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## FOR SOCIAL SECURITY, THE CRISIS CONTINUES

### INTRODUCTION

The Social Security system's financing crisis has not been ended. It simply has been camouflaged and postponed. Yet thanks to the 1983 legislation, designed to "rescue" the Social Security system, most lawmakers have convinced themselves that the retirement program now has a rosy long-term future. One commentator has even talked mockingly of a "crisis of riches," anticipating enormous surpluses that will need to be spent. Nothing could be further from the truth. The system is still chronically ill.

The latest official reports reveal that Social Security still faces major financing problems, particularly over the long term. To be sure, on the basis of the Social Security Administration's (SSA) widely cited intermediate assumptions (known as Alternative IIB), the program will start to run significant surpluses by 1990 and continue to do so until about 2005. But in approximately 2015, the program will start running substantial annual deficits, and these will continue indefinitely. By 2026, before today's young workers retire, the program's combined trust funds will be completely exhausted, leaving the program unable to pay promised benefits. Over the 75-year period projected in the SSA assumptions, the entire program will run a cumulative deficit 50 percent greater than the total amount the 1983 legislation raised in new revenues and saved by benefit cuts. Under these projections, paying all the benefits promised to today's young workers would require raising the total Social Security payroll tax rate to 23 percent, from 14.1 percent today.

Those looking for relief from federal deficits can take little comfort from the prospect of Social Security surpluses in the near term. The SSA projects that the program's annual surpluses will make only a small dent in future federal deficits. Since the program's financial projections do not indicate any surplus in the overall,

unified, federal budget, Social Security surpluses do not offer any prospect of a reduction in the national debt, as some have suggested. And by the time today's young workers retire, Social Security alone will be running annual deficits half as large, as a percent of GNP, as today's entire federal deficit.

Moreover under the SSA's supposedly pessimistic projections (Alternative III), significant annual surpluses never even develop. Rather, Social Security's trust funds become completely exhausted by 1998, revealing the program's continuing short-term vulnerability to adverse economic conditions. Paying all promised benefits to today's young workers under these projections would require a total Social Security payroll tax of about 37 percent. By the time today's young workers retire, Social Security alone would be running an annual deficit larger, as a percentage of GNP, than today's entire federal budget deficit.

Under the intermediate assumptions, Social Security tax rate increases now scheduled for 1988 and 1990 could be rescinded in the 1990s without immediately jeopardizing benefit payments. But without more fundamental reform, the program then would be unable to pay promised benefits to the baby boom generation without doubling payroll taxes. Permanent tax cuts in the 1990s could be made possible only by adopting fundamental reforms today.

It is clear that Social Security was not rescued in 1983. The system is still sailing on a crash course toward a financial iceberg. Congress must recognize this and change its course.

## SOCIAL SECURITY FINANCING: HOW IT WORKS

### A Pay-As-You-Go System

Social Security is financed primarily by payroll taxes paid by employers and employees. Payroll tax revenues are deposited in the Social Security trust funds used to pay the program's current beneficiaries. Any surplus of revenues over expenditures is loaned to the federal government in return for specially issued interest-bearing bonds. The federal government spends the borrowed funds on other programs.

The Social Security trust funds hold the bonds until the program's revenues fall short of expenditures, then the bonds are traded back to the government for the cash needed to finance benefits. If the program's revenues and accumulated trust fund bonds ever became insufficient to finance expenditures, then the program would be unable legally to pay promised benefits. It would, in effect, be bankrupt. The federal government then would have to bail out the system.

### Relationship with the Federal Budget

In the comprehensive, unified federal budget, all Social Security payroll taxes paid by employers and workers are counted as federal income. Funds paid into Social Security by the federal government, such as interest on the trust fund bonds and payroll taxes paid by the federal government as an employer, are intragovernmental transfers, counted neither as income nor expenditures for the federal government as a whole. Funds paid out of the Social Security trust funds to retired Americans and for other program benefits or administrative expenses are counted as federal expenditures.

The net impact of Social Security on the unified federal budget in any year is consequently measured by the surplus or deficit in the Social Security accounts for that year (not counting the amounts paid by the federal government itself into Social Security, since these are intragovernmental transfers).

### The Trust Funds and the National Debt

Total Social Security trust fund assets are not a store of funds for future use. The reason is that no money exists in the funds: the cash has already been loaned to the federal government and spent. The trust fund "assets" are no more than claims against the federal government, which will have to be financed out of federal revenues or borrowing when they are needed to finance Social Security benefits.

The total Social Security trust fund balance thus does not in any sense represent an offset to the national debt. The trust funds are merely an internal federal account indicating that one part of the federal government owes money to another part of the federal government. Indeed, trust fund assets will add to the national debt if they ever have to be cashed in to pay promised benefits. The national debt is only reduced when a surplus is run in the entire, unified federal budget.

The only real economic significance of the Social Security trust fund balance is that it indicates the size of the tab that may face future taxpayers in repaying the money borrowed from Social Security to finance other federal programs. As for Social Security itself, the trust fund balance indicates the cash the program can demand from the federal Treasury to pay promised benefits under current law.

### THE FINANCIAL OUTLOOK

Table 1 summarizes the latest financial projections for the program under the SSA's widely cited, intermediate, "Alternative IIB"

**TABLE 1**  
**Social Security Financing**  
**Alternative IIB Assumptions**

	Social Security Expenditures As a Percent of Taxable Payroll	Social Security Unified Budget Annual Surplus or Deficit As a Percent of GNP	Social Security Trust Funds <sup>1/</sup> As a Percent of GNP
1985	13.96%	0.12%	1.44%
1990	14.04%	0.68%	4.49%
1995	14.30%	0.58%	8.18%
2000	13.96%	0.72%	11.56%
2005	14.21%	0.61%	14.69%
2010	15.16%	0.22%	16.54%
2015	16.88%	-0.48%	15.58%
2020	19.04%	-1.33%	10.63%
2025	21.17%	-2.15%	1.37%
2030	22.64%	-2.69%	-10.22% <sup>2/</sup>
2035	23.24%	-2.88%	-20.37%
2040	23.26%	-2.84%	-28.17%
2045	23.20%	-2.77%	-33.77%
2050	23.20%	-2.74%	-37.74%
2055	23.14%	-2.68%	-40.42%

<sup>1/</sup> Calculated on the basis of trust fund totals at the end of the year.

<sup>2/</sup> Trust funds exhausted in 2026.

Source: Calculated from Harry C. Ballantyne, Chief Actuary, Social Security Administration, "Long-Range Estimates of Social Security Trust Fund Operations in Dollars," Actuarial Note 125, Social Security Administration, U.S. Department of Health and Human Services (April 1985); 1985 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, March 28, 1985; 1985 Annual Report of the Board of Trustees of the Federal Hospital Insurance Trust Fund, March 28, 1985.

assumptions. The projections are for all of Social Security (known as OASDHI), comprising programs for retirement income (OASI), disability insurance (DI), and Medicare hospital insurance (HI). The projections assume that any of the program's trust funds can borrow from any of the others as needed--assuming otherwise would simply mean that the program would be unable to pay full benefits even sooner than indicated.

According to these projections, Social Security will begin to run substantial surpluses around the year 1990, continuing until about 2005. Around 2015, however, the program will begin running substantial annual deficits, which will continue for the remaining 40 years of projections. By 2026, the trust funds for the entire program will be exhausted, and Social Security will be unable to pay any of the benefits promised under current law.<sup>1</sup>

### Short-Term Demographics

Such a financial picture is primarily a consequence of demographic trends. The "baby boom" generation, born during the high fertility years after World War II, is now working and paying taxes into Social Security. Starting in the 1990s, moreover, the relatively small generation born during the low fertility years of the Great Depression and World War II will be retiring, easing the program's benefit obligations. Combined with substantial Social Security tax increases during the late 1970s and scheduled through 1990, this favorable ratio of retirees to workers explains the near-term surpluses in the program.

### The Longer Term Trend

Around 2015, this pattern changes dramatically as the baby boom generation starts to retire, placing huge financial burdens on the system. At the same time, the work force will be dominated by the relatively small generation of workers born during the low fertility years since the mid-1960s, resulting in weaker revenue flows into the system. With this double whammy, the system's basic financial structure soon will collapse.

These projections suggest that under current law Social Security will not be able to pay all the benefits promised to young workers entering the work force today. By 2035, when these workers will be retiring, not only will the program's trust funds be exhausted, but

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1. The Alternative IIB projections for OASDI alone indicate that the trust funds for this portion of the program would be exhausted by 2049. But when HI is added in and the entire program is analyzed, as in Table 1, the data show the program taken as a whole unable to pay full benefits by 2026.

Social Security expenditures will be running almost 50 percent greater than revenues each year.<sup>2</sup> With no trust fund reserves, column 1 in Table 1 shows approximately how high payroll taxes would have to be raised to generate enough revenues to pay benefit obligations in those years. The data indicate that paying all the benefits promised to today's young workers would require a total Social Security payroll tax rate of more than 23 percent compared with 14.1 percent today.

Over the entire 75-year period projected by the SSA, the Alternative IIB assumptions show Social Security running a cumulative deficit 50 percent greater than the total amount raised by new revenues or by cuts in benefits under the 1983 legislation passed to save Social Security from bankruptcy.<sup>3</sup> These projections indicate, in other words, that Social Security still faces a long-term financing crisis that will impede the system's ability to honor its obligations to today's young workers.

#### CHECKING THE ASSUMPTIONS

The problems are even worse than these projections indicate, because the Alternative IIB assumptions are probably too optimistic.<sup>4</sup>

##### Economic Assumptions

The IIB assumptions view the economy as performing much better in the future than it has in most of the past 20 years. Example: inflation is assumed to stabilize at 4 percent by 1990, and unemployment at 6 percent, where they are expected to remain for the following 70 years. Further, the most important economic factor for Social Security, the rate of growth in real wages, is assumed to stabilize at 1.6 percent every year for about 20 years, and then 1.5

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2. Table 1 shows that expenditures in that year are 23.24 percent of taxable payroll. But revenues in that year are projected at 16.06 percent of taxable payroll. See 1985 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, March 28, 1985 (hereinafter "1985 OASDI Trustee's Report"), Appendix E, Table E3.

3. The 75-year deficit under Alternative IIB assumptions is 3.16 percent of taxable payroll. See 1985 OASDI Trustee's Report, Appendix E, Table E3. The 1983 legislation was projected to close the program's long-term revenue gap by 2.09 percent of taxable payroll. See 1983 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, (hereinafter "1983 OASDI Trustee's Report").

4. These assumptions are listed in 1985 OASDI Trustee's Report.

percent every year for the following 50 years. Yet over the past 15 years, real growth in wages has actually been negative, and over the past 30 years, real wages have grown at an average rate of only about 1.0 percent a year.

These economic assumptions, moreover, leave little room for the periodic, steep recessions that have characterized the past couple of decades. Such recessions can devastate Social Security financing, since slowdowns in employment and wages result in substantially less revenue than expected from the payroll tax. If strong inflation accompanies such recessions, as it did in the 1970s, indexed benefits cause expenditures to rise despite the weakened revenue base, further damaging the program's financial health. It was just such economic performance that created the financial crisis requiring the Social Security bailout legislation in 1977, which enacted the schedule of steadily increasing payroll taxes through 1990. Similar economic developments led to the more recent crisis and the 1983 bailout.

### Demographic Assumptions

Probably most important for the long term are the demographic projections. Alternative IIB projections assume that the life expectancy rate of growth over the last 40 years will slow. But if future retirees live longer than the SSA now projects, they will draw more benefits from the program, adding to its financial burdens.

The SSA longevity assumption is highly questionable. It reckons on no dramatic U.S. medical breakthroughs. This seems very implausible. Over the next 75 years, given the current pace of major medical and biotech discoveries, life expectancy could be extended well beyond that predicted by the cautious SSA. Even if the baby boom generation were to live an average of only five years more than now expected, the financial impact on Social Security would be overwhelming. Longer-than-anticipated life expectancies over the next 75 years may become, in fact, the new chief source of intractable financial problems for Social Security.

Alternative IIB projections also assume that the fertility rate will increase substantially and permanently from current levels. Yet, the downward trend in fertility has a 200-year history, falling from 7.04 in 1800 to 1.76 in 1983.<sup>6</sup> Powerful social, economic, and technological trends account for this decline and, if anything,

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5. Social Security Administration, Office of the Actuary.

6. See Peter J. Ferrara, Social Security: The Inherent Contradiction (Washington, D.C.: Cato Institute, 1980), Table 33. The fertility rate in each year is the average lifetime births per woman that could be expected, given births experienced by women at each age in that year.

portend a further drop--not an increase. Many West European countries already have significantly lower fertility rates than the U.S., such as West Germany, where the rate is 1.4. Moreover, it took the back-to-back cataclysms of the Great Depression and World War II to produce the relatively brief fertility increase of the postwar baby boom.

Lower future fertility rates, of course, mean fewer workers to pay taxes to finance the accrued benefit obligations under Social Security's pay-as-you-go system. This, in turn, means an even bleaker financial outlook for the program.

### Realism and Prudence

In contrast with the Alternative IIB assumptions, the SSA's so-called pessimistic Alternative III assumptions (see Table 2), are actually quite reasonable and prudent. Inflation in the Alternative III scenario, for example, is assumed to stabilize permanently at 5 percent, unemployment at 7 percent, and real wage growth at 1 percent. An economic slowdown is assumed in 1986, and a recession in 1989. Moreover, fertility and life expectancy are assumed to follow longstanding trends more closely. The Alternative III assumptions, in other words, do not expect past trends to alter significantly in the future.

Criticism that the assumptions for Social Security's financial projections are too optimistic has led the SSA to modify the Alternative IIB and Alternative III assumptions, making them less optimistic. Yet the Alternative III assumptions are still at least quite plausible, and many independent analysts agree with this view.<sup>8</sup> Indeed, the U.S. government itself is officially admitting that the Alternative III projections are at least reasonably possible by publishing them in the SSA reports.

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7. These assumptions are listed in 1985 OASDI Trustee's Report.

8. See, e.g., Rita Ricardo-Campbell, "Social Security Reform: A Mature System in an Aging Society" in John H. Moore, ed., To Promote Prosperity: U.S. Domestic Policy in the Mid-1980s (Stanford, California: Hoover Institution, 1984); Peter J. Peterson, "The Coming Crash of Social Security," The New York Review of Books, December 2, 1982; A. Haeworth Robertson, "The National Commission's Failure to Achieve Real Reform" and Paul Craig Roberts, "Social Security: Myths and Realities," in Peter J. Ferrara, ed., Social Security: Prospects for Real Reform (Washington, D.C.: Cato Institute, 1985); James R. Capra, Peter D. Skepardas, and Roger B. Kubarych, "Social Security: An Analysis of its Problems," Federal Reserve Bank of New York Quarterly Review, Autumn 1982.



## THE GRIM FUTURE

The Alternative III projections, summarized in Table 2, show the continuing short-term vulnerability of the program to adverse economic performance. Under these projections, annual surpluses never develop and the trust funds for the entire program will be completely exhausted in 1998. This means that the program would be unable to pay its promised benefits.

By 2035, when young workers entering the work force today will be retiring, Social Security expenditure obligations under these projections would be 2.3 times as large as revenue.<sup>9</sup> Paying all promised benefits in that year would require a total Social Security payroll tax rate of about 37 percent. This means a Social Security tax burden, split between employer and employee, of \$7,500 for a worker making \$20,000. The worker would still have to pay federal, state, and local taxes out of his remaining income.

The cumulative deficit for Social Security over the 75-year projection period, under these assumptions, would be more than 4.5 times as large as the financial gap closed by the 1983 legislation.<sup>10</sup> Clearly, with such a disastrous long-term outlook under plausible assumptions, simple prudence would dictate that fundamental reform be adopted now to avoid the possibility of intractable future difficulties.

## SOCIAL SECURITY, THE FEDERAL DEFICIT, AND THE NATIONAL DEBT

Since Social Security is almost one-third of the federal budget, its financial prospects raise important questions for federal finances as a whole. The projections based on the SSA's assumptions show that Social Security, as currently structured, offers only a relatively small reduction in federal deficits during projected surplus years, with the prospect of a much larger increase in federal deficits in future years.

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9. Table 2 shows expenditures in that year at 37.44 percent of taxable payroll. But revenues in that year are projected at 16.35 percent of taxable payroll. 1985 OASDI Trustee's Report, Appendix E, Table E3.

10. The 75-year deficit under Alternative III assumptions is 12.49 percent of taxable payroll, 1985 OASDI Trustee's Report, Appendix E, Table E3. The 1983 legislation under Alternative III assumptions was projected to close the program's long-term revenue gap by 2.7 percent of taxable payroll. See 1983 OASDI Trustee's Report.

### Alternative IIB Assumptions and the Deficit

Column 2 of Table 1 shows the annual Social Security surplus or deficit contributed to the unified federal budget under the Alternative IIB assumptions.<sup>11</sup> The projections show an annual surplus developing from 1990 to 2005 of about 0.60 percent to 0.70 percent of GNP. The annual surplus declines thereafter, and by 2015 the program runs annual deficits, which continue for the remaining 40 years projected. These Social Security deficits climb to more than 2 percent of GNP by 2025 and almost 3 percent of GNP by 2035.

The federal budget deficit in the fiscal year just ended was about 5.5 percent of GNP. The projected Social Security surpluses from 1990 to 2005 would offset from 10 to 13 percent of a federal budget deficit of the same size relative to GNP during those years. That would be a significant reduction in federal deficits. Such a Social Security surplus during the just-ended fiscal year would have reduced the nearly \$200 billion federal deficit by \$20 to \$30 billion. However, it is also clear that Social Security by itself will not come anywhere close to eliminating federal budget deficits of the same magnitude, relative to GNP, as today's federal red ink. Moreover, the extent to which Social Security could reduce federal deficits in future years is already reflected in the usual Office of Management and Budget and Congressional Budget Office projections of the deficit.

Over the long run, the projections in Table 1 show Social Security adding substantially to federal deficits each year. By the time today's young workers retired, and indefinitely thereafter, Social Security deficits would be increasing the total federal deficit by 2 to 3 percent of GNP--about half as much, relative to GNP, as today's entire federal deficit.

### Alternative IIB Assumptions and the National Debt

Column 3 in Table 1 shows the projected annual balances, as a percent of GNP, of the combined trust funds for all of Social Security

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11. The data actually overstate the annual Social Security surpluses for the unified budget, and understate the deficits, because only interest income paid by the federal government has been excluded from Social Security income in the calculation of surpluses and deficits in the table. Technically, taxes paid by the federal government as an employer and certain specified annual payments to the program from federal general revenues should also be excluded. But the Social Security Administration does not publish long-range projections of such items. Based on data published through 1994, the overstatement of surpluses and understatement of deficits probably amounts to about 0.10 percent of GNP each year.

under Alternative IIB assumptions. The balance peaks at 16.54 percent of GNP in 2010, falling into a substantial deficit by 2030.<sup>12</sup> By 2055, the program will have run a cumulative deficit of about 40 percent of GNP in that year.

A trust fund balance of today of the same magnitude, relative to GNP, at the peak balance in 2020 would be about \$600 billion. While this appears to be a significant sum, it would be no more than a modest cushion when compared with the enormous liabilities of Social Security, for it would constitute only a little more than 10 percent of the money intended to operate the program on a fully funded basis.<sup>13</sup> Moreover, such a positive balance would equal only about 40 percent of the total assets of private pensions, including Individual Retirement Accounts and 401(k) pension plans. And even this trust fund balance would last for only one year, dwindling eventually to zero.

In addition, this peak balance would not represent \$600 billion in cash, but rather \$600 billion in claims against the federal government. So these trust fund assets would not be, in any sense, an offset to the total national debt. They would be, instead, a mountain of federal IOUs, which could themselves become an addition to the national debt if they ever had to be cashed in to pay promised benefits--as seems likely. The total national debt can be reduced only by running a surplus in the overall, unified federal budget. Since there is no indication in the projections of annual Social Security surpluses and deficits in Table 1 that Social Security will lead to surpluses in the overall, unified federal budget, neither those projections nor the projected annual Social Security trust fund balances imply any reduction in the national debt.

### The Picture Under Alternative III Assumptions

Column 2 of Table 2 shows the impact Social Security would have on federal deficits under the less optimistic Alternative III assumptions.<sup>14</sup> Here, significant Social Security surpluses reducing federal deficits never develop, and by 1995 the program is running heavy deficits, which continue to expand for the next 60 years, adding considerably to overall federal deficits. Even before today's young workers retire, Social Security alone under these projections would be

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12. As noted in Table 1, the trust funds are actually exhausted in 2026.

13. Calculated from Statement of Liabilities and Other Financial Commitments of the United States Government as of September 30, 1984, in Office of the Secretary, U.S. Department of Treasury, Treasury Bulletin, 1st Quarter, Fiscal '85, Winter Issue.

14. The projections again actually overstate the annual Social Security surpluses for the unified budget, and understate the deficits, for the reasons explained in footnote 11.

**TABLE 2**  
**Social Security Financing**  
**Alternative III Assumptions**

	Social Security Expenditures As a Percent of Taxable Payroll	Social Security Unified Budget Annual Surplus or Deficit As a Percent of GNP	Social Security Trust Funds <u>1/</u> As a Percent of GNP
1985	14.26%	0.0%	1.35%
1990	15.61%	0.0%	1.45%
1995	16.30%	-0.28%	0.08%
2000	16.78%	-0.49%	- 1.12% <u>2/</u>
2005	17.96%	-0.97%	- 4.43%
2010	20.07%	-1.83%	- 10.13%
2015	23.34%	-3.11%	- 19.59%
2020	27.40%	-4.66%	- 33.38%
2025	31.74%	-6.27%	- 51.09%
2030	35.28%	-7.51%	- 70.66%
2035	37.44%	-8.19%	- 88.51%
2040	38.69%	-8.51%	- 95.18%
2045	39.76%	-8.73%	-119.06%
2050	40.81%	-8.95%	-130.79%
2055	41.52%	-9.04%	-140.10%

1/ Calculated on the basis of trust fund totals at the end of the year.

2/ Trust funds exhausted in 1998.

Source: Calculated from Harry C. Ballantyne, Chief Actuary, Social Security Administration, "Long-Range Estimates of Social Security Trust Fund Operations in Dollars," Actuarial Note 125, Social Security Administration, U.S. Department of Health and Human Services, April 1985; 1985 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, March 28, 1985; 1985 Annual Report of the Board of Trustees of the Federal Hospital Insurance Trust Fund, March 28, 1985.

running a deficit, as a percent of GNP, as large as today's deficit, relative to GNP, for the entire federal budget.

Column 3 in Table 2 shows the total Social Security trust fund balances as a percent of GNP under the Alternative III assumptions. No substantial trust fund balance ever develops, and the trust funds are completely exhausted by 1998. By the end of the projection period, if these assumptions prove more accurate, the program will have run a cumulative deficit almost one and a half times the GNP in that year.

#### A REASSESSMENT BY CONGRESS

The gloomy prospects for the nation's retirement system have been scrupulously ignored by Congress. Lawmakers predictably seek to avoid the political minefield of Social Security. Unfortunately, this determination to ignore the continuing problems of the system has been encouraged by a study that purports to show that the future of Social Security is remarkably rosy.

A recent, widely distributed article by former Senate aide Stuart Sweet indicates that the OASDI portion of Social Security (which is all of the program except hospital insurance, or about 80 percent of the entire program) under the Alternative IIB assumptions would run such a huge annual surplus that the federal budget would be balanced by 2001 and the entire national debt liquidated by 2016.<sup>15</sup> This is a distressingly erroneous representation of published, publicly available, government data. Due to a misunderstanding of the nature of Social Security financing, Sweet incorrectly calculates the Social Security surplus as reflected in the unified federal budget.<sup>16</sup> He also conducts his analysis in nominal dollars, and therefore does not

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15. Stuart Sweet, "America's Great Opportunity: The Incredible Social Security Surplus," A.B. Laffer Associates, Lomita, California, July 15, 1985.

16. Sweet incorrectly includes interest income on the Social Security trust fund bonds as reducing the federal deficit. But as noted, this interest is paid by the federal government itself, and consequently is an intragovernmental transfer, which cannot reduce the federal deficit.

adequately account for the impact of inflation and economic growth over time.<sup>17</sup> In addition, Sweet's calculations fail to include the deficits in the hospital insurance (HI) portion of the program.

In fact, by 2001, under Alternative IIB assumptions, OASDI would run a surplus in the unified federal budget of 1.1 percent of GNP.<sup>18</sup> As noted, the deficit in the fiscal year that ended September 30 amounted to 5.5 percent of GNP. Clearly, the projected OASDI surplus is not even remotely sufficient to eliminate federal deficits of today's magnitude as a percent of GNP. There is no justification, moreover, for focusing only on OASDI and excluding, as Sweet does, the projected deficits in the HI portion of the program from the analysis.

The federal budget may well be balanced by 2001, but that will be primarily because of factors such as economic growth, inflation, spending restraint, or tax increases--not because of Social Security.

#### POLICY IMPLICATIONS

Under current law, the total Social Security tax rate will increase in 1988 to 15.02 percent, and in 1990 to 15.3 percent. Under the Alternative IIB assumptions, these tax increases could be rescinded in the 1990s without immediately jeopardizing benefit payments. But this would eliminate most of the annual surpluses and the trust fund accumulation now projected to begin in the 1990s. Without significant trust fund reserves, the program will be unable to pay full benefits as soon as the later projected annual Social Security deficits begin. Counting all of the income and expenditures for the program itself, such deficits will begin by 2017.<sup>19</sup>

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17. Sweet assumes that the federal deficit, apart from Social Security, would remain at 200 billion in nominal dollars each year indefinitely. But this is unlikely, because inflation and economic growth would make 200 billion in nominal dollars a relatively trivial amount over time. With such an assumption, Sweet's analysis suggests that the federal deficit, apart from Social Security, would fall to about 1 percent of GNP in 2001, and be in balance soon thereafter. It is this assumption that, supposedly, balances the federal budget by 2001, and pays off the national debt by 2016, and not the impact of Social Security finances.

18. Calculated from Harry C. Ballantyne, Chief Actuary, Social Security Administration, "Long-Range Estimates of Social Security Trust Fund Operations in Dollars," Actuarial Note 125, Social Security Administration, U.S. Department of Health and Human Services, April 1985.

19. Calculated from the sources cited in Tables 1 and 2.

Without more fundamental reform, therefore, payroll tax cuts in the 1990s would leave the program unable to pay full benefits to the baby boom generation. Under the Alternative IIB assumptions, paying benefits without trust fund support would require total payroll tax rates of 21.2 percent in 2025 and 22.6 percent in 2030--or almost a doubling of today's rates.<sup>20</sup> Of course, under the Alternative III assumptions, there is no room for payroll tax cuts in the 1990s, since the program would face financial collapse by 1998.

The groundwork for permanent tax cuts in the 1990s, however, could be laid by more fundamental reform today, such as allowing workers to substitute expanded "Super IRAs" for part of their Social Security coverage. This reform would allow workers to contribute extra funds to their IRAs above amounts allowed under current law to purchase disability and life insurance and health care for their retirement years.

Under this plan, workers would receive 100 percent income tax credits for these contributions, rather than the usual IRA deduction. But to the extent that workers exercised this option, their Social Security retirement benefits would be reduced in proportion to the amount of tax credits received over the years. The accumulated funds in these Super IRAs would more than make up for these foregone Social Security benefits, leaving Americans with higher benefits overall.<sup>21</sup>

With this reform Social Security would be substantially strengthened financially, since payroll taxes financing Social Security would be maintained in full, while the tax credit for Super IRA contributions would be taken against income taxes, not payroll taxes. Moreover, over the long run Social Security expenditures would be reduced, as workers relied increasingly on their Super IRAs rather than Social Security. If this change were adopted now, and expanded over time, Social Security taxes could be cut in the 1990s. By the time the baby boom generation retired, Social Security expenditures could be reduced sufficiently to enable the benefit obligations made to the baby boomers to be financed in full. Moreover, as the option was continually expanded, Social Security expenditures would be reduced commensurately, and payroll taxes could be cut steadily.

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20. 1985 OASDI Trustee's Report, Appendix E.

21. See Peter J. Ferrara, ed., Social Security: Prospects for Real Returns (Washington, D.C.: Cato Institute, 1985); Ferrara, "The Social Security System" in Stuart Butler, Michael Sanera and W. Bruce Weinrod, eds., Mandate for Leadership II: Continuing the Conservative Revolution (Washington, D.C.: The Heritage Foundation, 1984); Ferrara, "Rebuilding Social Security, Part 2," Heritage Foundation Background No. 346, April 1984.

## CONCLUSION

The limited solvency of Social Security has been achieved through years of relentless increases in Social Security taxes (with many still scheduled to come) and substantial cuts in future benefits. This combination makes Social Security a poor deal for today's young workers, even if all promised benefits are somehow paid.<sup>22</sup> Further benefit reductions or accelerated tax increases might improve the fiscal outlook for the program, but only at the price of making it an even worse deal. Today's young workers would be foolish to base their retirement on the promise of Social Security benefits.

Fundamental reforms are necessary so that this generation can look forward to a secure and prosperous retirement. The longer Congress ignores the true condition of the system, and grasps at straws suggesting that Social Security is sound, the more today's young workers will lose.

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22. For further discussion of the bad deal Social Security now offers to today's young workers, see Peter J. Ferrara and John R. Lott, Jr., "Rates of Return Promised by Social Security to Today's Young Workers," in Peter J. Ferrara, ed., Social Security: Prospects for Real Reform (Washington, D.C.: Cato Institute, 1985).