The 2017 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds

Testimony by Stephen C. Goss, Chief Actuary, Social Security Administration
House Committee on Ways and Means, Subcommittee on Social Security
July 14, 2017

Chairman Johnson, Ranking Member Larson, and members of the subcommittee, thank you very much for the opportunity to speak to you today about the 2017 Social Security Trustees Report. This report has been produced and submitted to the Congress every year starting in 1941, the year after monthly benefits were first paid from a Social Security trust fund.

By law, the Trustees are required to report annually on the financial operations of the trust funds for the immediate past year, the projected operations of the trust funds over the next 5 years, and the actuarial status of the trust funds.

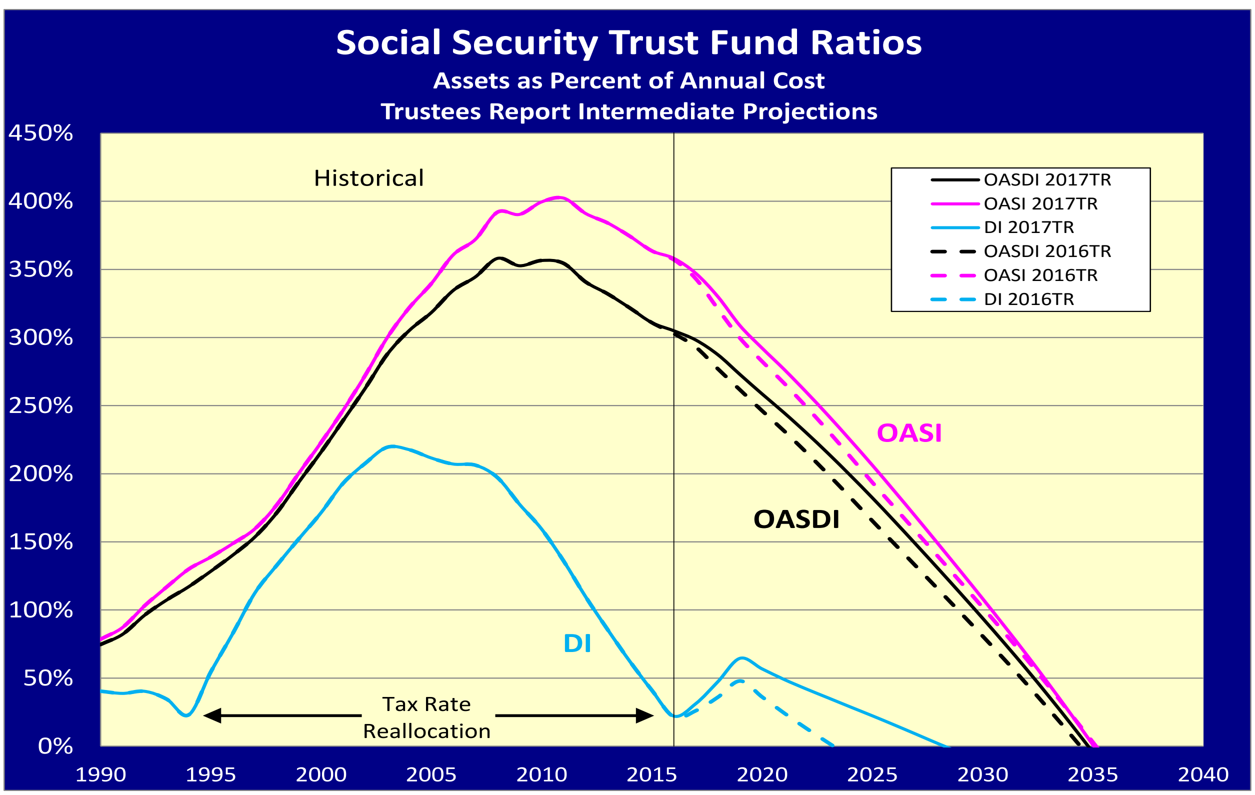
2017 Report

For the 2017 Trustees Report, we have two main changes from a year ago. First, based on continuing lower-than-expected disability application and incidence rates, the projected reserve depletion date for the DI Trust Fund is extended an additional 5 years, from 2023 in last year's report to 2028 in this report. Second, the long range (75-year) actuarial deficit is increased from 2.66 percent to 2.83 percent of payroll. The principal reasons for the increase in the deficit are the change in the valuation period, recent data for several demographic factors, and an assumption for a slightly lower level of worker productivity for the future.

During calendar year 2016, the Old-Age and Survivors Insurance (OASI) Trust Fund reserves increased by $21 billion, nearly $13 billion more than projected in last year's report. The Disability Insurance (DI) Trust Fund reserves increased by $14 billion, about $6 billion more than projected in last year's report. At the beginning of 2017, the combined OASI and DI Trust Fund reserves were close to $2.85 trillion, about three times the annual cost of the program.

Over the next 5 years, the combined reserves will grow steadily, reaching $3.00 trillion at the beginning of 2022. However, combined reserves will begin to decline in 2022. The decline is projected to be $18 billion in 2022, but increases thereafter as the baby-boom generations continue to move into retirement ages and are replaced at working ages by the lower-birth-rate generations born after 1964. The OASI and DI Trust Funds, individually and combined, are projected to be fully solvent through the next 10 years, thanks, in part, to the enactment in November 2015 of the payroll tax rate reallocation included in Bipartisan Budget Act of 2015. At the time of enactment, we estimated that the date of trust fund reserve depletion for DI would be extended 6 years from 2016 to 2022. In the 2016 Trustees Report, we projected that DI reserves would not deplete until 2023, largely due to the lower-than-expected recent level of benefit expenditures. For this year's report, we are projecting an additional 5-year extension of the DI reserve depletion date, to 2028. Applications for disability benefits have been declining steadily since 2010, and have continued to be below our prior projections. The total number of beneficiaries paid from the DI Trust Fund has now been falling since 2013.

Actuarial status of the trust funds is assessed on the basis of the projected ability of the trust funds to pay benefits scheduled in the law in full and on time. Under the law, all income is invested in trust fund reserves on a daily basis, and benefit obligations and administrative costs are paid on the basis of redeeming bonds held by the trust funds as needed. The law provides no ability for the trust funds to borrow or receive revenue from other than specified taxes and interest on the reserves. Thus, should reserves become depleted with continuing tax revenue less than needed to meet current obligations, benefits scheduled in the law would not be payable in full on a timely basis.

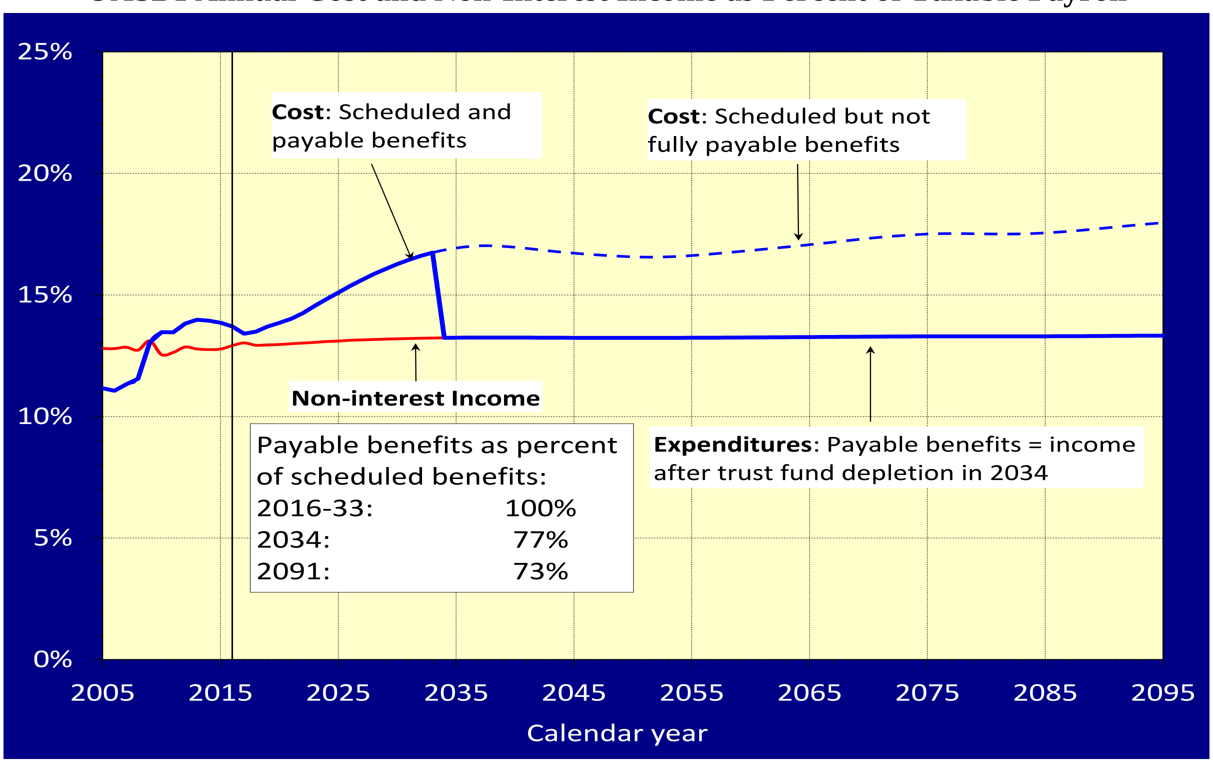


Fortunately, in the entire 82-year history of the program, the Congress has always made timely adjustments in the law to avoid reserve depletion and any sudden reduction in benefits paid. The real purpose of our reporting on the actuarial status of the trust funds is to illustrate to the Congress any expected shortfall in financing of scheduled benefits so that further adjustments to the law can be made on a timely basis.

Under the intermediate assumptions used for the 2017 report, we project that the combined reserves will be depleted in 2034, the same year as in the last report, with continuing income under current law equal to 77 percent of program cost at the time of depletion. By the end of the 75-year projection period, income under current law is projected to equal 73 percent of the cost of the program, slightly less than the projected 74 percent payable in last year's report. The projected revenue for the OASDI program for 2091 is now projected to fall short of scheduled revenue by 4.48 percent of taxable payroll, somewhat more than the 4.39 percent shortfall projected for 2091 last year.

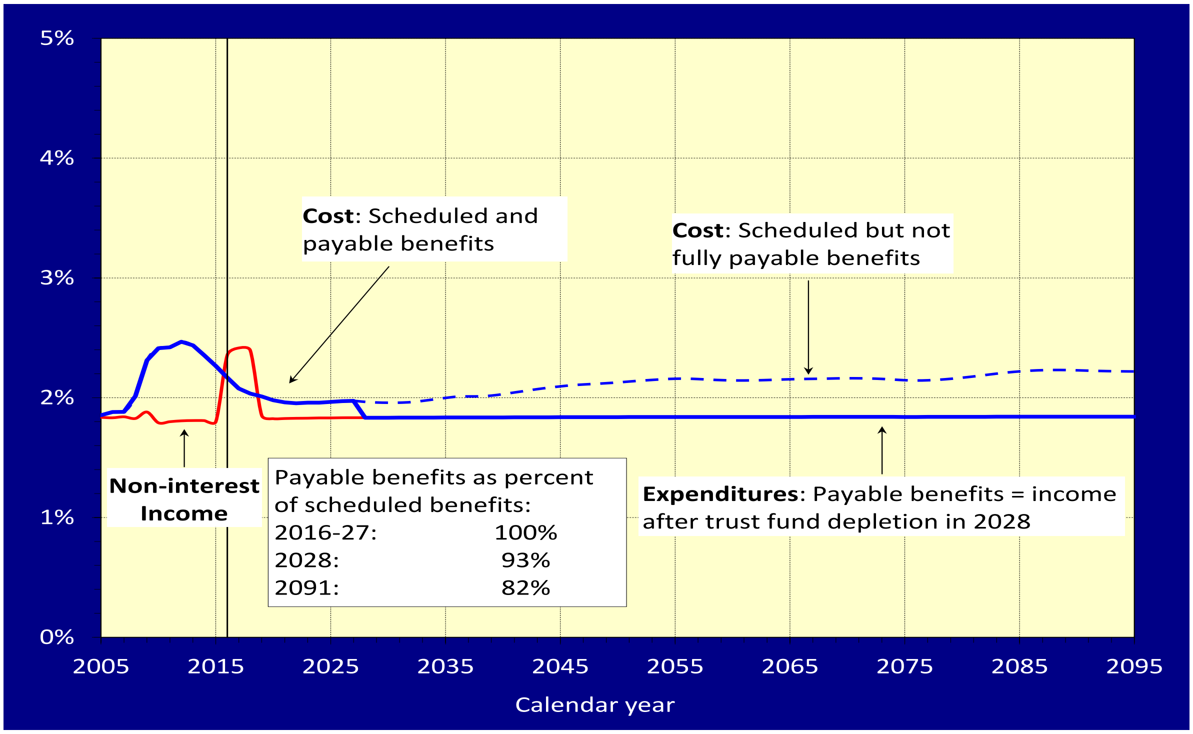
In essence, this means that by 2034 we will need adjustments in the law so that (1) the scheduled revenue for the OASDI program will be increased by about 33 percent, (2) scheduled benefits will be reduced by about 25 percent, or (3) some combination of these adjustments is enacted. Enacting changes well before reserve depletion, even if with delayed effective dates, will allow more options to be considered, more advance warning for those affected, and a more gradual phase-in of adjustments. Over the past 25 years, Trustees Reports have projected reserve depletion as early as 2029 and as late as 2042.

OASDI Annual Cost and Non-Interest Income as Percent of Taxable Payroll



Considered alone, the separate DI Trust Fund will require some adjustment before 2034. Even with the changes in the BBA 2015 and the financially favorable recent experience, DI reserves are projected to become depleted in 2028, at which time continuing income would be equal to 93 percent of scheduled cost. By the end of the 75-year period, scheduled income is projected to be sufficient to cover 82 percent of scheduled cost.

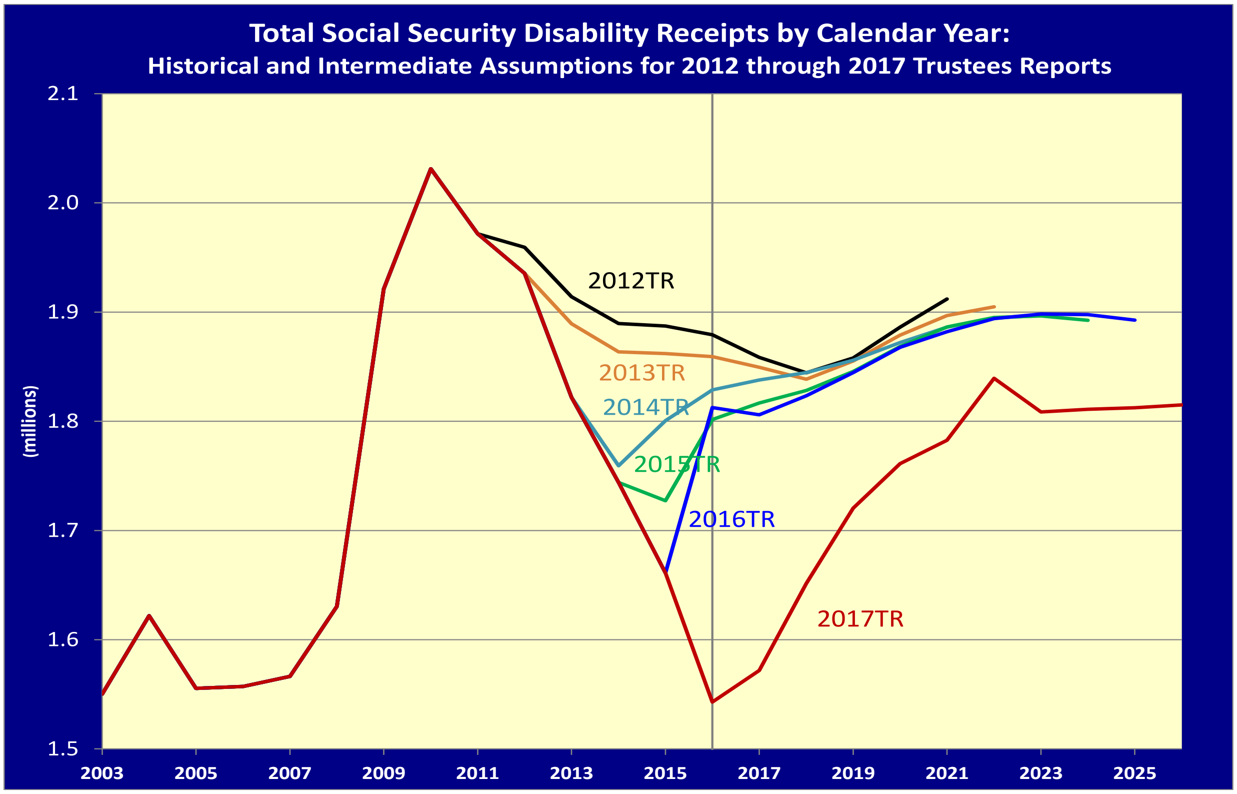
DI Annual Cost and Non-Interest Income as Percent of Taxable Payroll



The 5-year extension of the reserve depletion date for the DI Trust Fund in this year's report reflects:

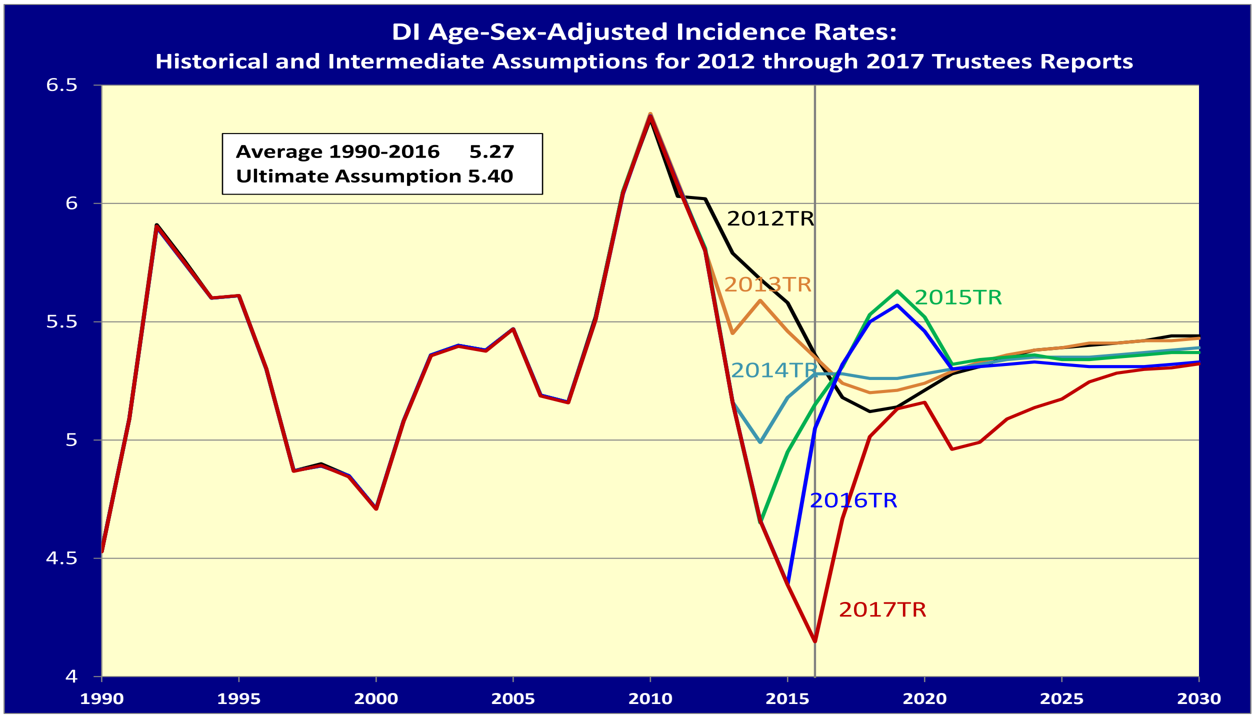
a) Another year, 2016, with disability applications and incidence rates falling well below our expectations. The number of applications for 2016, when the economy had not yet risen to the sustainable full employment level, was below the annual level at the peak of the last economic cycle (2007), and
b) An extension by several years of the period over which disability incidence rates will rise to the ultimate assumed levels.

The figure below shows the continued decline in Social Security disability applications received at the state Disability Determination Services through 2016, falling well short of expectations for several years now.



Given the degree of decline in applications through 2016 in an economy that is still well short of full recovery even to the sustainable full employment level, we are now projecting that applications will rise gradually to a level somewhat lower than in recent past reports. However, we and the Trustees believe it is too early to lower the ultimate level for disability incidence based on this recent experience.

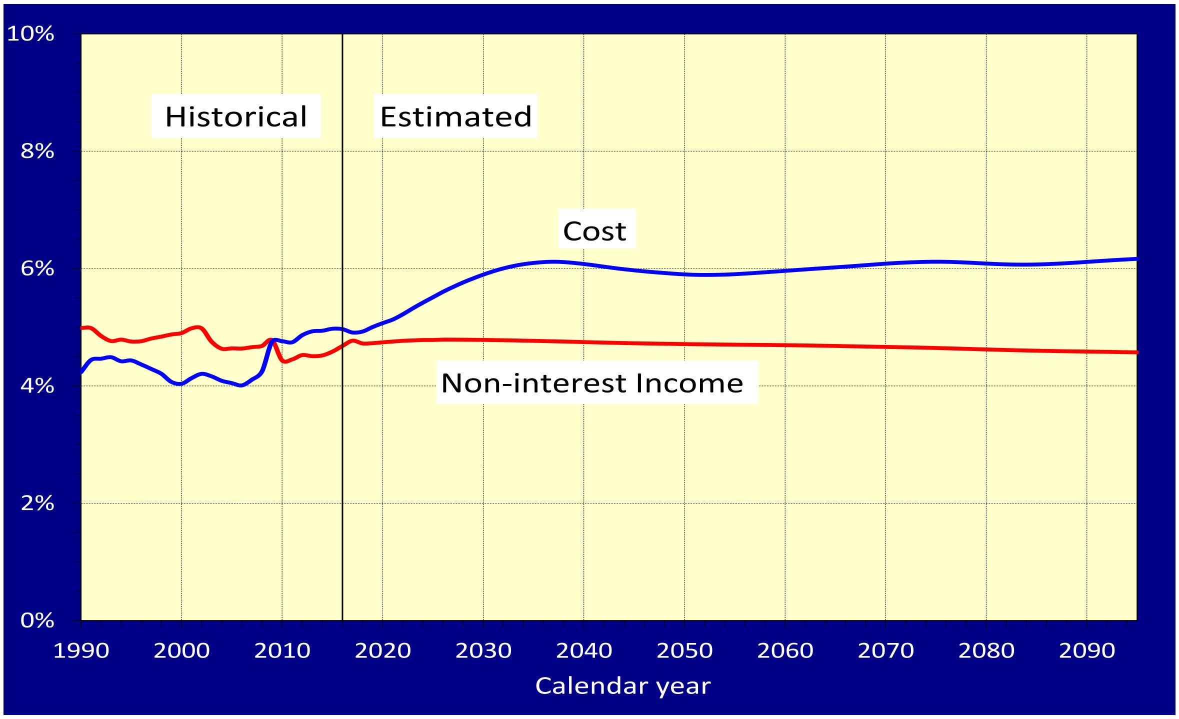
The figure below shows the more gradual rise to the ultimate incidence rate assumed for this year's report.



For the last several reports, we have assumed that the age-sex-adjusted disability incidence rate would rise quickly back to the expected ultimate rate of 5.4. This rate represents the number of newly disabled workers per 1,000 insured workers exposed to the risk of becoming disabled. Because actual incidence rates have continued to fall even with the economy still well short of full recovery, we have extended the period over which incidence rise to the ultimate assumed level. The temporary elevated levels of incidence in years through about 2021 in recent reports reflects the expectation that the backlog of disability cases awaiting a determination from an administrative law judge will be eliminated in the next 3 to 4 years.

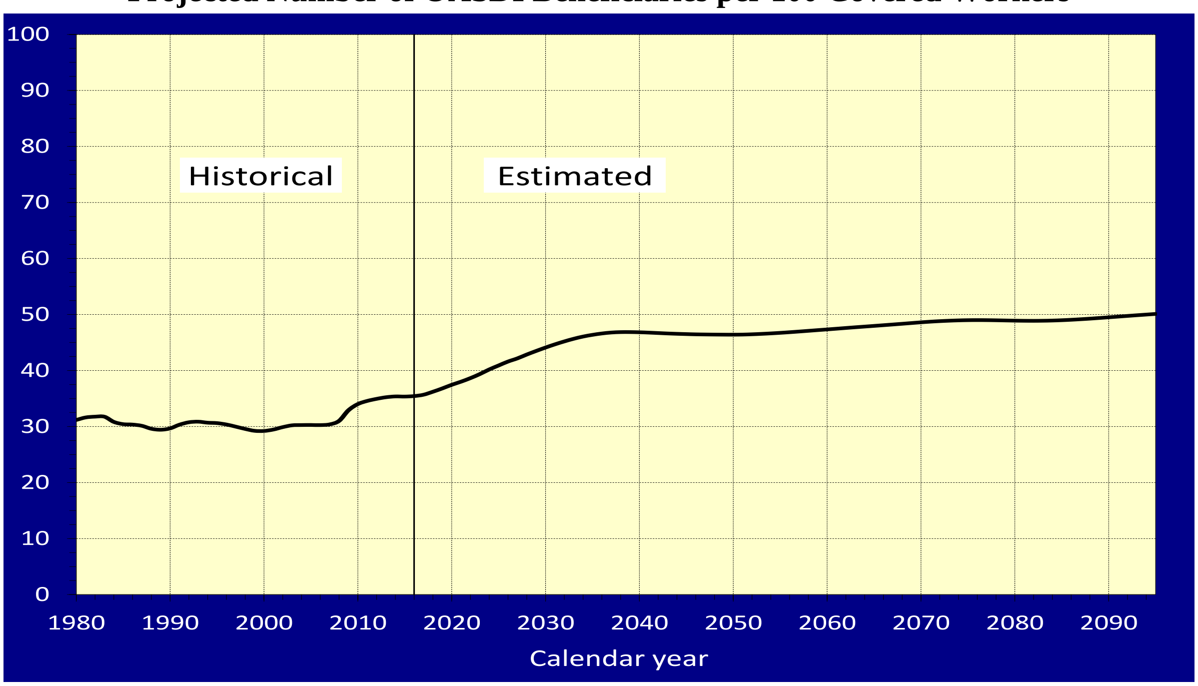
Expressed as a percent of the total Gross Domestic Product (GDP) of the United States, the scheduled cost of the OASDI program is projected to rise from 4.9 percent in 2017 to about 6 percent for 2035 and later. Projected scheduled revenue is lower over this period, between 4.5 and 4.8 percent of GDP. The fact that scheduled annual non-interest income, largely the 12.4 percent payroll taxes paid by employees and employers, is no longer sufficient to cover annual program cost is primarily due to the changing age distribution of the adult population. The fact that projected OASDI cost as a percent of GDP is basically stable after 2035 speaks to the sustainability of the program's benefit and revenue structure. The changing age distribution will simply require adjustments in scheduled income and/or cost.

SUSTAINABILITY: Cost as Percent of GDP

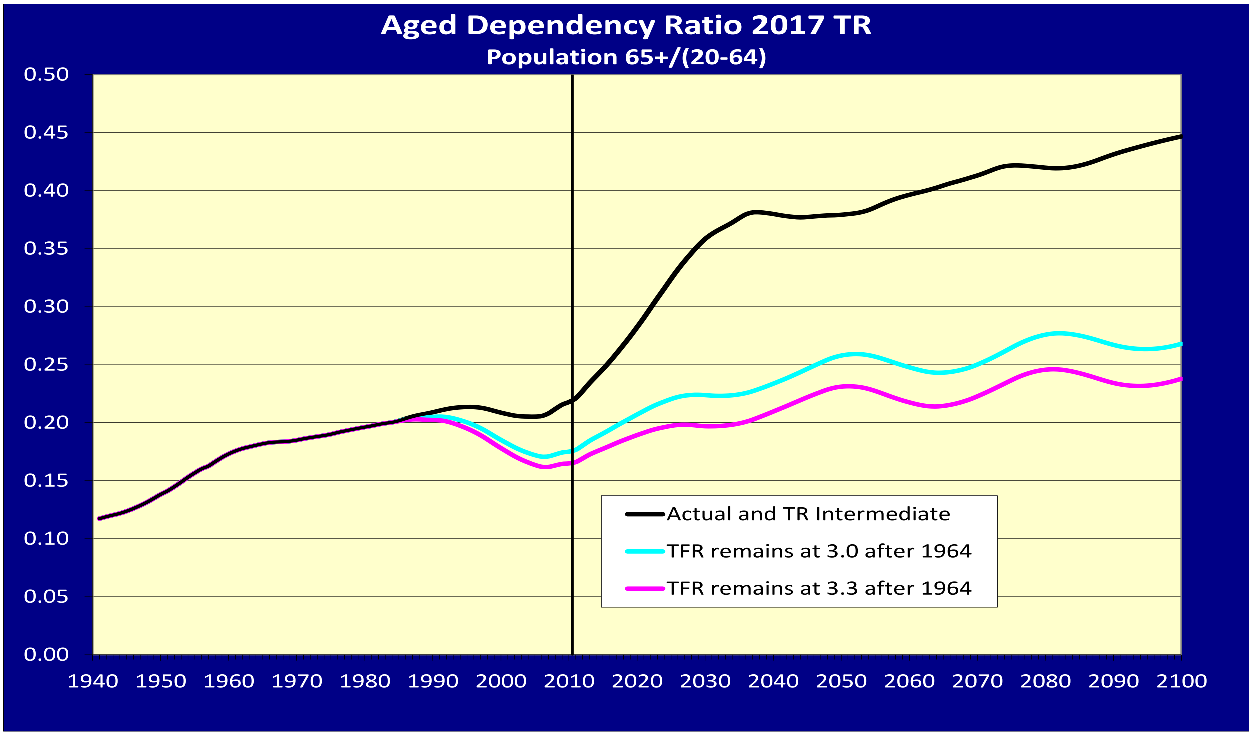


The cost as percent of GDP closely follows the ratio of beneficiaries to covered workers, because the average benefit under the program is designed to rise at about the same rate as average earnings.

Projected Number of OASDI Beneficiaries per 100 Covered Workers



The ratio of beneficiaries to covered workers in turn follows closely the "aged dependency ratio" (population age 65 and over as a percent of the working age population age 20 through 64). The figure below illustrates that the large increase in this ratio between 2010 and 2035 is due primarily to the drop in birth rates from about 3 children per woman historically (3.3 during the baby-boom years) to about 2 children per woman in recent years.



Changes in longevity through declines in death rates play a more gradual but steady role in the trend of the aged-dependency ratio. Changes in death rates over age 65 are important for the actuarial status of the OASDI program. Fortunately, mortality projections used in the Trustees Reports have provided a sound basis for evaluating the actuarial status of the program in the past. While some have suggested assuming dramatically faster mortality improvement, the track record for the Trustees Reports, plus the very substantial deceleration in mortality improvement since 2009 suggest that projections in the 2017 report represent a sound basis for evaluating prospects for the future.

Summary Measures of Actuarial Status

The Trustees Report uses several summary measures and tests to indicate the actuarial status of the trust funds from different perspectives. The actuarial deficit for the OASDI program as a whole increased from a 75-year shortfall of 2.66 percent of taxable payroll in last year's report to 2.83 percent of payroll in this report. The actuarial deficit is the excess of the cost for full scheduled benefits over the next 75 years, including the cost of having a reserve at the end of the period equal to 100 percent of annual cost, over the scheduled income for the program over the next 75 years, including the starting trust fund reserve level, all expressed as a percent of payroll.

Another summary measure is the unfunded obligation of the program. This is the difference between projected program cost in the next 75 years over the projected revenue (plus starting reserves). For the 2017 report, the unfunded obligation increased in present value dollars and as a percent of GDP over the 75-year period.

Unfunded Obligation through 2091		
Estimate for 2016 Trustees Report	**$11.4 trillion PV**	**0.89% of GDP**
Change valuation date only	**$11.9 trillion PV**	**0.91% of GDP**
Estimate for 2017 Trustees Report	**$12.5 trillion PV**	**0.95% of GDP**

Changes in Assumptions and Methods

On balance, changes in legislation, assumptions, recent experience, and methods had a small negative effect on the actuarial status of the OASDI program. The table below highlights the main factors in the change in the actuarial balance for this year.

Principal Reasons for Change in 2017 OASDI Trustees Report	
Actuarial Balance – Net change of -0.17 percent of payroll	
Valuation period	**-0.05 percent**
Legislation/Regulation ***(non-implementation of 2014 DAPA/DACA)***	**+0.00 percent**
Demographics ***(lower recent fertility and immigration; higher recent mortality)***	**-0.03 percent**
Economics ***(including lower level of labor productivity and potential GDP)***	**-0.08 percent**
Disability ***(recent experience and assumptions)***	**+0.03 percent**
Other program data and methods improvements	**-0.04 percent**

The change in the valuation period, effectively adding a year to the end of last year's 75-year period, increases the actuarial deficit because of the relatively large annual deficits at the end of the period.

For this report, we assumed that the 2014 executive actions establishing the Deferred Action for Parents of Americans (DAPA) program and expanding the Deferred Action for Childhood Arrivals (DACA) program would not be implemented. Recent directives from the Department of Homeland Security have confirmed this assumption. The net effect on the combined OASDI Trust Funds is negligible.

Lower recent experience for both birth rates and net immigration contribute toward an increase in the actuarial deficit. Continued higher-than-expected death rates and lower-than-expected disability application and incidence rates have significant but offsetting effects. Also, during the recent recession and partial recovery, productivity (economic output per hour worked) has not increased as fast as previously expected. For the 2017 report, we have accepted that a portion of this loss in labor productivity will be permanent, thus increasing the actuarial deficit. Finally, several changes were made in projection methods, the most significant being better recognition of earnings late in career for future generations that are assumed to start receipt of retirement benefits at older ages.

The Trustees apply a short-range test of financial adequacy that requires that reserves remain at or grow to at least 100 percent of annual cost over the next 10 years. The OASI Trust Fund as well as the combined OASI and DI Trust Funds satisfy this test. The DI Trust Fund once again does not.

Section 709 of the Social Security Act also requires that the Trustees report to Congress when a Trust Fund is projected to have reserves below 20 percent of annual cost in the future. In order to give Congress ample time to consider necessary adjustments, the Trustees make such reports when the reserve ratio is projected to be below 20 percent within the next 10 years. Again this year, the Trustees have submitted this notice to the Congress for the DI Trust Fund. The DI Trust Fund reserve ratio was 31 percent at the beginning of this year and will rise to 65 percent at the beginning of 2019, due in part to the tax rate reallocation enacted last year. The ratio will then decline and will fall below 20 percent by the beginning of 2026, and without Congressional action, reserves will become depleted in 2028.

The Trustees also report on the long-range test for close actuarial balance. This test requires that the program satisfy the short-range test of financial adequacy and, in addition, maintain a positive reserve throughout the remainder of the 75-year projection period, indicating the ability to pay all scheduled benefits in full on a timely basis. At this time, neither the OASI nor DI Trust Funds individually or combined meet this long-range test. While the financial and benefit structure of the OASDI program is sound, adjustments are needed to accommodate the changing age distribution of the population over the next 20 years that is largely the result of persistent lower birth rates after 1964.

Actuarial Opinion

The Social Security Act requires a statement of actuarial opinion from the Chief Actuary of the Social Security Administration regarding the reasonableness of assumptions and methods used in the report. I am happy to indicate that the actuarial opinion for the OASDI Trustees Report has never included a qualification of the assumptions and methods used to project the actual cost and operations of the trust funds under current law. However, starting with the 2014 report, the actuarial opinion has included a caveat regarding a reference in the OASDI report to an appendix on federal budget accounting in the Medicare report. This appendix, first introduced in 2004, describes the implications of projected OASDI and Medicare Trust Fund operations under the customary budget scoring convention. This caveat warns the reader that discussion of the trust funds in relation to the overall federal budget and implications for federal debt held by the public are distorted and misleading because of use of this budget scoring convention. This convention presumes that OASDI obligations scheduled in the law that cannot be paid in full and on time after Trust Fund reserve depletion, will nonetheless be paid at the expense of the General Fund of the Treasury. The General Fund is presumed to borrow from the public as needed to pay full scheduled benefits after reserve depletion. The problems with this convention are: (1) the law does not permit such general fund transfers, either before or after trust fund reserve depletion; (2) there has never been a precedent for a change in the law providing such transfers; and (3) results presented in the budget scoring context do not provide clear disclosure that they are hypothetical projections presuming a change in law that would allow for the indicated general revenue transfers to the trust funds after reserve depletion.

Please note that the 2017 and all prior years' Trustees Reports are available at https://www.ssa.gov/oact/pubs.html, along with a wide variety of additional actuarial analyses related to the reports and to changes policymakers have considered for making adjustments to the program.

Conclusion

Based on the experience of the past year and the intermediate assumptions of the 2017 Trustees Report, there are two main points I would like to make. First, the date of DI Trust Fund reserve depletion has been extended 5 years to 2028. Second, the actuarial status of the combined OASI and DI Trust Funds is slightly worsened compared to last year's report, with a slightly larger actuarial deficit over the long-range period. The long-known and understood shift in the age distribution of the United States population will continue to increase the aged dependency ratio, and in turn increase the cost of the OASDI program as a percentage of taxable payroll and GDP. Once this shift, reflecting the drop in the birth rate after 1964, is complete around 2035, the cost of the program will be relatively stable at around 6 percent of GDP. We look forward to working with this Committee and others in developing the adjustments to the law that will be needed to keep the program in good financial order providing retirement, disability, and survivor benefits for future generations.

Again, thank you for the opportunity to talk about the 2017 Trustees Report. I will be happy to answer any questions you may have.