings that are lost when a worker who has paid into the program becomes disabled, retires, or dies. Benefits are paid to the worker and to family members who had relied on the lost earnings. In January 2013, 56.9 million people, or more than one in six Americans, received Social Security benefits.[3] One family in four receives income from Social Security.[4] Beneficiaries include 36.9 million retired workers, 4.3 million widows and widowers, and 2.4 million spouses. About 3.4 million children under age 18 (or under age 19 and still in high school) receive benefits as dependents. About 8.8 million disabled workers receive benefits, along with about 1.0 million adults whose disabilities began in childhood and who were dependents of deceased, disabled or retired parents.[5]

How much does Social Security pay?

The average monthly benefit paid to all retired workers in January 2013 was $1,264, or about $15,168 annually (Table 1).[6] The average benefit was somewhat smaller for disabled workers ($1,130) and for widows and widowers age 60 or older ($1,217). Benefits are higher for families. For example, widowed mothers or fathers with two children received $2,536 a month, on average, or about $30,432 a year, while disabled workers with one or more children received $1,735 a month, on average, or about $20,820 a year.[7] For comparison, the 2013 federal poverty guideline for a family of two is $15,510 a year; for a family of three it is $19,530, and for four it is $23,550.[8]

Table 1. Average Monthly Benefits, January 2013	
By Beneficiary Type:	**Benefit**
Retired workers	$1,264
Disabled workers	$1,130
Widows or widowers (60 or older)	$1,217
By Family Type:	**Benefit**
Retired worker and spouse (62 or older)	$2,055
Widowed mother or father and two children	$2,536
Disabled worker and one or more children	$1,735

Source: SSA, 2013a; SSA, 2013b.

Social Security is the main source of income for most people age 65 and older. For one in two married beneficiary couples and nearly three in four unmarried beneficiaries over age 65, Social Security accounts for more than half of total income.[9] More information about the role of Social Security in the incomes of beneficiaries is in the Academy's publication "Social Security: A Key Part of Policies to Strengthen Retirement Security."[10]

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 1.7 percent COLA took effect in December 2012, increasing benefits paid in January 2013 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." 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 short term?

In 2013, the Social Security trust funds are projected to collect $854.8 billion and pay out $826.8 billion, leaving a surplus of $28.0 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, 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. Treasury securities, and these invested assets make up the trust fund reserves. Since 1935, Social Security has collected $16.3 trillion in revenues and interest and paid out $13.6 trillion in benefits and administrative costs, leaving a balance of $2.7 trillion in its trust funds at the end of 2012. 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 $2.9 trillion.

Table 2. Social Security at a Glance, 2011-2013

	2011	2012	2013 projected
Income (in billions)	$805.1	$840.2	$854.8
Outgo (in billions)	$736.1	$785.8	$826.8
Surplus (in billions)	$69.0	$54.4	$28.0
Trust fund balance[a] (in billions)	$2,677.9	$2,732.3	$2,760.3
Covered workers (in thousands)	157,736	160,910	162,823
Beneficiaries (in thousands)	54,816	56,176	57,712
COLA[b]	0.0%	3.6%	[c] 1.7%
Taxable maximum	$106,800	$110,100	[c] $113,700

Source: Board of Trustees, 2013.
[a] Trust fund balances shown are as of the end of the year indicated.
[b] COLAs shown are effective beginning with benefits paid in January of the year indicated.
[c] 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 trustees recognize that the reliability of the financial projections declines as the projection period increases. Under intermediate assumptions:

- Over the next 20 years, Social Security is projected to be fully funded – that is, its income and trust fund reserves can cover all scheduled payments.
- Over the next 25 years, Social Security finances are projected to be 96 percent sufficient – that is, scheduled resources are expected to cover 96 percent of expected outgo.
- Over the next 50 years, Social Security finances are projected to be 88 percent sufficient.
- Over the next 75 years, Social Security finances are projected to be 84 percent sufficient.

These measures of financial self-sufficiency illustrate the extent to which the program's assets and income are projected to meet future obligations.[11] 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 continuing to come into the funds would cover about 77 percent of scheduled benefits and administrative costs.

The long-range actuarial shortfall is projected to be 2.72 percent of taxable payroll – that is, 2.72 percent of all earnings that are subject to Social Security contributions. To put this in perspective, the projected shortfall would be eliminated if the contribution rate paid by employees and employers each were 7.7 percent instead of 6.2 percent.[12]

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

In the trustees' high-cost scenario, Social Security's reserves would be depleted in 2027 (instead of 2033 in the best-estimate scenario), and during the first 25 years, the program's finances would be sufficient to cover 86 percent (instead of 96 percent) of its outgo. In the low-cost scenario, Social Security would be depleted in 2068, and during the first 25 years, Social Security's finances would cover 106 percent (instead of 96 percent) of program outgo. The difference among estimates reflects the great uncertainty about what the distant future holds.

Disability insurance trust fund needs attention soon

Of the 6.2 percent of earnings that workers and employers each pay for Social Security, 5.3 percent is for the Old-Age and Survivors Insurance (OASI) trust fund, and the remaining 0.9 percent goes to the Disability Insurance (DI) trust fund to pay benefits for disabled workers and their families. While the two funds are often considered together as the OASDI, or Social Security, trust funds, by law they are separate and are not authorized to borrow from each other. Viewed separately, the DI fund can cover promised benefits only until 2016, while the OASI fund can do so until 2035.

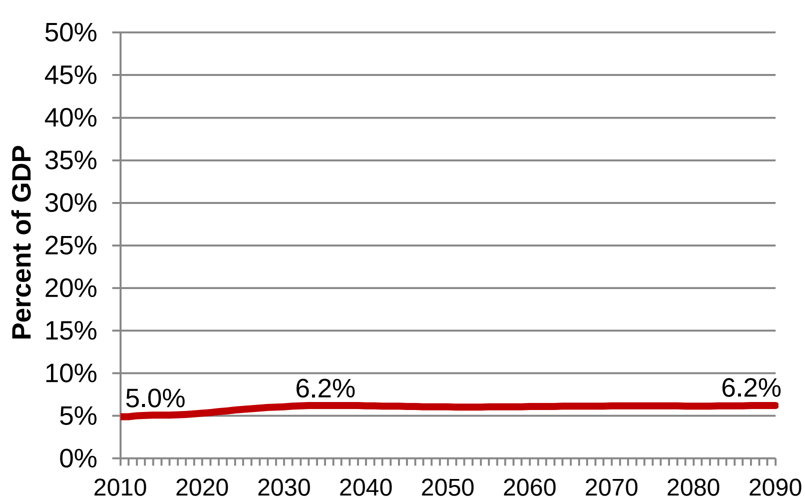
Lawmakers need to act before 2016 to ensure that current benefits continue for disabled workers and their families. One option is for Congress to reallocate the 6.2 percent tax rate to equalize the projected solvency of the two funds, as has been done many times before. The most recent reallocation in 1994 was expected to keep DI solvent until 2016. Despite the great uncertainty of long-range projections, that estimate has proved accurate. Another approach to make DI solvent is to raise the DI tax rate from 0.9 to 1.1 percent for workers and employers each. This would make DI solvent over the next 75 years, according to estimates by the Social Security actuaries and by the Congressional Budget Office with the Joint Committee on Taxation.[13]

All subsequent references to the Social Security trust funds in this brief refer to the combined OASDI trust fund. For more information on the DI trust fund and options to keep it solvent, see NASI's brief, "Social Security Disability Insurance: Action Needed to Address Finances."[14]

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 2012, Social Security outgo was 5.0 percent of the economy, or gross domestic product (GDP). It is projected to rise to 6.2 percent of the economy by 2035, when all baby boomers will be retired, and then to decline somewhat, remaining between about 6.0 and 6.2 percent of the economy thereafter (Figure 2).

Figure 2. Social Security Outgo as a Percent of the Economy (GDP), 2010-2090



Source: Board of Trustees, 2013: Table VI.F4.

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What happens to the Social Security surplus?

By law, Social Security's surplus funds are invested in interest-bearing Treasury securities that are backed by the full faith and credit of the United States. 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 benefits. In financial markets, Treasury securities (bills, notes and bonds) are considered an extremely safe investment because they are backed by the United States. Private pension funds maintain large investments in U.S. bonds, as do many institutional investors and 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 2012, 17 percent of the national debt was owed to the Social Security trust funds; another 14 percent was owed to other federal trust funds or accounts.[15]

Some people become concerned when they hear that Social Security's annual cash surpluses are loaned to the U.S. Treasury. This is not a misuse of Social Security funds; rather, it is the procedure that has been required by law since the inception of the program. This procedure has the advantage of investing Social Security's reserves in one of the safest financial instruments available.[16] 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 U.S. Treasury securities has never been broken.

What has changed since last year's projections?

Social Security's projected long-term revenue shortfall increased from 2.67 percent of taxable payroll in 2012 to 2.72 percent in the 2013 Trustees Report. In the absence of congressional action, the year in which the trust funds would be fully drawn down remained 2033.

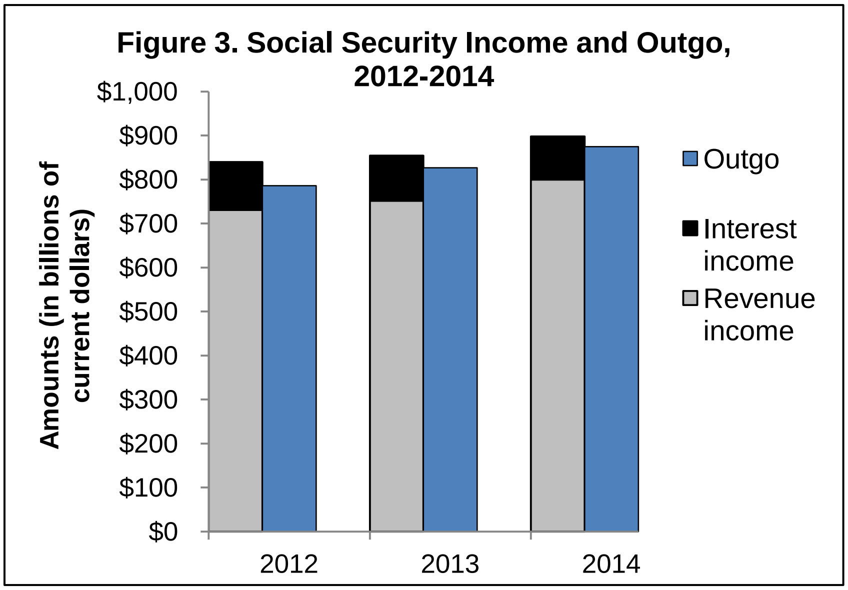
In short, the projections have changed little this year. The slight increase in the program's long-term shortfall is due primarily to the one-year advance in the 75-year projection period, which is now 2013-2087.

Year-to-year changes in the estimates are to be expected. Reasons for the changes between the 2012 and 2013 projections include changes in law, updates to data, and improvements in methodology.

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. In recent years some media reports have stated that "Social Security has gone cash flow negative." But the cash flow balance is not an accurate representation of the Social Security trust funds. In fact, the program had a $54 billion surplus of total income over total outgo in 2012 and is projected to continue running surpluses until 2021. Figure 3 shows Social Security's annual income from revenues and interest and its annual outgo for 2012 and as projected for 2013 and 2014.

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 earned on the reserves is an integral part of the program's income. It is a legal obligation of the federal government.



Source: Board of Trustees, 2013: Table VI.F8.

How can policymakers address Social Security's long-term shortfall?

Policymakers have many options to schedule additional revenues and/or reduce future benefits to keep the system in balance for the entire 75-year projection period (see NASI's report, *Fixing Social Security*).[17] For example, NASI recently conducted a national survey to find out how Americans would prefer to balance Social Security's finances for the long term. The study, *Strengthening Social Security: What Do Americans Want?*, found that Americans would rather pay more than see benefits reduced.[18] In particular, more than 7 in 10 Americans across generations and income groups preferred a package of changes that would raise revenues in two ways: by gradually eliminating the cap on taxable earnings and by gradually increasing the payroll tax rate from 6.2% to 7.2%. The preferred package would also increase the minimum benefit for low-paid workers with long work records, and adopt a COLA based on price increases experienced by seniors. This package of four changes would convert the program's projected long-term revenue shortfall into a modest surplus, providing a margin of safety. Many other options exist.

Conclusion

In the short term, legislation is needed to ensure that disability insurance benefits will continue as scheduled in law. A temporary reallocation of the existing 6.2 percent tax rate could strengthen DI and equalize the OASI and DI trust funds so that both funds can pay all legislated benefits through 2032. In the longer term, timely revenue increases and/or gradual benefit adjustments can bring the program into long-term balance, ensuring that Social Security will continue to pay all promised benefits for the next 75 years.

Endnotes

[1] In 2011 and 2012, the contribution rate for workers was temporarily reduced to 4.2 percent of earnings under the "payroll tax holiday" enacted in 2010 and extended through 2012. The resulting reduction in revenue was reimbursed dollar-for-dollar from general revenues. These reimbursement funds from general revenues made up 14% of Social Security's income that otherwise would have come from workers' contributions. See Walker, Bethell, and Reno, 2012.
[2] Board of Trustees, 2013: Table IV.A3.
[3] Social Security Administration (SSA), 2013a; U.S. Census Bureau, 2012a.
[4] U.S. Census Bureau, 2012b.
[5] SSA, 2013a.
[6] SSA, 2013a.
[7] SSA, 2013b.
[8] U.S. Department of Health and Human Services, 2013.
[9] SSA, 2012.
[10] Reno, 2012.

[11] 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.
[12] 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.
[13] Board of Trustees, 2013; Manchester, 2013.
[14] Reno, Walker, and Bethell, 2013.
[15] U.S. Department of the Treasury, 2013: Tables FD-1 and FD-3.
[16] Van de Water, 2010.
[17] Reno and Lavery, 2009.
[18] Tucker, Reno, and Bethell, 2013.

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