Social Security: A manageable problem

By Alicia H. Munnell *Wed, Apr 25, 2012*

If employees and employers each paid 1.34 percentage points more in payroll taxes, starting immediately, everyone who reaches retirement age at least through 2086 would receive the current package of Social Security benefits, according to Alicia Munnell of Boston College.

The following is excerpted from "Social Security's Financial Outlook: The 2012 Update in Perspective," a research brief by Alicia H. Munnell, director of the Center for Retirement Research at Boston College and Peter F. Drucker Professor of Management Sciences at the Carroll School of Management at Boston College.

The 2012 Trustees Report shows a significant increase in the program's 75-year deficit from 2.22 percent to 2.67 percent of taxable payroll and an advance in the date of trust fund exhaustion from 2036 to 2033. These changes reflect the slow recovery from the recession and rising disability rolls, among other factors.

While the deficit is larger and the date of exhaustion nearer, the story remains the same. The program faces a manageable financing shortfall over the next 75 years, which should be addressed soon to restore confidence in the nation's major retirement program and to give people time to adjust to needed changes.

Over the next 75 years, Social Security's long-run deficit is projected to equal 2.67 percent of covered payroll earnings. That figure means that if payroll taxes were raised immediately by 2.67 percentage points – 1.34 percentage points each for the employee and the employer – the government would be able to pay the current package of benefits for everyone who reaches retirement age at least through 2086.
A lasting fix for Social Security would require additional changes.

Solutions that focus just on the next 75 years sometimes involve the buildup of trust fund assets in the near term and the sale of those assets to pay benefits in the out years. Since the trust fund would have no further bonds to sell in the 76th year under this approach, the program would suddenly be short of money. Lasting solvency would require either a pay-as-you-go system with substantially higher pay- roll tax rates/lower benefits or the buildup of a trust fund larger than that required for 75-year solvency, the returns from which could cover some of the costs. Realistically, eliminating the 75-year shortfall should probably be viewed as the first step toward long-run solvency.

Social Security's shortfall looks less daunting when outlays are shown as a percent of Gross Domestic Product (GDP). The cost of the program is projected to rise from 5.0 percent of GDP today to 6.1 percent of GDP in about 2050, where it remains even after the re- tirement of the baby boom because of the permanent decline in fertility rates discussed earlier (see Figure 3). The reason why costs as a percent of GDP more or less stabilize – while costs as a percent of taxable payroll keep rising – is that taxable payroll is projected to decline as a share of total compensation due to continued growth in fringe benefits.

Although the Trustees Report focuses on Social Security's financial shortfall as a percent of either taxable payroll or GDP, it also reports the financing shortfall in dollars. One measure of the shortfall – the present discounted value of the difference between projected revenues and expenditures over the next 75 years – amounts to $8.6 trillion.

Although this number appears very large, the economy will also be growing. So dividing this number – plus a one-year reserve cushion – by taxable payroll over the next 75 years brings us back to the 2.67 percent deficit discussed above. As a percent of GDP over the next 75 years, this deficit is 0.9 percent.

The 2012 Trustees Report confirms what has been evident for two decades – namely, Social Security is facing a long-term financing shortfall which now equals 2.67 percent of taxable payroll or 0.9 percent of GDP. To put the magnitude of the problem in perspective, defense outlays went down by 2.2 percent of GDP between 1990 and 2000 and up by 1.7 percent of GDP between 2000 and 2010.

While Social Security's shortfall is manageable, it is also real. The long-run deficit can be eliminated only by putting more money into the system or by cutting benefits. There is no silver bullet. Despite the political challenge, stabilizing the system's finances should be a high priority to restore confidence in our ability to manage our fiscal policy and to assure working Americans that they will receive the income they need in retirement.