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Kicking Social Security's Empty Can Down The Road

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The Social Security Trustees' report was released in late July, and it shows the program's finances to have worsened compared to last year — an unsurprising outcome since Congress has not enacted any changes to improve the program's solvency.

A consistent and sizable worsening in Social Security's finances during the last decade means that we now face a bigger economic challenge in sustaining a modicum of economic security for today's and future generations of retirees, survivors, dependents and individuals with disabilities.

The Trustees' latest report shows that the entire Old Age, Survivors' and Disability Insurance (OASDI) program accrued an additional $1.8 trillion of unfunded obligations in present value during 2013 when future financial shortfalls are projected without any time limit.

Over just the next 75 years — a calculation that understates the system's present valued funding shortfall — it increased by $1 trillion.

The OASDI trust funds' claims on future Treasury tax receipts, however, increased by just $32 billion.

This comparison shows in terms of today's dollars how exceptionally rapidly Social Security's funding shortfall is growing over time.

Another example: Since the 2004 Trustees' report was issued, the program's unfunded obligation ("the can that the cohort of 2004 kicked to us in 2014") has grown larger by a whopping $14.5 trillion.

The current total shortfall of the OASDI program equals 4.1% of the present value of future taxable payrolls.

It means that to achieve fully funded status, the payroll tax rate would have to be increased by 33% — from its current 12.4% rate to 16.5% immediately and permanently.

Alternatively, benefits must be reduced across-the-board by a commensurate 25%, also immediately and permanently. According to the 2004 Trustees' report, the then-required immediate and permanent changes would have been a payroll tax increase of 28% or a benefit cut of 22%, respectively.

The comparison of the situation today with that of 2004 shows two things:

First, however these funding changes are introduced — whether in a piecemeal manner or all at once, via tax and benefit changes exclusively or the two in combination — there's simply no escaping them.

And, second, the only available trade-off is to make smaller changes now — to impose smaller economic costs on many more generations of Social Security participants — or to make larger changes later on a fewer number of younger and future-born generations.

This year's report also shows the financial implications of current laws for just the Disability Insurance trust fund: It would be exhausted by the year 2016.

After that point, absent change to the program, only 81% of full DI benefits could be paid to individuals with disabilities.

The report also shows that OASDI is headed for insolvency by 2033, after which only 77% of full OASDI benefits could be paid absent program reforms.

This calculation involves the commingling of OASI and DI funding streams to extend DI's solvency beyond 2016.

Such a commingling of OASI and DI funding is the DI "solution" that is preferred by many who wish to prevent any structural changes to Social Security — especially to DI, given its quickly approaching funding cliff.

Without commingling of OASI and DI funding, however, OASI would remain solvent for one additional year — through 2034.

This fact could pit retirees against individuals with disabilities.

One observer commented that such commingling is necessary to prevent DI beneficiaries from being held hostage immediately and be forced to surrender to benefit cuts.

But the cost of their "release" from DI insolvency by commingling the two trust funds is to compel non-disabled retirees (OASI beneficiaries) to acquiesce to facing benefit cuts one year earlier — in 2033 instead of 2034.

The fact is that solving DI's funding problem by a simple reallocation of OASI revenues would postpone much-needed structural reforms to the DI program.

The DI program is beset with many operational problems — ranging from fraud on the part of claimants and case officials to serious procedural shortcomings in how medical evidence is acquired and interpreted in many hard-to-diagnose conditions such as back pain and mental illness when determining whether applicants are allowed onto the DI program.

For Congress to postpone Social Security reforms and, especially in the short term, to simply allow funding transfer from OASI to DI without any accompanying structural reforms to the DI program would be to, once again, "kick the can down the road."

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