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REPUBLICAN STAFF COMMENTARY

Social Security Surpluses: Fiscal Fact or Accounting Fiction?

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Highlight

By 2036, Social Security's annual cash-flow deficits could increase the federal debt held by the public by more than $12 trillion and the annual interest payments to the public by more than $600 billion.

Social Security is probably the most widely discussed, but least understood, government program. Confusion is pervasive even among policymakers. In a recent letter to President Obama, a group of self-described experts claimed Social Security cannot run deficits and does not contribute to the federal budget deficit.[1] But contrary to such claims, the latest Social Security Trustees' report shows Social Security will run annual cash-flow deficits until 2036.[2] These deficits, which began in 2009, could add trillions to the federal debt held by the public and hundreds of billions in annual interest costs. How could the experts be so wrong? This commentary explains the arcane budgetary treatment of Social Security and addresses some of the most common trust fund fallacies.

IS SOCIAL SECURITY PART OF THE FEDERAL BUDGET?

Social Security is a government program that provides monthly cash benefits to retired or disabled workers – as well as their spouses, dependents, and survivors. These benefits are funded primarily by a payroll tax imposed on wages and net earnings from self-employment.

Social Security has its own "trust fund;"[3] Social Security receipts and outlays are labeled "off-budget;"[4] and the Social Security Administration is an "Independent Agency."[5] Despite all of these special features, Social Security is still a government program. When Social Security has a cash-flow surplus, Social Security taxes are available to pay for other programs. When Social Security has a cash-flow deficit, the government must collect other non-Social Security taxes or borrow from the public to pay for Social Security benefits.[6]

To understand how Social Security affects the federal budget, it is necessary to distinguish between cash transactions with the public and non-cash transactions within the government.

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[1] Letter to President Obama signed by 276 academics, economists, and other individuals, April 12, 2011. http://strengthensocialsecurity.org/letter-of-experts-opposed-to-cuts-in-social-security-benefits.
[2] Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds, May 2011. http://www.ssa.gov/oact/TR/2011/index.html.
[3] Social Security Amendments of 1939 (Public Law 76-379).
[4] Social Security Amendments of 1983 (Public Law 98-21). Social Security's administrative costs are labeled "on-budget."
[5] Social Security Independence and Program Improvements Act of 1994 (Public Law 103-296).
[6] Social Security is part of the "unified" federal budget, which is the focus of most policymakers. Its "off-budget" status affects how it is recorded in the budget, not how it affects the government's cash-flow.

WHAT IS THE SOCIAL SECURITY TRUST FUND?

The Social Security trust fund is a government account maintained by the U.S. Treasury.[7] The trust fund neither receives payments from taxpayers nor makes payments to beneficiaries. It is simply an accounting device used to record transactions made on behalf of Social Security by the government.

When individuals pay Social Security payroll taxes, the money goes into the general fund of the Treasury along with all of the other taxes collected by the government. When individuals receive Social Security benefits, the money comes out of the general fund of the Treasury just like any other government expenditure.

The government records these transactions by increasing or decreasing the balance in the trust fund. The balance is comprised of federal debt, or more precisely, special issue non-marketable U.S. government debt securities.[8] When payroll taxes exceed benefits, Social Security is said to "invest" its surplus in these securities and the balance goes up. Conversely, when benefits exceed payroll taxes, Social Security is said to "redeem" its investments in these securities to cover the deficit and the balance goes down.

When people talk about the "trillions" in the trust fund, they are knowingly or unknowingly referring to the balance of unredeemed non-marketable U.S. government debt securities, not a pile of unspent cash.

WHAT PURPOSE DOES THE TRUST FUND SERVE?

The securities held by the trust fund technically create budget authority. As long as there is a positive balance in the trust fund, the Treasury has the legal authority to pay benefits.

There is a statutory limit on the total amount of debt that can be issued by the federal government.[9] This limit applies to debt held by the public as well as debt held by government programs like Social Security.[10] When Social Security is running a deficit, the Treasury can redeem the securities held by the trust fund and sell a corresponding amount of marketable U.S. government debt securities (i.e. Treasury bills, notes, bonds, and TIPS) to the public, thereby raising the money needed to pay benefits without increasing the total amount of debt subject to limit.[11]

Once the trust fund balance is exhausted in 2036, the Treasury will no longer be able to pay benefits in full or on time. This does not mean benefits will not be paid. Payroll taxes will continue to be collected. The program will operate on a cash-flow basis, paying benefits in proportion to payroll taxes. Although current law does not specify whether benefits would be reduced or delayed, when the trust fund was nearly exhausted in the early

[7] Social Security has two separate accounts, the Old-Age and Survivors Insurance (OASI) Trust Fund and Disability Insurance (DI) Trust Fund. This commentary discusses them on a combined basis.

[8] Public Law 103-296 requires the U.S. Treasury to print paper securities that are kept in a locked filing cabinet in Parkersburg, West Virginia. See photo at http://www.socialsecurity.gov/history/gwbushstmts5b.html#04052005.

[9] The current statutory debt limit is $14.294 trillion, which Congress is expected to increase later this year.

[10] The amount of federal debt held by the public is determined by the government's cash-flow. When total spending exceeds total taxes, the government has a budget deficit. To finance this deficit, the government borrows from the public by selling Treasury debt securities. The relationship between annual deficits (or surpluses) and annual changes in publicly held debt is not exactly $1-for-$1 because (1) federal credit programs are recorded in the budget on an accrual basis, and (2) changes in the Treasury's cash balance. The amount of federal debt held by government programs like Social Security primarily reflects non-cash transactions within the government. For more on the topic of "intrabudgetary" transactions, see Congressional Budget Office, Federal Debt and Commitments of Federal Trust Funds, October 2002; and Impact of Trust Fund Programs on Federal Budget Surpluses and Deficits, November 2002. http://www.cbo.gov/publications/bydoctype.cfm?dtype=10.

[11] In 1985, Treasury redeemed a portion of the Social Security trust fund to avoid exceeding the debt limit. Congress has since prohibited its use for debt management purposes. But current law permits the redemption of trust fund debt as needed to pay benefits. See Public Law 104-121.

1980s, the Trustees' said benefits would be delayed. Should Congress fail to take legislative action by 2036, the expected delay will result in roughly nine monthly benefit checks per year, instead of twelve.[12]

How Much Has the Federal Government Borrowed from Social Security?

The Social Security trust fund is credited with four types of income from two different sources. [See the Box below.] They are all equally important from a trust fund perspective. But from a cash-flow perspective, what matters are the taxes collected from the public.

When non-federal workers and beneficiaries pay taxes on their wages and benefits, the government collects money from the public that can be used to pay benefits. When the government makes general revenue transfers or interest payments to Social Security, the government simply credits the trust fund with additional securities. No money is collected from the public.

In some cases, what appears to be money collected from the public is really just bookkeeping. Civilian federal employees hired after 1983 are covered by Social Security; and military personnel have been covered since 1957. The government is responsible for withholding payroll taxes from the wages of its workers as well as paying the employer's matching share. These payroll taxes are recorded in the budget as both receipts and outlays, effectively netting to zero. No money is collected from the public.[13]

	Sources of Income Credited to the Social Security Trust Fund
Cash Transactions with the Public	**Taxes on Wages–** Workers covered by Social Security pay a 12.4% payroll tax on their first $106,800 in annual wages. The maximum taxable amount is increased whenever there is a Social Security cost-of-living adjustment (COLA). The payroll tax is split 50/50 between workers and employers, but the employer's share is ultimately passed on to workers in the form of lower wages. **Taxes on Benefits–** Social Security beneficiaries with income above $25,000 (single) or $32,000 (couple) pay income taxes on as much as 50% of their benefits. These income thresholds are not adjusted for inflation.[14]
Non-Cash Transactions within the Government	**General Revenue Transfers–** Social Security receives credit each year to offset the cost of certain noncontributory benefits. While these credits are typically small, notable exceptions include a $20 billion credit in 1983 to offset the cost of providing noncontributory benefits to members of the U.S. military.[15] Social Security has also received credit for payroll taxes that were *not* collected, including most recently a $105 billion credit in 2011 to offset a temporary payroll tax holiday.[16] **Interest Payments–** The securities held by the Social Security trust fund earn interest at a rate equal to the average rate on all of the outstanding marketable U.S. government debt securities with a maturity of more than four years. These outstanding securities range in maturity from one day to 30 years.

[12] Congressional Research Service, "Social Security: What Would Happen If the Trust Funds Ran Out?" http://aging.senate.gov/crs/ss1.pdf.

[13] Withholding payroll taxes from federal workers means less money is required to pay net wages; it does not mean the government has more money to spend on other things.

[14] Social Security beneficiaries with income above $34,000 (single) and $44,000 (joint) pay income taxes on as much as 85% of their benefits, with the additional 35% credited to the Medicare Hospital Insurance Trust Fund.

[15] Most of the $20 billion was recorded as payroll taxes and interest payments. Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds, April 1984, page 16. http://www.ssa.gov/history/reports/trust/1984/1984.pdf

[16] Public Law 111-312 reduced the payroll tax by two percentage points in 2011.

The Box below shows cumulative trust fund transactions from 1937 through 2010.[17] From a trust fund perspective, the Social Security surplus was $2.61 trillion. From a cash-flow perspective, the Social Security surplus was $0.65 trillion.[18] Thus, the amount borrowed from Social Security is $0.65 trillion, or 25 percent of the total trust fund balance. The difference of $1.96 trillion is just bookkeeping.

Cumulative Social Security Trust Fund Transactions 1937-2010 ($ in Trillions)

	Cash Transactions with the Public	Non-Cash Transactions within the Government	Total
Taxes on Wages: Non-Federal Workers	$12.42	-0-	$12.42
Taxes on Wages: Federal Workers	-0-	$0.46	$0.46
Taxes on Benefits	$0.27	-0-	$0.27
General Revenue	-0-	$0.02	$0.02
Interest Payments	-0-	$1.48	$1.48
TOTAL INCOME	$12.69	$1.96	$14.65
Benefit Payments and Administrative Costs	$12.04	-0-	$12.04
NET BALANCE	$0.65	$1.96	$2.61
Percent of Total	25%	75%	100%

Source: SSA, OMB, and JEC Republican Staff Calculations

HOW MUCH DOES THE FEDERAL GOVERNMENT OWE SOCIAL SECURITY?

The amount owed to Social Security can be analyzed from two perspectives: (1) the amount owed to beneficiaries in terms of scheduled benefits, and (2) the amount owed to the trust fund in terms of securities. Each perspective provides a different but related answer.

Social Security is a defined benefit program, not a defined contribution program. Benefits are determined by a formula unrelated to the balance in the trust fund. Beneficiaries are entitled to their benefits, not a pro rata share of the trust fund. But their entitlement to benefits is limited by the Anti-Deficiency Act which prevents the Treasury from paying benefits without legal authority. As a result, when the trust fund is projected to be exhausted under current law, the amount owed to beneficiaries exceeds the amount owed to the trust fund. Conversely, when the trust fund is projected to remain solvent under some potential reform, the amount owed to the trust fund exceeds the amount owed to beneficiaries.[19]

According to the latest Trustees' report, scheduled benefits will exceed Social Security taxes collected from the public throughout the 75-year projection period. The relative size of the cumulative deficit depends on whether these cash-flows are expressed in nominal values, constant values, or present values.[20] [See the Table at the top of page 5.]

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[17] Payroll taxes were first collected in 1937; monthly benefits were first paid in 1940; and benefits were first subject to the income tax in 1984.

[18] Social Security Administration, OASI and DI Trust Fund Tables, http://www.socialsecurity.gov/OACT/ProgData/funds.html; and Office of Management and Budget, Historical Table 13-1, http://www.gpoaccess.gov/usbudget/fy12/hist.html

[19] The amount owed to beneficiaries and the owed to the trust fund could only be the same in a closed system in which the last surviving beneficiary received her final monthly benefit check that was exactly equal to the remaining balance in the trust fund, leaving a final balance of $0.

[20] Nominal values are expressed in dollars without any adjustment. Constant values are expressed in dollars adjusted by the Trustees' inflation rate. Present values are expressed in dollars adjusted by the Trustees' interest rate.

Cumulative Social Security Cash-Flows 2011-2085 ($ in Trillions)			
	Nominal Value	Constant Value	Present Value
Taxes on Wages: Non-Federal Workers	$399.3	$104.8	$37.2
Taxes on Benefits	$30.3	$7.7	$2.6
TOTAL INCOME	$429.6	$112.5	$39.8
Benefit Payments and Administrative Costs	$571.2	$147.1	$50.5
DEFICIT	$141.6	$34.5	$10.7
Source: SSA and JEC Republican Staff Calculations			

According to the latest Trustees' report, the present value of Social Security's unfunded obligation is $6.5 trillion over the next 75 years.[21] An unfunded obligation from a trust fund perspective simply means an excess of scheduled benefits over trust fund securities. From this perspective, if Congress credited the trust fund with an *additional* $6.5 trillion in securities, the Treasury would have the legal authority to pay scheduled benefits through 2085.[22] But having the authority to pay benefits is not the same thing as having the money to pay benefits.

From a cash-flow perspective, scheduled benefits will exceed the Social Security taxes collected from the public by $10.7 trillion in present value. The difference between the cash-flow deficit and the unfunded obligation is $4.2 trillion. [See the Table below.] This is the amount of general revenue needed to redeem trust fund securities under current law. This claim on general revenue is funded from a trust fund perspective, but unfunded from a cash-flow perspective; whereas the $6.5 trillion unfunded obligation is not funded from either perspective.

Reconciliation Between Unfunded Obligation and Cash-Flow Deficit (Present Value $ in Trillions)			
Unfunded Obligation	Trust Fund Claim on General Revenue under Current Law $4.2 Trillion		Cash-Flow Deficit
	Taxes on Wages: Federal Workers	Current Trust Fund Balance	
$6.5	$1.6	$2.6	$10.7
Source: SSA and JEC Republican Staff Calculations			

How Much Will Social Security Add to the Federal Debt Held by the Public?

Debt held by the public is different from debt held by the Social Security trust fund. Borrowing from the public involves an actual financial transaction in which investors exchange money for U.S. government debt securities. Servicing this debt affects the government's cash-flow through the payment of interest to the public. On the other hand, only 25 percent of the debt held by Social Security reflects taxes collected from the public. Moreover, servicing this debt does not affect the government's cash-flow. Interest accrues to the trust fund in the form of additional securities. No money is collected from the public.

According to the latest Trustees' report, Social Security will run annual cash-flow deficits every year until 2036. To the extent the government borrows from the public to cover these deficits, the federal debt held

[21] 2011 Trustees' report, Table IV.B6.

[22] Assuming the additional securities were issued by January 1, 2011, the trust fund would be exhausted by January 1, 2086.

by the public will increase by more than $12 trillion, and the annual interest payments to the public will increase by more than $600 billion.[23] [See the Appendix on page 8.]

WHY ARE THE EXPERTS WRONG?

The self-described experts mentioned earlier insist Social Security cannot run a deficit and cannot contribute to the federal budget deficit. Their letter to President Obama states the following:

> *"As experts on Social Security, the federal budget or the economy, we write to correct a commonly held misconception – that Social Security somehow contributes to the federal government's deficit. In fact, Social Security's Old Age and Survivors Insurance Trust Fund and its Disability Insurance Trust Fund are prohibited from paying benefits unless those funds have sufficient income and assets to cover the cost, and they have no borrowing authority to acquire the requisite income and assets. Consequently, Social Security is prohibited by law from deficit-spending and thus contributing to the federal deficit."*

This statement is false or misleading in nearly every detail. [See the Charts on page 7.]

Social Security Can Run Deficits: As explained on page 2, the purpose of the trust fund is to provide the Treasury with the legal authority to pay benefits even when there is a Social Security deficit. The Treasury exercises this authority by redeeming the securities in the trust fund. According to the latest Trustees' report, Social Security will run annual cash-flow deficits until the trust fund is exhausted in 2036. Only after the trust fund is exhausted, will Social Security be prohibited from running any more deficits.

Social Security Can Add to the Federal Budget Deficit: When total federal government spending exceeds total federal government taxes, there is a federal budget deficit. When Social Security spending exceeds Social Security taxes, there is a Social Security deficit. Because Social Security is a government program, its deficit adds to the total deficit. This is basic arithmetic.[24]

CONCLUSION

Social Security remains immensely popular among Americans of every age. This popularity is based in large part on the belief that workers contribute to the program and thereby earn the right to receive benefits. The "trillions" in the trust fund serve as a constant reminder of this "intergenerational compact." Unfortunately, widespread confusion over how Social Security affects the federal budget has served to stifle debate about the urgent need for reform.

Many people believe the reason Social Security will go broke is because Congress "raided" the trust fund and spent the money on other things. That's not true. The trust fund will be exhausted in 2036 because that's when all of the money Congress "stole" from Social Security will be fully repaid. The truth is, Social Security is unsustainable in its current form because the amount of benefits paid or scheduled to be paid is greater than the amount of taxes collected or scheduled to be collected.

Until policymakers and the public recognize the Social Security trust fund for what it really is – an unfunded claim on future general revenue – the long-term viability of the program will remain in doubt.

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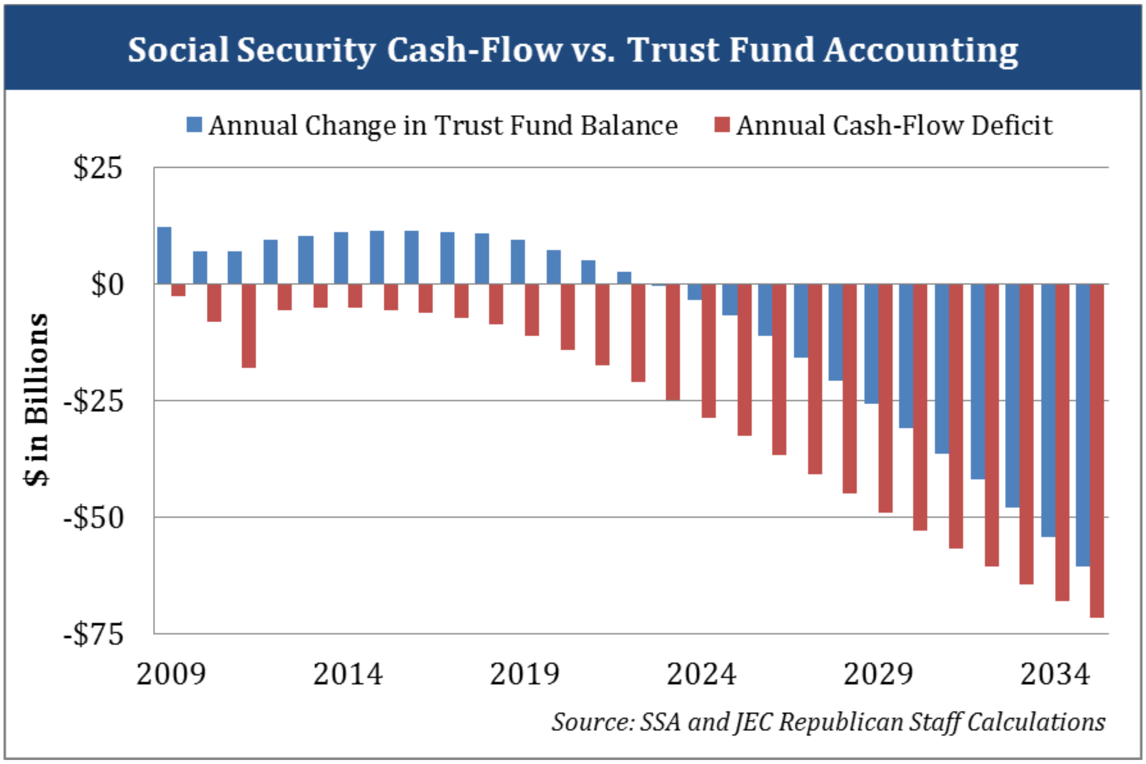
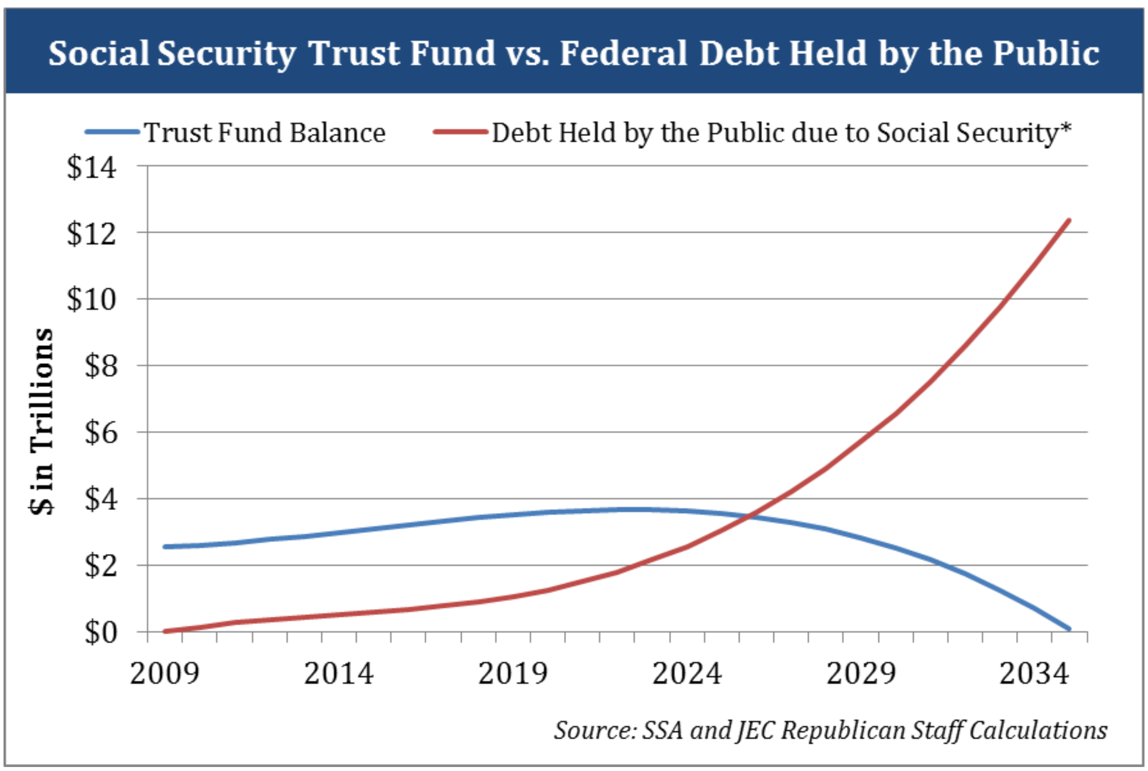
[23] JEC Republican Staff Calculations.

[24] Assume total federal spending = TS, total federal taxes = TT, Social Security spending = SSS, Social Security taxes = SST. If SSS is greater than SST, then TS - TT is always greater than [TS - SSS]-[TT - SST]. The hypothetical question of whether or not other taxes or other spending would have been higher or lower if Social Security did not exist is beyond the scope of this commentary. But the answer to this question would not change the basic arithmetic. For more on this question, see Kent Smetters, Is the Social Security Trust Fund Worth Anything?, NBER Working Paper No. 9845, July 2003. http://www.nber.org/papers/w9845.





**Assuming the federal government borrows from the public to cover Social Security's annual cash-flow deficits.*

Appendix - Social Security Trust Fund and Federal Debt Held by the Public ($ in Billions)

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	Increase due to Social Security Cash-Flow Deficits Column (7)	
Calendar Year	Taxes on the Wages and Benefits of the Public	Taxes on the Wages of Government Workers	General Revenue Transfers	Interest Payments	Benefits and Administrative Costs	Annual Cash-Flow Deficit Column (2) minus Column (6)	Trust Fund Balance at End of Year	Annual Change in Trust Fund Balance	Federal Debt Held by the Public	Interest Payments on Publicly Held Debt
2008							$2,419	n/a		
2009	$660	$29	*	$118	$686	($25)	$2,540	$122	$26	$1
2010	$632	$29	$2	$118	$713	($81)	$2,609	$69	$110	$3
2011	$558	$29	$105	$115	$738	($180)	$2,678	$69	$298	$9
2012	$715	$31	$5	$116	$772	($57)	$2,773	$95	$369	$14
2013	$763	$32	*	$121	$814	($51)	$2,874	$101	$437	$17
2014	$810	$33	*	$127	$861	($51)	$2,984	$109	$508	$20
2015	$855	$35	*	$133	$911	($56)	$3,096	$112	$587	$23
2016	$903	$37	*	$140	$965	($62)	$3,210	$114	$676	$27
2017	$950	$38	*	$147	$1,023	($73)	$3,322	$112	$782	$32
2018	$1,000	$40	*	$156	$1,087	($86)	$3,431	$109	$906	$38
2019	$1,049	$41	*	$165	$1,161	($111)	$3,526	$95	$1,063	$46
2020	$1,098	$43	*	$172	$1,240	($142)	$3,599	$73	$1,260	$55
2021	$1,148	$45	*	$181	$1,324	($176)	$3,649	$50	$1,503	$67
2022	$1,199	$47	*	$189	$1,411	($212)	$3,673	$24	$1,798	$83
2023	$1,253	$49	*	$196	$1,502	($249)	$3,669	($4)	$2,149	$102
2024	$1,309	$51	*	$201	$1,596	($287)	$3,634	($35)	$2,562	$126
2025	$1,368	$54	*	$204	$1,695	($327)	$3,566	($69)	$3,043	$154
2026	$1,429	$56	*	$199	$1,797	($368)	$3,453	($113)	$3,594	$183
2027	$1,494	$59	*	$192	$1,903	($409)	$3,295	($158)	$4,218	$216
2028	$1,562	$61	*	$181	$2,012	($450)	$3,088	($207)	$4,921	$253
2029	$1,633	$64	*	$169	$2,123	($490)	$2,830	($258)	$5,705	$294
2030	$1,707	$67	*	$153	$2,237	($530)	$2,520	($310)	$6,576	$341
2031	$1,786	$70	*	$134	$2,354	($568)	$2,157	($363)	$7,536	$393
2032	$1,869	$73	*	$112	$2,475	($606)	$1,736	($421)	$8,593	$451
2033	$1,955	$77	*	$87	$2,599	($644)	$1,255	($481)	$9,753	$515
2034	$2,044	$80	*	$58	$2,726	($681)	$713	($542)	$11,017	$584
3035	$2,138	$84	*	$26	$2,855	($717)	$106	($607)	$12,392	$658
2036	Trust Fund Exhausted									
*Less than $50 million										

Source: Social Security Administration's Office of the Chief Actuary and JEC Republican Staff Calculations