S T R A I G H T T A L K
on Social Security and Retirement Policy

URBAN INSTITUTE No. 17 • February 15, 2000

SOCIAL SECURITY BENEFITS UNDER CURRENT LAW: WHAT HAPPENS WHEN THE TRUST FUND RUNS DRY?

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IN EVALUATING SOCIAL SECURITY REFORM proposals, policymakers often compare them to current law to determine relative winners and losers. However, this practice is complicated by the inherent inconsistencies contained in current law. On the one hand, Social Security's benefits are scheduled to grow; on the other hand, the law restricts payments once the trust fund is depleted, which is expected to happen relatively soon. Depending on how reformers interpret current law—whether they think it requires finding additional money to keep up with benefit growth or lowering benefits to match available funds—their reform proposals can appear to have extremely different effects.

Under one portion of current law, the value of lifetime Social Security benefits is scheduled to grow indefinitely—even though the taxes funding them are not expected to grow as quickly. Initial benefits for new retirees increase as real wages in the economy rise. Lifetime benefits climb even faster than annual benefits because people are living longer, usually resulting in an expansion in the number of years of retirement support provided.[1] Under current law, Social Security outlays will not be met by whatever payroll tax is necessary. Instead of setting a tax rate each year that is high enough to cover promised benefits in that year, tax rates are constant. For a very brief period—until about 2014—excess taxes will accumulate in the trust fund to finance promised benefits in the future. As the baby boomers continue to retire, the interest on those accumulations and then the assets themselves are scheduled to be spent until the trust fund is depleted in about 2034.

Another portion of current law specifies that all benefit payments shall be made only from the trust fund. If Social Security's income and assets are insufficient to cover its costs, the Treasury Department no longer has the authority to make all benefit payments implied by the benefit formula. Of course, Congress could enact legislation allowing Treasury to run deficits in the trust fund or use some other source of revenue.

However, if Congress fails to legislate, the law offers no guidance on how benefits should be reduced. For an administrator trying to interpret the law, possible solutions include making fewer periodic payments or, what is almost the same, reducing benefits just enough so that they are covered by existing taxes. With the latter option, benefits would eventually be reduced to about 71 percent of outlays now implied by the formula discussed above (figure 1).[2]

In an alternative scenario, Congress may act to maintain the promised growth inherent in the benefit formula, regardless of whether or not enough money is in the trust fund (figure 1). This solution is implied by the Social Security Administration's estimates of future benefits.

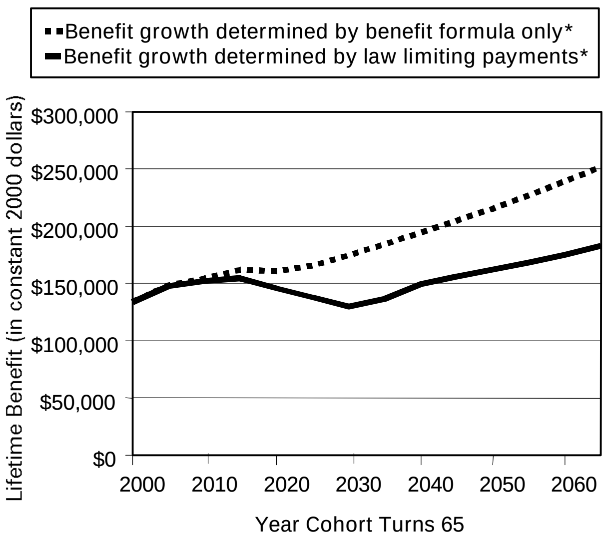
1. The scheduled increase in the normal retirement age from 65 to 67 will temporarily slow this expansion.

2. 1999 Social Security Trustees' Report.

While current law might be reflected by any of the above scenarios, none outlines precisely what is likely to occur once legislation is enacted. The reality of implementation complicates most policy. For example, if benefits are reduced so that they can be covered by existing taxes, policymakers will probably reduce them gradually. Similarly, if taxes are raised to cover promised benefits, the taxes will probably be set at a constant rate, rather than adjusted annually to match benefit payments.

FIGURE 1.

Lifetime Social Security Benefits: Two Interpretations of Current Law



*Trust fund will be depleted in 2034 according to 1999 Social Security Trustees' intermediate assumptions.

Note: Data are for single males with an average wage profile based on Social Security's Modeling In the Near Term (MINT) project. All amounts discounted to present value at the Normal Retirement Age (NRA) using 2.0 percent real interest rate. Assumes retirement at the NRA.

Source: Model developed by C. Eugene Steuerle and Adam Carasso, the Urban Institute, 1999.

Because the law is unclear and there are many interpretations of what would happen without new legislation, policymakers should not emphasize one scenario to the exclusion of others. The Congressional Research Service has displayed benefits under the two scenarios shown in figure 1, and the 1999 Social Security Technical Panel recommends considering both. A balanced presentation is required to inform the public about the possible consequences of current law and to provide a more complete framework for the comparison of reform proposals.

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This series is made possible by an Andrew W. Mellon Foundation grant.

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