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Statement of Robert D. Reischauer[1]

Subcommittee on Social Security, Committee on Ways and Means

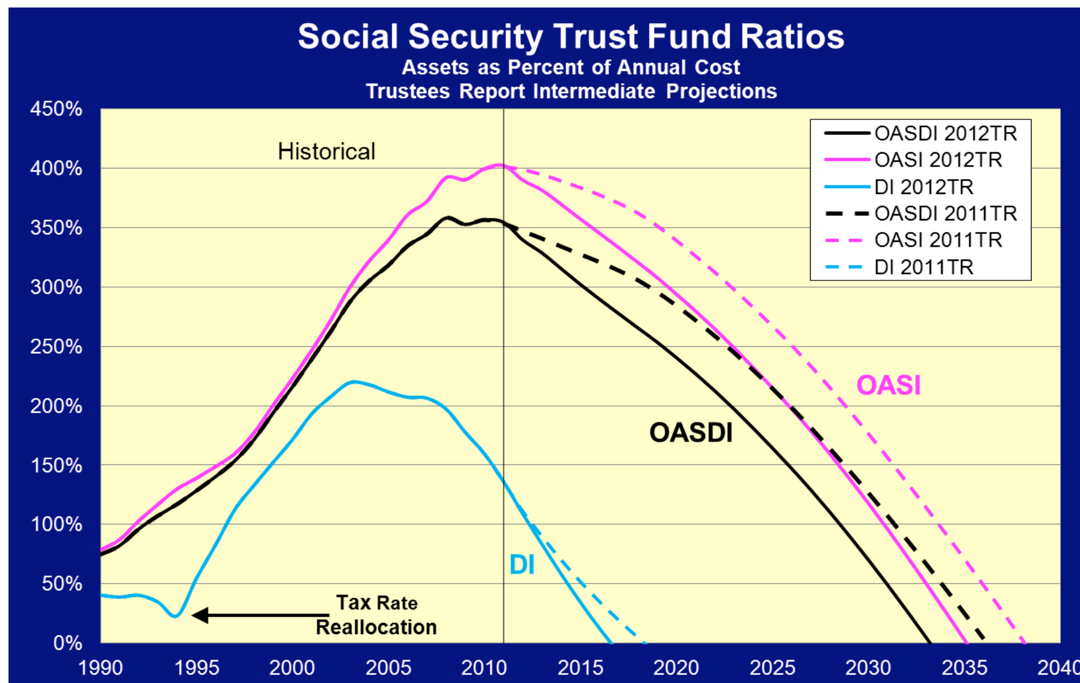
U.S. House of Representatives

June 21, 2012

Chairman Johnson, Ranking Member Becerra, and members of the subcommittee, I appreciate this opportunity to discuss the 2012 Social Security Trustees Report with you. My fellow Public Trustee Dr. Charles P. Blahous covered the basic operations and projected financing shortfall of the program in his presentation. My statement focuses on the changes that have occurred in the program's financial outlook since last year's report and the impact that a weak economy can have on this outlook. To illustrate my points, I have included in my statement a number of charts that were prepared by the Office of the Chief Actuary of the Social Security Administration.

The projections of the financial health of the Social Security program that are contained in the annual Trustees Reports change each year, sometimes by small amounts, sometimes by moderate amounts, and sometimes by large amounts. To judge whether the financial health of Social Security is improving or deteriorating, the media and the public focus on whether the years in which the two trust funds are projected to be exhausted have receded or advanced since the last report. If the movement has been by more than a year or two, the year-to-year changes are regarded as significant.

By this measure, the changes between the 2011 and 2012 Trustees Reports indicate a significant deterioration in the financial health of the Social Security program. (See Chart) The exhaustion date of the OASI Trust Fund is now projected to be 2035, three years sooner than was projected in last year's report. The projected exhaustion date of the DI Trust Fund has advanced two years from 2018 to 2016 and the exhaustion date for the two trust funds combined (OASDI) is projected to come in 2033, three years year sooner than was projected in last year's report.



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[1] President Emeritus of the Urban Institute and Public Trustee of the Social Security Trust Funds. The views expressed in this statement should not be attributed to the Urban Institute, its sponsors, staff, or trustees.

A more comprehensive measure of a trust fund's financial condition is its actuarial balance over the 75-year valuation period. This balance is essentially the difference between annual income and costs, summarized over the 75-year projection period and expressed as a percentage of taxable payroll.

A negative actuarial balance—an actuarial deficit—can be interpreted as the percentage points that would have to be either added to the current-law income rate or subtracted from the cost rate in each of the next 75 years to bring the fund into actuarial balance. By definition, for a trust fund to be in actuarial balance its income must equal its costs over the valuation period and at the end of the 75th year the trust fund must hold assets equal to the 76th year's cost.[2]

The actuarial deficits of both Social Security trust funds have deteriorated since last year's report. The DI Trust Fund's actuarial deficit has worsened by -0.07 percent of taxable payroll, the OASI fund's deficit has deteriorated by -0.38 percent of taxable payroll and the deficit of the combined trust funds has weakened by -0.44 percent of taxable payroll (See Table). The deterioration in the combined trust funds' deficit is the largest single year decline since this measure was first calculated in 1982.

Long-Range Actuarial Deficit of the
OASI, DI, and OASDI Trust Funds
(percent of taxable payroll)

	OASI	DI	OASDI
2011 Trustees Report	-1.92	-0.30	-2.22
2012 Trustees Report	-2.30	-0.37	-2.67
Difference	-0.38	-0.07	-0.44*

*Difference adjusts for rounded components

Year-to-year changes in Social Security's projected financial situation always occur because the valuation period is moved one year forward. Changes can also occur because new legislation is enacted, underlying economic and demographic assumptions are modified, administrative practices are revised, projection methodologies are refined, and new data become available. The 75-year valuation period used in the 2012 Trustees Report adds the year 2086, a year with a large negative balance, and drops 2011, a year with a more modest negative balance, to the valuation period used in the 2011 Report. This change from the previous report accounts for a bit less than 9 percent of the increase in the actuarial deficit. (See Chart)

[2] Because Social Security's annual deficits, expressed as the difference between the cost rate and income rate, are projected to increase gradually from 2017 to 2037, to decline slightly during the 2038 to 2052 period and then to increase through 2086, the single tax rate increase for all years starting in 2012 sufficient to achieve actuarial balance would result in large annual surpluses early in the period followed by increasing annual deficits in later years. The relatively large deficits at the end of the 75-year projection period—equal to 4.50 percent of taxable payroll in 2086—indicate that sustained solvency would require payroll tax rate increases or benefit reductions (or both) by the end of the period that are substantially larger than those needed on average for the valuation period (2012-86).

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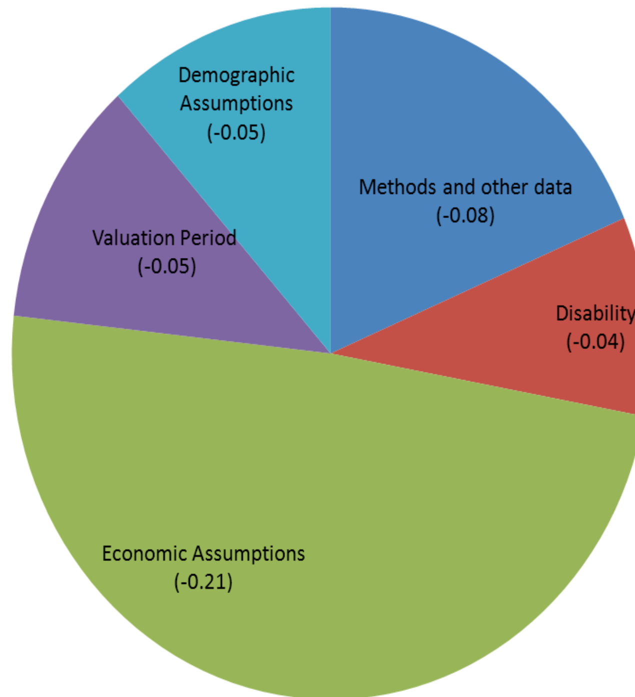


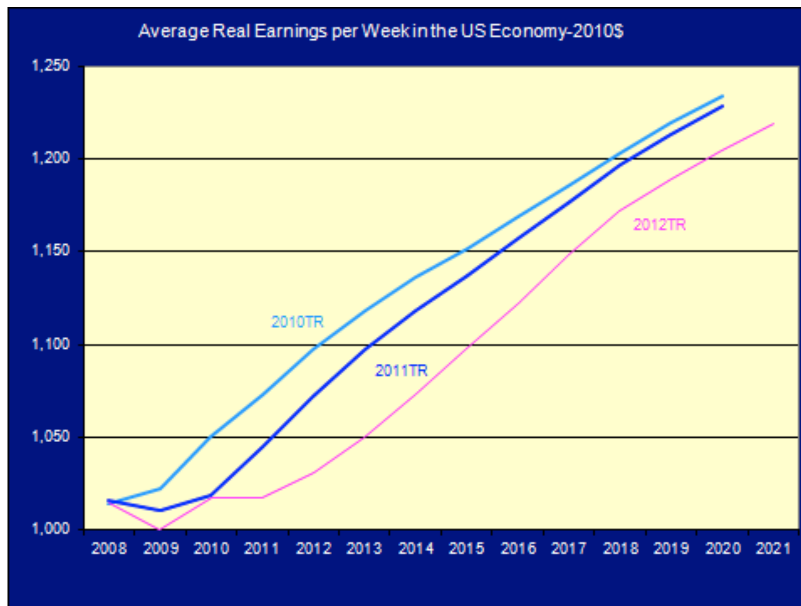
No legislation enacted during the past year significantly affected Social Security's long-range financial position.

While the ultimate demographic assumptions in this year's Report are the same as those in the 2011 Report, updated starting demographic values and the transition from these values to the ultimate assumptions increased the actuarial deficit modestly. Specifically, the availability of more recent data showed lower 2009 and 2010 birth rates, lower 2010 immigration rates, and a slightly smaller initial population than was assumed in the 2011Report.

Almost half of the increase in the actuarial deficit between the 2011 and 2012 Reports is accounted for by changed economic assumptions and more recent information about the economy's performance. About two-thirds of this is related to updated starting values and less optimistic assumptions about the near term growth of the economy. They illustrate how relatively small errors in our ability to forecast short-term economic conditions can have significant impacts on Social Security's financial well-being.

Price inflation between the third quarters of 2010 and 2011was faster than was assumed in the 2011 Report. Rather than a 0.7 percent increase in benefits, as was assumed in the 2011 Report, beneficiaries received a 3.6 percent December 2011COLA, increasing the program's costs.

A weaker than expected economy resulted in average taxable earnings for 2011 that were below the level assumed in the 2011 Report. (See Chart) The assumed levels of average taxable earnings have been adjusted downward from the levels assumed in the 2011 Report by 2.0 percent for 2012 and by lesser amounts in future years in this year's report. (See Chart) These adjustments reduce expected future payroll tax revenue.

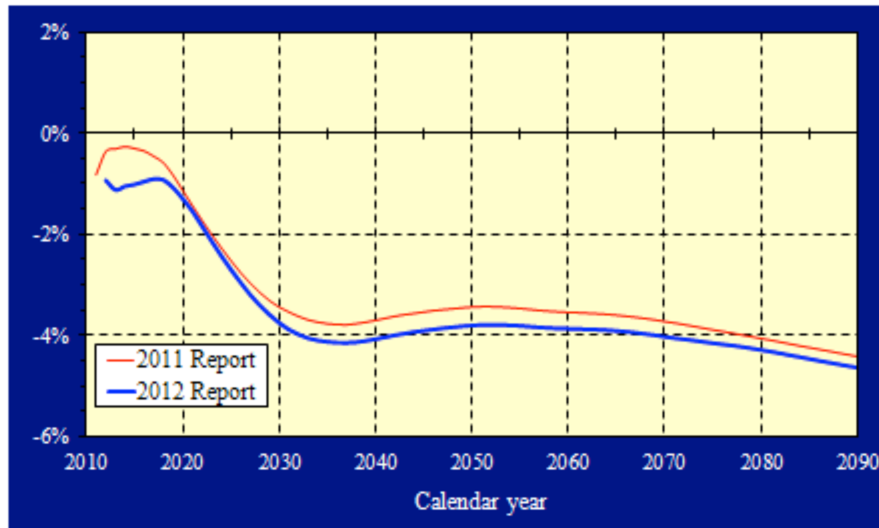


Real interest rates in 2011 and those projected in the 2012 Report for the next few years are lower than was assumed in the 2011 Report. Lower real interest rates reduce the amount of real interest income that the trust funds will receive on their new investments.

The 2012 Report's estimate of the gap between non-interest income and costs over the next few years is significantly larger than that shown in the 2011 Report largely because of these economic factors, in particular a larger than expected COLA and the shortfall in average taxable wages. (See Chart below) The expectation that full recovery from the Great Recession will take one year longer than was assumed last year, with full employment not being attained until 2019, also contributes to the larger gap.

OASDI Annual *Cash-Flow* Balances 2011-2086

(Non-interest income minus cost as a percent of payroll)



Another change introduced in the 2012 Report has a more significant impact over the longer term. In past reports the Trustees assumed that the average number of hours worked per week would not change in the future. The 2012 Report assumes that after 2021 the average number of hours worked per week will decline 0.05 percent a year, reflecting the aging of the workforce and the belief that future workers will want to take some of their productivity gains in the form of more leisure. This assumption translates into a reduction in the real wage differential—the percentage point difference between the growth of average covered wages and the growth of consumer prices. After 2021, this assumption will act to reduces taxable earnings and payroll tax revenues from the levels assumed in the 2011 report by ever increasing amounts. It accounts for about one-third of the 0.21percentage point increase in the actuarial deficit associated with economic factors and is the primary reason for the reduction after 2021in the cash flow balances shown in the previous chart.

The 2012 Report also revised the assumption made about the incidence of disability. Compared to last year's report, the ultimate age-adjusted disability incidence rates were increased by 2 percent for males and 5 percent for women. These rates are more consistent than were the previous report's assumptions with the disability levels and trends experienced over the past decade. The new assumptions increased the actuarial deficit by -0.04 percent of taxable payroll.

Several improvements in methods and new program data were introduced in the 2012 Report. Two methodological refinements are expected to improve the accuracy of the estimates of the benefits paid to the average worker who retires in the future. Taken together the new data and methodological refinements increase the projected long-run actuarial deficit by 0.08 percent of taxable payroll.

The actuarial deficits detailed in the 2012 Trustees Report and summarized in this statement underscore the need for legislative action to put Social Security on a sustainable path. The sooner we address this challenge, the less disruptive the changes will be. Those most adversely affected can be given the time they need to prepare, the burden can be more equitably shared across the generations, and the political animosity and public anxiety associated with the unavoidable changes can be moderated.

The analysis in the 2012 Report of the Trustees also underscores how important a strong economy and healthy long-run growth are to the Social Security program. While the economy should gradually recover from the recession and period of tepid growth it has experienced recently, prolonged periods of economic weakness can affect for decades the economy's potential, the productivity and earnings of the work force and patterns of labor force participation. Some insight into the magnitude of these effects can be gleaned from the following chart which contrasts the economic projection contained in the 2008 Trustees Report, the last report before the Great Recession, with those of subsequent reports. The unavoidable conclusion is that maintaining a strong economy is critical to a sustainable Social Security program.