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SOCIAL SECURITY'S FINANCIAL OUTLOOK: THE 2022 UPDATE IN PERSPECTIVE

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Introduction

The 2022 Trustees Report contains no real news about the overall future of the Social Security program. The Trustees did not change any of the ultimate economic or demographic assumptions, and the 75-year deficit declined only very slightly – 3.42 percent of taxable payrolls in 2022 compared to 3.54 percent in 2021. The year for depletion of trust fund assets increased by one year – from 2034 to 2035. Note these calculations were done in February 2022, and the future path of the economy looks more uncertain than it did earlier in the year.

One factor contributing to the stability in the long-run picture is the more sanguine assessment of the Disability Insurance component of the program. To reflect the continued decline in caseloads, the Trustees reduced the assumed long-range disability incidence rate. At this point, the Disability Insurance trust fund, which pays disability benefits, is no longer projected to be depleted within the 75-year projection period.

This *brief* updates the numbers for 2022 and puts the current Report in perspective. It also briefly discusses developments on the disability front and strongly rebuts the repeated contention that retirees are particularly hurt by inflation because they "live on fixed incomes."

The bottom line, however, is that the program continues to run a 75-year deficit of roughly 3.5 percent of taxable payrolls, and the trust fund will be depleted by 2035, after which the program can pay only about three quarters of benefits. None of this is new; Social Security's shortfall over the next 75 years has been evident for the last three decades. It should be addressed sooner rather than later in order to share the burden more equitably across cohorts, restore confidence in the nation's major retirement program, and give people time to adjust to needed changes.

The 2022 Report

The Social Security actuaries project the system's financial outlook over the next 75 years under three sets of cost assumptions – high, low, and intermediate. Our focus is on the intermediate assumptions, which represent the Trustees' best estimates of future developments. Under these assumptions, the cost of the program rises rapidly to about 17 percent of taxable payrolls in 2040, drifts up to about 18 percent of taxable payrolls in 2078, and then declines slightly (see Figure 1 on the next page).

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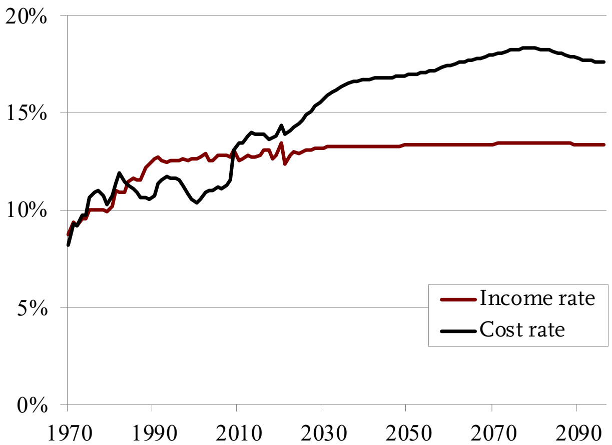
Figure 1. Projected Social Security Income and Cost Rates, as a Percentage of Taxable Payroll, 1970-2096



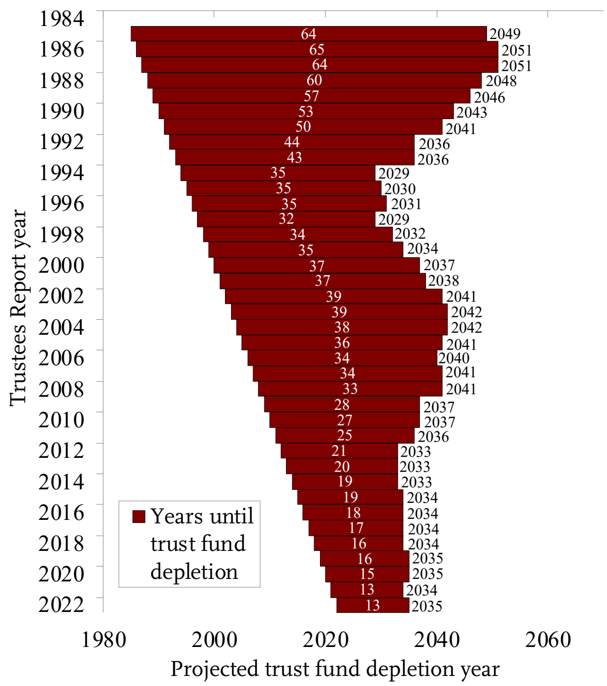
Source: 2022 Social Security Trustees Report, Table IV.B1

The increase in costs is driven by demographics, specifically the drop in the total fertility rate after the baby boom (those born between 1946 and 1964). Women of childbearing age in 1964 had an average of 3.2 children; by 1974 that number had dropped to 1.8. The combined effects of the retirement of baby boomers and a slow-growing labor force due to the decline in fertility reduce the ratio of workers to retirees from about 3:1 to 2:1 and raise costs commensurately. In addition, the long-term increase in life expectancies causes costs to continue to increase even after the ratio of workers to retirees stabilizes. The increasing gap between the income and cost rates means that the system is facing a 75-year deficit.

The 75-year cash flow deficit is mitigated somewhat in the short term by the existence of a trust fund, with assets currently equal to about two years of benefits. These assets are the result of cash flow surpluses that began in response to reforms enacted in 1983. Since 2010, however, when Social Security's cost rate started to exceed the income rate, the government has been tapping the interest on trust fund assets to cover benefits. And, in 2021, as taxes and interest fell short of annual benefit payments, the government started to draw down trust fund assets to meet benefit commitments. These drawdowns will continue until the trust fund is depleted in 2035.

The depletion of the trust fund is not news. Virtually since the year the trust fund began accumulating assets, the Trustees have projected its demise. The point is that the window of opportunity to restore balance has narrowed dramatically over time. Whereas we used to have 65 years to figure out how to avoid trust fund depletion, that number has dropped to 13 years (see Figure 2). If nothing is done before depletion, benefits for all current retirees will have to be cut immediately.

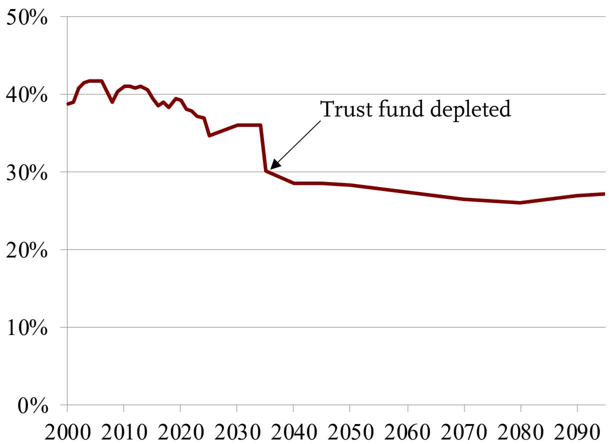
Figure 2. Projected Trust Fund Depletion Years, 1984-2022



Sources: 1984-2022 Social Security Trustees Reports.

The depletion of the trust fund does not mean that Social Security is "bankrupt." Payroll tax revenues keep rolling in and can cover 80 percent of currently legislated benefits initially, declining to 74 percent by the end of the projection period. Relying only on current tax revenues, however, means that the replacement rate – benefits relative to pre-retirement earnings – for the typical age-65 worker would drop from about 38 percent to about 27 percent – a level not seen since the 1950s (see Figure 3 on the next page). (Note that the replacement rate for those claiming at 65 has already declined because of the increase in the Full Retirement Age from 65 to 67.)

Figure 3. Replacement Rate for the Medium Earner at Age 65 from Existing Tax Revenues, 2000-2095



Sources: Clingman, Burkhalter, and Chaplain (2014-2022); and *2013 Social Security Trustees Report*.

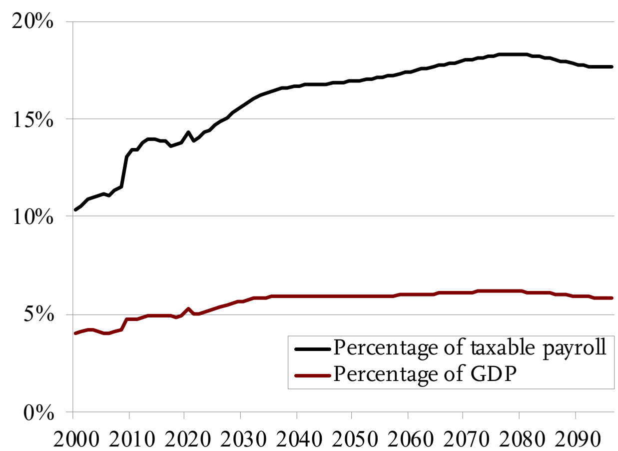
Moving from cash flows to the 75-year deficit requires calculating the difference between the present discounted value of scheduled benefits and the present discounted value of future taxes plus the assets in the trust fund. This calculation shows that Social Security's long-run deficit is projected to equal 3.42 percent of covered payroll earnings. That figure means that if payroll taxes were raised immediately by 3.42 percentage points – about 1.7 percentage points each for the employee and the employer – the government would be able to pay the current package of benefits for everyone who reaches retirement age through 2096, with a one-year reserve at the end.

At this point in time, solving the 75-year funding gap is not the end of the story in terms of required tax increases. Once the ratio of retirees to workers stabilizes and costs remain relatively constant as a percentage of payroll, any solution that solves the problem for 75 years will more or less solve the problem permanently. But, during this period of transition, any package of policy changes that restores balance only for the next 75 years will show a deficit in the following year as the projection period picks up a year with a large negative balance. Policymakers generally recognize the effect of adding deficit years to the valuation period, and many advocate a solution that involves "sustainable solvency," in which the ratio of trust fund assets to outlays is either stable or rising in the 76th year. Thus, eliminating the 75-year shortfall should be viewed as the first step toward long-run solvency.

Some commentators cite Social Security's shortfall over the next 75 years in terms of dollars – $20.4 trillion. Although this number appears very large, the economy will also be growing. So, dividing this number – plus a one-year reserve – by taxable payroll over the next 75 years brings us back to the 3.42 percent-of-payroll deficit discussed above.

The Trustees also report Social Security's shortfall as a percentage of GDP. The cost of the program is projected to rise from about 5 percent of GDP today to about 6 percent of GDP as the baby boomers retire (see Figure 4). The reason why costs as a percentage of taxable payroll keep rising – while costs as a percentage of GDP more or less stabilize – is that taxable payroll is projected to decline as a share of total compensation due to continued growth in health benefits.

Figure 4. Social Security Costs as a Percentage of GDP and Taxable Payroll, 2000-2096

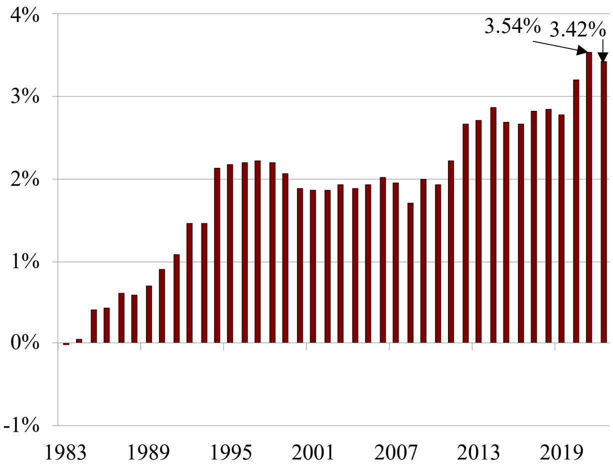


Sources: 2022 Social Security Trustees Report, Table IV.B1 and Figure II.D4.

2022 Report in Perspective

The 75-year deficits in the last two Trustees Reports are the largest since 1983 when Congress enacted major legislation to restore balance (see Figure 5 on the next page). The major question is why did the deficit grow over the period 1983-2022, and a secondary question is why did it decline ever so slightly since last year's Report.

Figure 5. Social Security's 75-Year Deficit as a Percentage of Taxable Payroll, 1983-2022



Sources: 1983-2022 Social Security Trustees Reports.

Changes in 75-Year Deficit Since 1983

Social Security moved from a projected 75-year actuarial surplus of 0.02 percent of taxable payroll in the 1983 Trustees Report to a projected deficit of 3.42 percent in the 2022 Report. As shown in Table 1, leading the list of reasons for this change is moving forward the valuation period. That is, the 1983 Report looked at the system's finances over the period 1983-2057; the projection period for the 2022 Report is 2022-2096. Each time the valuation period moves out one year, it picks up a year with a large negative balance. The cumulative effect of this process over the last 39 years has been to increase the 75-year deficit by 2.26 percent of taxable payrolls.

A worsening of economic assumptions – primarily a decline in assumed productivity growth and the impact of the Great Recession – have also contributed to the increase in the deficit. Another contributor to the growth in the deficit over the past 39 years has been increases in disability rolls, although, as discussed later, that picture has changed dramatically in recent years.

Partially offsetting the negative factors has been a reduction in the actuarial deficit due to legislative and regulatory changes. Methodological improvements and updated data have also had a positive impact on the system's finances. The biggest boost has come from changes in demographic assumptions, such as a slower pace of mortality improvement overall. The net effect of all these changes in 2022 is a 75-year deficit equal to 3.42 percent of taxable payrolls.

Table 1. Reasons for Change in the 75-year Balance from 1983 to 2022, as a Percentage of Taxable Payroll

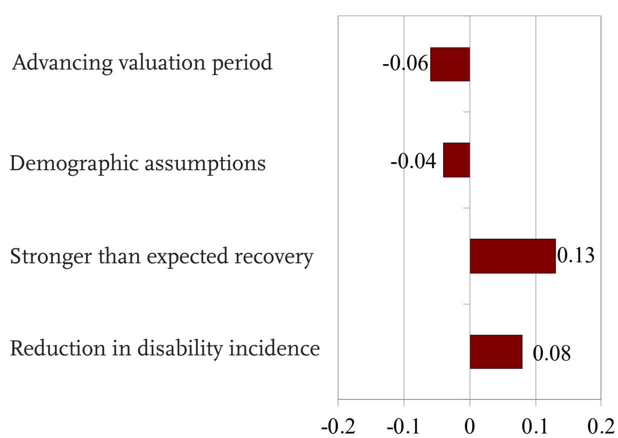
Item	Change
Actuarial balance in 1983	+0.02%
Changes in actuarial balance due to:	
Valuation period	-2.26
Economic data and assumptions	-1.02
Disability data and assumptions	-0.46
Legislation/regulation	+0.06
Methods and programmatic data	+0.11
Demographic data and assumptions	+0.14
Actuarial balance in 2022	-3.42%

Source: Chu and Burkhalter (2022).

Changes from Last Year's Report

The 3.42 percent of taxable payrolls in the 2022 Report is slightly lower than the 3.54 percent in last year's Report. This change was the result of four factors (see Figure 6). Advancing the valuation period by one year to include 2096, a year with a large negative balance,

Figure 6. Reasons for Change in the 75-year Balance from the 2021 to the 2022 Trustees Report



Source: 2022 Social Security Trustees Report, Table IV.B7.

alone increased the actuarial deficit by 0.06 percent of taxable payrolls. New demographic data and changes in demographic assumptions about birth rates and immigration also increased the deficit. On the other hand, a stronger and faster economic recovery than anticipated in last year's Report and a reduction in the ultimate assumption about the disability incidence rate more than offset the adverse factors. The next section provides a little more information on the disability issue and the final section hammers home the point that retirees do not "live on fixed incomes."

The Changing Disability Picture

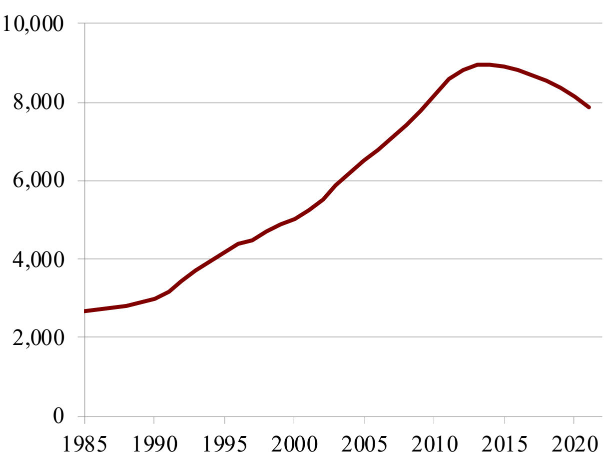
Anyone listening to conversations on Social Security's Disability Insurance (DI) program would get the impression that the problem is out of control and the highest national priority is getting people with disabilities off the rolls and back to work.

Indeed, for most of the last 35 years, the disability rolls were soaring (see Figure 7). Three factors explain the steady increase. First, legislation passed in 1984 broadened the definition of disability and provided applicants and medical providers with greater opportunity to influence the decision process. Second, the population was aging, so the baby boom generation 'aged into' the higher incidence rates following the 1984 reforms. Third, the secular rise in female labor force participation increased the fraction of women eligible by their work history for disability benefits and they too aged into the higher incidence rates. These factors behind rising rolls are not likely to occur again.

Indeed, recent data suggest that the trajectory of the program has shifted. After peaking in 2014, the stock of beneficiaries has been declining. Note, this discussion is not about percentages; these data refer to the absolute number of people. Fewer people are receiving DI benefits today than in 2014.

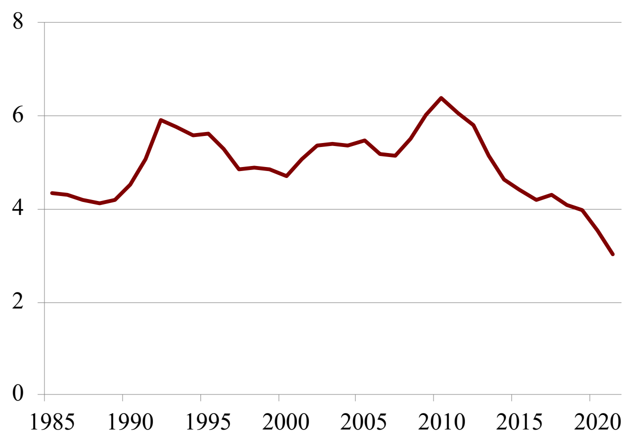
The total number on the rolls consists of those already receiving benefits and new awards. The increase in life expectancies continues to put some upward pressure on the number of beneficiaries, but in recent years that pressure has been more than offset by the declining incidence rate (see Figure 8). The incidence rate is the number of new beneficiaries per thousand insured workers.

Figure 7. Total Number of Disability Insurance Beneficiaries in Thousands, 1985-2021



Note: The data are for disabled-worker beneficiaries only; spouses and children are excluded.
Source: 2022 Social Security Trustees Report, Table V.C5.

Figure 8. Disability Insurance Incidence Rates (Awards per Thousand, Age-Sex-Adjusted), 1985-2021



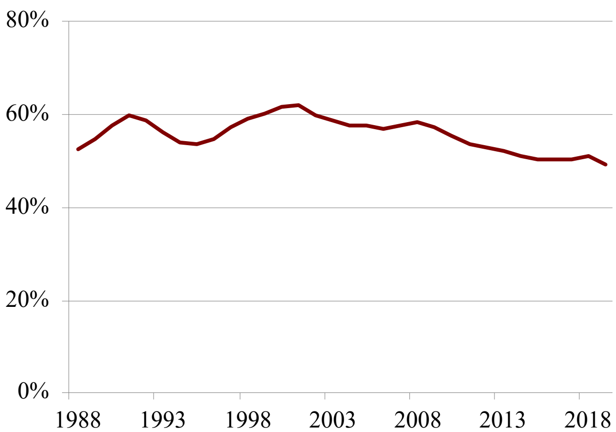
Source: 2022 Social Security Trustees Report, Figure V.C3.

No one quite knows why the incidence rate has declined. The list of possible factors include:

- economic expansion after Great Recession;
- easier access to health care in wake of ACA;
- shift to less physical jobs;
- closing of some field offices, even pre-COVID; and
- new policies and procedures.

Some evidence suggests that the latter may be important. Beginning in 2009, the Social Security Administration implemented a number of changes in the training of the Administrative Law Judges who decide the DI applications. New performance monitoring was added for judges with allowance rates or denial rates far from the average; a "How Am I Doing?" tool allowed staff and judges to track their performance; and fewer cases per judge allowed more time for consideration. In the wake of that initiative, the allowance rate – the percentage of applications approved – has trended down from 57 percent in 2009 to 49 percent in 2019 (see Figure 9).

Figure 9. Allowance Rate for Disabled-Worker Claims, by Filing Year, 1988-2019



Sources: U.S. Social Security Administration (2021); and Goss et al. (2013).

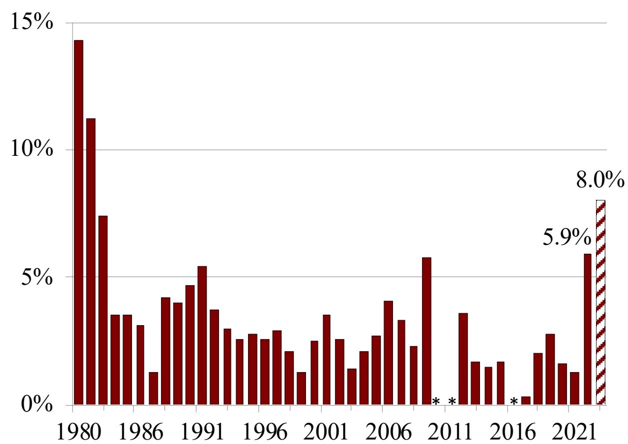
Add on top of all this, Social Security offices closed for COVID in 2020 and just reopened this April. At this point, a legitimate concern may be whether those who need the help are getting it.

In any event, given the persistent decline, the Trustees lowered the assumed long-range disability incidence rate from 5.0 to 4.8 per thousand insured. This change had a major effect on the finances of the DI program; the depletion date for the DI trust fund moved from 2057 in last year's report to being able to pay full benefits for the entire 75-year projection period.

Retirees Don't "Live on Fixed Incomes"

The press repeatedly reports that our current inflation situation is particularly hard for retirees who "live on fixed incomes." The fact of the matter is that Social Security is the major source of retirement income for most Americans, and Social Security provides an automatic cost-of-living adjustment (COLA) to reflect increases in the Consumer Price Index (CPI). The COLA for 2022 was 5.9 percent, one of the largest since the 1980s (see Figure 10). And the COLA for 2023 could well be 8 percent. Yet the press and the public do not appear convinced that retirees are protected against the erosive impact of inflation. The skepticism may revolve around three issues: 1) the COLA is backward looking and may not reflect current levels of inflation; 2) Social Security may not be using the right index to calculate the COLA; and 3) Medicare Part B premium increases offset the COLA. It is worth addressing each of these issues.

Figure 10. Social Security Cost-of-Living Adjustments, 1980-2022



Notes: Asterisks for 2010, 2011, and 2016 indicate no COLA. Striped bar for 2023 indicates the anticipated COLA.
Sources: Historical data are from U.S Social Security Administration (2022). Projection for 2022 is author's estimate based on inflation data to date.

Timing of the COLA

Since the COLA first affects benefits paid after January 1 for the next year, Social Security needs to have figures before the end of the previous year. As a result, the adjustment for 2022 was based on the increase in the CPI for the third quarter of 2021 over the third quarter of 2020. This backward-looking calculation means that, when inflation starts to rise, the COLA will be less than the inflation that people are experiencing. Indeed, that is true this year; benefits were increased by 5.9 percent, but year-over-year inflation is running above 8 percent.

Two counterpoints are relevant here. First, it makes sense to base the COLA on actual data rather than a forecast, which could involve constant corrections for over- or under-predicting. Second, while the COLA under-compensates when inflation starts to rise, it will over-compensate as inflation falls. That is, an 8-percent COLA for 2023 based on retrospective data may be greater than actual inflation as pressures ease up. Over the complete cycle, then, the COLA fully compensates for inflation.

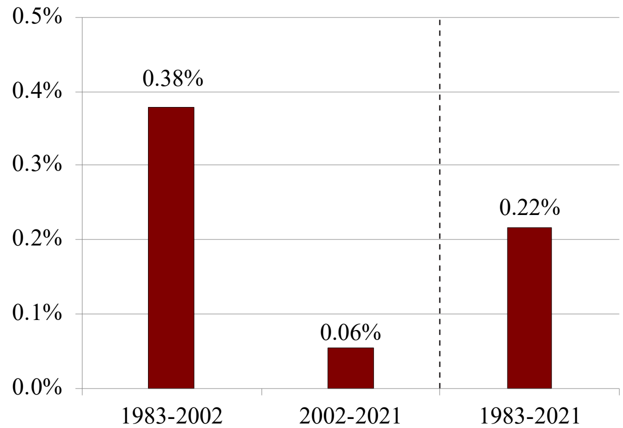
Appropriate Price Index

Some critics contend that the CPI-W – the price index for urban wage earners and clerical workers, which is currently used to determine the COLA – understates inflation for retirees because the elderly spend more of their money on medical care and the cost of medical care has been rising rapidly.

In 1987, Congress directed the U.S. Bureau of Labor Statistics to calculate a separate price index for persons 62 and older. This index, called the CPI-E, has been extended back to December 1982. From the third quarter of 1983 to the third quarter of 2021, the average annual increase for the CPI-E was 2.8 percent, compared to 2.6 percent for the CPI-W.

Interestingly, though, in the last two decades the difference between the rate of increase in the CPI-E and CPI-W has nearly disappeared (see Figure 11). While the CPI-E rose 0.38 percent per year faster than the CPI-W over the entire 1983-2002 period, the two indexes showed virtually identical average annual increases during 2002-2021. The main reasons for this shift were a slowing in the rate of increase in the price of medical care and the changing pattern of transportation costs.[1] Moreover, the population is aging so retirees constitute a much larger share of the sample.

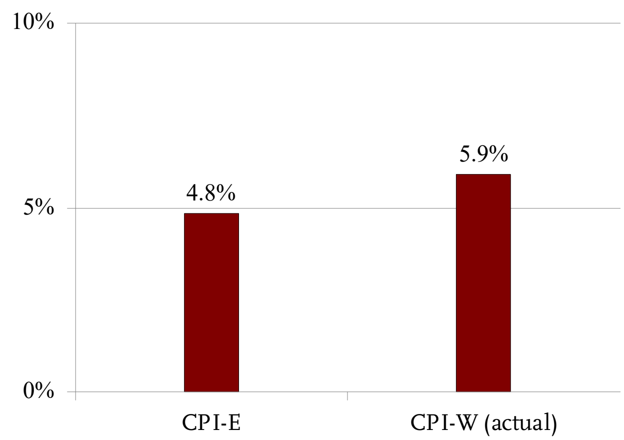
Figure 11. Average Rate of Inflation Differential Between Third Quarter CPI-E and CPI-W, 1983-2021



Source: Author's calculations using U.S. Bureau of Labor Statistics (1983-2021a).

Interestingly, for the most recent adjustment, the CPI-W produced a much higher COLA than the CPI-E (see Figure 12).

Figure 12. Hypothetical Social Security COLA for 2022 Using CPI-E and Actual COLA Using CPI-W



Sources: U.S. Bureau of Labor Statistics (2021b); and U.S Social Security Administration (2022).

The bottom line is that the CPI-W is a perfectly acceptable index for adjusting Social Security benefits, and will become an increasingly appropriate reflection of the spending pattern of retirees as the population continues to age.

Part B Premiums

The skepticism about being protected from inflation may have gotten a special boost this year, as retirees faced a particularly large increase in the premium they pay for Medicare Part B.[2] Part B covers physician and outpatient hospital services and, relevant for this discussion, drugs that are administered in a physician's office rather than purchased at a pharmacy.

In November 2021, the Centers for Medicare and Medicaid Services (CMS) announced that the Medicare part B premium would increase by 14.5 percent. Roughly half of this increase was attributable to the need to create a contingency reserve to cover significantly higher expenditures associated with Aduhelm, Biogen's controversial new drug aimed at slowing the loss in cognition from Alzheimer's disease. The estimated cost for one year's treatment was $56,000.

Subsequently two things happened. First, in December 2021 Biogen announced that it would cut the price of Aduhelm nearly in half to $28,200 annually. Second, in January 2022 CMS issued a preliminary decision to limit Medicare's coverage of the new drug to those enrolled in clinical trials, greatly restricting its use. (This decision was finalized in April.)

In January 2022, the Secretary of Health and Human Services asked CMS to reassess its recommendation for the Part B premium and perhaps lower the premium mid-year. CMS reported back in May, concluding that a mid-year change was not feasible nor did the agency have the authority to send out refund checks and that the best way forward was to incorporate the savings in the 2023 premium.

So, two points are relevant here. First, while the unusually high Part B premium did offset a portion of the Social Security COLA, it did not eliminate inflation protection. An individual receiving $1,600 (the approximate average retiree benefit) saw benefits go up by $94 from the COLA, but paid $22 more in Medicare premiums, resulting in a net increase of $72 or 4.5 percent. Second, the 2023 Part B premium increase should be quite low, which will help retirees cover some of the higher prices they face due to nationwide inflation.

The bottom line here is that retirees do not live on fixed incomes; their monthly benefits go up when prices rise. Yes, the need for a solid number means that the COLA lags a bit as inflation starts, but the COLA will exceed the inflation rate as price increases slow. Yes, no index is perfect, but the CPI-W differs very little from the CPI-E and is a perfectly fine measure on which to calculate COLAs. Yes, the very large increase in the Part B premium was ill-timed, but the extraordinary events seem to have played themselves out and the savings will be seen in the 2023 premium. Retirees are protected against the ravages of inflation.

Conclusion

The 2022 Trustees Report confirms what has been evident for almost three decades – namely, Social Security is facing a long-term financing shortfall that equals 1 percent of GDP. The changes required to fix the system are well within the bounds of fluctuations in spending on other programs in the past. Moreover, action needs to be taken before the trust fund is depleted in 2035 to avoid a precipitous cut in benefits. Americans support this program; their representatives should fix its finances.

The interesting change in the 2022 Trustees Report pertains to the assumption regarding disability incidence. The number of new people entering the disability rolls per thousand insured workers has been on the decline since 2010, and the 2022 Report formally incorporates that pattern by changing the ultimate long-range disability incidence assumption. The sharp decline does raise the question whether all those needing help are getting it.

The other major issue raised by the current high rates of inflation is the fact that Social Security provides a COLA to maintain retirees' purchasing power as prices rise. This aspect of the program is wonderful. Unfortunately, press reports repeatedly contend that "retirees live on fixed incomes." This statement is simply not correct. Benefits go up when prices go up. Yes, questions may arise about the timing, the index, and the offsetting effect of the Medicare Part B premium. But, these issues should not cloud the basic fact that Social Security protects retirees against a decline in their purchasing power as prices rise.

Endnotes

1 Prices for transportation moved from rising slower than average to rising at the average rate, which hurt younger people more than older people (Munnell and Hubbard 2021).

2 The Part B premium is set at 25 percent of projected program costs and must ensure that the program's Trust Fund has sufficient reserves to cover costs during the year.

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