Social Security’s Funding Shortfall

Overview
Social Security provides monthly cash benefits to retired or disabled workers, their family members, and family members of deceased workers. Many people of all ages have some connection to the program, including an estimated 178 million covered workers and approximately 64.5 million beneficiaries in 2020.

The program’s income and outgo are accounted for with the Social Security trust funds. They represent funds dedicated to pay current and future Social Security benefits. In 2019, the program had total income of $1,062 billion (92.4% from dedicated tax revenues), total expenditures of $1,059 billion (98.9% for benefit payments), and trust fund reserves of $2.9 trillion (U.S. Treasury securities) available for future program spending. Under the 2020 intermediate assumptions, the Social Security Board of Trustees project, with these asset reserves, the trust funds to remain “solvent” until 2035 (the 2020 intermediate assumptions reflect the trustees’ understanding of Social Security at the start of 2020; it does not include potential effects of the Coronavirus Disease 2019, or COVID-19). That is, until that time, the trust funds are projected to be able to pay full benefits scheduled under current law on a timely basis. In 2035, however, the trust fund reserves are projected to be depleted. While the program would continue to operate with scheduled tax revenues, those revenues are projected to cover about 79% of scheduled benefits through the end of the projection period (2094). It is unclear how the U.S. Treasury would handle the payment of scheduled benefits under such a scenario.

Social Security’s projected long-range funding shortfall is driven largely by demographic factors. Declines in fertility and increases in longevity result in a lower ratio of workers to beneficiaries (projections show the ratio of workers paying into the system to support each beneficiary is estimated to fall from 2.8 in 2018 to 2.3 in 2035). Changes to Social Security have long been an issue of interest to Congress from a trust fund solvency perspective. Policy proposals to address Social Security’s projected funding shortfall typically include a combination of revenue increases and benefit adjustments. Although the process of selecting specific program changes would likely involve intense debate in Congress, policymakers generally agree that taking legislative action sooner rather than later could mitigate the effects on workers and beneficiaries and allow people as much time as possible to adjust to the changes.

How Is Social Security Financed?
Social Security is a self-financing program. Of its total income, 92.4% is from dedicated tax revenues: (1) payroll taxes paid by employers, employees, and self-employed individuals; and (2) federal income taxes paid by about half of beneficiaries on a portion of their benefits. The program also receives interest income on the asset reserves held by the Social Security trust funds (7.6%) and a small amount (less than 1%) of other income (including reimbursements from the U.S. Treasury’s general fund).

Social Security coverage is nearly universal, with an estimated 93% of all workers participating in the system in 2020. The Social Security payroll tax rate is 12.4%, divided evenly between the worker and the employer; the tax is applied to the worker’s earnings up to an annual limit ($137,700 in 2020). Any covered earnings above the annual limit are not subject to the Social Security payroll tax and are not counted in the worker’s benefit computation. Social Security benefits are intended to replace part of a worker’s earnings. As such, a worker’s benefit is based on his or her career-average earnings in covered employment (i.e., earnings subject to the Social Security payroll tax) and a progressive benefit formula that is intended to provide adequate benefit levels for workers with low career-average earnings.

Issue Before Congress
- Over its 85-year history, Social Security has collected $23.0 trillion and paid out $20.1 trillion, leaving trust fund asset reserves of $2.9 trillion.
- Projections show that Social Security will be unable to pay scheduled benefits in full and on time starting in 2035, primarily due to demographic factors.

What Is Social Security’s Projected Financial Outlook?
For many years, Social Security collected more tax revenues than needed to pay benefits, resulting in the accumulation of trust fund asset reserves (held in the form of interest-bearing U.S. Treasury securities) available for future program spending. Starting in 2010, however, Social Security’s total expenditures began to exceed noninterest income (i.e., cash-flow deficits emerged), requiring the program to draw on trust fund reserves to pay scheduled benefits. The trustees project that Social Security will continue to run cash-flow deficits throughout the 75-year projection period (2020-2094) and that annual cash-flow deficits will grow markedly over time. For example, the program’s cash-flow deficit was $78 billion in 2019 and is projected to be $460 billion in 2034 (constant 2020 dollars). (2020 Social Security Trustees Report, intermediate assumptions.)

In 2021, Social Security’s cost is projected to exceed total income (i.e., tax revenues plus interest income). Trust fund reserves are projected to decline steadily from their peak of $2.9 trillion to zero in 2035. Following the depletion of trust fund reserves, scheduled tax revenues are projected to
beneficiaries would have to wait until the Social Security funds available to pay the benefits time, the Antideficiency Act prevents an agency from borrowing to supplement or replace traditional Social Security benefits. Some of the more commonly discussed proposals include increasing the amount of covered earnings subject to the payroll tax (the taxable wage base), increasing the payroll tax rate, raising the retirement age, modifying the benefit formula, and changing the annual cost-of-living adjustment (COLA) calculation.

Striking a balance between Social Security’s future revenue and benefit streams can prove challenging. From a policy perspective, for example, an increase in either the taxable wage base or the payroll tax rate could provide an equal amount of additional revenues. These two options, however, would affect different groups within the population. Increasing the taxable wage base would affect only the estimated 6% of covered workers who have earnings above the current taxable wage base, while increasing the payroll tax rate would affect all covered workers. From a political perspective, public opinion regarding different options can vary among constituencies.

What Is the Timeframe for Action?
Social Security is the primary source of retirement income for many beneficiaries. Given projections showing that in less than 16 years scheduled benefits cannot be paid in full and on time, and the magnitude of the projected funding shortfall, policymakers generally agree that legislative action should be taken sooner rather than later. As stated in their 2020 annual report to Congress, “The Trustees recommend that lawmakers address the projected trust fund shortfalls in a timely way in order to phase in necessary changes gradually and give workers and beneficiaries time to adjust to them. Implementing changes sooner rather than later would allow more generations to share in the needed revenue increases or reductions in scheduled benefits.”

To illustrate the magnitude of changes needed to maintain Social Security solvency over the next 75 years, the trustees point out hypothetically two options that it would take:

- an immediate 3.14 percentage point increase in the payroll tax rate (from 12.40% to 15.54%)
- an immediate 19% reduction in scheduled benefits for all current and future beneficiaries (or a 23% reduction for newly-eligible beneficiaries only).

For more information, see CRS Report RL33028, Social Security: The Trust Funds.

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