Recession hits Social Security hard

Geithner unveils report on entitlement programs. Social Security trust fund may be exhausted 4 years sooner than earlier forecast. Medicare is much worse off.

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NEW YORK (CNNMoney.com) -- The recession has taken its toll on Social Security. The officials who oversee the program forecast Tuesday that the Social Security trust fund will be exhausted by 2037 -- four years earlier than estimated last year.

The trust fund reflects a $2.4 trillion surplus paid into Social Security over 20 years that Uncle Sam has borrowed, spent and promised to pay back. Trust fund exhaustion represents the point at which only 76% of benefits could be paid out.

The main reason for the change in forecast: Demand for benefits has grown while money paid in has fallen because of growing unemployment and new tax breaks in the economic stimulus package passed in February.

Since the start of 2008, 5.7 million payroll tax jobs have disappeared. And another 4.3 million jobs are being filled on a part-time basis.

In the nearer term, the trustees estimate that Social Security will take in fewer taxes than the benefits that will be paid out by 2016. Last year, they estimated the near-term shortfall would occur in 2017.

Those who describe Social Security's situation as a crisis point to the 2016 date as the most important, because that's when the government has to start paying the system back with interest.

"When Social Security needs to draw down the 'surplus,' the Treasury will have to borrow money, raise taxes or cut other spending in order to redeem the IOUs," said Charles Konigsberg, a federal budget expert at deficit watchdog group the Concord Coalition.

Others, however, say that benefits can be paid out in full for the next few decades, and that the Social Security surplus has helped the government avoid borrowing more than $2 trillion over the past 20 years.

Regardless, everyone agrees it will be easier to address the long-term solvency problems sooner rather than later. In the meantime, there is no threat to current and soon-to-be retirees' benefits.

"Despite projections that Social Security can continue to pay full benefits for nearly 30 years, the sooner action is taken the more options for reform will be available and the fairer reforms will be to our children and grandchildren," said Treasury Secretary Timothy Geithner, a managing trustee of the program.

Social Security benefits represented 4.4% of gross domestic product in 2008, but that share is projected to rise to 6.2% in 2034.

One way to understand the extent of Social Security's shortfalls is to consider how much more payroll tax would be needed today for the system to achieve actuarial balance over 75 years. The trustees estimate the current 12.4% payroll tax on the first $106,800 of a worker's wages would need to be raised to 14.4%. Or it could be done by reducing benefits by 13%.

But no one is suggesting such abrupt changes be made. Rather, a combination of measures phased-in over time is the path lawmakers are considering.

One of the factors causing the long-term shortfall: Americans are living longer. That's why the American Academy of Actuaries is advocating that lawmakers gradually increase the age at which a person can start collecting full Social Security benefits.

And during the 2005 Social Security reform debate, the notion of progressive indexing gained some political traction. Progressive indexing means that benefits of future high-income retirees would be indexed to inflation rather than to wages, as is currently the case. That would have the effect of reducing benefits from their current promised levels because inflation tends to grow more slowly than wages.

Medicare: No easy solutions

The recession also hit Medicare, which is in far worse shape than Social Security.

The Medicare hospital insurance trust fund - which funds Part A of Medicare - is forecast to be tapped out by 2017, or 2 years earlier than the trustees' estimate last year. At that point the system would only be taking in enough in payroll taxes to pay 81% of hospital insurance costs.

The trustees characterized the exhaustion date as "an urgent concern." They said congressional action will be needed to "ensure uninterrupted" benefits.

Starting last year, the fund -- which covers hospital stays and related care -- had already begun taking in less than the system paid out in benefits.

Last year, Medicare's costs were equal to 3.2% of GDP. But they're projected to soar to 11.4% by 2083. The trustees estimate that the 2.9% of worker's wages dedicated to Medicare today would have to rise to 6.78%. Or Medicare's outlays would need to be reduced by 53%.

Kathleen Sebelius, Health and Human Services Secretary and a trustee, said financial stability for Medicare is ultimately tied to health care reform.

"We know that success ... depends on our ability to fix what's broken with the rest of the system," she said at a briefing, noting that when an uninsured person goes on Medicare, the costs to care for that person are higher than for someone who has had health insurance throughout his adult life.

Fixing Medicare "is more of a process," said Cori Uccello, the senior health fellow for the American Academy of Actuaries. She noted that the burden will likely need to be shared by taxpayers, those in the health industry and Medicare beneficiaries alike.

Part of that burden will be relieved once the growth of health care costs is slowed. But, Uccello said, "[That] is not going to happen overnight. It will take many years to see results." ■

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