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June 9, 2022, Hearing of the US Senate Committee on the Budget: "Saving Social Security: Expanding Benefits and Demanding the Wealthy Pay Their Fair Share or Cutting Benefits and Increasing Retirement Anxiety"

Chairman Sanders, Ranking Member Graham, and members of the committee, thank you for the invitation to speak with you today on the current financial status and future prospects for the Old-Age and Survivors Insurance and Disability Insurance programs, commonly referred to as Social Security.

Results of the 2022 Trustees Report

The annual report to Congress on the Social Security program is required by law to include the trust fund operations of the prior year, the projected operations of the next 5 years, and the actuarial status of the funds.

The data and projections in this year's report include the Trustees' best estimates of the effects of the COVID-19 pandemic and the ensuing economic recession and recovery. Assumptions for the 2022 report were set by mid-February of 2022. The pandemic is projected to have continuing significant effects on the Social Security program in the near term, and relatively little net effect over the long run. As we have seen since February, the future course of the pandemic is still uncertain.

At the end of 2021, the Social Security program was providing monthly benefits to about 65 million people: 56 million from the OASI Trust Fund and 9 million from the DI Trust Fund. During 2021, an estimated 179 million people had earnings covered by Social Security and paid payroll taxes on those earnings.

The economic recovery from the brief recession in 2020 has been stronger and faster than assumed in last year's report. As a result, the assumed 1-percent reduction in the level of labor productivity and GDP that was incorporated in the 2021 report is eliminated for the 2022 report.

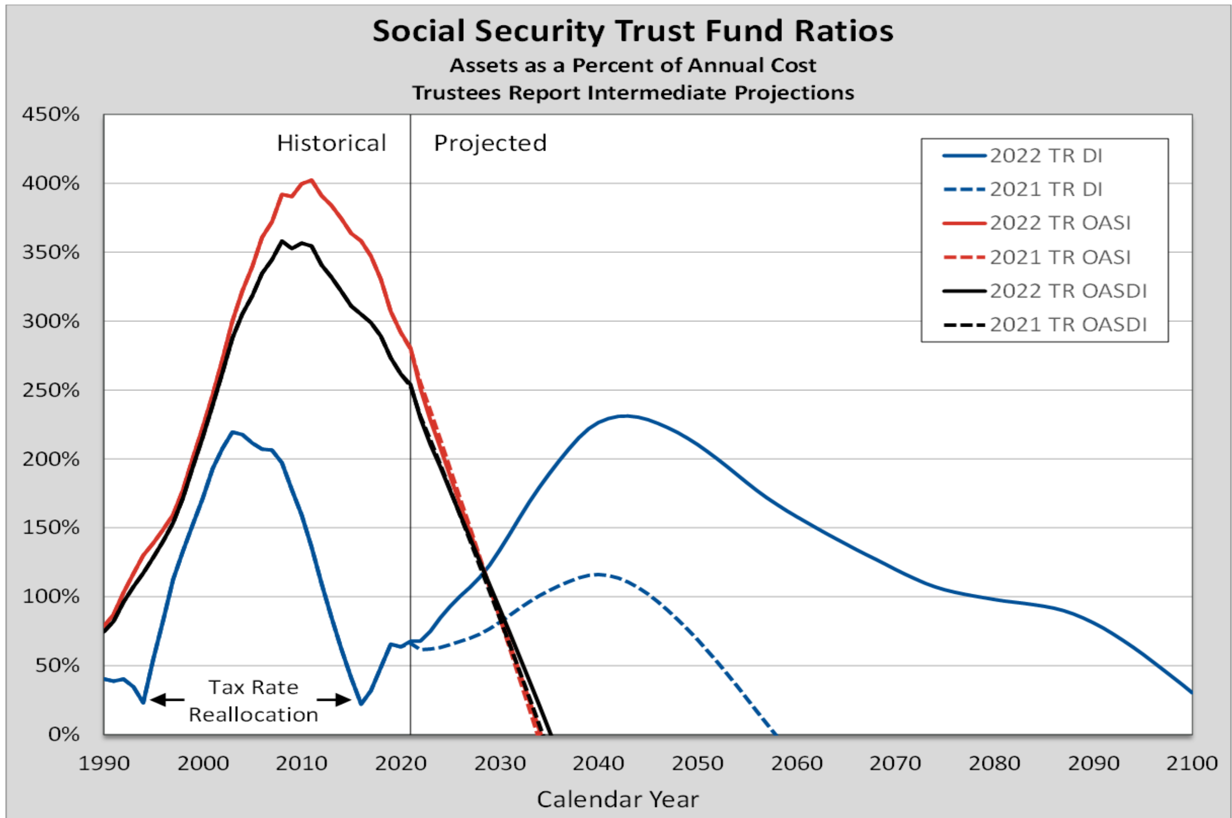
The December 2022 COLA is projected to be 3.8 percent for this year's report, down from 5.9 percent for the December 2021 COLA. However, recent increases in the CPI make it likely that the December 2022 COLA will be over 8 percent. We note that average earnings levels also appear to be increasing faster than had been assumed for this year's report. These two changes will tend to have offsetting effects on the financial status of the Social Security program.

Based on the intermediate assumptions, the long-range actuarial deficit for the combined OASI and DI Trust Funds over the next 75 years is now 3.42 percent of taxable payroll, 0.12 percent of payroll lower than the deficit of 3.54 percent of payroll shown in last year's report. This 75-year deficit equals 1.2 percent of the nation's economy, or GDP, over that period.

"Solvency" for the Social Security trust funds at any point in time means having sufficient asset reserves to allow for full, timely payment of all scheduled benefits that are due. Social Security does not have the ability to borrow under current law, and would be unable to pay scheduled benefits in full and on time if reserves become depleted, because continuing tax revenue would be less than monthly benefit obligations. As such, Social Security cannot contribute to the level of total federal

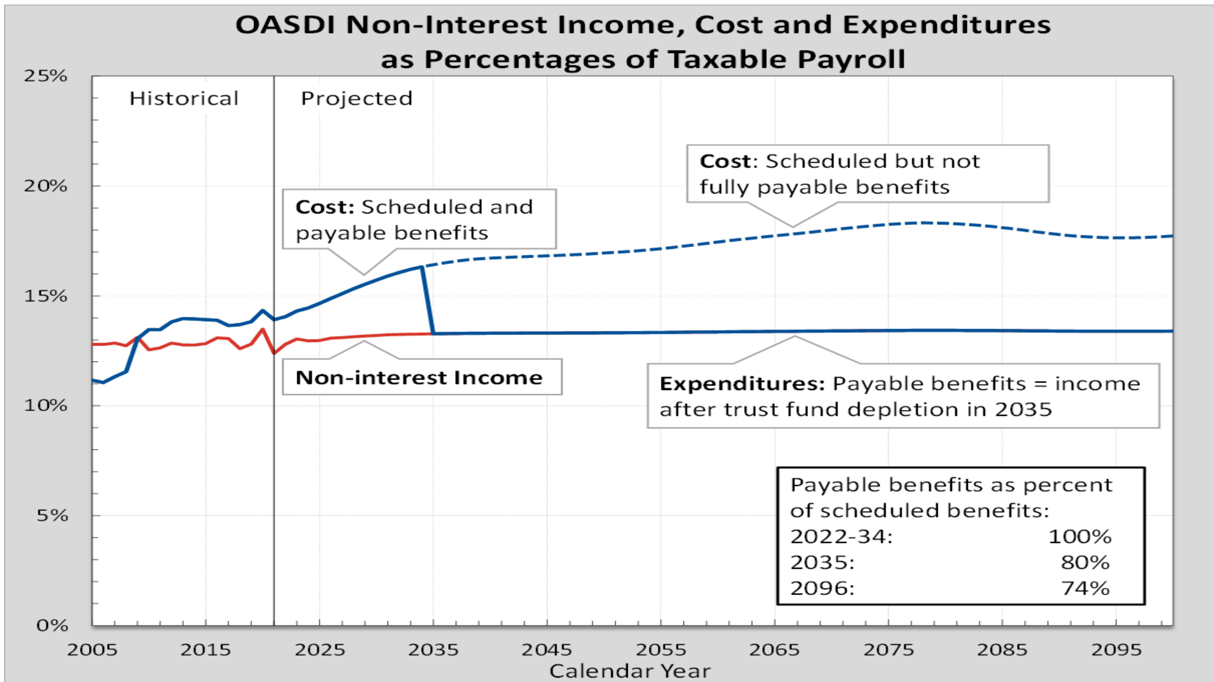
debt and can only diminish the mount of federal borrowing from the public to the degree the trust funds hold reserves in US Treasury securities.

As shown in the graph below, the level of the combined OASI and DI Trust Fund reserves is projected to decline until the combined reserves become depleted in 2035, one year later than projected in last year's report. Over the past 30 reports, the year of combined reserve depletion has ranged from 2029 to 2042. The OASI Trust Fund reserves are projected to become depleted in 2034, also one year later than in last year's report.

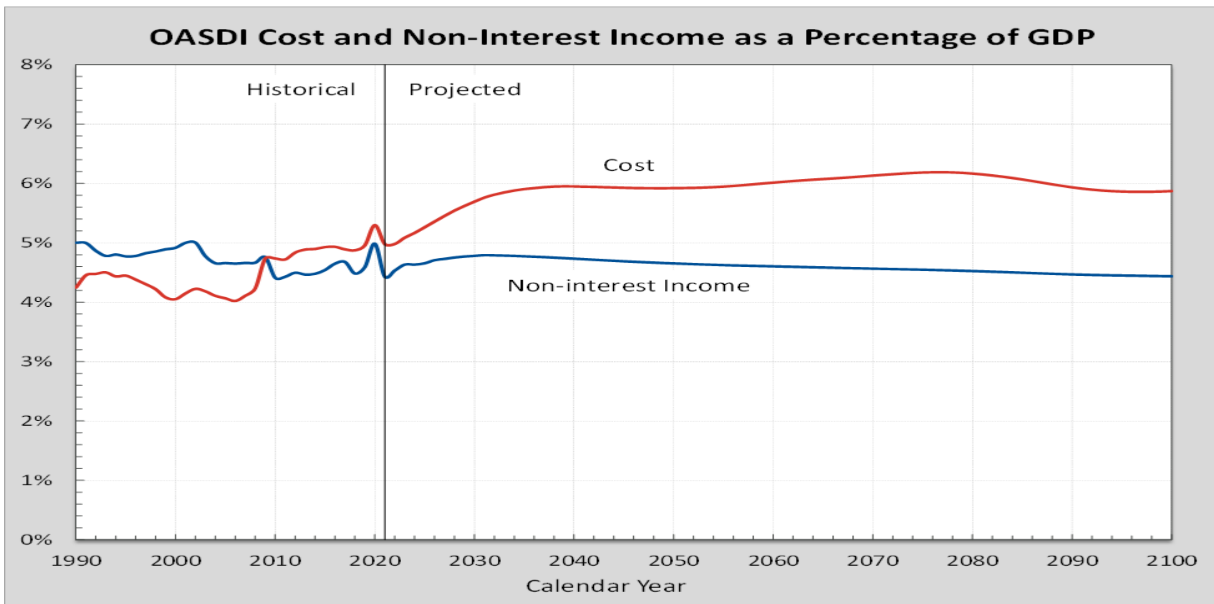


DI Trust Fund reserves are now projected to be positive through the end of the 75-year projection period. In last year's report, DI reserves were projected to become depleted in 2057. This change results largely from more favorable recent disability incidence rates and the reduction in the assumed ultimate disability incidence rate.

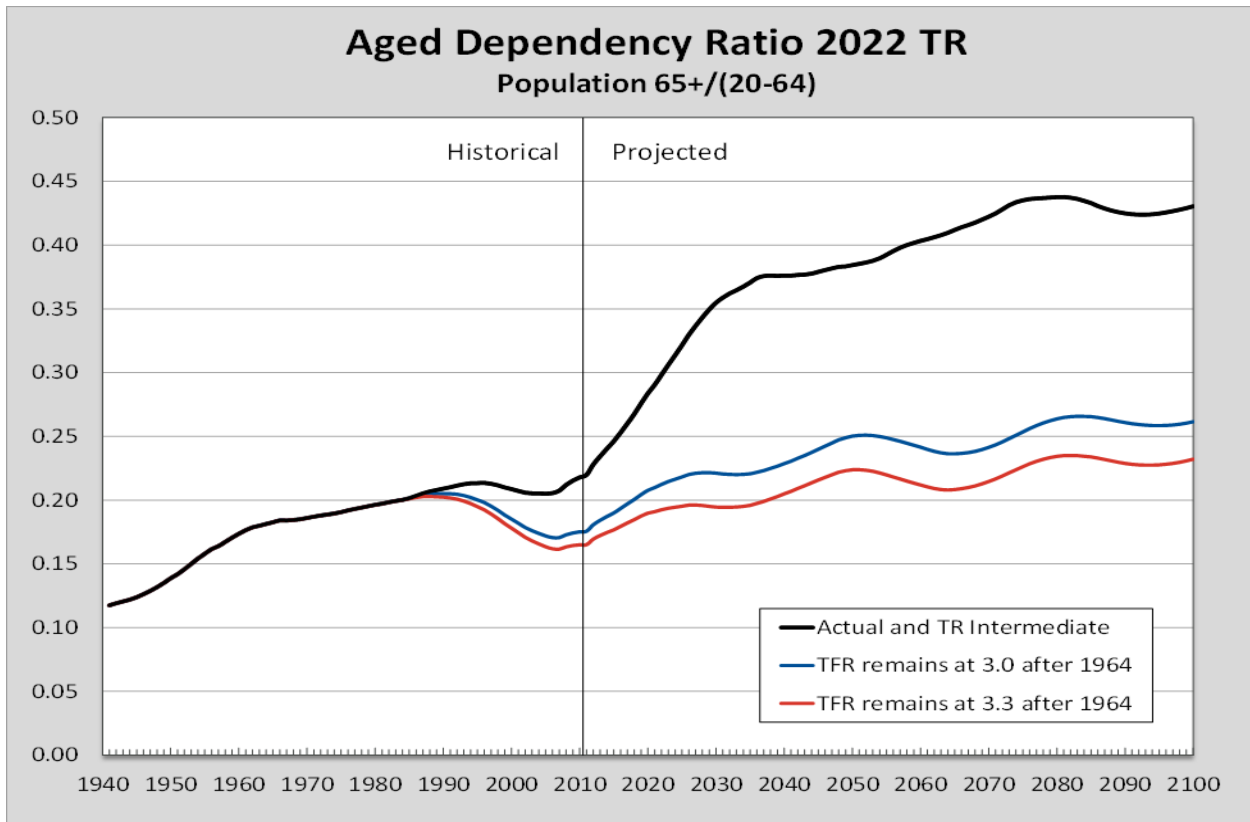
The graph below shows that Social Security program cost has been increasing more rapidly than non-interest income since 2008, and is projected to continue to do so through about 2040, after which time the difference between scheduled benefit cost and scheduled non-interest income will be fairly stable. Without legislative change, continuing revenue after reserve depletion in 2035 would be sufficient to finance 80 percent of scheduled cost, declining to 74 percent by 2096.



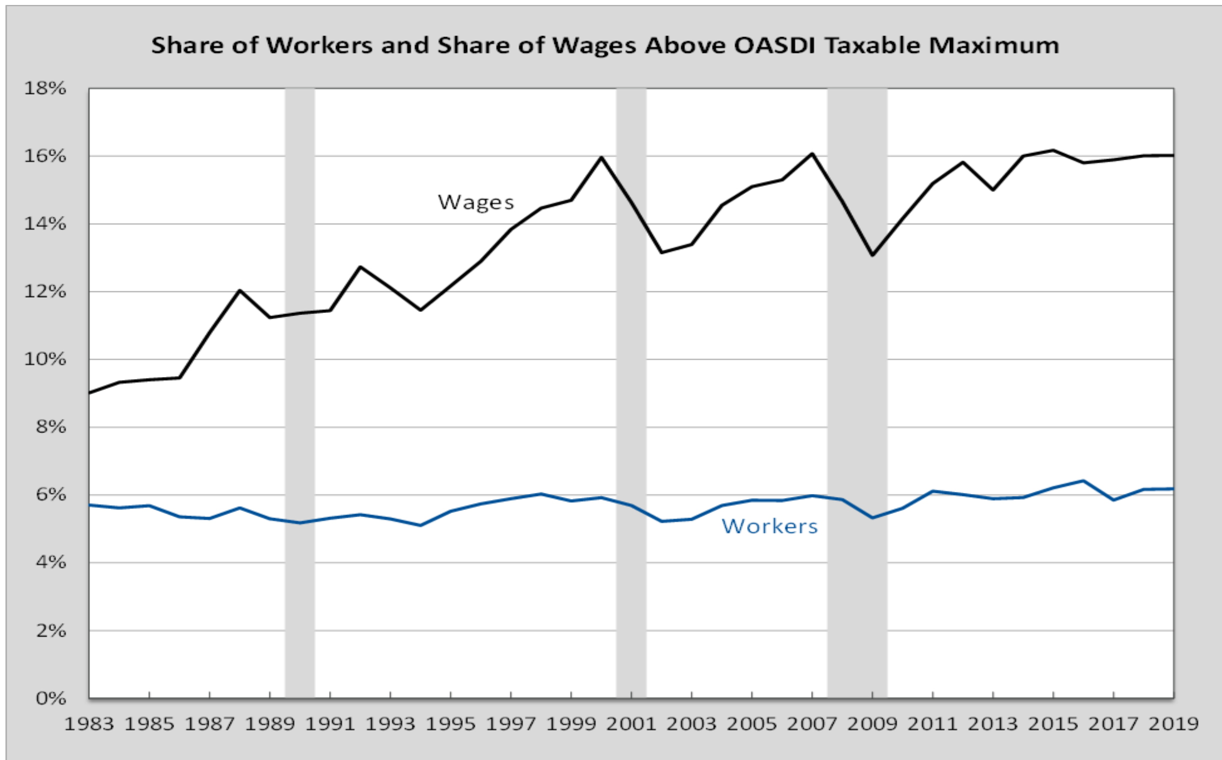
It is also useful to consider the scheduled cost and revenue for Social Security as a percent of GDP, the total value of goods and services produced in the country. For many years prior to 2008, the cost of benefits was about 4.2 percent of GDP, but it has been projected to rise to about 6 percent of GDP by 2040 and remain at that level thereafter. This imbalance needs to be addressed in order for the Social Security program to be fully solvent in the long run. Current-law scheduled benefits are sustainable, but an increase in revenue equivalent to 1.2 percent of GDP over the 75-year long range period would be required.



The natural question is why the cost of providing scheduled Social Security benefits is rising so significantly in 2008 through 2040. The primary reason is the changing age distribution of the US population. Birth rates have declined from about 3.3 children per woman in a lifetime between 1946 and 1965 to about 2 children in a lifetime since about 1970. These reduced birth rates have fundamentally altered the ratio of the population over age 65 (a rough proxy for the beneficiary population) to the population at ages 20-64 (a rough proxy for the working age population). This "aged dependency ratio" almost doubles between 2008 and 2040. As seen in the graph below, the ratio would have risen far less if birth rates had remained close to the levels seen prior to 1970. The much more gradual increase seen in the blue and red lines is due to increasing longevity.

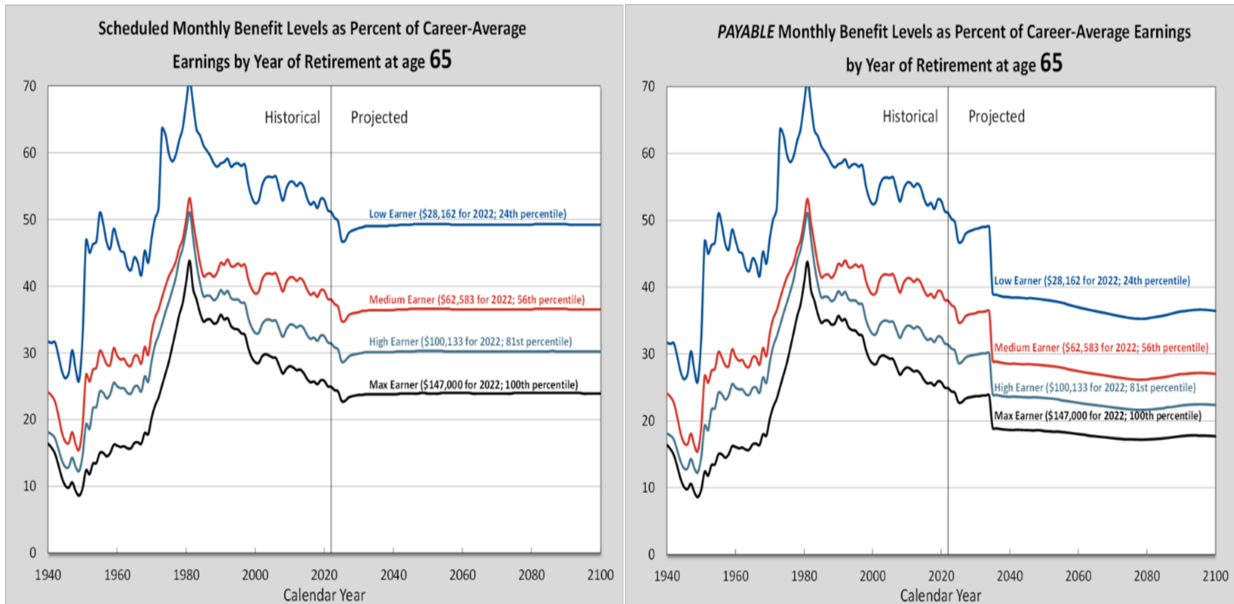


An additional factor that has affected Social Security financing is the fact that the share of total earnings subject to the payroll tax has declined since 1983, because of an increasing concentration of earnings among the highest earners. Earnings taxed by Social Security are limited to the taxable maximum level ($147,000 in 2022), which is indexed annually to the rise in the national average wage level. The graph below shows that consistently since 1983, about 6 percent of wage earners have had annual wages above the taxable maximum level. But between 1983 and 2000, the share of covered earnings received by that top 6 percent of workers has risen from about 9 percent to 16 percent, substantially lowering the tax base for financing the Social Security program.



With the increasing cost relative to GDP because of the changing age distribution of the adult population, and the declining share of workers' earnings subject to payroll tax, Social Security financing has been under increasing pressure. In the absence of legislative changes, the full scheduled level of benefits intended in current law will not be payable starting in 2035.

The adequacy of Social Security benefits is best understood by considering benefit replacement rates. The replacement rate is the ratio of the monthly benefit payable from Social Security to the average monthly career earnings level for a worker beneficiary. These replacement rates were included in Trustees Reports for many years prior to 2014, and are now available annually based on the latest Trustees Report assumptions at https://www.ssa.gov/OACT/NOTES/ran9/index.html. Replacement rates at age 65 are shown in the graphs below for retired worker beneficiaries starting receipt of benefits in different years, both on the basis of scheduled benefits and on the basis of payable benefits—what would be payable in the absence of legislation to eliminate reserve depletion in 2035 and the shortfalls thereafter.

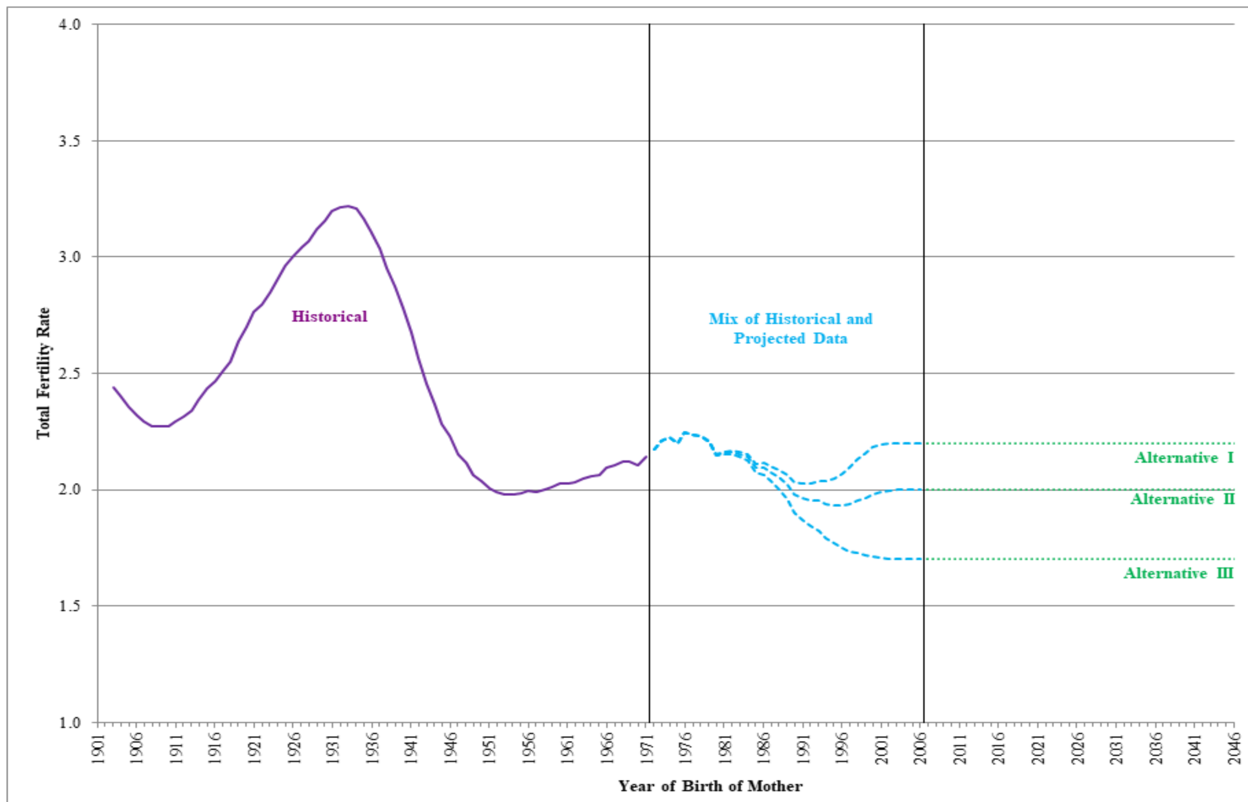


Because Social Security has no borrowing authority, the scheduled benefit levels will not be payable starting in 2035 in the absence of legislative change. In that case, only 80 percent of scheduled benefits would be payable after trust fund reserve depletion in 2035, declining somewhat to 74 percent payable in 2096.

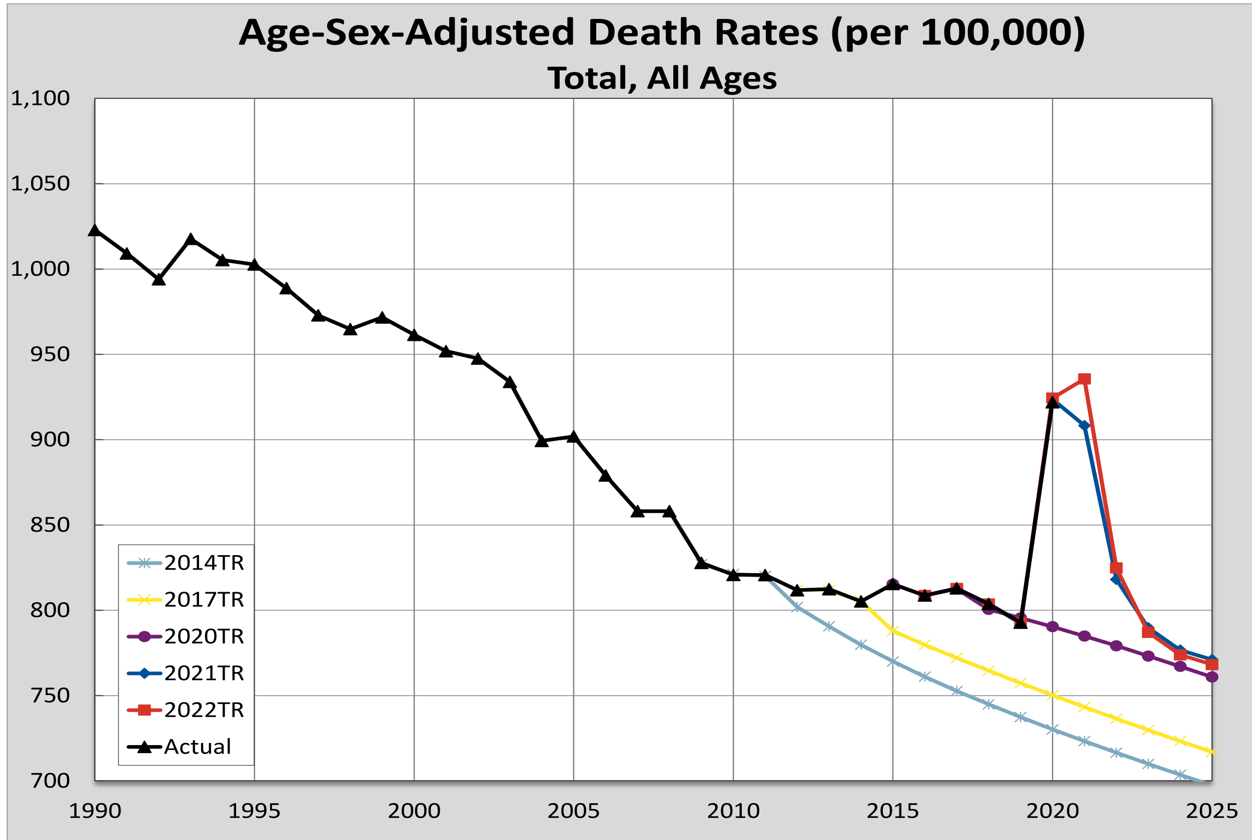
Assumptions Underlying the Projected Actuarial Status of the Social Security Trust Funds

As indicated earlier, birth rates are the most consequential factor in determining the future cost of Social Security relative to the program's income. The drop in birth rates after 1965 is changing the age distribution of the population very substantially and will require an increase in the future contribution rate from current workers, a reduction in benefit levels from those in current law, or additional sources of revenue for the program. Birth rates for women over their lifetime on a generational basis (by birth year of mother) dropped substantially for women born through 1950, and then rose through cohorts of women born in the mid 1970's. But this trend has reversed again in more recent years, and fertility rates are expected to drop below 2 children per woman in a lifetime for women born in the mid-1990s, reflecting the diminished birth rates seen since the great recession of 2007-09. However, the birth rates reflected in the intermediate assumptions for the Trustees Report are assumed to ultimately rise to the levels suggested by birth expectations surveys, which indicate that women on average still intend to have around 2 children in a lifetime.

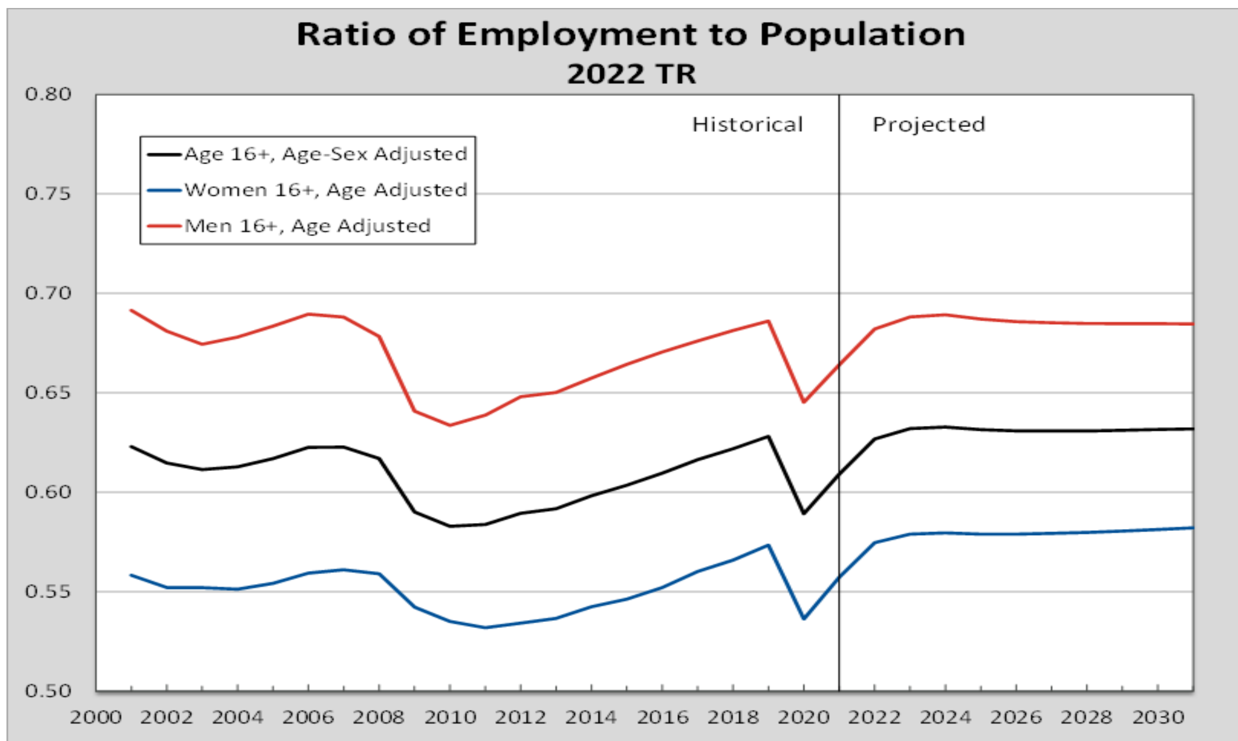
Historical and Projected Total Fertility Rates by Birth Cohort



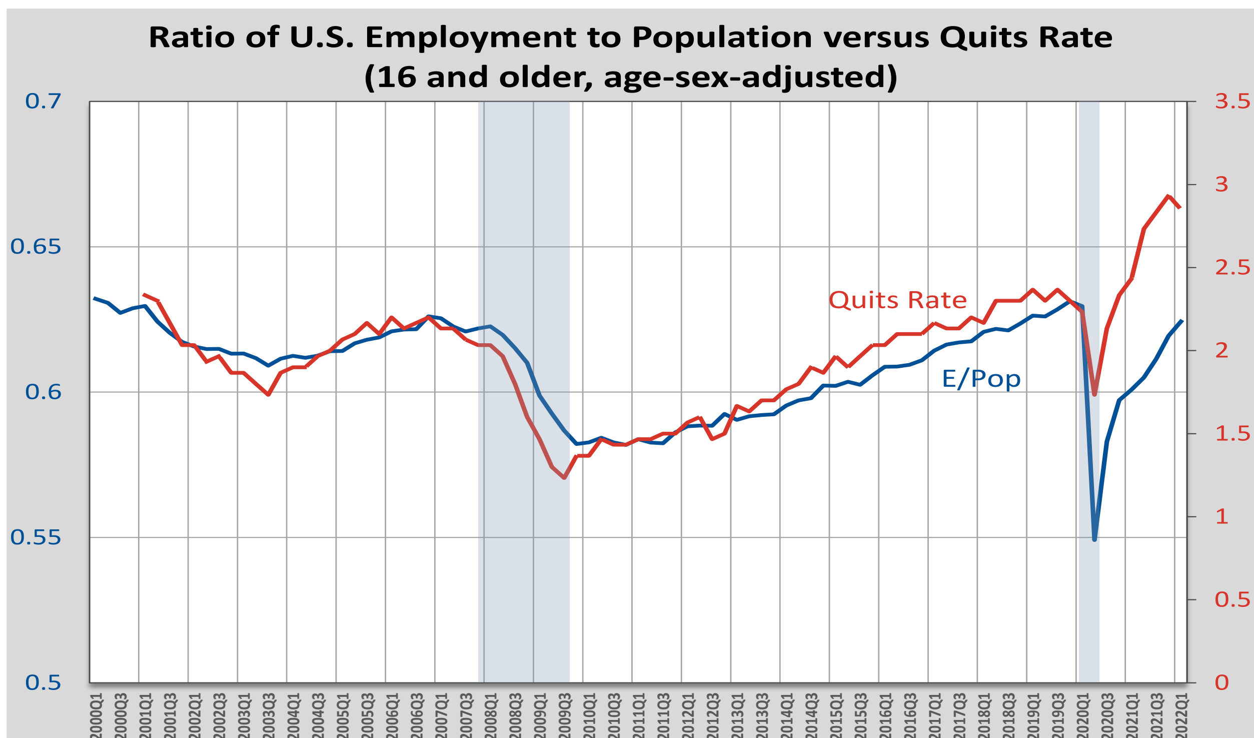
Death rates declined substantially in the latter half of the 20th century, with advances from antibiotics, health care from Medicare and Medicaid, and treatment in cardiovascular disease, in particular. However, since 2009, the decline in age-sex-adjusted mortality in the US has slowed very substantially. Compared to the Trustees' projections in 2014 and 2017, death rates through 2019 have remained much higher than expected. Note that the substantial elevation in death rates in the current pandemic is expected to dissipate in the next 2 to 3 years.



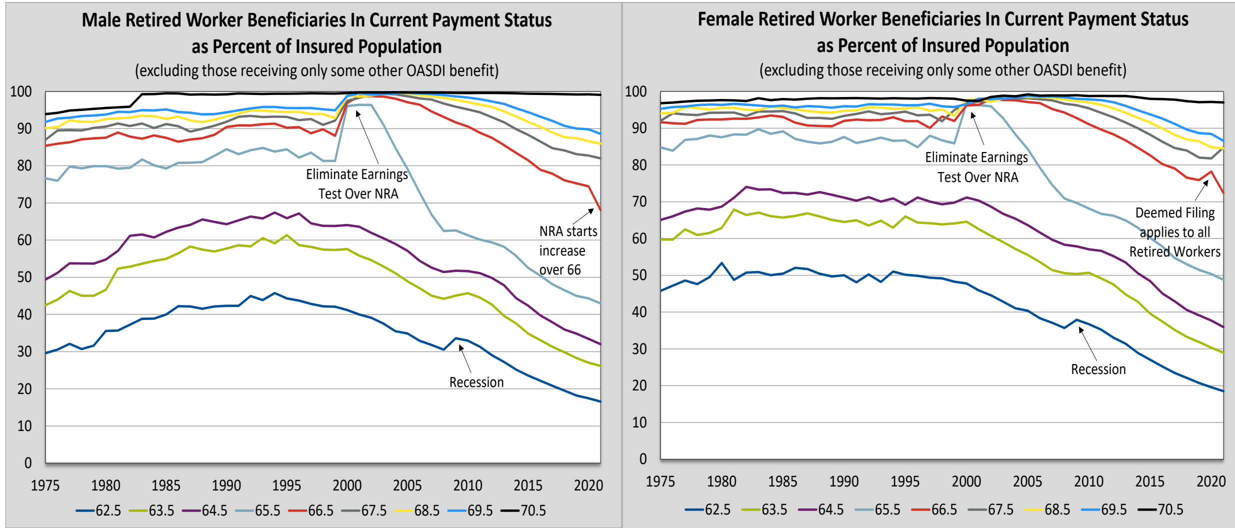
Employment has been a positive story in 2021 and 2022. While the drop in the ratio of employment to adult population recovered very slowly after the 2007-09 recession, taking almost 10 years to fully recover, employment rates since the 2020 recession have rebounded dramatically, contributing to the slightly improved actuarial status for Social Security seen in the 2022 Trustees Report.



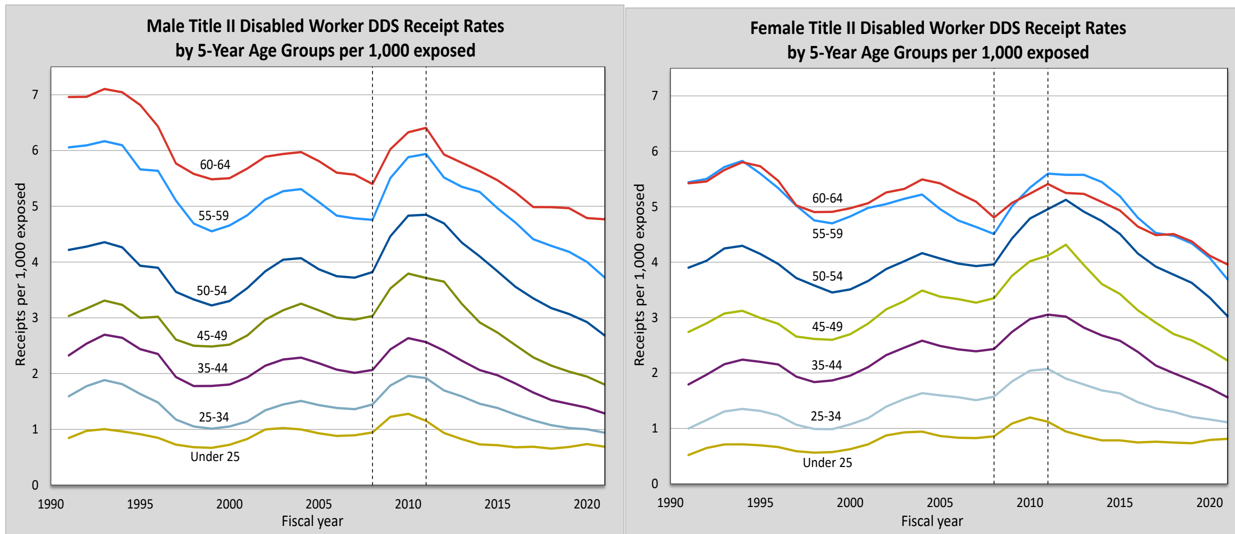
The graph below helps explain the rapid recovery in employment since 2020. The "quits rate," the percentage of workers who voluntarily leave a job, has risen in the recent recovery to an unusually high level, indicating the great demand for employees and the opportunity for job change.



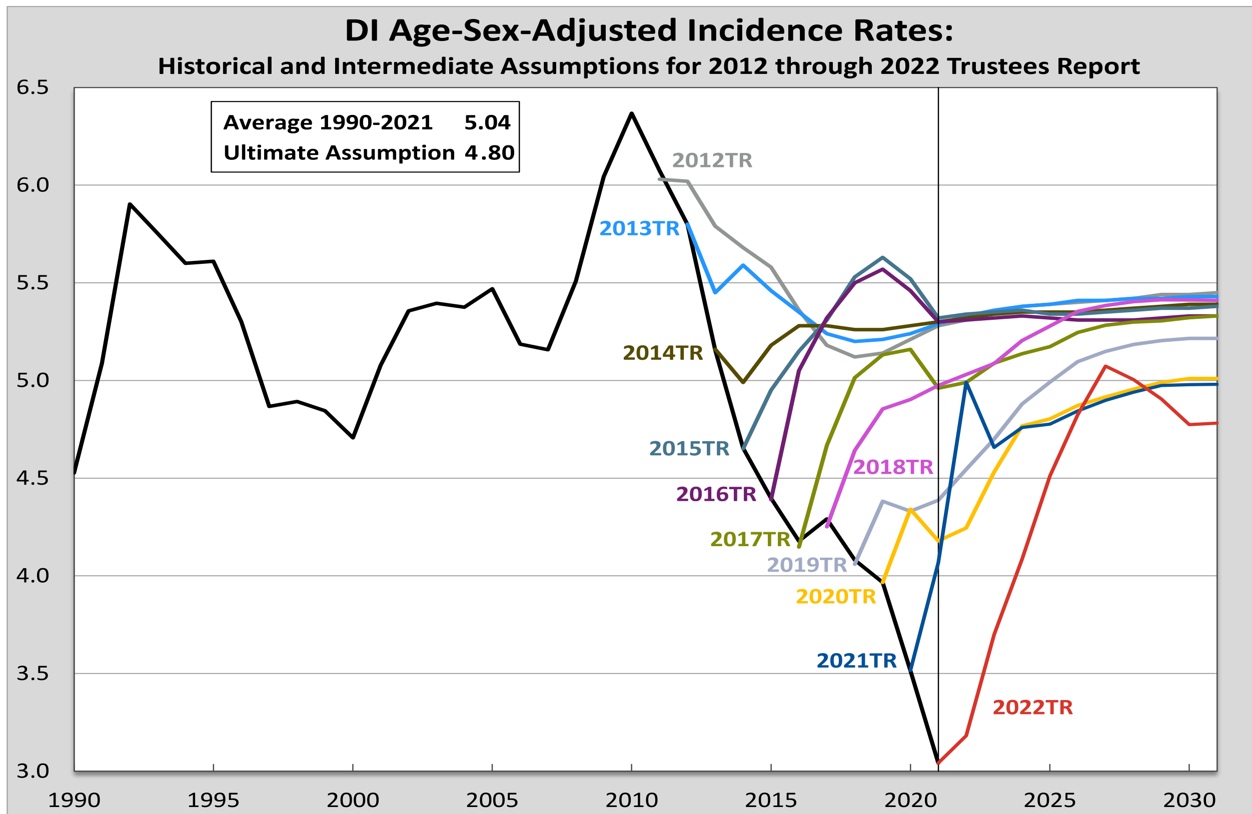
A further notable trend has been the increasing age at which individuals are retiring and starting their Social Security retirement benefits. The percentage of insured workers who start receiving their benefits at ages below the normal retirement age (age 65 until 2000, and now age 67) has declined substantially since the mid 1990's, and more and more individuals are waiting until well after normal retirement age to start their benefits in more recent years. Consistent with the increased demand for workers with the changing age distribution of the population, many workers have been working longer.



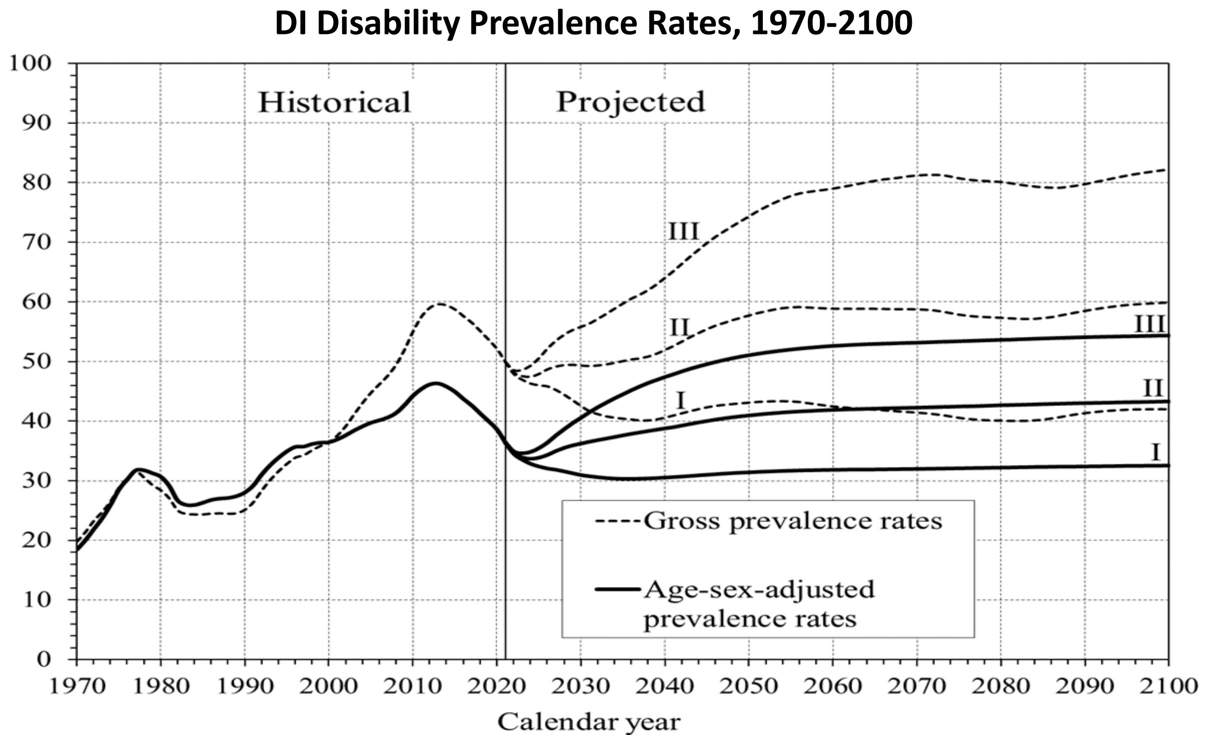
The rate of application for Social Security disability benefits has also dropped substantially since 2010 to very low levels in 2016 through 2019, prior to the pandemic.



The level of disability applications and thus the disability incidence rate has been far below expectations since the projections in the 2012 Trustees Report. This experience has led to several incremental reductions in the ultimate assumed disability incidence rate, including a further reduction to 4.8 per thousand exposed workers for the 2022 Trustees Report. This experience and incremental change in the ultimate incidence rate is the primary reason for the current projection that the Social Security Disability Insurance program will now be adequately financed through the next 75 years.



However, disability incidence rates are still assumed to rise to a level substantially above the levels seen in the years before the pandemic. As a result, disability prevalence, the share of insured workers receiving benefits, is projected to rise to levels near the historical peak seen immediately following the 2007-09 recession.



Conclusion

Legislation will be needed before 2035 in order to sustain the ability to pay all Social Security benefits in full and on time. The retirement of the baby-boom generation is increasing the number of beneficiaries much faster than the increase in the number of covered workers, as subsequent lower-birth-rate generations replace the baby-boom generation at working ages. After 2040, this increased ratio of beneficiaries to workers will persist indefinitely due to the lower level of birth rates compared to the birth rates before 1970. This fundamental change in the age distribution of the population will require the Congress to modify scheduled benefit levels, scheduled payroll tax levels, or add additional sources of revenue for the Social Security program.

By 2035, the Congress will need to reduce scheduled benefits by about 25 percent, increase scheduled revenue by about 33 percent, or make some combination of these changes. The sooner changes are enacted, the more options can be considered, the more gradually changes can be phased in, and the more advance notice will be possible for those who will be affected.

Thank you again for the opportunity to talk to you today. I look forward to answering any questions you may have.