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THE COMMISSION'S STRAW MAN Social Security well prepared for retirement of baby boomers in 2016

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President Bush's Commission to Strengthen Social Security (CSSS) will meet to discuss its interim report on July 24, 2001. Until this point, the debate around Social Security has almost always focused on the year in which the accumulated trust fund would be depleted, currently projected as 2038. But this latest report from the CSSS attempts to focus shortfall fears on 2016, the first year in which payroll tax revenues supposedly will fail to fully cover all benefits. The Social Security system, which has run a surplus since the early 1980s in order to prepare for the baby boomers' retirement, is well situated to meet the financial demands that lay ahead. The commission's co-chairmen, former Senator Patrick Moynihan and AOL Time Warner Chief Operating Officer Richard Parsons, have said that, "[i]f no changes are made before [2016], the government will either have to raise taxes, cut benefits or other government spending, or add to the public debt" (WSJ 2001). This statement is untrue.

According to the latest annual report of the Social Security trustees, 2016 is the first year in which Social Security will no longer receive more in taxes than it pays out in benefits (SSA 2001). Yet from 2016 to 2024, the Social Security trust fund will actually continue to grow as its assets earn interest. Then, from 2025 to 2038, Social Security will be able to meet its obligations to retired baby boomers by selling its accumulated assets. This is, in fact, why the assets were accumulated in the first place.

By 2038, time will have taken its toll on the ranks of the baby boomers. The oldest members of this generation will be in their 90s, and the youngest will be 75. Their size as a group will be much diminished, and the Social Security trust fund will have done its job. The surpluses built up over the decades from the early 1980s to 2016 (or 2024, if you count the interest earned till then) will have been sufficient to finance the retirement of the entire generation without straining Social Security.

Since the early 1980s, the trust fund has intentionally built up assets to increase the long-term solvency of Social Security. In December 1982, the National Commission on Social Security Reform, also called the Greenspan Commission after its chairman Alan Greenspan, made a set of recommendations that it claimed "would meet about two-thirds of the long-range financial requirements" of the Social Security program (NCSSR 1983). By reducing benefits slightly and by increasing tax revenues, the commission's recommendations helped to build

up Social Security trust funds. The majority of the Greenspan Commission, including then-Senator Patrick Moynihan, fully expected that the trust funds would redeem their assets to finance later cash flow shortfalls.

During the years that excess payroll taxes were accumulating as a surplus in the Social Security trust fund, these funds were loaned to the U.S. Treasury. As a result, the trust fund holds U.S. Treasury securities as its assets. In 2025, the trust fund will begin redeeming those securities. U.S. Treasury securities are the safest financial investments in the world, and it is highly unlikely that the Treasury will default on these obligations. In other words, there is no truth to the myth that Social Security will not be able to finance the retirement of the baby boom generation.

How will the Treasury meet its obligations and redeem the Treasury securities held by the Social Security trust fund when they come due after 2024? This question gives rise to the second myth – that, in order for the Treasury to honor its obligations to Social Security, it will require an increase in taxes, reductions in government expenditures, or increases in government debt. Such claims are also untrue.

According to the most recent long-term forecasts by the Congressional Budget Office (CBO) and by the Office of Management and Budget (OMB), the federal government will run surpluses well into the future.¹ OMB (2000) projects that the federal budget will show a surplus until 2075 if discretionary expenditures grow with inflation, and until 2040 if discretionary spending grows with GDP (which is much faster than it has grown in recent years). CBO's (2000) long-term forecast, which assumes that costs for Medicare and Medicaid will triple as a share of GDP by 2040—which is far more than projected by OMB or by the Health Care Financing Administration (HCFA 2001)—still shows a combined surplus for the federal government beyond 2020. Thus, even under some rather bleak projections with respect to health care costs, the federal government will be able to meet its obligations to Social Security well beyond 2016.

There is always the possibility that projected surpluses will not materialize for the simple reason that long-range forecasts of these sorts are naturally fraught with uncertainty. Even in a worst-case scenario in which the federal government no longer has a surplus when it comes time for Social Security to redeem its Treasury securities, the government will still be able to honor its obligations. Social Security will not face a crisis, and neither will the federal government. Government debt held by the public relative to GDP has been reduced substantially over the last decade, from 50% of GDP in 1993 to just 35% in 2000 (CBO 2001a), far below the 60% debt-to-GDP ratio used by most economists as the cut-off point. And forecasts show the debt-to-GDP ratio dropping further, to 5.3% by 2011, even after enacting the latest round of tax cuts (CBO 2001c). Assuming that the debt held by the public relative to GDP remains at 5% until 2016, it would take until 2040 for the ratio to reach 30% again.² The debt reduction that began in 1993 will provide the government with sufficient leeway to honor its commitment to Social Security to repay the loans from the trust fund and finance the retirement of the baby boom generation.

This modest transfer of funds from the federal government to Social Security as the Treasury securities held by the trust fund are redeemed does not pose a problem for Social Security. These events have been anticipated for some time, and many people, including former Senator Moynihan, have understood that the federal government has an obligation to redeem the securities held by the Social Security trust fund during the several decades when the baby boomers retire. The Social Security trust fund has been lending money to the federal government since 1985. And the federal government will have to make good on those loans when the trust fund needs the money back to pay retirement benefits to an aging baby boomer generation. It would be unthinkable, not to mention unprecedented for the government to renege on an obligation of this kind.

Based on pessimistic assumptions about the future growth of the economy, Social Security is projected to encounter a shortfall after 2038 equal to about one-third of its promised benefit payments. In reality, this shortfall can be covered within the parameters of the current system. One easy way of addressing the projected shortfall would be to remove the existing cap on the wages and salaries subject to payroll tax, which is currently set at \$80,400. Raising—or eliminating—this cap would cover most, if not all, of the anticipated shortfall, and it would make the financing of Social Security more progressive.

Endnotes

1. These forecasts do not take the recent tax cuts into consideration. However, the long-term forecasts are likely to be affected only mildly by tax cuts that are phased out again.
2. This number is based on GDP projections taken from CBO (2000).

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