Why Social Security's big benefit cut won't happen: The U.S. Treasury already is filling its funding gap:

Legislative Choices for Paying Promised Benefits

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U.S. Senate Budget Committee hearing: "Protecting Social Security for All: Making the Wealthy Pay Their Fair Share"

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***The Center on Capital & Social Equity educates the public about economic inequality and advocates for the bottom 50%. Click here for CCSE work on Social Security and retirement income policy, 2014-present.)**

On March 31, Social Security's trustees issued their annual financial report with a familiar warning: Unless Congress changes the law, Social Security will only have enough money to pay about 80% of current benefits by 2034. That's when the program's reserves run dry, and it can only pay out what Social Security taxes bring in.

The actuarial warning of a sudden drop in benefits has become an annual ritual – this year almost identical to what the program's actuaries have been saying for many years. And the response from the politically divided 118th Congress will very likely be the same. It probably will not pass legislation to address Social Security's long-term solvency problem.

Social Security's long-range financing is a very large problem. Resolving it involves clashing interests including those of taxpayers v. beneficiaries, old v. young, and well-off v. low-income. In 2022, the government spent $1.2 trillion on Social Security -- about one fifth of $6.3 trillion in total federal spending. To achieve long-term solvency, program actuaries estimate Congress will have to raise Social Security revenues by one third or reduce benefits by one fourth -- or negotiate a combination of the two approaches.

Measured another way, the trustees project Social Security's 75-year actuarial deficit to be 1.3% of GDP through 2097. To provide an order of magnitude of the annual cost of filling the funding gap, 1.3% of this year's GDP (about $26 trillion) equals $388 billion. Social Security's annual cost will increase from 5.2% of GDP in 2023 to 6.3% in 2076, then decline to 6.0% by 2097. Though a big job, finding a few hundred billion dollars a year should be doable, especially after Congress recently added trillions to the national debt to navigate the Covid years.

Social Security's Trust Funds

While not evident or widely discussed, the federal government has already begun the process of filling the long-term funding gap. As shown in Table 1 below, after almost 40 years of resulting in a surplus, Social Security's revenues dropped below expenditures in 2021. As a result, the government has had to raise an additional $56 billion in 2021, $22 billion in 2022, and an estimated $53 billion this year to pay beneficiaries. Social Security's funding gap is projected to grow $378 billion in 2032, or about $271 billion in today's dollars adjusted by the U.S. long-term inflation rate. See table below.

Table 1

Operations of Combined OASI & DI Trust Funds, Calendar Yrs 2018-32

		[Dollar amounts in billions]			
	Income	**Cost**	**Asset Reserves**		**Trust fund ratio**
			Net increase	**Amount at**	**at start of year**
			during year	**end of year**	
	Historical data				
2018	$1,003	$1,000	$3	$2,895	289
2019	1,062	1,059	3	2,897	273
2020	1,118	1,107	11	2,908	262
2021	1,088	1,145	**-56**	2,852	254
2022	1,222	1,244	**-22**	2,830	229
	Intermediate estimates				
2023	1,335	1,388	**-53**	2,777	204
2024	1,351	1,485	**-134**	2,643	187
2025	1,419	1,574	**-155**	2,488	168
2026	1,492	1,667	**-176**	2,312	149
2027	1,557	1,760	**-203**	2,109	131
2028	1,623	1,856	**-234**	1,875	114
2029	1,688	1,955	**-267**	1,608	96
2030	1,754	2,056	**-302**	1,306	78
2031	1,821	2,159	**-338**	968	60
2032	1,886	2,264	**-378**	590	43

Source: 2023 OASDI Trustees Report, pp. 49-50. Dollar amounts not adjusted for inflation. See: IV. ACTUARIAL ESTIMATES (ssa.gov)

Social Security's two trust funds – for Old-Age and Survivors Insurance (OASI) and Disability Insurance (DI) – are managed by the Department of the Treasury. Unlike most trust funds, Social Security's do not hold marketable assets, but rather promissory notes left by the Treasury. Social Security taxes (technically "insurance contributions") are deposited in the combined OASDI trust fund on a daily basis and invested in "special-issue" Treasury securities. The cash exchanged for the securities goes into the Treasury's general fund, indistinguishable from other cash. To pay beneficiaries, the Treasury in separate actions redeems the special bonds in the Social Security trust fund. (A thorough description of trust fund's history and function can be found in "Social Security Cash Flows and Reserves" by David Pattison, and a brief one here.)

Social Security's trust funds serve two purposes: (1) providing a checking account to track money continually flowing in and out of the programs, and (2) holding asset reserves, accumulated during years of surplus along with interest. Notwithstanding the internal functions of the trust fund, Social Security operates on a pay-as-you-go basis when viewed as part of the consolidated federal budget. In the end, money paid out needs to come from somewhere in current federal spending, borrowing, and tax revenue. Past Social Security surpluses in effect have been borrowed by the government to use for other budget items.

When reserves run low, the trust funds also sound an alarm. The combined trust funds this year still hold about $2.8 trillion in reserves – enough to pay two more years of claims. But as the outsized Baby Boom generation leaves the work force, reserves are declining rapidly. Once depleted, under current law Social Security has legal authority to only pay what it collects in taxes. That, the trustees warn, would result in a sudden drop in benefits in 2034.

What Happened Last Time

Congress began making major changes in 1972 anticipating the financial challenges the Baby Boom generation would create for Social Security half a century later. But it left the task unfinished and more needs to be done. Initial efforts aimed at long-term solvency were incomplete and did not prevent Social Security from almost running out of cash in the early 1980s. Congress and the administration took emergency measures to make sure there was adequate cash flow.

The modern era of OASDI trust fund financing, according to Pattison, began with changes enacted in 1972 and 1977 that indexed benefits and the tax base to average wages. While this minimized the need for Congress to make frequent adjustments, level-tax financing increased pressure to schedule tax increases far in advance to finance the Baby Boom's retirement. A tax increase was scheduled for 2010, when the boomers were expected to begin retiring. In 1977, the tax hike was advanced 20 years to begin in 1990. The Social Security tax level also was raised to 12.4 percent of wages, where it remains today.

To go with the tax increases enacted during the previous decade, 1983 legislation strengthened Social Security's long-term financing with a major benefit cut. It takes the form of a gradual increase for full retirement benefits from age 65 to 67, which is still being implemented. Increasing the age for receiving full benefits by two years particularly impacts low-income workers who on average live shorter lives than people with higher incomes.

Since Social Security was created during the Great Depression, life expectancy has diverged dramatically for low- and high-income people. While it continues to rise for the middle-class and affluent, life expectancy has remained flat for lower-income workers and now may be in decline. As I pointed out in a study published by the Society of Actuaries, this trend has reduced Social Security's progressivity. Congress should avoid raising the age to receive full benefits again.

Although the 1977 amendments enabled a large accumulation of reserves before the boomers' retirement, the changes did not kick in soon enough to prevent Social Security from running low on cash in the early 1980s. To deal with the cash-flow problem, Congress passed legislation in 1982 and 1983 that included temporary borrowing from Medicare's Hospital Insurance fund.

It's hard to imagine borrowing money from Medicare in the near future to tide Social Security through a cash-flow crunch. The 2023 trustees report projects that Medicare's hospital fund will run dry in 2031, three years earlier than Social Security's combined OASDI trust fund. These days, in an emergency, the Treasury might turn to the Fed, which bought its bonds to finance much of the Covid stimulus spending.

Social Security's Political Strength

Despite many financial, political, and demographic challenges, Social Security has never missed a benefit payment since it was created in 1935. Social Security is the nation's most popular and arguably most effective public program. As the number of people receiving benefits grows, so does its resilience to political attack. In 2022, there were 66 million OASDI beneficiaries, and the number will exceed 80 million a decade from now. They represent a sizeable chunk of the number of people who voted in the last two presidential contests (155 million in 2020 and 138 million in 2016).

Imagine what might happen if the U.S. government suddenly cut monthly Social Security payments, which average $1,827, by 20 percent this year. The economic disruption would be enormous, not only for tens of millions of elder and disabled people and family members who could no longer pay all their bills, but also for food stores, landlords, medical providers, nursing homes, and others receiving the money downstream. That's why it is very unlikely that Congress will not act to keep checks coming even if it waits until the last minute.

Social Security recipients' political influence may grow along with their numbers. There were about 2.8 workers for every OASDI beneficiary in 2022. This ratio had been stable from 1974 through 2008, but has declined since then, due to the economic recession of 2007-09 and the beginning of a major demographic shift, as workers of lower-birth-rate generations replace workers of the baby-boom generation. The ratio of workers to beneficiaries is expected to drop to 2.3 by 2035 when the baby boomers will have largely retired, and to decline very gradually thereafter due to increasing longevity.

Legislative Choices

Congress has several options. (1) Though such efforts have failed over the last thirty to forty years, party leaders could get together with the Administration to develop a "grand plan" to put Social Security on a path to long-term financial stability while providing sufficient cash flow while the changes are implemented. As noted earlier, program actuaries estimate Congress will have to raise Social Security revenues by about one third or reduce benefits by one fourth -- or negotiate a combination of the two approaches to achieve 75-year solvency. Introducing changes over a long time diminishes, but does not eliminate, political risk. Moving that much money in a single package would result in large-scale wins and losses for different parts of the population and interest groups. But it does avoid the political disaster of a sudden major cut.

(2) A second approach arises from history. As their predecessors did the last time long-term financing reforms were made, lawmakers could kick the can down the road and make major, but less ambitious, changes that would keep Social Security funded for several years or decades, leaving it to future Congresses to finish the task of fully funding the baby boom generation's retirement.

(3) The easiest way to avoid a sudden cut in benefits in 2034 and resulting political fallout would be to do nothing but change a few words in the Social Security Act. New language would require the Treasury to keep paying promised benefits whether or not there happen to be any reserves left in the Social Security trust fund. There would be no reserves left to spend down anyhow, only the usual trillions of dollars moving in and out of the trust fund in taxes and payments each year. Social Security's trust fund could remain useful as a checking account and accounting device. The Treasury would be obliged to pay out whatever the program's benefit formula required.

Just as they already must borrow or tax in the amount of $53 billion to meet Social Security's funding needs in 2023 by providing cash in exchange for declining reserves, Congress and the Administration could keep financing the program on a year-to-year basis waiting until the last minute to adjust the law. This would not be as financially prudent as achieving long-term solvency. But it is a possibility. If matters get to that point, the subsequent political conflict over filling a widening funding gap could soon bring about a broader long-term agreement.

(4) Congress also could do nothing until the last minute. As the trust fund neared exhaustion in 2033, lawmakers might find themselves in an intriguing scenario: The estimated $378-billion plug ($271 billion in today's dollars) added to the consolidated federal budget the year before to redeem reserves would be available for other uses if automatic benefit cuts were allowed to proceed. As the deadline approached, members of Congress could debate what to do with the extra room that a 20% or so benefit reduction might leave in the budget -- just as millions of

Social Security beneficiaries and their families descended on Washington, D.C. Congress could repeat this process annually. It wouldn't be the first time Congress patched up a mess resulting from a dysfunctional funding law on a regular basis. Washington insiders may recall the many years of the Medicare "Doc Fix".

The Best Path Forward

Politics aside, the most prudent option is for Congress to stabilize Social Security's long-term financing – the sooner the better – while taking care that the program remains equitable. Program actuaries emphasize the growing ratio of retirees to workers as a major factor impinging on the program's solvency along with lower birth rates and economic growth. Other forces are at work including the widening gap between rich and poor.

Congress could restore Social Security's shrinking tax base by reestablishing and expanding funding provided by those who benefited from decades of growing wealth and income disparities. Since Social Security relies primarily on a tax on labor for its sustenance, the relative growth of capital income gradually has been crowding out its revenue. As wealthier people continue to amass equities, bonds, and other assets, the portion of national income from capital investment has increased significantly. In the United States, labor's share fell about eight percentage points between 1995 and 2013.

In addition, widening income equality has crimped payroll tax receipts. National income subject to Social Security tax has dropped significantly below the 90-percent level that was intended. Because incomes have risen faster above Social Security's tax cap than below it, the trustees project less than 83 percent of payroll will be subject FICA tax by the end of 2032.

As an advocate for low-wage workers, I wrote five years ago that collecting Social Security taxes above the tax cap (now $160,200) and higher investment taxes alone could restore program solvency. Several bills currently proposed by Democrats suggest changes along these lines. There are other options. More revenue could be collected through the estate tax and by closing a loophole through which investments can be inherited without being subject to capital gains taxes. Congress already has added extra Medicare taxes for high earners on both income and capital gains, thereby providing precedent to do the same for Social Security. Many of course may disagree rely more on benefit cuts than tax increases to achieve financial stability.

In my view, if benefit cuts are part of a rescue plan, they should be applied only to beneficiaries with the highest levels of income and wealth. The minimum benefit for both Social Security and SSI, its backstop, should be raised at least to the poverty line. As mentioned earlier, raising the standard retirement age, which periodically bobs up in policy discussions, is a benefit cut falling disproportionately on the poor and middle class. Repeating this type of change would be grossly unfair. It would particularly disadvantage voters in states with low levels of income and high numbers of elderly.

Both President Biden and the leading GOP candidate for president, Donald Trump, have stated they won't cut Social Security, in effect daring rivals to alienate voters who depend on the program. If politics somehow prevent the leaders of both parties from hammering out a plan to restore long-term solvency before the reserves run dry, the Treasury and Congress may end up where they are now: having to find new money to pay for the current benefit package year by year.

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