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Letter to the Public from the Former Trustees of Social Security and Medicare

The 2020 annual reports of the Social Security and Medicare trustees underscore the increasingly urgent need for legislative corrections to both programs' finances. Social Security's Old-Age and Survivors Insurance (OASI) Trust Fund, the Social Security Disability Insurance (DI) Trust Fund, and the Medicare Hospital Insurance (HI) Trust Fund all have actuarial shortfalls that require adjustments to their tax revenue and benefit payment schedules. While Medicare's Supplementary Medical Insurance (SMI) Trust Fund is structured so that it cannot have an actuarial deficit, it too requires reforms to address its future cost growth rate, which current projections indicate will exceed the growth in participants' incomes and the federal government's tax base which shoulder the program's costs.

The extent to which the severe economic contraction related to the COVID-19 pandemic will harm Social Security and Medicare finances is not reflected in the 2020 trustees' reports and, at this point, is unknown. Critical economic and other assumptions upon which the reports' projections are based had to be decided well before the COVID-19 virus spread in the United States. Nevertheless, the 2020 trustees' reports provide useful warnings that should be heeded by lawmakers, the media, and the public concerning the magnitudes of the financing challenges that were already facing Social Security and Medicare. Beyond these pre-existing problems, the ongoing economic contraction is certain to further weaken the finances of both programs, accentuating the urgency of legislating financial corrections soon. In particular, the solvency of the Medicare HI and Social Security DI trust funds may be imperiled much earlier than is recognized in these latest reports.

The long-range (75-year) shortfall in the combined Social Security trust funds is measured at 3.21% of taxable payroll in the 2020 report. This is a significant (>15%) increase over the 2019 report's estimate of 2.78%, and one that will be made even larger by the current economic contraction. Closing this shortfall (which equals 19% of scheduled benefits over the next 75 years) by raising the payroll tax rate would require an immediate increase from its current 12.4% level to a much higher rate of 15.54%. Alternatively, closing the shortfall by reducing benefit payments for all who are not yet eligible to file for benefits would require the equivalent of a 23% reduction across the board. This 23% figure rose from 20% in the previous year's report, exemplifying the high cost of further delay in correcting program finances. The current economic contraction will push these required adjustments up even higher, and if action is further delayed to when the trust funds' depletion dates are imminent (2034 for OASI and 2065 for DI in the latest report), the corrections needed will be so large that it will be highly unlikely Social Security's historical self-financing basis can be maintained.

One reason Social Security's shortfall was becoming more urgent even before the COVID-19 crisis hit is simply the passage of time. Every year without legislative action brings the depletion of the trust funds nearer. Given lawmakers' unwillingness to cut benefits of those already receiving them, the effects of corrections will have to be spread among a smaller number of birth cohorts, increasing burdens on those affected. Second, last year lawmakers repealed the so-called "Cadillac tax," a provision in the Affordable Care Act that was to be imposed on expensive health plans. This tax had been expected to slow the growth of premiums in employer-sponsored health insurance plans. Its repeal increased projections for future premium growth, reducing the amount of worker compensation subject to Social Security and Medicare payroll taxes. Third, the trustees revised downward their long-term fertility rate assumption from 2.0 to 1.95, recognizing the persistence of the recent trend toward lower birthrates. Finally, continued low inflation and interest rates have the effect of increasing projected trust fund shortfalls.

All of the above factors worsened the Medicare financial outlook as well, as did the incorporation of higher-than-expected spending in Medicare Advantage. However, more than offsetting these negative factors, the trustees adopted for this year's report a methodological change that modestly reduced the projected Medicare shortfall. This methodological change more precisely projects health care expenses per Medicare beneficiary on the basis of their expected remaining years of life. As longevity increases, health care expenditures at each specific age decrease, because that age is further removed from one's expected time of death. While this adjustment reduced projected spending growth in Medicare, the HI trust fund is still projected to be depleted in 2026, the soonest of the three trust funds whose financial viability the trustees monitor. As with the other trust funds, Medicare HI's depletion date could move sooner as the economic contraction reduces payroll tax collections. Spending in Medicare's SMI trust fund is projected to grow even faster. In just the next 15 years, SMI spending is projected to grow by over 50% relative to the nation's economic output, from 2.28% of GDP today to 3.62%, dramatically increasing pressure on premium-paying beneficiaries and federal finances alike.

We commend the trustees as well as the various staff, offices, and departments associated with the trustees' process for several presentational improvements included in the latest annual reports. This year's annual summary of the reports leads with a breakdown of the various changes in assumptions and methods that affected the projected outlook over the last year. In addition, the Social Security Actuary's office has improved public access to the data and assumptions underlying the projections by locating downloadable Excel files on the main trustees' report webpage. These changes enhance the accessibility, transparency, and credibility of the trustees' projection methods.

While we cannot yet project how much the current economic contraction will worsen the financial outlook, various qualitative effects are certain. Foremost among these is a substantial reduction in payroll tax collections, as unemployment has soared as a consequence of the health crisis. We also expect benefit claims to rise somewhat in the near term. Disability claims typically rise during a recession. In addition, some of the large baby boom generation who find themselves unemployed may claim retirement benefits earlier than they had planned. Furthermore, declines in interest rates, as well as in the number of individuals with incomes sufficient to make their Social Security benefits subject to taxation, should also contribute to reduced trust fund income. Of these various changes, the decline in payroll tax revenues should constitute the largest change from current projections, and the one most determinative of upcoming deterioration in the trust funds' financial outlooks.

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Of the several trust funds whose possible depletion is monitored by the trustees, Medicare's HI trust fund and Social Security's DI trust fund are the ones likely to be affected the most by the economic contraction. Medicare's HI trust fund entered 2020 with reserves sufficient to fund fewer than seven months' worth of benefits; the reserves held by Social Security's DI trust fund were sufficient to fund fewer than eight months' worth of benefits. Therefore, over the next several years, both trust funds are critically dependent on incoming payroll taxes being nearly sufficient by themselves to fund annual benefit obligations. If instead payroll tax collections plunge, both trust funds' depletion dates could move dramatically closer—conceivably looming within the next four years. While OASI's reserve depletion date should also be expected to move closer, the large carry-over balance in its trust fund should mean the movement will be by fewer years than DI's.

The worsening financial outlooks for Social Security and Medicare not only highlight the importance of enacting corrective legislation as soon as health and economic circumstances permit, they further bolster the case for quickly confirming new public trustees. The 2021 reports, which new public trustees should play an important role in crafting, could well be the most consequential in decades. The reports could contain troubling projections that cause lawmakers to pursue painful and contentious decisions very soon. And yet the economic and other assumptions upon which the 2021 reports' projections will be based are likely to be made amidst great uncertainty. Even by the end of 2020, when the reports' critical assumptions must be made, there will be little consensus among economists on the likely depth and duration of the COVID-19 recession. Nor will there be agreement among experts on the extent to which the recession will modify the long-term structure and potential of the economy, social behavior, immigration, and many other critical inputs for the reports. Having bipartisan expert public trustees participate in these decisions will help assure the public of the integrity, objectivity, and quality of the process.

The Social Security and Medicare financing challenges have been serious for some time and were already growing increasingly urgent before the appearance of COVID-19. This crisis will only shorten the time that lawmakers have to stabilize the financial outlooks for these vital programs.

Sincerely,

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