

Reforming Social Security Sooner Rather Than Later

OCTOBER 2023

Key Points

- Social Security's combined trust fund reserves are projected to become depleted around 2034, at which time its income would be able to pay only 80% of the benefits scheduled for its 80 million beneficiaries.
- If Congress has not acted by 2034, we will be faced with an automatic 20% cut in benefits to people already receiving benefits, the need to immediately increase Social Security taxes by 25%, or some combination of benefit cuts and tax increases.
- Earlier reform action would allow for tax increases and benefit reductions to be phased in gradually and provide individuals more time to plan and adjust to the changes.

Social Security's combined trust fund reserves are projected to become depleted around 2034,¹ at which time its income would be able to pay only 80% of the benefits scheduled for its 80 million beneficiaries. It is important that Congress immediately focus on this issue because delay makes the solution more difficult, as it gradually limits the viable options to those relying on increasing taxes. If Congress has not acted by 2034, we will be faced with:

- An automatic 20% cut in benefits to people already receiving benefits,²
- The need to immediately increase Social Security taxes by 25%, or
- Some combination of cuts in benefits and increases in taxes.

When Congress amended Social Security in the past, benefit reductions were only applied to individuals not yet eligible for benefits, so current recipients did not have their benefits cut. In addition, Congress has always phased in large benefit reductions, as a large reduction to one cohort, while not affecting the prior cohort, could be seen as unfair. If Congress wants to continue these two traditions, and avoid a large tax increase in 2034, reform is needed as soon as possible so that the phased-in changes are enough to pay all benefits in 2034.

Congress will have more reform options if they act sooner. Earlier action allows for tax increases and benefit reductions to be phased in gradually and makes it less likely that a 25% payroll tax increase is needed in 2034. Earlier action is also important to individuals, as it provides them more time to plan



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¹ Numbers in this issue brief are from the 2023 Social Security Trustees Report, which projects the combined funds (the Old-Age and Survivors Insurance Trust Fund and the Disability Insurance Trust Fund) will be depleted in 2034 using the intermediate assumptions. Their more pessimistic (but less likely) high-cost assumptions project that assets will be depleted in 2031, per [Table IV.B.4](#). The Old-Age and Survivors Insurance (OASI) Trust Fund alone is projected to be depleted one year earlier, in 2033. We used the combined funds depletion year for our analysis (just like a [paper by the Congressional Research Service](#)), as Congress could allow the funds to borrow from each other, as in 1983. We've known about this problem for a long time. For over two decades, our [annual issue briefs on the Trustees Reports](#) have asserted the importance of taking action sooner rather than later.

² It is not clear how that reduction will be applied—whether the same 20% cut to every beneficiary, or larger cuts to those with larger benefits and/or those who retired recently, or some other method, such as delaying benefit payments until assets are available, which would mean that retirees might not receive all 12 checks each year.

and adjust to the changes, enables them to make better decisions now,³ and provides greater confidence that they will receive their benefits. In addition, earlier action enables Congress to also impact people over the next 10 years, so that benefit reductions can be smaller, as discussed in the 2023 Trustees Report.⁴

The last time the trust funds were close to depletion was in 1983. The cash shortfall that year was 1.0% of taxable payroll. In contrast, the expected cash shortfall in 2034 will be three times as large (3.12% of taxable earnings, per [Table VI. G2](#)), so paying all benefits that year will require much larger tax increases and/or benefit reductions than in 1983.⁵ If Congress cannot agree on Social Security reform until 2034, enacting benefit reductions for only those who become eligible for benefits in 2034 or later will not help, so delay could force them to increase Social Security taxes by 25% in 2034 (unless Congress is willing to break its tradition of not cutting benefits already being paid or is willing to use general revenue⁶). That may be difficult, as Congress may also need to enact tax increases to keep Medicare’s Hospital Insurance Trust Fund from being depleted around 2031.⁷ The following discusses reforms that can help eliminate Social Security’s cash shortfall by 2034.

3 In a survey by [Schroeders](#), 44% of non-retired people said they would commence their Social Security benefits early, even though they know that the best time for healthy people to commence benefits is at age 70, due to their concerns that Social Security will not be able to pay full benefits after 2034.

4 Page 5 of the 2023 Trustees Report states that, “scheduled benefits would have to be reduced by ... 21.3% applied to all current and future beneficiaries effective in January 2023, or ... 25.2% ... starting in 2034.” It is not possible to make the program solvent over the next 75 years if benefit reductions are only applied to those who become eligible for benefits in 2034 or later.

5 Congress was able to pay benefits in 1983 by delaying the June 1983 COLA to December, requiring employers and the Treasury to transfer payroll taxes to the Social Security trust funds more quickly, allowing the Old-Age and Survivors Trust Fund to borrow from Medicare’s Hospital Insurance Trust Fund, and reimbursing Social Security for the cost of benefits attributable to noncontributory military wage credits for service before 1957. Congress also enacted PL 98-63 on July 30, 1983, to provide Social Security \$1.3 billion. The already scheduled tax rates were accelerated to 1984, so that the employee and the employer tax rates increased from 5.4% to 5.7%, and the self-employed tax rate was increased from 8.05% to 11.40%, which helped pay benefits in 1984 and later. Many of those options will not be available in 2034.

6 Using general revenue is discussed in this Center for Retirement Research [paper](#).

7 Per page 7 of the [2023 Trustees Report of the Hospital Insurance and Federal SMI Trust Funds](#).

The 2023 Social Security Committee, which authored this issue brief, includes Amy Kemp, MAAA, ASA, EA—*Chairperson*; Sam Gutterman, MAAA, FSA, FCA, FCAS, HonFIA, CERA—*Vice Chairperson*; Janet Barr, MAAA, ASA; Gordon Enderle, MAAA, FSA; Margot Kaplan, MAAA, ASA, FCA; Iris Kazin, MAAA, FSA, FCA, EA; Eric Klieber, MAAA, FSA; Mahrukh Mavalvala, MAAA, FSA, EA; Gerard Mingione, MAAA, FSA, EA; Brian Murphy, MAAA, FSA, FCA, EA; John Nylander, MAAA, FSA; Larry Rubin, MAAA, FCA, FSA; Jeffery M. Rykhus, MAAA, FSA; Keith Sartain, MAAA, FSA, EA; and Joan Weiss, MAAA, FSA.

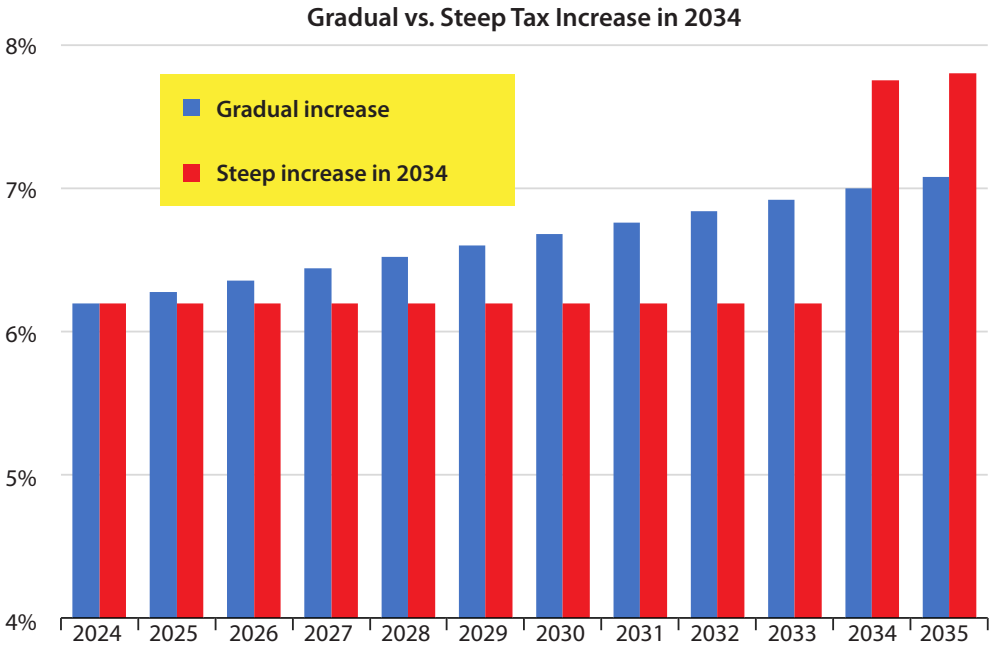
The committee extends special thanks to former committee member Ron Gebhardt’sbauer, MAAA, FSA.

Tax Increases

Options that can help increase Social Security’s income (so that it can pay all scheduled benefits) are:

1) Increase the payroll tax rate by 25%

- This would raise the current 6.2% tax rate to 7.75%⁸ for both workers *and* employers, yielding enough to pay 100% of benefits in 2034.⁹
- Employee and employer payroll tax rates have never been increased by more than 0.5 percentage points of taxable payroll in any one year.¹⁰
- Increasing the tax rate will be financially difficult for some people with very low income, unless the EITC (Earned Income Tax Credit) is also increased. The EITC offsets the payroll tax for low-income people. Increasing the EITC would reduce income taxes and increase the national debt, so federal income taxes would need to be increased to make this revenue neutral.
- It would be less disruptive to employers and workers if increases in the tax rate were gradually phased in (e.g., by 0.1 percentage points per year as suggested in [several provisions in E.1](#) analyzed by Social Security Administration [SSA] actuaries), but that approach would need to be enacted soon in order to pay all benefits in 2034. The graph below compares a gradual to a steep tax increase.



8 It would raise the self-employed tax rate from 12.4% to 15.5%.
 9 Even if the payroll tax rate is increased to 7.75% in 2034, that would not cover all benefits in subsequent years as costs continue to increase faster than income (primarily due to people living longer and lower fertility rates). [Table VI.G2](#) of the 2023 Trustees Report shows the cash shortfall gradually increases until 2077 when it is 5.06% of taxable payroll, so the tax rate would have to gradually increase to 8.73% in 2077 for both workers and employers. Benefit reductions could reduce these tax rates.
 10 The self-employed payroll tax rate was increased by 0.95 percentage points in 1981 and 3.35 percentage points in 1983 (when that rate became twice the employee rate).

2) Eliminate the taxable maximum (\$160,200 in 2023) so that all earnings are taxed.¹¹

- This approach would avoid impacting low-income workers, but it could be a large tax increase on high income workers (and their employers).
- It would not be enough by itself, as it would cover only 78% of the 2034 shortfall,¹² so additional changes would be needed.
- Proposals with large tax increases typically phase in so that workers and employers are not hit by the full increase in a single year. It could start with a 1% tax rate on income over the current taxable maximum and gradually increase over time to the full tax rate. Enacting this option in 2034 with a phase-in would be too late to cover the 2034 cash shortfall. It would need to be enacted sooner to have an impact on 2034. Earlier enactment would also push out the date when a permanent fix is needed.

3) Tax all earnings above \$400K ([Provision E2.13](#))¹³ or increase the taxable maximum so that 90% of all earnings would be subject to the payroll tax ([Provision E3.1](#)).¹⁴

These two provisions would provide only 55% and 36% respectively of the amount needed to pay all benefits in 2034, so additional changes would be needed.

- When the ad hoc increases in taxable maximum were enacted in 1977, they were phased in over three years from 1979 to 1981.
- Gradually increasing the tax rate on the newly covered earnings would be another way to phase in this tax increase.

4) Tax investment income,¹⁵ estates and gifts,¹⁶ and earnings such as carried interest¹⁷

- These additional sources of taxable income would represent a substantive change to Social Security financing, needing a great deal of consideration, as none of these items has ever been taxed for Social Security purposes. Taxing these items would further shift the nature of the program away from individual equity and could meet considerable resistance.
- These provisions could be phased in, so that they are less disruptive to individuals and businesses, by starting with a 1% tax rate and gradually increasing it over time to the full tax rate, but it would need to start sooner to help cover the 2034 shortfall.

¹¹ See Social Security's Office of the Chief Actuary (OCACT) website, [Provision E2.2](#). The results cited in this issue brief for this and all other provisions are based on the intermediate assumptions of the 2023 Trustees Report.

¹² The impact on Social Security's 2034 cashflow is the same whether enacted now or in 2034—12.4% of the additional earnings being taxed, or 2.52% of taxable payroll per the [Provision E2.2](#) website. That is 78% of the 3.12% shortfall for 2034.

¹³ This particular provision would apply a small 2% replacement rate to the newly taxed earnings, as otherwise, Social Security benefits could become very large for these high earners.

¹⁴ In 1983 Social Security taxed 90% of all earnings per Figure 6.1 of OCACT's [2023 Long Range Economic Assumptions](#).

¹⁵ [Provision F6](#) would add the 6.2% Social Security tax to the 3.8% Medicare tax on investment income as defined in the ACA, solving 19% of the 2034 deficit.

¹⁶ [Provision F7](#) would return the estate and gift tax thresholds and tax rates to the 2009 levels, solving 16% of 2034 deficit.

¹⁷ [Provision F8](#) would tax active S-corporation officers and limited partners at the 12.4% on investment income as defined in the *Affordable Care Act* (ACA), with unindexed thresholds as in the ACA, starting in 2023, solving 29% of the 2034 deficit.

Phase-ins help people adjust, prepare, and plan for changes.

When Congress passed the Social Security Amendments of 1983, they raised the Normal Retirement Age for full benefits from age 65 to age 66 starting 17 years later in 2000. Thus, no one over age 45 in 1983 was impacted. Phase-ins also help people who are close to retirement (especially those with no other income). They may have already decided to retire based on numbers that they read in their Social Security benefit statements. If the retirement age was increased by one year to age 68 without a phase-in, someone age 61 would have to work another year to get the same benefit. If they cannot go back to work, they would receive a benefit that is about 7% smaller. If the Social Security reforms also reduced the benefit formula by, say, 5% for a particular person, their benefit could be about 12% smaller. If both of these provisions are phased in over, say, six years, the benefit would go down by 2% per year.

5) Increase Social Security's investment income.¹⁸

This option would have no impact on the 2034 shortfall if enacted in 2034. It would need to be enacted soon while the trust funds have assets, and even that will not provide much help. It will have more impact if other reforms increase the trust funds. Another idea is to use general revenues (or increased income taxes) to create a separate fund that invests in equities and use its admittedly volatile earnings to provide benefits.¹⁹ Estimates of the impact are not available, as these two provisions have not been analyzed by Social Security's actuaries.

6) Cover the remaining state and local government employees.²⁰

This option would have no impact on the 2034 shortfall if enacted in 2034. If enacted today, it would cover only 8% of the 2034 shortfall because most state and local government employees are already covered by Social Security, and probably only new hires would be required to be covered.²¹ It would require very significant restructuring of several state and local government retirement systems and might encounter significant opposition.

¹⁸ Social Security is not allowed to invest in corporate stocks or bonds, so its investment returns (over the long run) are around 2 percentage points below that of a diversified portfolio of a typical pension plan. Congress could compensate Social Security for this restriction by giving its special issue Treasury bonds an additional 2% return. This would increase the national debt, unless Congress increases a tax to pay for it, such as the capital gains tax.

¹⁹ See this [Center for Retirement Research website](#) for further discussion on this proposal.

²⁰ [Provision F1](#) covers all newly hired state and local government employees not already participating in Social Security.

²¹ Federal workers were brought into Social Security in the 1983 Act by applying the change to just newly hired workers.

7) Tax Social Security benefits more (like pensions).²²

This option would have no impact on the 2034 shortfall if enacted in 2034. If enacted today, it would not help much—only 8% of the 2034 shortfall, because Social Security benefits are already partially taxed. The federal income tax is progressive and has deductions, so there would be little or no impact on low-income people.

Benefit Reductions

If Congress is unable to act before 2034, a reduction in benefits to people not in pay status at that point would have no impact on 2034's cashflow (unless Congress is willing to break its tradition of not cutting benefits already being paid). Benefit reductions need to be implemented sooner to have a meaningful impact by 2034, especially if they are phased in.²³

8) Reduce benefits for higher-income recipients (who are not yet eligible for benefits).²⁴

- **Reduce the 15% replacement rate** ([Provision B3.14](#)) at the high end of the benefit formula to 5% over five years. This would cover only 3% of the 2034 shortfall because it only applies to people with incomes greater than the top bend point (\$80,652 in 2023). It reduces the benefits of people at the taxable maximum by 3.4% for each birth cohort over the next five years. That is a larger benefit cut each year than the following reform options. If this is a concern, it could be phased in over more years.
- **Reduce benefits for people above a median income** ([Provision B3.8](#)) by also reducing the 32% replacement rate to 10% for people above the median income. Unfortunately, it covers less than 1% of the 2034 shortfall because its implementation is delayed to 2029 and it phases in over a long 33-year period. Due to the long phase-in, it reduces benefits by only 0.9% for each cohort year, but once it is fully phased-in, it has a substantial impact on costs and benefits (31% reductions for people at the top).
- **Progressive price indexing** ([Provision B1.2](#)) limits the growth in the initial Social Security benefit to the inflation rate for someone whose income is at the taxable maximum. It does that by gradually reducing the replacement rates for people above the 30th percentile of the income distribution, so it would impact 70% of future retirees.

²² [Provision H.2](#) would tax Social Security benefits more like pension benefits by phasing out the thresholds for whether the Social Security benefit is taxed.

²³ Proposals with benefit reductions often provide a minimum benefit, so low-income people are not negatively impacted. However, a minimum benefit (1) conflicts with Social Security's individual equity principle (if you pay more in taxes, you get more in benefits), (2) can subsidize people who have small Social Security benefits but large pensions or a large amount of assets, (3) duplicates what the Supplemental Security Income (SSI) program does, and (4) would be more expensive than if SSI paid the minimum benefits due to SSI's means test. Benefit reductions in (8) and (9) avoid these problems and don't harm low-income people.

²⁴ Proposals that have large benefit reductions for higher-income people, if combined with a large increase in the taxable maximum, could adversely impact support for the program among those people.

- Social Security replaces a certain percentage of one's pre-retirement income, depending on income level. For someone earning at the poverty level, Social Security replaces most of their pre-retirement income. They would not be impacted by this proposal. In contrast, for someone earning the taxable maximum, Social Security replaces about one-fourth of their income (if they commence benefits at their normal retirement age). This provision would cut that initial benefit in half in about 60 years. It keeps on reducing the replacement rate, but the initial benefit maintains the same purchasing power that people born in prior years got.
- Because implementation doesn't start until 2030, this provision covers less than 1% of the 2034 shortfall. If implemented immediately, it could cover about 5% of the shortfall.
- This provision will not meet Social Security's individual equity principle because benefits eventually become the same for the top 70% of beneficiaries. At that point, the initial benefits for future retirees at the taxable maximum would be smaller than the benefits of people at lower earnings levels, and benefits would no longer be related to their pre-retirement earnings.
- **A means test** could have more impact, as it could fully eliminate benefits for people with incomes or assets over certain thresholds. However, this would also make it more difficult to enact.²⁵ A *partial* means test ([Provision B7.7](#)) analyzed by the Social Security actuaries does not affect high-income workers as dramatically but also does not have much impact (only 5% of the 2034 shortfall).

9) Gradually raise Social Security's Normal Retirement Age (SSNRA) to reflect longer lifespans.

As with all options, raising Social Security's Normal Retirement Age has pros and cons. It can have positive impacts on the economy if it encourages people to work productively longer, but it can be difficult for people in physically demanding jobs. See our issue brief [Raising the Social Security Retirement Age](#) for more analysis of this issue.

- **Indexing the SSNRA** ([Provision C1.3](#)) to maintain a constant ratio of years in retirement to working years would raise the age 67 retirement age by about one month every two years. However, even if implemented soon, it would cover only 3% of the 2034 shortfall due to its slow phase-in (one year increase in SSNRA every 24 years). This is more than fully offset by expected longevity increases, so one could state that there is no reduction in total benefits that a person receives over their lifetime.
- **Accelerating the increase in the SSNRA** ([Provision C1.4](#)) to two months per year for 12 years would reduce benefits by about 1.1% each year for the next 12 year of birth (YOB) cohorts. The SSNRA would reach age 69 in 2034 and cover about 10% of the 2034 shortfall. Increasing the SSNRA by three months per year, as proposed in [Provision C1.7](#) would reduce benefit amounts by about 1.65% for each YOB cohort.

²⁵ There are a number of concerns with means testing discussed in our 2012 document [A Guide to Analyzing Social Security Reform](#) (page 6).

- **Offsets for those with low incomes:** Raising the retirement age adversely impacts low-income people more than others, as on average they do not live as long.
 - The 90% replacement rate used for low-income people in the benefit formula could be increased, so that the impact of increasing the SSNRA is offset by larger benefits.
 - The percentage impact on benefits would gradually decrease as earnings increase.

10) A reduction in COLA ([Provision A3](#)): Some proposals use the chained consumer price index (CPI), which could reduce the cost-of-living adjustment (COLA)—compared to its current basis using the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W)—by about 0.3 percentage points each year. It reflects the effect of buying less-expensive items when prices increase. This proposed change in the COLA would cover 13% of the 2034 shortfall. This is larger than other options because it impacts all current and future beneficiaries. This has a powerful negative effect on benefits over time, especially on the oldest beneficiaries.

- Other COLA proposals use the Consumer Price Index for Americans 62 years of age and older (CPI-E) ([Provision A6](#)), which is based on typical purchases of the elderly. The SSA actuaries estimate that using the CPI-E would increase the annual COLA by about 0.2 percentage points on average. It would increase costs by about 8% of the 2034 shortfall, eliminating about 60% of the savings from the Chained CPI if both were enacted. (It is labeled “Chained CPI-E” in the chart below.)

Combinations of Provisions Show That Substantial Tax Increases Will Be Needed

Immediately enacting the provisions in (8), (9), and (10) with the largest reductions in 2034 cash flow—i.e., progressive price indexing, accelerated increase in SSNRA, and chained CPI—would reduce costs so that the 2034 shortfall is reduced by about 28%. In addition, immediately enacting provisions (5), (6), and (7) discussed in the Tax Increases section could increase the 28% to almost half of the 2034 shortfall. They would also bring in more income during the phase in period, so they would also delay the depletion date somewhat.

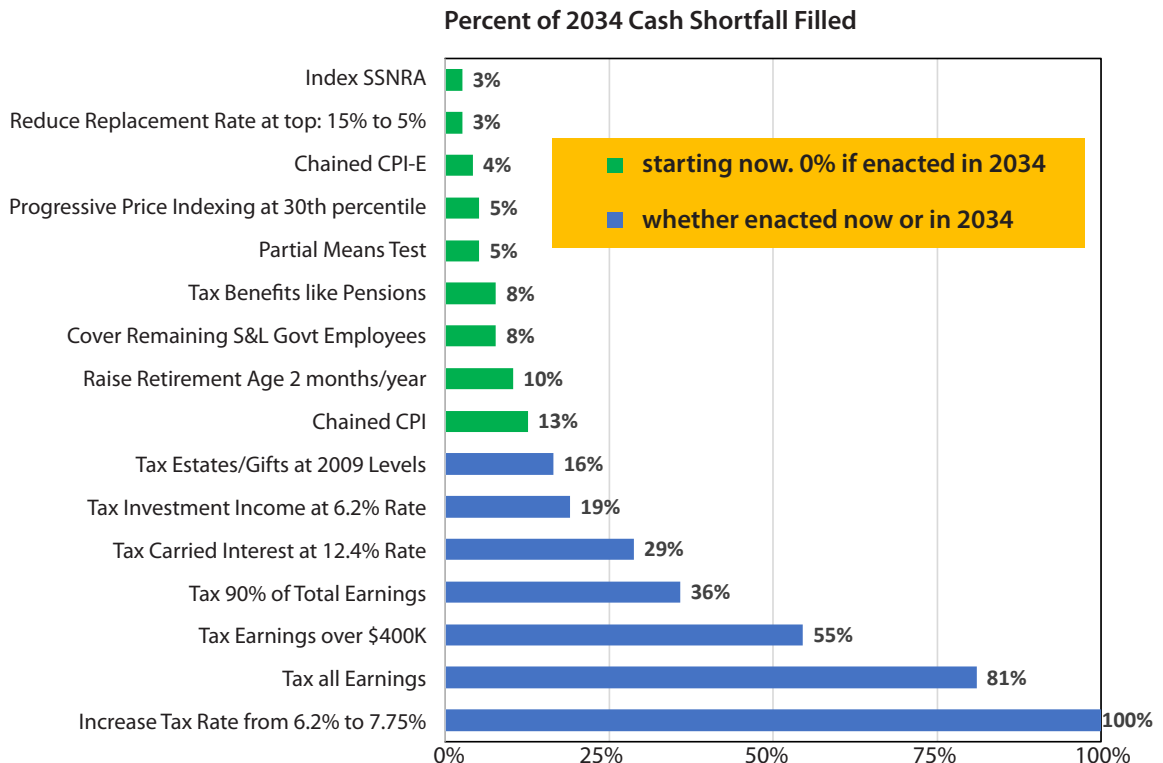
Even if all those provisions are enacted soon, Social Security taxes would still need to be increased substantially to cover the other half of the shortfall. That could be achieved by, for example:

- increasing the tax rate by half as much as in (1) to 7.0%, or
- taxing all earnings above \$400,000 as in (3), or
- taxing 90% of all earnings as in (3) plus taxing one of the new sources of income (investment income, carried interest, or estates/gifts) in (4).

Other combinations would also be possible. However, if Congress is not able to pass something soon, less would be phased in by 2034, so the amount needed from the tax side would have to increase. If Congress cannot reform Social Security until 2034, all of the reform would need to be through increased taxes (unless Congress is willing to break its tradition of not cutting benefits already being paid or is willing to borrow from general revenue).

Caveats

Eliminating the 2034 shortfall does not guarantee that benefits will be payable forever. The percentages in the chart below are different from the percentages needed to solve Social Security’s Long-Range Actuarial Balance (discussed in the [Academy’s Social Security Challenge](#)) but they are equally important. Social Security’s long-term solvency problem will not be solved unless the more immediate concern of paying all scheduled benefits in 2034 is also solved. For example, accelerating the increase in Social Security’s Normal Retirement Age in (9) covers 37% of the Long-Range Actuarial Balance, but only 10% of the 2034 shortfall (due to the slow phase-in that would only be applied to newly eligible beneficiaries). The focus of this issue brief and the percentages in the chart below is on eliminating the shortfall in 2034 so that all scheduled benefits (as amended) can be paid when the trust fund reserves are depleted. The chart below illustrates the impact of the options discussed above. Other options analyzed by Social Security’s Office of the Chief Actuary can be found [here](#).



More details on these reform options can be found in our issue briefs on [tax increases](#), [benefit reductions](#), and [raising the retirement age](#).²⁶ In addition, Congress could consider using automatic mechanisms to keep Social Security sustainably solvent over the long term, as discussed in our issue brief [Social Security—Automatic Adjustments](#). Examples are:

- increasing the Social Security retirement age automatically as lifespans increase and
- increasing the payroll tax rate automatically if fertility and immigration rates are lower than expected.

Conclusion

A solution to Social Security’s solvency is needed sooner rather than later. Immediate action by Congress could:

- make it less likely that a very large tax increase is needed in 2034;
- give Congress more options;
- enable phasing in tax increases and benefit reductions, which is less disruptive to employers, workers, and beneficiaries;
- give people more time to plan and adjust to the changes, enabling people to make better decisions now;
- spread the impact to people over the next 10 years, so that changes on each person can be smaller; and
- give people greater confidence that they will receive their benefits.

²⁶ Increased immigration and employment could help right away if productivity, consumption, and earnings increase. See our issue brief [Immigration and Social Security](#).

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