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SOCIAL SECURITY TRUSTEES REPORT: AN EYE-OPENER IF YOU KNOW WHERE TO LOOK

The 2003 *Social Security Trustees Report*, released on March 17, contains a wealth of information, some of it quite surprising, about the future of the Old Age, Survivors, and Disability Insurance program (OASDI). Did you know that, in the face of impending insolvency, Social Security:

- is promising, over time, to pay future retirees more than twice the real benefits that current retirees receive?
- will pay some future upper income working couples almost $105,000 a year in real, inflation-adjusted benefits?
- will be giving most future two-earner retired couples more in Social Security benefits than the current median family income?
- will effectively require each working couple to support a retiree?

All of this is true, and it is revealed to the careful reader of the various tables in the *Trustees Report*.

Most people only look at two bits of data in the *Trustees Report* — the year the system will start running annual cash flow deficits (2018), and when it will run out of spending authority by exhausting its trust fund (2042).[1]

Serious students of Social Security should look beyond these cash flow and trust fund numbers to learn more of why the system is in trouble and what can be done about it. The excellent background material in the Report and its appendices can be of great help.

Promised benefits are soaring in real value, and will more than double by 2080.

Consider Table VI.F11. - Estimated Annual Scheduled Benefit Amounts for Retired Workers (*OASDI Report*, pp. 189-190.) The table (partially reproduced on the next page) shows the benefits that future generations are projected to receive after they reach age 65 in future years, 2003 through 2080. These benefits are displayed for people who earn various levels of wages relative to the rest of the population (low wage, average wage, high wage, and the maximum wage subject to the payroll tax). The benefits are presented in real inflation-adjusted dollars, and as a percent of pre-retirement income. They are shown for people who work until the normal retirement age (rising gradually from 65 to 66 and 67), or who retire at a fixed age of 65 in the years shown.

It is often mentioned that the Social Security benefit formula is structured to provide all generations over time with about the same benefits relative to pre-retirement income. This is known as a "constant replacement rate," and it is projected to be 55.3% for low wage workers (earning 45% of the average wage), 41% for workers who earn the average wage all their lives, 34% for high earnings workers (160% of average wage) and 27.3% for maximum covered wage workers, assuming they retire at the normal retirement age applicable for their age cohort. What many people do not realize, and what may come as a surprise or shock, is that these "constant replacement rates" actually mean that benefits will rise significantly over time as real wages grow.

Real wages are projected to increase by more than 125% over the 75-year planning period. A constant percent of a rising real wage means a rising real benefit. The average wage worker turning 65 in 2003 will get $13,970 upon claiming benefits at his normal retirement age of 65 years and 2 months. A similar worker turning 65 in 2030 will get $18,860 upon claiming benefits in 2032 at his normal retirement age of 67. A worker reaching age 65 in 2080 will get $32,228 upon claiming benefits at age 67 in 2082. The real benefit for the 2082 retiree will be 230% of that of the 2003 retiree. Those figures are for a single retiree. Add 50% for a spouse. If both spouses have worked at these wages, double the amounts.

A retired married professional couple, each having earned the maximum covered wage, would collect between them a total of $41,828 upon claiming benefits in 2003 at age 65 and two months, $61,504 if claiming benefits at age 67 in 2032, and $104,828 upon starting benefits at age 67 in 2082. We are promising some future (2082) upper income retirees an annual benefit that is twice the current nationwide median family income ($51,407 in 2001), and that would be in addition to any pension or savings that this upper income couple had accumulated. Rising real benefits, marching upward in lock-step with the growth of per capita real wages (and the rising cap on earnings subject to the payroll tax), are a key part of the OASDI system's projected slide into deficit.

Social Security Benefit Amounts for Retired Workers
Workers at Indicated Pre-Retirement Wage Levels
In Real Dollars and as Percent of Pre-Retirement Wages
Estimates for 2003 to 2080, Intermediate Assumptions

Year Attains Age 65	Age at Normal Retire-ment	Worker with Low Earnings		Worker with Medium Earnings		Worker with High Earnings		Worker with Max Covered Earnings	
		Real 2003 $	Percent of Earnings	Real 2003 $	Percent of Earnings	Real 2003 $	Percent of Earnings	Real 2003 $	Percent of Earnings
2003	65:02	$8,475	56.1	$13,970	41.6	$18,357	35.1	$20,929	29.8
2005	65:06	8,852	56.8	14,579	42.1	19,230	35.2	22,145	29.4
2010	66:00	9,244	55.5	15,228	41.2	20,185	34.1	24,088	28.0
2015	66:00	9,801	55.9	16,146	41.4	21,414	34.3	26,022	27.7
2020	66:02	10,331	55.9	17,024	41.4	22,569	34.3	27,557	27.6
2030	67:00	11,448	55.3	18,860	41.0	25,009	34.0	30,752	27.3
2040	67:00	12,745	55.2	20,999	40.9	27,842	33.9	34,197	27.3
2050	67:00	14,210	55.3	23,408	41.0	31,034	33.9	38,080	27.3
2060	67:00	15,804	55.3	26,035	41.0	34,517	33.9	42,349	27.3
2070	67:00	17,584	55.3	28,969	41.0	38,404	33.9	47,114	27.3
2080	67:00	19,563	55.3	32,228	41.0	42,725	34.0	52,414	27.3

Source: OASDI Trustees Report, 2003, Table VI.F11.

Workers to support the system are getting scarce.

The other key cause of the coming deficits is the declining ratio of workers to retirees, projected to fall from 3.3 in 2002 to 2.2 by 2030 (when most of the baby boom generation will have retired) and to 1.8 by 2075. (See Table IV.B2. - Covered Workers and Beneficiaries, pp. 51-52, intermediate assumptions.) If the working population were keeping up with the number of retirees (producing a constant ratio of taxable wages to promised benefits), the System could afford to pay a constant replacement rate without having to raise the payroll tax rate. But with the ratio of workers to retirees falling by about 45 percent, either the replacement rate must fall by about 35 percent or the payroll tax rate must rise by about 50 percent, from 12.4% to 18.9% of taxable payroll for OASDI, excluding Medicare. That is the rate that would be needed to close the outyear deficits. ***Why should a "social insurance safety net" tax future low income workers up to nearly 19% of their wages to pay almost $105,000 a year in retirement benefits to an upper income couple?***[2]

Covered Workers Per OASDI Beneficiary Intermediate Case

Year	Workers Per Beneficiary
2000	3.4
2005	3.3
2010	3.2
2015	2.9
2020	2.6
2025	2.3
2030	2.2
2035	2.1
2040	2.1
2045	2.0
2050	2.0
2055	2.0
2060	1.9
2065	1.9
2070	1.9
2075	1.8
2080	1.8

Source: OASDI Trustees Report, 2003, Table VI.F11.

Just trimming the *growth* of benefits growth can minimize the pain of fixing the system.

These tables make an important point. Since real benefits are projected to more than double under current formulas, it is possible to offset much of the projected OASDI deficit by trimming the growth of benefits, either across the board or for middle and upper income beneficiaries, without actually having to cut benefits in real terms from one generation to the next. In fact, in 1994, Representatives Dan Rostenkowski (then Chairman of the House Ways and Means Committee) and J.J. Pickle (then Chairman of the Ways and Means Social Security Subcommittee) each introduced legislation containing gradual changes in the benefit formula that would have achieved that result (H.R. 4245 and H.R. 4275, respectively). President Bush's Social Security Reform Commission, in one of its options, went so far as to suggest that real benefits be frozen at 2008 levels.

Personal saving and pension arrangements can cushion the transition.

Of course, trimming benefit growth would make Social Security's retirement system, already a bad financial investment compared to private saving, an even worse deal. But raising taxes to cover projected benefits would also lower the rate of return, and would be the worst deal of all, because holding more of a bad investment is worse than holding less of a bad investment. Fortunately, the adverse effects could be offset by allowing people to put some of their Social Security tax "contribution" aside to earn a higher return in a personal pension fund invested in private sector stocks and bonds. That arrangement would require the federal government to trim its own spending to pay for the diversion of the payroll tax. That is only fair, because the government should never have promised these unaffordable benefits to begin with, knowing that the worker/retiree ratio was bound to drop. If future Congresses have less money to spend because of the misbehavior of past Congresses, so be it. Better that than putting a crushing tax burden on future workers.

Sensitivity tables suggest faster wage growth and immigration could help the system.

The *Trustees Report* appendices also present "sensitivity tables" showing how the system's outlook would change as the assumptions about productivity, wages, and population growth are altered. For example, a rise in real wage growth (the "real wage differential") from 1.1 percent annually to 1.6 percent would trim the projected 75 year deficit (the "actuarial balance") by about 27 percent, and delay trust fund exhaustion by 7 years. (Table VI.D4. - Sensitivity to Varying Real-Wage Assumptions, p. 155.) On an annual basis (not shown) the saving would taper off to about 22 percent of the deficit in 2080. Growth economists have long pointed out that real wages might rise that much faster if the multiple layers of tax imposed on saving and investment under the current income tax system were eliminated, boosting productivity increases that drive real wages. This suggests that fundamental tax reform would be a good way to address part of the pending retirement problem.

Another policy step that would help OASDI would be to increase immigration. An increase in immigration from an assumed 900,000 per year to 1,300,000 per year would trim the projected 75 year deficit by nearly 14 percent, and would delay trust fund exhaustion for 3 years. (Table VI.D3. - Sensitivity to Varying Net Immigration Assumptions, p. 153.) On an annual basis (not shown) the saving would taper off to about 10 percent of the deficit in 2080. Even with such improvements, it would still be necessary to shift over time to a system of personal accounts, but the transition would be much easier with a more rapidly growing economy.

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Endnotes

1. The OASDI program's outlays will exceed its tax revenue in 2018. Thereafter, OASDI will have to use some of the interest payments that the trust funds receive from the Treasury to cover part of its outlays, instead of just lending the interest back to the Treasury. At that point, OASDI will be adding to rather than reducing the total federal budget deficit, and will require real money from the Treasury instead of just another paper IOU. Treasury will have to increase its borrowing from the public to pay a portion of the OASDI benefits (unless the rest of the federal budget is in sufficient surplus to cover the interest payments.) About a decade later, OASDI's cash deficit will exceed its interest income, and it will have to begin drawing on the budget authority represented by its "trust funds" holdings of Treasury debt. When that happens, the Treasury will similarly have to redeem the trust fund principal by raising money in the credit markets, borrowing from the public to cover the "redemptions." OASDI will exhaust the spending authority in the trust funds by 2042, and then will have to delay benefit checks unless Congress has taken action to shore up the system.

2. That tax rate would be for OASDI only. Hospital Insurance (Medicare Part A), also funded by the payroll tax, faces even larger future deficits, rising to 7.75% of taxable payroll by 2075. (HI Report, Table II.B9, p. 47.) Its tax rate, currently 2.9%, would have to rise to 10.65% to balance that system. Supplemental Security Income (Medicare Part B), funded 75% by from general revenues and 25% from premiums, will also experience sharply higher costs, and will be a drain on the general revenues of the government. It currently takes 7.8 percent of federal personal and corporate income taxes. In 2075, it will require 30 percent of federal personal and corporate income taxes. (*2003 HI Trustees Report*, Table II.C15, p. 88.)