



TESTIMONY

Social Security's Finances

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Chairman Graham, Ranking Member Merkley, and Members of the Committee, thank you for the opportunity to testify today.

The Congressional Budget Office projects that the trust fund for Social Security's Old-Age and Survivors Insurance (OASI) program will be exhausted in 2032. At that time, benefits provided to retired workers, their eligible dependents, and some survivors of deceased workers will be reduced under current law. In this testimony, I will provide some context about the program's finances, explain the payable-benefits scenario for trust fund exhaustion that CBO evaluated, provide results under that scenario, and discuss the uncertainty of the projections.

Context

Social Security is financed by payroll taxes and income taxes on benefits. Revenues from those taxes are credited to the OASI trust fund, as well as to the Disability Insurance (DI) trust fund, which is legally separate. The payroll tax, which accounts for 96 percent of Social Security's revenues, is generally 12.4 percent of a person's earnings up to a maximum annual amount (\$184,500 in 2026). Employees and their employers each pay half of the tax; self-employed people pay the entire amount. In addition, up to 85 percent of recipients' benefits are subject to income tax, depending on their overall income. CBO estimates that 48 percent of Social Security beneficiaries will pay income tax on their benefits in 2026. Besides tax revenues, the OASI and DI trust funds receive intragovernmental interest payments on the Treasury securities they hold.

As required by law, CBO's baseline projections reflect the assumption that Social Security will pay benefits as scheduled under current law regardless of the status of the program's trust funds.¹

Relative to the size of the economy, spending for Social Security is projected to rise from 5.2 percent of gross domestic product (GDP) in 2026 to 6.0 percent of GDP

in 2056 if benefits are paid as scheduled. Most of that projected increase occurs over the next decade, as members of the baby-boom generation retire. Nevertheless, outlays for Social Security continue to grow as a percentage of GDP, albeit slowly, through 2056 because of projected increases in life expectancy.

Unlike outlays, revenues for Social Security are projected to change little in relation to GDP over the next 30 years, remaining close to their average of 4.5 percent of GDP from 2026 to 2056. In CBO's projections, a slight decline in payroll tax revenues, measured in relation to the size of the economy, is offset by a slight increase in revenues from income taxes on Social Security benefits, leaving total revenues for the program fairly stable during that period, a trend that would continue after 2056. Payroll taxes decrease slightly relative to GDP because earnings grow more quickly for higher earners than for lower earners, causing the amount of earnings below the maximum taxable amount to decline as a percentage of GDP over the next three decades. Revenues from income taxes on Social Security benefits increase slightly as a percentage of GDP because the structure of the individual income tax means that, over time, the percentage of benefits that are taxed increases, as does the average tax rate they are subject to.

In those baseline projections, the balance of the OASI trust fund is exhausted (that is, reaches zero) in fiscal year 2032. (All years discussed in this testimony are federal fiscal years.) At that time, the program would have insufficient funds to pay, on a timely basis, the full amounts that OASI beneficiaries are entitled to under current law.² The DI trust fund remains solvent for the next 30 years. If their balances were combined, the Old-Age, Survivors, and Disability Insurance (OASDI) trust funds would be exhausted in 2033.

Limiting Social Security Benefits to Payable Amounts

In the illustrative scenario examined in this testimony, retirement and survivors' benefits would be limited to the amounts payable from dedicated funding sources

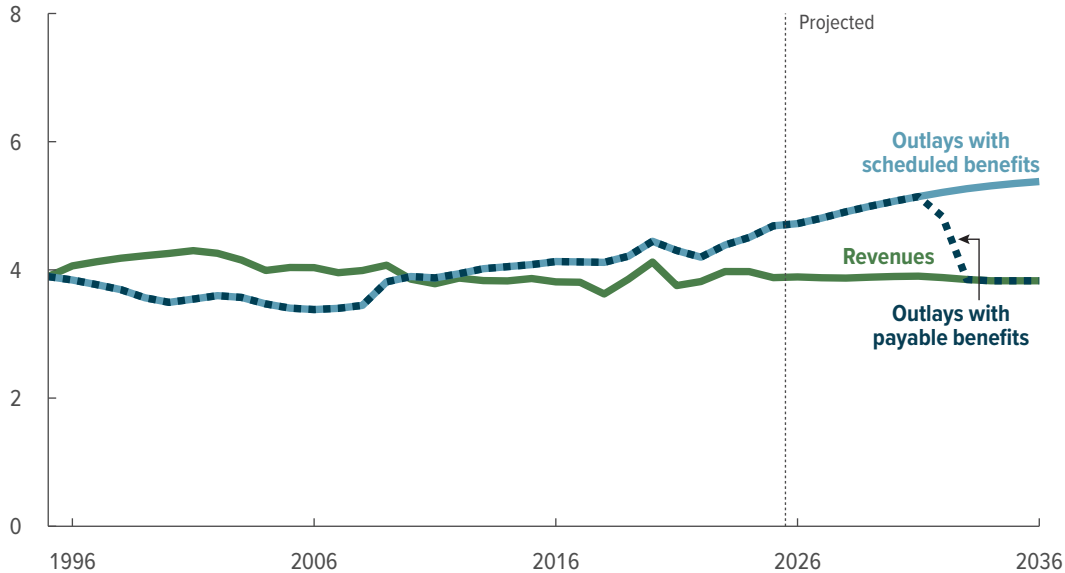
1. Provisions in section 257 of the Deficit Control Act require CBO to project spending for certain programs, including Social Security, under the assumption that they will be fully funded and thus able to make all scheduled payments, even if the trust funds associated with those programs do not have sufficient resources to make full payments. See sec. 257(b)(1) of the Balanced Budget and Emergency Deficit Control Act of 1985, Public Law 99-177 (codified at 2 U.S.C. § 907(b)(1)).

2. The balances of the trust funds represent the total amount that the government is legally authorized to spend. For details about legal issues related to exhaustion of a trust fund, see Barry F. Huston, *Social Security: What Would Happen If the Trust Funds Ran Out?* Report for Congress RL33514, version 34 (Congressional Research Service, September 28, 2022), www.congress.gov/crs-product/RL33514.

Figure 1.

Revenues and Outlays for the Old-Age and Survivors Insurance Program, With Scheduled and Payable Benefits

Percentage of GDP



Without legislative action, the balance of the OASI trust fund is projected to be exhausted in 2032. Before accounting for economic effects, CBO projects that outlays for OASI would total 3.8 percent of GDP in 2036 if benefit payments were limited to the program's annual income after the fund's exhaustion. Outlays would total 5.4 percent of GDP in 2036 if the program paid the full benefits scheduled under current law.

Data source: Congressional Budget Office. See www.cbo.gov/publication/61882#data.

OASI = Old-Age and Survivors Insurance.

beginning in 2032, the year of the OASI trust fund's exhaustion. To project the effects of that change, CBO estimated the total reduction in Social Security benefits that would be necessary for the program's outlays to match its revenues in each year from 2032 to 2036. Before accounting for economic effects, CBO estimates that the reduction would amount to \$2.7 trillion over the 2032–2036 period.³ That amount reflects an average reduction in benefits of 28 percent per year in the years after the exhaustion of the OASI trust fund's balance (see Figure 1).⁴

For simplicity, this illustrative scenario incorporates the assumption that once the OASI trust fund was exhausted, OASI benefits paid to all existing and new beneficiaries would be reduced by those percentages. That is, benefits paid to all beneficiaries would be

reduced by 7 percent in 2032 and by an average of 28 percent per year from 2033 to 2036. The method for reducing payments is not prescribed in current law, and different methods would have different effects on beneficiaries, the economy, and the budget. In addition, in this scenario, the reduction in benefits would not be announced until the beginning of 2032, and people would not adjust their work and saving behavior before the announcement. Differences in that timing would lead to different macroeconomic effects (that is, effects that result from changes in the economy).

This testimony presents estimates of the budgetary and economic effects of a reduction in OASI benefits paid through 2036 and discusses the longer-run effects qualitatively.

Outcomes Under the Payable-Benefits Scenario

CBO estimates that limiting OASI benefits to the amounts payable once the trust fund was exhausted would make budget deficits and debt significantly smaller than they are in the agency's baseline projections. Limiting benefits to payable amounts would also affect the economy in several ways.

3. In this illustrative scenario, reduced collections of taxes on OASI benefits increase the shortfall by \$129 billion over the 2032–2036 period.

4. CBO's baseline projections implicitly incorporate transfer payments from the Treasury's general fund to the OASI trust fund to cover any shortfall. In the current baseline, that shortfall and, therefore, those payments total \$2.7 trillion over the 2032–2036 period.

Budgetary Effects

The primary deficit (which excludes net outlays for interest) would be smaller in the payable-benefits scenario than it is in CBO's baseline projections. For example, accounting for economic effects, CBO estimates that in 2036, the primary deficit would be \$0.3 trillion instead of \$1.0 trillion—a reduction of \$0.7 trillion. The associated reduction in net outlays for interest would reduce the total deficit in 2036 by an additional \$0.2 trillion (for a net reduction of \$0.9 trillion), bringing the total deficit to \$2.2 trillion from \$3.1 trillion. Federal debt held by the public would be \$52.8 trillion in 2036, rather than \$56.2 trillion. Measured as a percentage of GDP, such debt would be 8.1 percentage points lower in 2036—equaling 112 percent rather than 120 percent of GDP.

For simplicity, CBO's analysis of this illustrative scenario does not include changes in federal spending that would result from greater participation in other benefit programs. For example, smaller OASI benefits would give some people an incentive to apply for Disability Insurance, and other beneficiaries would become newly eligible for, or would qualify for larger benefits from, means-tested transfer programs such as Supplemental Security Income and the Supplemental Nutrition Assistance Program.

Economic Effects

Initially, a decrease in demand for goods and services resulting from the reduction in OASI benefits would cause GDP to decline. Over time, though, that initial reduction in demand would be more than offset by the effects of increased work and savings and reduced federal borrowing, causing GDP to rise. Those changes would affect different groups of people to varying degrees.

Short-Term Economic Effects. Initially, the reduction in Social Security payments would cause consumer spending to decrease by dampening the overall demand for goods and services. The resulting reduction in real GDP (that is, the nation's economic output adjusted to remove the effects of changes in prices) would coincide with an increase in the unemployment rate and a reduction in the rate of inflation. In CBO's view, the Federal Reserve would respond to those effects by lowering interest rates as part of its dual mandate to pursue maximum employment and price stability.

The Federal Reserve's actions would offset some of the decline in the demand for goods and services brought on by the reduction in Social Security payments.

Additionally, the reduction in payments would cause savings and the supply of labor to increase. On net, real GDP in 2033—the year after the OASI trust fund's exhaustion—would be 0.7 percent lower than it is in CBO's baseline projections. In later years, real GDP would be greater than projected in the baseline.

The reduction in debt as a percentage of GDP and the increase in the saving rate would further reduce interest rates, though the increase in the labor supply would partly offset those effects by raising the rate of return on capital. On net, the interest rate on 10-year Treasury notes in 2033 would be 0.4 percentage points lower in the payable-benefits scenario than in the baseline projections, in CBO's estimation.

Long-Term Economic Effects. In 2036, output would be 1.0 percent greater than it is in CBO's baseline projections, for three main reasons. First, the labor supply would expand as some people worked more or stayed in the labor force longer to make up for smaller benefits. Second, an increase in private investment would follow a rise in private savings as some workers saved more while working to offset the effect of smaller benefits on their income and spending in retirement. Third, smaller budget deficits would reduce interest rates, increase the amount of funds available for private investment, and boost output. Effects after 2036 are outside the projection period covered in this testimony.

In CBO's assessment, increases in private investment and the capital stock would cause output and average wages to be higher and interest rates to be lower over the long term in the payable-benefits scenario than they are in the baseline projections.⁵ The larger labor supply would put downward pressure on wages, partly offsetting that wage growth, and would amplify the increase in output and the decline in interest rates.

Distributional Effects. People would be affected differently by the reduction in OASI benefits, depending on their wealth, employment status, income, and age. Beneficiaries who relied on Social Security for much, if not all, of their monthly income would immediately reduce their spending. Beneficiaries with wealth also would reduce their spending, on average, but by smaller

5. The capital stock is the stock of long-lasting assets used to produce goods and services. It includes tangible assets (such as computers and transportation equipment) as well as intangible assets (such as software and patents).

proportions, slowing the rate at which they drew down that wealth to make their resources last longer.

The reduction in benefits also would affect people's decisions about work, and those effects would differ depending on their employment status. Some Social Security beneficiaries, particularly those who stopped working relatively recently, might return to work to supplement their income. And some workers, especially older workers, would choose to work more hours and might delay claiming Social Security to boost their income and savings.

On average, people would increase the amount they worked over their lifetime, but those effects would vary with income. The increases would be larger, in percentage terms, for people with lower income than for those with higher income.

The reduction in Social Security benefits and the associated effects on the economy would generally decrease income and wealth for older people. At older ages, people would have less time to adjust their work and saving behavior and less time to benefit from the eventual increase in the size of the economy. Conversely, the effects of the reduction in benefits would generally increase income and wealth for younger people, who would have more time to change their behavior and to benefit from the eventual increase in the size of the economy and higher wages. That boost in wealth and income would be largest, in percentage terms, for younger people with higher income.

How CBO Projected Those Outcomes

In this illustrative scenario, the reduction in benefits is unexpected and, as a result, workers do not adjust their decisions about work or saving beforehand. Therefore, projections for the payable-benefits scenario do not differ from CBO's baseline projections until 2032, when the reduction in benefits would begin. From 2032 onward, benefits would be reduced to the amounts payable from dedicated funding sources, and people would alter their behavior to reflect the expectation that their Social Security benefits would be adjusted as the available funding for those benefits changed over time. For simplicity, this scenario does not incorporate changes in participation in other federal programs, including means-tested transfer programs.

CBO used a suite of models to analyze the macroeconomic effects of the reduction in Social Security

benefits.⁶ Although CBO has not analyzed every way in which the payable-benefits scenario would affect the economy, the agency analyzed four key channels:

- The reduction in benefits would decrease retirees' income, dampening the overall demand for goods and services and causing output to be lower than it otherwise would have been.
- The reduction in benefits would cause some people to work more or stay in the labor force longer than they would have otherwise. Both factors would cause the labor supply, and thus the economy's output, to be greater than it otherwise would have been.
- In CBO's assessment, some workers who had not yet retired would respond to the prospect of smaller benefit payments by boosting their saving and reducing their spending.⁷ Those changes would lessen the effect that smaller benefit payments in the future would have on people's future income and spending. The increase in savings also would boost the capital stock and GDP.
- Federal debt would be less than it is in the baseline projections. As a result, more money would be available for private investment in capital goods and services, the stock of private capital would grow, and output would expand.

Uncertainty of CBO's Projections

The budgetary and economic effects of the policies underlying the payable-benefits scenario are highly uncertain. That uncertainty has three main sources: uncertainty about how much people might anticipate benefit reductions and how those expectations would affect budgetary and economic outcomes, uncertainty about how reductions in Social Security benefits would

6. For information about those models, see Congressional Budget Office, "CBO's Policy Growth Model" (April 2021), www.cbo.gov/publication/57017, and "An Overview of CBO's Life-Cycle Growth Model" (February 2019), www.cbo.gov/publication/54985; Nathaniel Frenzt and others, *A Simplified Model of How Macroeconomic Changes Affect the Federal Budget*, Working Paper 2020-01 (Congressional Budget Office, January 2020), www.cbo.gov/publication/55884; and Felix Reichling and Charles Whalen, *Assessing the Short-Term Effects on Output of Changes in Federal Fiscal Policies*, Working Paper 2012-08 (Congressional Budget Office, May 2012), www.cbo.gov/publication/43278.

7. In this analysis, CBO did not address the potential effects of households' moving their savings into or out of tax-deferred or taxable savings accounts.

affect the budget and the economy, and uncertainty about future economic conditions.

In this scenario, the reduction in benefits is not announced until the beginning of 2032, and people do not adjust their work and saving behavior beforehand. If people anticipated the change in benefits earlier, they would adjust their behavior earlier, which would alter the macroeconomic effects of the benefit reduction.⁸ In addition, the budgetary and economic effects of the reduction in benefits would depend on what specific actions the Social Security Administration took if a trust fund was insolvent and on

8. Evidence suggests that some people expect Social Security benefits to be reduced from the amounts scheduled under current law. See Emily Ekins and Hunter Johnson, *New Poll: Most Americans Expect Social Security Benefit Cuts; a Third Believe the Program Won't Exist When They Retire* (Cato Institute, December 2025), <https://tinyurl.com/cato-survey>; and Erzo F. P. Luttmer and Andrew A. Samwick, "The Welfare Cost of Perceived Policy Uncertainty: Evidence From Social Security," *American Economic Review*, vol. 108, no. 2 (February 2018), pp. 275–307, <http://doi.org/10.1257/aer.20151703>.

what economic effects any specific reduction in benefits would have. If those factors or others differed from the assumptions underlying CBO's projections, budgetary and economic outcomes would differ, too.

This testimony is largely based on Appendix C of *The Budget and Economic Outlook: 2026 to 2036*. Xinzhe Cheng, Kyoung Mook Lim, Noah Meyerson, and Delaney Smith conducted the analysis for this testimony with guidance from Molly Dahl, Elizabeth Cove Delisle, Devrim Demirel, Jaeger Nelson, Sam Papenfuss, and Julie Topoleski. Nicholas Johnson fact-checked the testimony. In keeping with the Congressional Budget Office's mandate to provide objective, impartial analysis, this testimony makes no recommendations. Jeffrey Kling reviewed the testimony, Christine Bogusz edited it, and R. L. Rebach prepared it for publication. The testimony is available at www.cbo.gov/publication/62217.

