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Busting the myth of Social Security insolvency

Year after year in its annual reports, the Social Security Board of Trustees has been forecasting that the Social Security trust fund is on track to be depleted in the 2030s. More recently, rumors predicting the impending demise of the Social Security system have gotten louder. As a result, some Americans now believe that benefit payments will end abruptly in about seven years.

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The truth is that Social Security is not going away. The system will, however, need some big changes that could include cuts to benefits. If you've paid into Social Security your whole working life (and want to get back as much as you can), here's what you need to know about how the system works, what led to the current financial condition and what changes have been proposed

CASH IN, CASH OUT

Unlike most government programs, Social Security is self-funded. It takes in revenues from dedicated sources and uses those funds to make payments to beneficiaries. One advantage of that self-funded structure is that the system doesn't depend on Congress to authorize funding every year. But it also doesn't have access to any other federal funds. If revenues collected in any given year exceed benefit payments, the surplus is retained in the Social Security trust fund. On the other hand, if benefit payments exceed revenues collected, it can't borrow from the government's general revenue coffers. Any shortfall that can't be covered by the trust fund can't be paid.

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

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1980s: FENDING OFF THE FIRST DEFICIT

Every year, the Social Security Board of Trustees releases a report that presents the current financial condition of Social Security and that includes projections for the following 75 years. In the early 1980s, the trustees forecasted that the system soon would face annual deficits, and that, barring changes to address them, benefits would be cut. At the time, the system took in revenues only from payroll taxes.

In response, Congress passed legislation that made sweeping changes to the system, including raising the payroll tax rate, gradually increasing the full retirement age and establishing an additional revenue source: an income tax on benefits paid. Because those changes led to annual surpluses in subsequent years, they also allowed for a third reliable revenue source: interest on assets in the Social Security trust fund. As a result of all the changes, the balance in the Social Security trust fund climbed to nearly $3 trillion by the end of 2020.

1990s: HIGHLIGHTING THE FLAW IN THE FIX

The large-scale changes made in the 80s were intended to make the Social Security system sustainable for the long term. However, some years later the trustees again began warning Congress that the long-term stability of Social Security was in jeopardy. Why? The intended fix was based on some incorrect assumptions, including that wages would grow relatively evenly across income levels and that the decline in U.S. fertility rate would level off at 2.0 children per woman.

Most wage growth since the 1980s has been concentrated at the higher end of the spectrum, which matters because there's a cap on the total amount of income subject to Social Security tax each year. The higher someone's income, the greater the proportion of it that is above the cap. In the early 1980s, about 90% of all wages were subject to the payroll tax; today that's closer to 83%.

Additionally, the fertility rate did not stabilize at 2.0, but continued to fall due to a range of demographic trends and in particular after the Great Recession. The rate is currently around 1.6.

2020s: REACHING A TIPPING POINT

The system reached a tipping point in 2021. That year, benefit payments exceeded revenues for the first time since the early 1980s and the system began drawing down trust fund assets to make up the difference. Although it had been predicted for decades, the drawdown made the headlines and arguably started the rumors that Social Security was going to end.

Many possible solutions have been proposed (see table on next page) to try to address the mismatch, but in contrast to the sweeping reforms of the early 80s, Congress has not implemented any largescale changes that would fix the math.

BIG CHANGES SEEM INEVITABLE

Because the Social Security system is self-funded, regardless of what happens to the trust fund, we can expect Social Security to continue to collect revenues, and thus be able to make benefit payments. That means the system is not heading toward a cliff, where all checks suddenly stop, but that significant changes – including potential benefit cuts – are likely.

According to the trustee's 2026 report, the Social Security Old-Age & Survivors Insurance (OASI) trust fund will be depleted in the fourth quarter of 2032 and revenues will cover only about 78% of projected benefit obligations. This depletion date is one calendar quarter earlier than the 2025 report and a full year earlier than the 2024 report. That means we could see cuts of up to 22% across the board for all beneficiaries.

The primary drivers of this year's change are:

- Lower assumptions for long-term fertility, from 1.9 to 1.75 children per woman
- Lower assumptions for actual and future net immigration
- Lower tax revenues due to the One Big Beautiful Bill Act

In contrast, last year's changes to trust fund expectations were driven primarily by the passage of the Social Security Fairness Act, which increased benefit payments to a small segment of the population.

THE TAKEAWAY FOR COLLECTION DECISIONS

If you're nearing retirement, and you buy into the myth that Social Security is going away, you may be tempted to start collecting benefits early – even though that means you collect a reduced amount – with the goal of collecting as much as you can while the system is still viable.

Social Security checks are not going to stop. So if benefit payments are cut at some point in the future, you still likely won't be better off if you took the lower benefit payments starting from a younger age. Because every situation is unique, it's best to speak to a financial professional before deciding when to start collecting benefits.

Proposals by the numbers

A number of ideas have been put forth that would cover some portion of the projected shortfall. The below table lists the most noteworthy of these.

PROPOSAL	% COVERED*
Expenses	
Change benefit formula to keep pace with inflation in prices rather than wages	74%
Reduce cost-of-living adjustment (COLA) by 1%	51%
Increase full retirement age (FRA) to 70 by 2037 and slightly each year thereafter. Increase minimum age to 64 by 2033.	44%
Give less favorable COLA treatment to higher income earners	37%
Change benefit formula to reduce amount given to higher earners	27%
Increase FRA to 69 and minimum age to 64 by 2032	24%
Revenues	
Increase payroll tax from 12.4% to 16.0%	102%
Remove payroll tax caps	67%
Remove payroll tax cap and give employees credit for payments above the cap	49%
Increase payroll tax by 0.1% each year until 2052	47%
Remove payroll tax cap for employers, raise payroll cap for employees to reach 90% of all wages	41%
Impose a 12.4% tax on investment income as defined in the Affordable Care Act (ACA)	35%
Phase out payroll tax exclusion of employer-sponsored group health insurance premiums	28%

*The percentage of the shortfall in the long-range actuarial balance that the proposal eliminates using assumptions included in the 2025 annual report.
See full analysis at ssa.gov/OACT/solvency/provisions

All the items in the table above refer to changes that would require Congressional action and can't be implemented through executive actions alone, whether executive orders or department recommendations. Keep in mind that executive actions can, however, impact how many people work at the Social Security Administration, what they work on and the systems they use to do their work. Any large-scale changes could lead to unintended consequences, including potential mistakes. If you are already collecting benefits, carefully review your payment amounts for any erroneous changes. If you are not yet collecting, periodically review your Social Security account at SSA.gov, including your earnings history, to identify and correct any errors.

Please consult your financial professional for more information. For financial professionals, please contact Nuveen at 800-221-9271. Visit us at Nuveen.com

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Endnotes

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