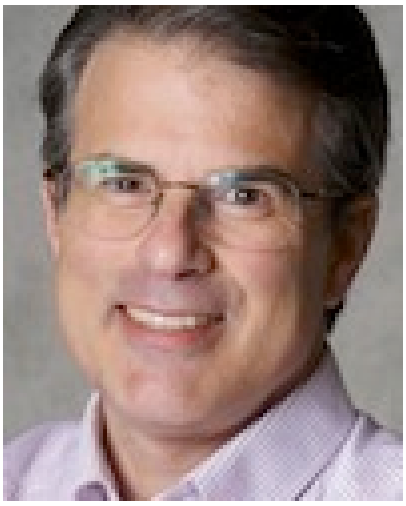
Social Security Needs Our Attention

By Kerry Pechter *Thu, Sep 2, 2021*

Time is money, and the longer we ignore the Social Security situation, the more we'll have to pay to fix it. The just-released 2021 Trustee's Report shows the cost of delay.



The 2021 Social Security Trustees **report** has just been published. One flashing red number from the new report: $19.8 trillion. That's the present value of the unfunded obligations of the OASDI—Social Security and Disability Insurance—between 2021 and 2096. That number went up by $3 trillion in the past year.

I thought the $19.8 trillion figure might mean that Social Security would be able to pay all its benefits for the next 75 years if it received an instant infusion of almost $20 trillion. Wrong, according to Andrew Eschtruth of the Center for Retirement Research (CRR) at Boston College.

"The 19.8 trillion is not an investment-oriented concept, so it's not intended to provide the answer to the question you are asking, which is 'How much would the government need in hand today to fully fund all benefits for the next 75 years,' he said in an email.

"The 19.8 trillion does not take interest earnings into account at all. It simply provides the present value of the aggregate cash flow shortfalls over the period. So it subtracts income (tax revenue) from costs in each year and provides the present discounted value of the amounts over the 75-year period."

If Social Security were an advance-funded pension plan, or if the public voted to transition it to a fully funded pension plan, the transition might cost something like $20 trillion. But that would not reflect the $500 billion to $1 trillion per year that a $20 trillion pension fund might generate in interest.

Confused about the health of Social Security, and whether it will "be there" in the future? I am.

Eschtruth sent me to a **supplement** to the main 2021 trustees report for further explanation. The supplement said that $19.8 trillion was the unfunded obligation of Social

Security for the next 75 years. But it went on to say that the present value of Social Security's unfunded obligation for the *infinite* future is currently *$59.8 trillion*, up $6.8 trillion from a year ago.

Of course, projections for the infinite future are highly uncertain. We don't know what the US population will be in the 22nd century, or if the earth will even be able to sustain life as we know it at that time.

A better way to grasp the cost of Social Security's looming shortfall is to estimate the tax hike that would be necessary to ensure that the program's tax revenues will equal its benefit obligations in the future.

"To illustrate the magnitude of the 75-year actuarial deficit, consider that for the combined OASI and DI Trust Funds to remain fully solvent throughout the 75-year projection period:

- Revenue would have to increase by an amount equivalent to an immediate and permanent payroll tax rate increase of 3.36 percentage points to 15.76%;
- Scheduled benefits would have to be reduced by an amount equivalent to an immediate and permanent reduction of about 21% applied to all current and future beneficiaries, or about 25% if the reductions were applied only to those who become initially eligible for benefits in 2021 or later; or
- Some combination of these approaches would have to be adopted.

The trustees pointed out that the longer we wait to raise payroll taxes (if we want to maintain promised benefits), the higher we will have to raise them. If we don't deal with it before 2034, there will need to be a permanent 4.20 percentage-point payroll tax rate increase to 16.60% starting at that time, a permanent 26% percent reduction in all benefits or some combination of these approaches.

Of course, these are not the only options open to us. Various advocacy groups and policy groups like the CRR, AARP and the Bipartisan Policy Center have proposed various combinations of tax rates, increases in the "FICA limit" (the level of income subject to payroll taxes ($137,700 in 2020), cuts in benefits, or a change in the growth rate of benefits, that would bring Social Security revenues in line with expenditures. Raising the retirement age for full benefits may be proposed but it won't be popular.

The fatal flaw in Social Security—the hole in the bucket—seems to be the rising "dependency ratio." Birth rates have fallen and life expectancies have risen, so there are fewer workers per beneficiary. In 1955, a year after Social Security was expanded to cover

10 million more workers, 68 million workers paid in (4% tax withheld on up to $4,200 income) and 7.64 million people received benefits. There were almost nine contributors for every dependent.

By 1990, the dependency ratio had worsened substantially. About 133 million people contributed to OASDI and 39.8 million received benefits, for a ratio of about 3.4 contributors to one dependent. The tax rate reached 12.4% for the first time that year, on up to $51,000 income. In 2020, 175 million contributed and 65 million received benefits for a ratio of about 2.6 workers per beneficiary. The tax rate was 12.4% on up to $137,000 in income.

These are harsh numbers, reflecting a basic unfairness for some observers. “Crudely, the first generation gets $3 for each $1 paid, the second generation pays more but then gets $2 for each $1 paid, the next generation $1 for each $1 paid, and eventually some generation gets 80 cents for each $1 paid,” Gene Steurele of the Urban Institute told me yesterday.

“Or, again, in simplified form, remember that one generation has four workers per retiree, the next three workers per retiree, the next two workers per retiree, etc. Suppose the birth rate falls to zero and everybody is over 65 at some point. How is that last generation going to come out ahead? It’s the denial of these facts that makes reform so hard.”

Steurele’s argument made me wonder where I stood on the ladder of descent into higher taxes and lower benefits. My first job paid $6,500. My Social Security benefit at age 70 will be about $36,000. Am I getting a worse deal than my parents, and a better deal than my children? Given the complexity of the Social Security crediting formula, I can’t tell.

I feel like I’ve paid my share, or part of it. Starting with the Social Security reforms of 1983, I and other workers started pre-funding our own benefits. With our help, Social Security revenues exceeded outflows, creating a trust fund. The trust fund’s principal will decline by $1.5 trillion, from $2.9 trillion today, over the next 10 years, and will be exhausted by 2033, based on current projections.

Since the US Treasury buys back trust fund bonds from Social Security, an increasing amount of current benefits are now coming out of the nation’s general account to supplement payroll taxes. There was no crisis when those flows started; the public barely noticed. But, unless Congress changes the law, benefits will automatically drop by about 20% in 2033, to the level funded purely by payroll taxes. Higher immigration might help, but that’s a touchy subject.

I’m not especially worried about the future of Social Security. As one long-time retirement policy wonk assured me last week, Social Security is still the “third rail” of American politics. Phones on Capitol Hill will be ringing with calls from angry Gray Panthers who vote, he said, if Congress ever threatens it.