LONG-RANGE FISCAL POLICY BRIEF

CBO

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The Future Growth of Social Security: It's Not Just Society's Aging

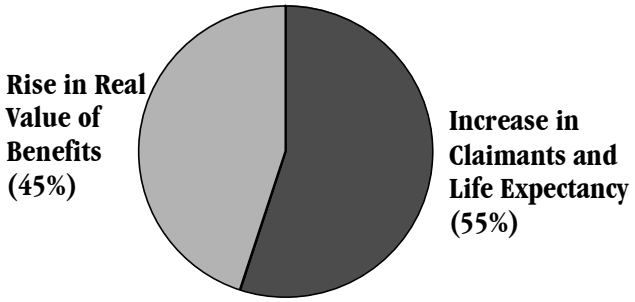
The Congressional Budget Office (CBO) projects that spending for Social Security, adjusted for inflation, will rise from $483 billion in 2003 to $2.5 trillion in 2075. Those estimates are based on CBO's 10-year baseline budget outlook and the "intermediate" long-range assumptions of the trustees of the Social Security system.[1]

Approximately 55 percent of the higher spending is due to an expected increase in the number of beneficiaries, as the number of new claimants grows and as life expectancy rises (*see Figure 1*). The Social Security trustees estimate that the population age 65 or older will increase from 37 million today to 75 million in 2035 and to 95 million in 2075. Life expectancy for people currently age 65 is estimated to be 83 years. In 2035, it is estimated to be 85 years, and in 2075, 87 years.

The remaining 45 percent of the rise in spending is due to a projected increase in the real value of Social Security benefit checks. Under the trustees' assumptions, the purchasing power of the average earner's benefits at retirement is expected to nearly double between now and 2075.

Figure 1.

Factors Contributing to the Rise in Social Security Spending from 2003 to 2075



Source: Congressional Budget Office.

Note: Spending is calculated in constant dollars.

Rising Benefit Levels

The computation of a person's initial Social Security benefits is automatically linked to the general rise in wages in the economy. Under rules put into effect in 1979, benefits of newly eligible recipients are based on a formula and earnings records that are adjusted for wage growth. Those adjustments, referred to as wage-indexing, are designed to keep the ratio of initial benefits to preretirement earnings —that is, replacement rates—approximately the same from one group of new recipients to the next.

As set forth in the Social Security Act, benefits are computed by applying a three-bracket formula to an average of a worker's earnings over much of his or her career.[2] For a worker becoming eligible for benefits in 2003, the formula sets benefits at 90 percent of average monthly earnings up to $606; for earnings from $607 to $3,653, it uses a 32 percent rate; and for earnings above $3,653, it uses a 15 percent rate. The Commissioner of Social Security is required to adjust the formula each year for newly eligible recipients by raising the bracket levels by the amount that average wages in the economy rose two years earlier. Also, a worker's earnings are indexed for average wage growth from the year in which the earnings occurred to the year in which he or she reached age 60, creating what are called average indexed monthly earnings, or AIME (earnings at

1. See Social Security Administration, *The 2003 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds* (March 17, 2003).

2. To calculate retirement benefits, the highest 35 years' worth of earnings are used. For younger disabled workers and survivors of deceased workers, fewer years of earnings may be used.

age 60 and later are included at their nominal value). Without those adjustments, replacement rates would decline as more of the earnings of future recipients fell into the lower-yielding brackets of the formula. With the adjustments, replacement rates remain constant (*see Figure 2*).[3]

However, wages tend to rise along with productivity in the economy, at a faster rate than prices. Thus, over the long run, a system pegged to wage growth will gradually afford greater purchasing power.[4] For a worker retiring today at age 65 with average earnings over his or her career, annual benefits are estimated to be nearly $14,000. For a 65-year-old retiree in 2075, those benefits will grow to $26,000, providing nearly twice as much purchasing power (*see Figure 3*).

Policy Implications

The projected rise in Social Security spending thus comes not only from an aging society but also from a benefit structure that since 1979 has built in rising levels of real benefits. Under current rules, the cost of the program could rise from 4.4 percent of gross domestic product (GDP) today to 6.6 percent by 2075—a 50 percent increase. If, alternatively, the real value of the benefits was held constant for new cohorts of recipients, the cost of the program would rise to 5.3 percent of GDP in 2033 and subsequently decline to 3.9 percent in 2075, CBO estimates (*see Figure 4*).

Without real increases in Social Security benefits, future workers would be responsible for more of their retirement income. But a process that automatically grants those in-

3. A scheduled increase in the age at which a worker can receive full benefits—from 65 in 2000 to 67 in 2027—will somewhat reduce the real growth of benefits. Replacement rates will decline during that period but will be constant thereafter.

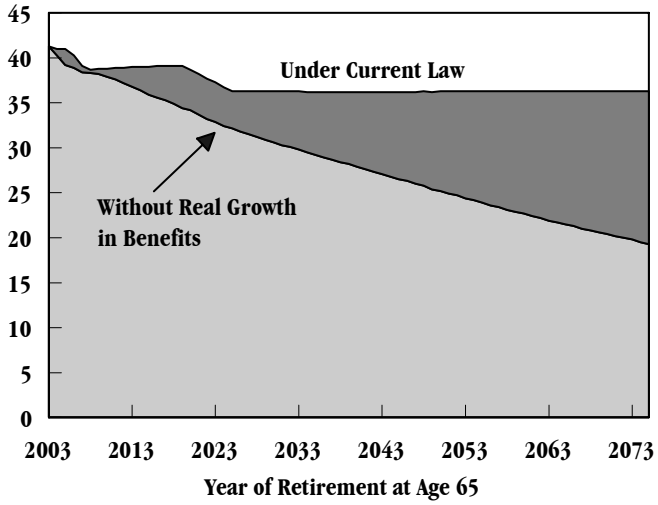
   Adjustments in the rules for computing benefits should not be confused with automatic cost-of-living adjustments (COLAs). The former are employed to determine a person's initial benefits. COLAs are designed to maintain the purchasing power of those benefits once a person is on the rolls.

4. Under the trustees' 2003 projections, ultimately, wages will grow by 4.1 percent per year; prices, by 3.0 percent.

Figure 2.

Projected Replacement Rates for Social Security from 2003 to 2075

(First year's benefits as a percentage of final earnings)



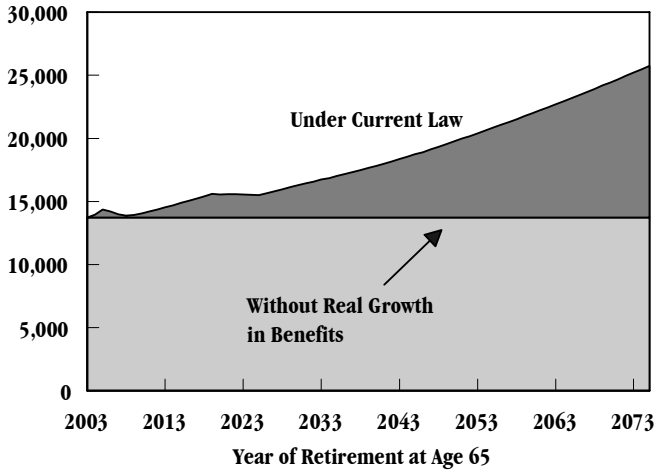
Source: Congressional Budget Office.

Note: Replacement rates based on workers with average earnings patterns. Benefits under current law include adjustments for real wage growth.

Figure 3.

Projected "Real" Rise in Social Security Benefits from 2003 to 2075

(Annual benefits in 2003 dollars)



Source: Congressional Budget Office.

Note: Benefits based on workers with average earnings patterns. Benefits under current law include adjustments for real wage growth.

creases establishes a significant priority in the federal allocation of resources. By absorbing a larger share of the budget, Social Security spending could crowd out other functions of government or require higher taxes on tomorrow's workers.

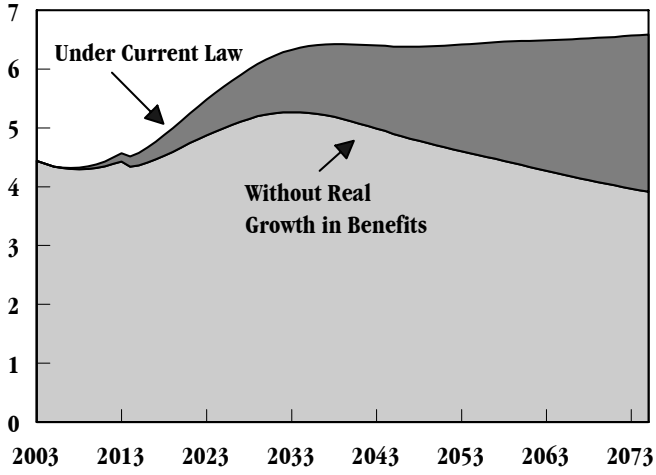
Automatically increasing the real value of benefits came relatively late in the program's development. During Social Security's first 40 years, benefits were raised only as policymakers saw a need and perceived that the resources would be there. Retaining or modifying the current practice involves judging the merits of making sizable automatic transfers to the aged and disabled relative to other budgetary priorities and, ultimately, other claims on the economy.

Note: In this brief, the estimates that exclude real growth in benefits do not reflect a specific proposal. Many possible modifications to the rules for computing benefits could produce results similar to those illustrated here, including different indexing, changes in the age at which full benefits are paid, and alterations in which earnings are countable or in the period over which earnings are averaged.

Figure 4.

Projected Rise in Social Security Spending as a Share of Gross Domestic Product from 2003 to 2075

(Percentage of GDP)



Source: Congressional Budget Office.

Note: Benefits under current law include adjustments for real wage growth.

Related CBO Publications: *Budget Options* (March 2003), Chapter 4; and *Social Security: A Primer* (September 2001).

This policy brief was prepared by Dave Koitz. It and other publications by CBO are available at the agency's Web site (www.cbo.gov).

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