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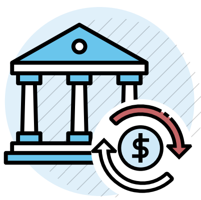
SOCIAL SECURITY SERIES
PART 1: The Dilemma

I. Overview

Social Security pays out more money than it takes in.



Source: GAO. | GAO-23-106667

Since its inception in 1935, Social Security has become a major source of income for millions of Americans.[1] In January 2023, over 57 million retirees and other individuals received Social Security benefits.[2] For many retirees, Social Security makes up a substantial percentage of their overall retirement income. Significant financial challenges threaten the Social Security Administration's (SSA) long-term ability to continue to pay retirees and other beneficiaries full benefits.[3] Specifically, costs for Social Security's benefit program for retirees, their dependents, and their survivors—costs that are paid from the Old-Age and Survivors Insurance (OASI) Trust Fund—have been exceeding the program's tax revenues since 2010 and are projected to continue doing so. Unless action is taken, the program is projected to be unable to pay full scheduled benefits in 10 years.[4] The sooner actions are taken to address these financial challenges, the more gradually changes can be phased in and workers would have more time to adjust to any changes and factor them into their retirement plans.

This is the first in a series of three reports that are intended to briefly outline (1) why policymakers need to address OASI's financial challenges, (2) criteria for evaluating options for reforming OASI, and (3) major types of reform that have been proposed. This first report focuses on OASI's financial challenges and draws on our past work examining Social Security and the nation's fiscal health as well as on data and projections from the 2023 Social Security Trustees Report.[5]

II. Why is Social Security Important?

Social Security cash benefits help keep people out of poverty.

Source: GAO. | GAO-23-106667

Social Security is considered the bedrock of the U.S. retirement system. The Social Security Act was enacted in 1935, in part, to help ensure that older Americans would have adequate income in retirement and not have to depend on welfare. Social Security provides cash benefits based on lifetime wages. These cash benefits replace a portion of an individual's earnings that are lost due to their retirement or death. For nearly 90 years, many American workers and their families have counted on these benefits to pay their bills and maintain their standard of living in retirement.

Many Social Security beneficiaries rely on its benefits for the majority of their income while retired. In 2023, Social Security benefits will replace just over 71 percent of pre-retirement earnings for newly entitled beneficiaries with relatively low career average earnings of about $15,900 per year—these beneficiaries will receive about $11,300 in benefits for the year.[6] Social Security benefits also represent a substantial percentage of some workers' total retirement income, ranging from 83 percent of income for the lowest income quintile (with a median income of about $14,400 per year) to 30 percent for the fourth income quintile (with a median income of just over $81,500 per year) in 2017.[7] Of those receiving benefits in January 2023, 74 percent were retired workers who received an average annual benefit of nearly $22,000.

III. How Are Benefits Calculated?

Monthly Social Security retirement benefits generally are calculated using the highest 35 years' worth of wage-indexed earnings on which the worker paid Social Security payroll taxes. Family members may also receive benefits, which are based on the primary worker's benefit amount. For example, spouses who survive a worker may be eligible for benefits. Benefits are calculated in three steps (see fig. 1):

Figure 1: Summary of Steps to Calculate Social Security Retirement Benefits

Adjust each year of a worker's career earnings for wage growth. Then take the highest 35 years of adjusted earnings (including zeroes) and average them.

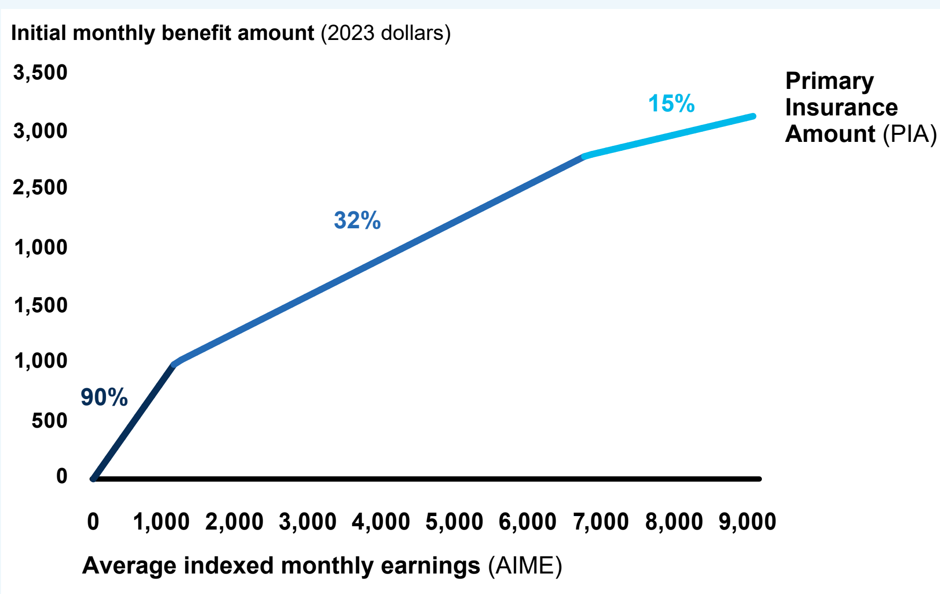
STEP 1

This ensures that a worker's future benefits reflect the general rise in the standard of living that occurred during the worker's career. The resulting figure is called the average indexed monthly earnings (AIME).

Use a progressive formula to calculate the initial monthly benefit amount– known as the Primary Insurance Amount (PIA).

STEP 2

As the figure below shows, the initial monthly benefit amount is the sum of three separate percentages of portions of AIME. The formula's percentages are fixed in federal law, but the segments of AIME they cover are updated annually to reflect wage growth.



Make adjustments to account for various other factors, such as those relating to retirement age.

STEP 3

Retirement age: For retired workers, Social Security pays unreduced benefits at full retirement age, which is 67 for those born 1960 or later. A worker may begin collecting benefits as early as age 62, but the monthly benefit amount is reduced. Moreover, workers who begin receiving benefits after their full retirement age receive a benefit increase for each month of delayed retirement up to age 70.

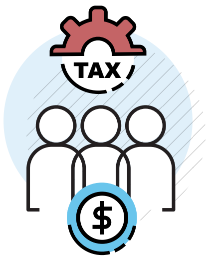
Cost-of-living adjustments: Each year, Social Security benefits may be adjusted upward for price inflation. Specifically, monthly benefits may be adjusted annually based on the Consumer Price Index, which is produced by the Bureau of Labor Statistics. Over the last 20 years, the cost-of-living adjustment has ranged from zero (in 2009, 2010, and 2015) to 8.7 percent (in 2022).

Source: GAO analysis of Social Security Administration documents. | GAO-23-106667

Note: For 2023, to calculate the PIA, the benefit formula takes the sum of 90 percent of the first $1,115 of a worker's AIME, 32 percent of earnings over $1,115 through $6,721, and 15 percent of earnings over $6,721 through $12,427. The amount of taxable earnings included in the benefit formula is capped. Specifically, a person claiming benefits at age 62 after 40 years of earning the maximum-taxable earnings would have a maximum AIME equal to $12,427 in 2023.

IV. How Is OASI Financed?

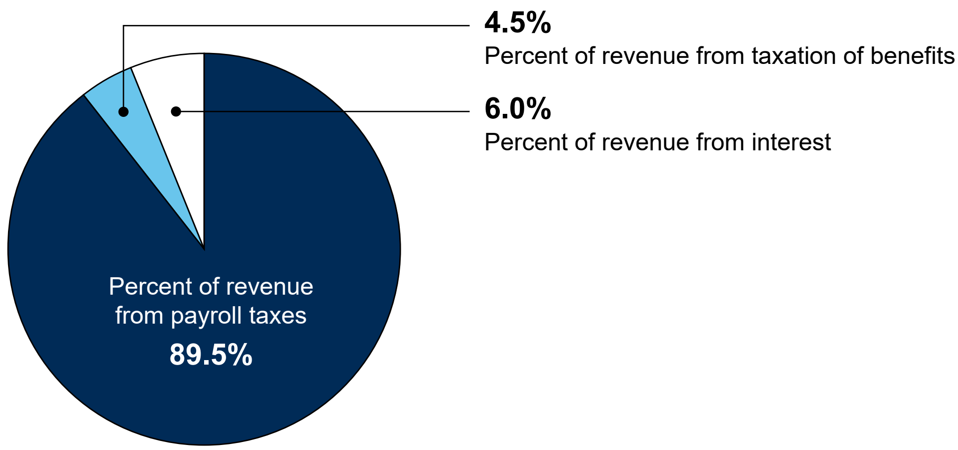
Most of Social Security's revenues come from payroll taxes.



Source: GAO. | GAO-23-106667

Social Security's revenues—which were $1.1 trillion in calendar year 2022—primarily come from payroll taxes (see fig. 2). Workers and employers pay a payroll tax, and the amount of that tax that is allocated to the OASI Trust Fund is 10.6 percent (5.3 percent of covered earnings from workers and the same amount from employers) of wages and self-employment income.[8] The amount of a worker's earnings subject to payroll taxes is capped. For 2023, this cap—referred to as "maximum taxable earnings"—is $160,200. Social Security's other sources of revenue include income taxes attributable to Social Security benefits and interest income on the Trust Fund assets. SSA uses these sources of revenue to pay for the benefits of all Social Security beneficiaries.

Figure 2: Old-Age and Survivors Insurance Revenue Sources as a Percentage of Total Revenue, Calendar Year 2022

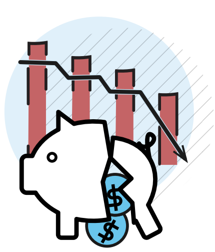


Source: GAO analysis of data from the 2023 Social Security Trustees' Report. | GAO-23-106667

Note: Some individuals may have to pay federal income taxes on their Social Security benefits. For example, individual income tax filers pay tax on up to 50 percent of their benefits if their income (defined as the sum of modified adjusted gross income, certain tax-exempt interest income, and half of their Social Security benefits) is between $25,000 and $34,000 (between $32,000 and $44,000 for a married couple filing jointly). OASI Trust Fund assets are invested in interest-bearing obligations of the United States or in obligations guaranteed as to both principal and interest by the United States. Thus, Social Security receives interest income from these investments.

V. What Is the Dilemma?

Social Security's retirement trust fund is projected to run out of reserves in 10 years.

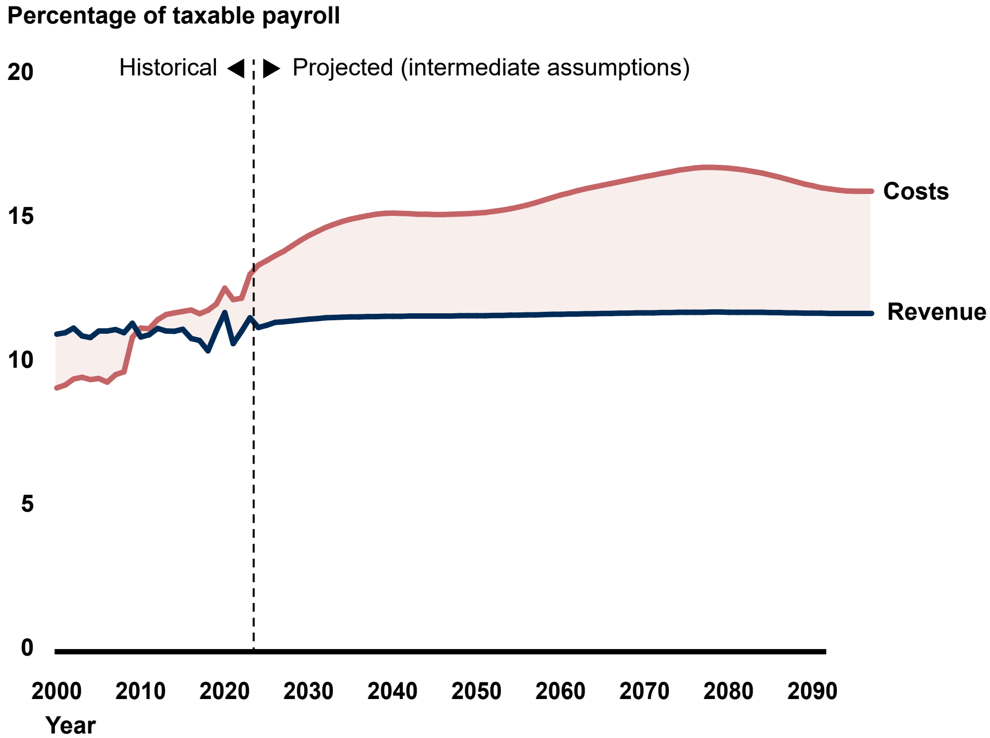


Source: GAO. | GAO-23-106667

The Trustees estimate the OASI Trust Fund will deplete its reserves in 10 years. OASI's costs, which are mostly benefit payments, have exceeded its tax revenues since 2010 (see fig. 3). Since 2021, costs have exceeded total income (including interest) and are expected to continue exceeding income throughout the Trustees' 75-year projection period. SSA has drawn on accumulated surpluses in the OASI Trust Fund to make up the difference between cost and income.[9] If this trend continues and no action is taken, the OASI Trust Fund will deplete its reserves and Social Security will be unable to pay full scheduled benefits.

Specifically, using the Social Security Trustees' middle or "intermediate" set of assumptions, which represents the Trustees' best estimates of the future course of the population and economy, the OASI Trust Fund reserves are projected to become depleted in 2033. At that point, if no action is taken, program revenue would be sufficient to pay retirees just 77 percent of their scheduled benefits. However, because the Social Security Act does not provide a procedure for paying less than full benefits it is difficult to know how this would unfold.

Figure 3: Old-Age and Survivors Insurance (OASI) Costs Are Projected to Continue Exceeding Revenues through Calendar Year 2100



Source: GAO analysis of data from the 2023 Social Security Trustees' Report (intermediate assumptions). | GAO-23-106667

Note: This figure presents past and projected annual OASI revenue (from payroll taxes, taxation of benefits, and general fund reimbursements—but excluding interest income) and cost rates, expressed as a percentage of taxable payroll. The difference between the revenue and cost rates is the OASI Trust Fund's operational "balance" for the year. How these rates compare over time is indicative of the long-term status of the Trust Fund.

Earlier action reduces the stress of change.

Source: GAO. | GAO-23-106667

Earlier action reduces the stress of change. Data and projections from the 2023 Social Security Trustees Report suggest that early action would be advisable. Earlier action, and more certainty about future changes, would allow changes to be more gradually phased in and would also better allow workers to adjust to any changes and factor them into their retirement plans.

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Endnotes

[1] Unless otherwise noted, we use “Social Security” and “retirement” (such as when we discuss “retirement benefits”) to refer to the Old-Age and Survivors Insurance (OASI) benefit program, which replaces a portion of earnings that are lost when a worker retires. For ease of reference, we refer to recipients of these benefits as “retirees” even though some individuals may still be able to qualify for and receive retirement benefits while working. Although we refer to “Social Security” in this way for this report, “Social Security” can also refer collectively to OASI and the Disability Insurance (DI) program, a separate benefit program that replaces earnings that are lost due to a worker’s disability.

[2] Social Security Administration, *Monthly Statistical Snapshot, January 2023*. The Social Security Administration is the federal agency that administers the OASI and DI programs.

[3] See, for example, GAO, *The Nation’s Fiscal Health: Federal Action Critical to Pivot toward Fiscal Sustainability,* GAO-22-105376; *The Nation’s Fiscal Health: After Pandemic Recovery, Focus Needed on Achieving Long-Term Fiscal Sustainability*, GAO-21-275SP; and *Social Security’s Future: Answers to Key Questions*, GAO-16-75SP.

[4] Federal trust funds are accounting mechanisms that collect revenues and other monies and track expenditures for a specific purpose. There are two trust funds for Social Security’s benefit programs: one for the OASI program (the OASI Trust Fund) and one for the DI program (the DI Trust Fund). The OASI and DI Trust Funds are legally separate and, absent statutory authority, SSA cannot move money between the funds. This report focuses on the OASI program. For additional information on federal trust funds, see GAO, *Federal Trust Funds and Other Dedicated Funds: Fiscal Sustainability Is a Growing Concern for Some Key Funds*, GAO-20-156 and *Federal Trust and Other Earmarked Funds: Answers to Frequently Asked Questions,* GAO-01-199SP.

[5] Board of Trustees, Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds, *The 2023 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds* (Washington, D.C.: Mar. 31, 2023). The Social Security Trustees Report provides information about the financial operations and actuarial status of the OASI and DI Trust Funds, including estimates of when the Trust Funds’ reserves will become depleted and how much the programs will be able to pay after that date.

[6] In 2023, newly entitled beneficiaries with relatively high pre-retirement career average earnings of about $101,600 per year will have nearly 32 percent of their average pre-retirement earnings replaced by Social Security benefits, receiving an average annual benefit of a little more than $32,300. SSA calculated these statistics by using hypothetical “scaled” earnings levels (e.g., very low, low, medium, high). The values are for retirement at age 65 in 2022. See K. Burkhalter, and C. Chaplain, "Replacement Rates For Hypothetical Retired Workers," Actuarial Note no. 2023.9 (Social Security Administration, Office of the Chief Actuary, March 2023).

[7] Congressional Research Service, *Retirement Income Security: Issues and Policies* (Washington, D.C.: Feb. 17, 2023)

[8] Self-employed workers also pay a payroll tax, and the amount of their payroll tax that is allocated to the OASI Trust Fund is 10.6 percent of covered earnings. These workers are allowed an income tax deduction for half of the payroll tax. “Covered earnings” are work-related earnings, such as wage income, that are subject to Social Security taxation. When including payroll taxes that are allocated to the DI Trust Fund, the payroll tax rate for workers and employers is 6.2 percent each, for a combined tax rate of 12.4 percent.

[9] As we have previously reported, a build-up and eventual draw-down of the OASI and DI Trust Funds was anticipated in 1983, when certain legislative changes were enacted. The payroll tax rate was scheduled at a level that created surpluses (income in excess of outflows) while the baby boom generation was in the workforce and an expectation of future deficits (outflows in excess of income) as the baby boom generation retired. The accumulated surpluses built a reserve in the Trust Funds that the deficits were expected to draw down. See GAO-22-105376. The combined Old- Age and Survivors Insurance and Disability Insurance Trust Fund was projected to have a positive balance throughout the 75-year projection period at the time of the 1983 Trustees Report. Historical analyses performed by SSA of the actuarial balance suggest that most of the unexpected deterioration since then can be attributed to economic factors.

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This document is based on GAO audit products and is subject to update.

We provided a draft of this report to SSA for review and comment. SSA provided technical comments, which we incorporated as appropriate.

We conducted our work from February 2023 to May 2023 in accordance with all sections of GAO’s Quality Assurance Framework that are relevant to our objectives. The framework requires that we plan and perform the engagement to obtain sufficient and appropriate evidence to meet our stated objectives and to discuss any limitations in our work. We believe that the information and data obtained, and the analysis conducted, provide a reasonable basis for any findings and conclusions in this product.