THE RESEARCH ROOM

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The Looming Social Security Funding Crisis

Most of us have procrastinated at some point in our lives. We put off doing what needs to be done because it's hard or just not enjoyable. Often, when we can no longer put the task off, it is much more difficult to accomplish than it had to be. Oh, if only we had not delayed.

So it is with Social Security. We've known for more than 20 years that the program is likely to have insufficient funds to pay full benefits to retirees by the 2030s, but we have not acted. Any fix requires increasing Social Security taxes[1], raising the retirement age, reducing benefits, or some combination — any of which are politically challenging. But if changes had been made earlier, they could have been smaller than they will now need to be because the effects would have had more time to compound. We still have time to act, but the window is quickly closing.

Earlier this year, the Social Security Trust Fund released its annual report on the financial status of Social Security. As expected, the news was not good. The trustees projected that the fund's reserves will be depleted by 2033, when today's 56-year-olds reach full retirement age. Without a fix, revenues from payroll taxes and income taxes on Social Security benefits would be sufficient to pay for just 80% of benefits promised to retirees.

Social Security finances

Social Security is a "pay-as-you-go" program. Today's benefits are funded primarily by payroll taxes collected from current workers.

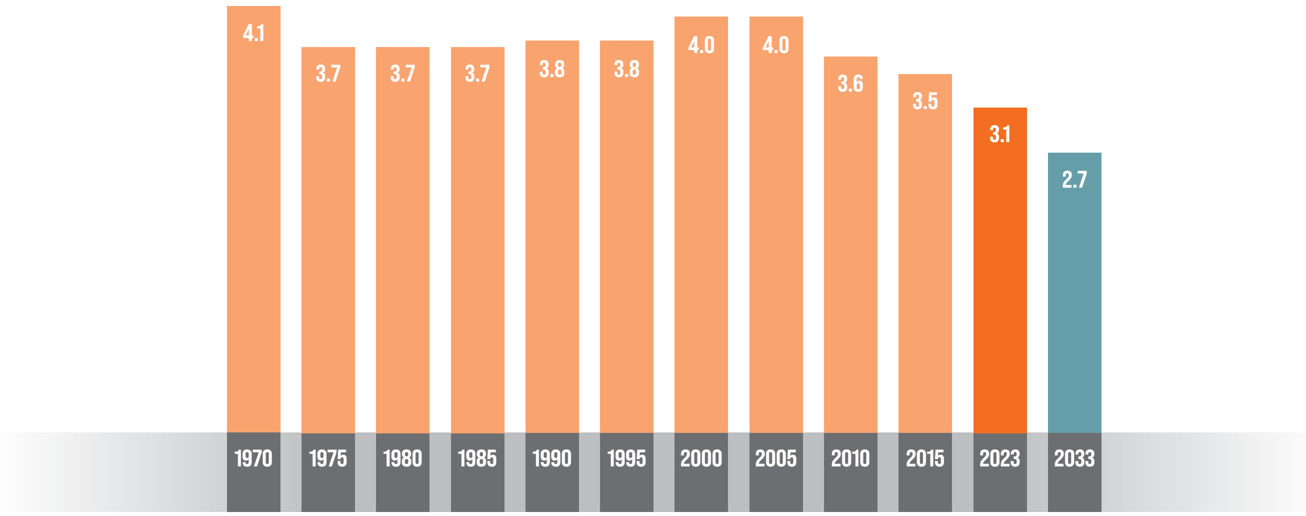
However, because the baby boom generation is very large relative to prior generations and Social Security taxes were increased in 1983, revenues to the trust fund exceeded benefits from 1984 through 2020. With these additional dollars, the trust fund purchased interest-bearing securities from the U.S. Treasury. In 2020, the fund held $2.8 trillion of these securities.

Beginning in 2021, the trust fund has not been collecting enough in taxes to pay for benefits, so it is redeeming some of the securities to fill the gap. The trust fund has redeemed nearly $100 billion of the securities over the past two years. Annual redemptions are expected to top $220 billion in 2026 and $400 billion in 2032. In the following year, the fund will have insufficient securities to cover the revenue/spending imbalance.

The primary reason for the funding imbalance is the decline in the number of workers paying into the system relative to the number of retirees. As the chart on the following page shows, this worker-to-retiree ratio ranged from 3.5 to 4.1 from 1970 through 2013. However, it has been declining since 2008 and was at just 3.2 last year. The ratio is expected to fall to 2.7 workers for each retiree by 2033.

If nothing is done by our representatives in Washington, D.C., the Social Security Trust Fund **will not have sufficient funds in 10 years** to pay full benefits for an estimated 71 million Americans.

WORKER TO RETIREE RATIO 1970-2033



What's next?

If nothing is done by our representatives in Washington, D.C., the Social Security Trust Fund will not have sufficient funds in 10 years to pay full benefits for an estimated 71 million Americans.

Although it has never been done, the government could use general tax revenues to fill the gap. However, that would add an estimated half a trillion dollars to the federal government's annual deficit, with that amount rising over time, and only worsen the federal government's already precarious finances. Annual deficits relative to the U.S. gross domestic product (GDP) are expected to increase from 3.9% last year to 6.3% in 2033. Federal debt, the cumulation of annual deficits, is expected to rise from 98% of GDP to 112%. Even without the added spending that would come from supplementing Social Security, debt is likely to be more than 150% of GDP by 2050.

A second possibility is that politicians look back to 1983 and realize that the system can be fixed. In that year, the worker-beneficiary ratio had dropped to 3.5 and the program was on the verge of having insufficient funds to fully pay benefits.

On a bipartisan basis, Congress and then-President Ronald Reagan approved changes to help keep Social Security's finances solvent for decades. Both parties had "wins" and "losses." According to Paul Light of the Brookings Institute:

"Democrats accepted a six-month delay in the annual cost-of-living adjustment and the increase in the retirement age, while Republicans accepted a faster-than-planned rise in payroll taxes and a substantial tax increase on the self-employed. The two sides closed the deal by subjecting up to half of Social Security benefits to income taxes for higher-income beneficiaries, a provision that allowed Democrats to say Republicans had passed a tax increase and Republicans to say Democrats had agreed to a benefit cut."

The value of time

In an article for the Pew Economic Policy Group in 2010, Charles Blahous III and Robert Greenstein argued that solving the Social Security problem soon was optimal because it allowed any tax increases or benefit cuts to be phased in slowly, lessening the hardship on workers and retirees.

For example, the 1983 increase in the retirement age from 65 to 67 did not affect anyone 46 or older. For those younger, the increase was gradual, culminating with the 67-year-old retirement age applicable to those who were 23 or younger at the time. This allowed future retirees to adjust their retirement plans.

We are now 13 years out from Blahous and Greenstein recommending that the problem be addressed, with little sign of progress. As former President Harry Truman said, "There is some risk involved in action — there always is. But there is far more risk in failure to act." ■

Forward Analytics is a Wisconsin-based research organization that provides state and local policymakers with nonpartisan analysis of issues affecting the state.

1. This could mean increasing the current rate of 6.2% or increasing the amount of income to which the rate is applied. In 2000, the tax was applied to earnings up to $76,200, with that amount rising each year. For 2023, the Social Security tax is applied to wages up to $160,200.