

Social Security's Grim Milestone: Half a Year in the Red

Chuck Blahous | December 7, 2009

Data recently made public by the Social Security Administration confirm that in October, 2009, the program reached a grim milestone: six consecutive months of operating cash deficits. This is the first time Social Security has faced this situation over the entire time period, dating back through 1987, for which SSA posts the monthly data online.

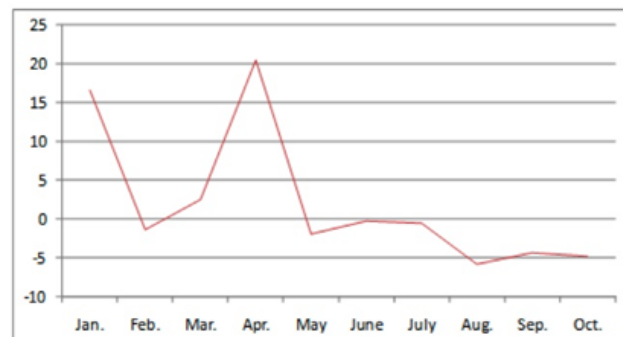
From May through October inclusive, Social Security's outgoing payments have exceeded incoming program revenue, generated mostly by the payroll tax (with a smaller amount coming in via the taxation of benefits). When a cash-deficit situation develops during a period that the program is still technically solvent, full benefits continue to be paid. The operational deficit is effectively made up with general revenues, putting additional strain on a sagging federal budget.

The primary reason for the early arrival of Social Security's deficits is the recession, which is depressing payroll tax revenue. The drop in employment, and its corollary effect on payroll taxes, is coinciding with a long-anticipated surge in benefit claims as the Baby Boomers begin to hit the retirement rolls. These factors have combined to accelerate Social Security's financial difficulties relative to previous projections.

Social Security's May, 2009, dip into the red can be seen in the following graph.

The January and April spikes in the program's monthly balances seen above are typical seasonal fluctuations, arising from the periodic crediting of benefit tax revenues to Social Security. This can be readily seen by comparing Social Security's 2009 cash flows with those of 2008, as on the graph below.

Social Security: Monthly Cash Balances, 2009
(\$ Billions)



The graph above shows how the recession has caused Social Security's 2009 finances to be persistently weaker than in 2008, with the gap generally growing worse in the latter part of the year as unemployment has risen. From May through October, Social Security's incoming cash revenue has fallen short of payment obligations by a total of \$17.7 billion.

In what might initially seem to be a paradox, the balance in the Social Security Trust Fund has nevertheless risen by nearly \$42 billion over the same period, from \$2.457 trillion to \$2.499 trillion.

The significance of the Trust Fund's continuing rise should not be misunderstood or overstated. The program's ongoing monthly deficits are placing a strain on the federal budget at the present time, despite the increasing balance of the Trust Fund.

The rising debt that the Trust Fund holds can perhaps best be understood by conceptualizing it as being like a mortgage owed by the federal government, albeit an unusual kind of mortgage in which no cash payments are made by the borrower (the federal government) until the lender (Social Security) needs



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money. As long as Social Security's own incoming tax revenue is sufficient to fund its benefit payments, the government is not required make any payments on the mortgage. When Social Security's incoming tax revenue falls short, however, the government needs to produce extra cash and start paying that mortgage off. The mortgage debt will continue to grow, however, as long as the interest on the debt is greater than the monthly cash payments being made.

An individual analogy may help to make this clearer. If an individual homeowner took out a mortgage and then paid only \$1770 on it over six months, when

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the mortgage's interest costs alone over that period were \$5930, then at the end of those six months that person would owe a further \$4160 on the mortgage despite having made several payments. Paying down just a portion of the interest and none of the principal on a mortgage parallels what is happening here. The money obligated to the Social Security Trust Fund continues to rise as the fund accrues interest; but our cash-strapped government now has to deliver additional money to support benefit payments, and has had to do so for half a year.

History shows an extreme unlikelihood that the situation will have turned around when the November figures are available. November is historically a weak month for Social Security operations, posting negative flows in 11 of the past 22 years, despite the fact that the program has consistently run large annual surpluses during that time. Moreover, in the six instances since 1987 that October operations have been in the red, November has followed suit every time. And in none of those previous Octobers

were the deficits as large as in October, 2009; nor was unemployment as high as it is today.

It is too soon to tell whether the half-year of persistent monthly deficits will soon translate into full calendar years of net deficits. If these annual deficits arrive by next year as predicted in the September baseline of the Congressional Budget Office (CBO), this will be significantly sooner than either they or the Social Security Trustees have previously projected. In 2008, CBO predicted that cash surpluses would persist through 2019. The Trustees' projections for the onset of cash deficits have since 1983 ranged from 2012-2021. Like those of other government forecasters, these projections failed to predict the depth of the recent recession.

Contrary to one of the strangely persistent myths of American politics, the Trustees' projections have never been unduly conservative. They have generally been consistent and qualitatively accurate in light of subsequent data, with errors tending to be on the side of being slightly aggressive (meaning optimistic from the perspective of system financing). That Social Security's deficits may be arriving earlier than projected in any previous Trustees' report should at long last put an end to the urban myth of overly-conservative projections.

Seniors will continue to receive their Social Security benefit checks despite Social Security's grim half-year of operating in the red. The early arrival of a half-year of consistent monthly deficits, however, should serve as a wake-up call that like other forms of retirement income, Social Security finances are being hit hard by the recession. The necessity of repairs to the program's financial outlook is growing more urgent than previously supposed.