

## MEMORANDUM

**DATE:** June 29, 2010  
**TO:** Editorial page editors and writers  
**FROM:** Tom Kiley  
**SUBJECT:** Social Security

Your community is one of 19 cities holding events on June 26 sponsored by America Speaks during which citizens will discuss their ideas about how to reduce the federal deficit. Moreover, the 2010 annual report of the Social Security trustees could be released as early as next week, and on June 30, the President's deficit commission will hold a public meeting. These events will put a spotlight on the federal budget deficit – and will likely spur more discussions about Social Security's impact on the deficit.

This memorandum explains that, contrary to popular belief, Social Security is *prohibited* from borrowing. Therefore, in the words of Social Security Chief Actuary Stephen Goss, Social Security's "Trust Funds enforce long-term budget neutrality [because] total spending to date cannot exceed income to date." This means that if the trust funds are exhausted and current revenues are not sufficient to pay promised benefits, benefits will simply be cut – Social Security will not become insolvent and it will not contribute to the federal budget deficit.

This memorandum also explains that Social Security is financially sound – with sufficient resources from dedicated taxes paid by workers and employers to pay full benefits through 2036 and a long-term shortfall that can be closed with modest increases in revenues. For these reasons, we do not believe cuts to Social Security benefits should be considered to reduce the deficit.

## Social Security and the deficit

**Social Security is not running a deficit.** On the contrary, between the tax receipts it takes in and the interest it earns on the bonds held in its trust funds, Social Security is running a *surplus* of over \$100 billion per year.

While it's true that demands on Social Security will increase in coming years as the Baby Boomers retire and life expectancy increases, it's also true that the government fully anticipated and planned for these demographic events. In 1983, Congress raised taxes and reduced benefits in order to run surpluses and build up a Social Security trust fund that would be able to continue paying full benefits through the peak retirement years of the Baby Boomers and to Americans who are living longer. That trust fund, to which annual Social Security surpluses are added, now stands at \$2.4 trillion. It is projected to continue growing for the next 14 years, when it will reach

\$4.3 trillion. According to Social Security actuaries, the trust fund is large enough to pay all promised benefits through 2036 (or 2042, according to the Congressional Budget Office).

At that point, once the trust fund is exhausted in 2037, Social Security will not have the financial resources to pay benefits in full. Though this will happen sooner than had previously been expected, this is not because of unanticipated demographic changes such as lengthening life expectancy. Rather, factors leading to this projected shortfall include slower-than-expected wage growth in recent decades, a growing share of income accruing to high income workers (income above a \$106,800 earnings cap is not subject to Social Security payroll taxes), and a greater share of employee compensation being paid in the form of health insurance and other untaxed benefits, rather than wages.

**After 2037, Social Security will not contribute to the deficit, because it is prohibited by law from taking on debt in order to pay benefits.** Instead, if the projected shortfall were to go unaddressed, Social Security would pay reduced benefits, equal to about 75% to 80% of promised benefits, according to the Social Security actuaries and CBO, respectively. This is a situation that Congress must take action to avoid, but it is not the catastrophic collapse that some alarmists warn about. Eliminating this shortfall would require raising revenues equal to about 0.5% to 0.7% of gross domestic product, according to CBO and Social Security, respectively (GDP is the best measure of the overall size of the U.S. economy). While this is not a trivial amount, it is entirely manageable.

Closing Social Security's long-term shortfall in order to maintain promised benefit levels is therefore a small part of the nation's overall deficit challenges. Even if Congress changed the law and turned to general revenues to pay promised benefits, this would increase the long-term budget deficit by only about 5-10% per year on average. This is not an insignificant amount, but it clearly shows that Social Security is not at risk of a financial crisis and does not pose unmanageable challenges for the federal budget outlook.

## How to address these challenges

A dedicated 12.4% payroll tax, split evenly between workers and employers on all earnings up to the cap of \$106,800, provides most of Social Security's financing, which is separate from sources of revenue that finance other federal government programs. A modest increase in the tax *rate* or an increase in the cap are two ways of shoring up Social Security's finances to ensure that it can continue to pay full benefits after 2037. Raising the cap is the preferable option: Most of the increases in earnings and life expectancy in the last three decades have accrued to workers higher up the income ladder. In 1983, 10% of all earnings were above the cap of \$106,800, and therefore not subject to the Social Security payroll tax; in 2008, that share had grown to 16%. Simply raising the cap to once again cover 90% of earnings would reduce the shortfall by 28 percent. Eliminating the cap altogether and using a flatter benefits formula for earnings above the current cap would be more than enough to close the projected shortfall.

Alternatively, raising the payroll tax rate for workers and employers by one percentage point each would fully shore up Social Security's finances. And, of course, the ultimate solution could involve some combination of adjusting rates and raising the cap.

## Why not reduce benefits?

Social Security has proven to be the most reliable and most important source of retirement income for most American retirees. Traditional pensions have grown increasingly scarce. In their place, American workers have come to rely more heavily on 401(k) plans and other defined-contribution plans, which carry much more risk for the individual. As we saw in the market meltdown that began in 2007 retirees can lose significant portions of their hard-earned retirement savings as a result of market downturns. Half of all households have no retirement savings accounts at all. Of those who do, half have less than \$45,000 in those accounts. Even for older households approaching retirement, only six in ten have a retirement account; among those, the median account balance would provide less than two years' income for households in that age group.

Americans also say that they would prefer to address Social Security's future shortfalls by increasing revenues rather than by decreasing benefits. For example, more than three-fourths of respondents to a recent survey conducted by the National Academy of Social Insurance said Social Security should be preserved "even if it increased taxes on workers." In general, survey respondents preferred strengthening Social Security over cutting taxes by a more than two-to-one margin, and support was even higher for lifting the cap on covered earnings.

## Why not raise the retirement age?

Proponents of increasing the retirement age – now scheduled to rise to age 67 – point out that Americans are living longer. On average, this is true – but averages often obscure important realities just under the surface. Over the past quarter century, for example, life expectancy among lower-income men – those in the lower half of the income distribution – has increased by one year; for men in the top half of the income distribution, life expectancy has increased by 5 years. Among lower-income women, life expectancy appears to have actually *declined*.

It is simply not accurate to suggest that people are living longer and, therefore, should have to wait longer before reaching retirement age – the fact is that a large share of Americans are *not* living longer. In any case, raising the normal retirement age is simply an across-the-board benefit cut—it does not mean people will be able to work longer. The scheduled increase in the normal retirement age from 65 to 67 (it is currently 66) is the equivalent of a 13% cut in benefits for someone retiring at 65, at a time of worsening retirement insecurity for most American workers.

Americans are already working longer – by choice or by necessity – but there is little evidence that the labor market will absorb a greater number of older workers if the Social Security retirement age is raised again. The labor force participation rate of Americans age 55 and older has risen dramatically over the past two decades, especially for older women, and is only three percentage points below the postwar peak. But this doesn't mean older workers are always successful at keeping or finding jobs. The unemployment rate for older workers has more than doubled, and is now at a postwar high. Though it remains somewhat lower than for workers overall, the gap has narrowed. And when older workers lose their jobs, their job prospects are grim. These workers are much more likely to count among the long-term unemployed and to see a steep drop in earnings if they do manage to find a job.

## Conclusion

The federal government is running large deficits which are necessary to fight the recession. Even after the economy has fully recovered, however, the federal government will continue to run structural deficits. It is important that policymakers find the proper mix of revenue increases and spending reductions to lower those deficits while maintaining investments in national priorities. Social Security cannot add to the deficit if the trust fund runs out, and even if the law were changed so general revenues could be used to pay promised benefits, this would increase the deficit by only 5-10%. With this in mind, we'd strongly urge you to editorialize *against* calls for cutting Social Security benefits in the name of so-called fiscal responsibility. These are benefits which Americans have paid for and earned after a lifetime of hard work and which are crucial to providing a decent standard of living in retirement.