

## Resource Sheet #14

### Does Social Security Really Face an \$11 Trillion Deficit?

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#### **Summary**

President Bush and Vice President Cheney have told audiences that Social Security faces an \$11 trillion shortfall if nothing is done to fix the current system. But they fail to mention that this is over the course of the "infinite future." Over the next 75 years -- still practically a lifetime -- the shortfall is projected to be \$3.7 trillion.

The "infinite" projection is one that the American Academy of Actuaries says is likely to mislead the public into thinking the system "is in far worse financial condition than is actually indicated," and therefore should not be used to explain the long-term outlook.

#### **Analysis**

In a roundtable conversation on January 11, the president said the Social Security system "is going to be short the difference between obligations and money coming in, by about \$11 trillion, unless we act."

Vice President Cheney echoed this claim in a January 13 speech at Catholic University when he said, "Again, the projected shortfall in Social Security exceeds \$10 trillion."

Both are correct -- but fail to mention that nearly two-thirds of that colossal bill doesn't come due until after the year 2078.

#### **The Trustees Report**

The projection comes from the 2004 Social Security Trustees [report](#) which estimates that the system's unfunded obligations are \$10.4 trillion over the course of what they call the "infinite horizon." Historically, the infinite-horizon projection has not been included in the annual report, and was only added in 2003.

Previously the Trustees had used only a 75-year projection to estimate the system's long-term deficits, roughly the length of a human lifetime. (Average life expectancy at birth has now increased to just over 77 years, up from just under 75 years as recently as the 1980's, according to the [National Center for Health Statistics](#) .) The Social Security Trustees' 2004 projection shows a \$3.7 trillion shortfall over this 75-year period.

The Trustees reasoned that the 75-year window should be extended to the infinite future to give policymakers a better idea of the changes necessary to keep the system sustainable indefinitely -- especially beyond 2078 when they said Social Security's deficit will be increasing even faster than during the next 75 years.

A [technical panel](#) set up to advise the Social Security Administration later said that infinite-horizon model is useful but "it is difficult to understand." The panel recommended that the infinite-horizon calculations be expressed more prominently as

a percentage of the taxable payroll rather than the actual dollar amount. Referring to the 2003 trustees report, the panel said:

**Technical Panel on Assumptions and Methods:** The Report also briefly mentions the infinite horizon actuarial deficit of 3.8 percent. This figure is more informative than the dollar value of the infinite horizon unfunded obligations, and should be presented more prominently.... While the...information is useful, it is difficult to understand. The \$10.5 trillion is a large figure, but it needs to be seen in the context of the present value of taxable payroll over the infinite horizon, which is on the order of \$275 trillion.

Later, in the 2004 report issued last March, the Trustees updated those figures to a \$10.4 trillion deficit and a \$295.5 trillion taxable payroll.

### **Social Security Deficit and Payroll Taxes**

The percent of taxable payroll is the portion of an employee's payroll tax that goes toward Social Security and is currently set at the rate of 12.4 percent, half of which is paid by the employer and the other half by employee. Over 75 years, the Trustees estimate the actuarial deficit is 1.8 percent of taxable payroll. This means that for the system to be completely solvent over the next 75 years, without adjusting benefits, payroll taxes would have to go up to 14.2 percent immediately. And to be solvent for the "infinite future," the \$10.4 trillion shortfall equals 3.5 percent of taxable payroll, or a tax increase to 15.9 percent of wages.

### **The Infinite Horizon – Is it useful?**

Contrary to the technical panel's endorsement, the American Academy of Actuaries, a nonpartisan organization that sets standards of practice for actuaries in the US, disputes the value of the infinite horizon projection. In fact, they said it probably would mislead anyone lacking technical expertise and that it provides "little if any useful information" about the system's long-term finances. In a December 2003 [letter](#) to the Social Security Advisory Board, the Academy wrote:

**American Academy of Actuaries:** ...The new measures of the unfunded obligations included in the 2003 report provide little if any useful information about the program's long-range finances and indeed are likely to mislead anyone lacking technical expertise in the demographic, economic, and actuarial aspects of the program's finances into believing that the program is in far worse financial condition than is actually indicated.

The Academy states that there is already much uncertainty using 75-year projections, and that extending estimates into the infinite future only increases that uncertainty, producing results that "are of limited value to policymakers." They point out that changes which took place over the last 75 years were unforeseeable to actuaries in 1928, such as the Great Depression or the baby boom, and therefore have no reason to expect that unforeseeable changes will not occur in the future.

Demographic and economic assumptions have always been a controversial issue among demographers predicting the long-term sustainability of Social Security. Significant advances in life expectancy have taken place over the last century, which exert more pressure on the system's finances as people live longer lives. Whether future mortality rates will continue to slow or increase with medical technology, the Academy of Actuaries argues that the inconsistencies which arise from such long-range assumptions are "inevitable" when making projections over the course of infinity. For this reason, they conclude that the infinite-horizon measurement is a "detriment" to the Trustees Report. They write:

**American Academy of Actuaries:** Thus, we believe that including these values in the Trustees Report is unnecessary and is, on balance, a detriment to the Trustees' charge to provide a meaningful and balanced presentation of the financial status of the program.

One final note: The Trustees and actuaries give the \$10.4-trillion figure and others what is called "present value," a theoretical lump-sum figure that takes into account expected future inflation and interest rates. Otherwise, any continuing deficit projected into the infinite future would automatically become an infinitely large sum.

### **Sources**

[Table IV.B7](#).--Unfunded OASDI Obligations for 1935 (Program Inception) Through the Infinite Horizon, "THE 2004 ANNUAL REPORT OF THE BOARD OF TRUSTEES OF THE FEDERAL OLD-AGE AND SURVIVORS INSURANCE AND DISABILITY INSURANCE TRUST FUNDS," 23 March 2004: 59.

[Technical Panel on Assumptions and Methods](#) (2003), Report to the Social Security Advisory Board. Washington, D.C., October 2003.

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