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President Bush's Tax Plan Would Improve the Ability to Deal with Future Social Security Deficits

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President George W. Bush's proposed tax cut plan would increase economic growth and make it easier to afford the additional money required for Social Security reform. The President's dividend tax proposal alone is expected to create an average of 512,000 new jobs each year and increase GDP by over $79 billion annually, according to dynamic economic estimates prepared by The Heritage Foundation's Center for Data Analysis.

An important but often ignored side effect of higher employment and economic growth is the strengthening of the Social Security trust fund due to extra payroll tax collections. Over just the first 10 years, the higher employment caused by the dividend tax proposal would also provide over $100 billion more to the Social Security trust fund than it is currently expected to receive. Significantly more resources will flow to that trust fund after the first 10 years. While this economic growth will not solve or even significantly delay Social Security's coming fiscal crisis, the additional money will make it easier for Social Security to meet its benefit obligations over the next several years.

Given these facts, one has to wonder why the President's critics charge that the tax plan would damage Social Security. Social Security is financially stable for now, but this will not always be the case. In 2017, Social Security will begin to pay more in benefits than it receives in payroll taxes. Unless the program is reformed, it will continue to run deficits for at least the next 60 years. Between 2017 and 2077, Social Security will require $25 trillion (in inflation-adjusted 2002 dollars) more than it will receive from payroll taxes just to meet its obligations.

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How the Trust Fund Operates. The Social Security trust fund is a mechanism to pay future benefits, not a source of actual money that can be used to pay those benefits. Excess payroll taxes that are not needed immediately to pay benefits are loaned to the government in return for special-issue Treasury bonds. The bonds are really nothing more than an IOU and have no other value than as a promise to impose higher general revenue taxes on future workers. It is future higher taxes that will pay Social Security benefits. The annual payroll tax surpluses, which many thought were being used to build up a reserve for baby boomers, have already been spent on other government programs or to reduce the government debt.

When an employer pays income and payroll taxes to the Treasury on behalf of his or her employees, the employer sends in one periodic check or electronic fund transfer that represents both the total income taxes and the total Social Security payroll taxes that are due. That money is all deposited into Treasury's general fund with no distinction made between income and payroll taxes. On a regular basis, the Treasury estimates how much of its aggregate tax collections are due to Social Security taxes and credits the trust fund with that amount. No money actually changes hands; this crediting is strictly an accounting transaction. These estimates are corrected after income tax returns show how much in payroll taxes was actually paid in a specific year. Then individual workers are credited with the amount that was withheld from their paychecks.

Furthermore, Social Security benefit checks are actually Treasury checks. Each month, Social Security directs the Treasury to pay benefits to a list of individual recipients and tells Treasury how much each individual is to receive. The total amount that the Treasury pays to workers is subtracted from the bookkeeping entry representing the Social Security trust fund. Again, no money actually changes hands; the funds were always in a Treasury account.

If the bookkeeping entry shows any payroll tax funds that are not needed to pay benefits, the Treasury issues the Social Security Administration a special-issue Treasury bond in that amount. The bond acts as an IOU and promises to provide general revenue funds in that amount plus interest when Social Security needs additional money to pay benefits. After the trust fund has been credited with the IOUs, Social Security's extra tax collections are treated just like any other tax and spent to pay the government's bills. That money could be used to repay federal debt owned by the public or spent to pay for any other type of federal program from aircraft carriers to education research.

False Charges That the Tax Cut Would Hurt Social Security. President Bush's plan would not reduce Social Security's ability to pay benefits, alter the Social Security trust fund, or change the program's projected insolvency date. Because the proposed tax cut does not raise or lower Social Security payroll taxes, the program would remain able to pay all benefits owed through 2017, and its trust fund account would be credited with at least the same amount in IOUs.

Social Security's finances are accounted for separately from the rest of the government, and as long as the program collects enough payroll taxes each year to meet its current obligations, changes in other taxes do not affect its financial outlook. Regardless of whether the tax cut plan passes or not, excess Social Security taxes that are not needed to pay current benefits would continue to be swept into the government's general revenues and spent on a variety of programs just as they have been for decades.

Similarly, unified federal budget deficits or surpluses have no effect on Social Security's ability to pay benefits or the amount in IOUs that will go into the Social Security trust fund. The only change would be an estimated additional $100 billion in trust fund IOUs from increased economic growth. Legally, Social Security taxes must be used only for that program—with excess revenues loaned to the government. Even though Social Security payroll taxes are mixed in with other federal revenues when both are received, the separate accounting of those payroll taxes allows the program to remain unaffected. As long as Social Security runs an annual cash flow surplus, this will remain true.

Conclusion. Both the President and Congress should act to reform Social Security in the very near future. Every day that they delay only increases the eventual cost of reform. However, paying for that reform requires the economic growth that would be created by President Bush's tax plan. Charges that the tax plan would weaken Social Security or transfer money out of Social Security to the rich are simply wrong. Similarly, worries that the tax plan would take money that is needed to pay for Social Security reform are misplaced. What Social Security needs more than anything else is a growing, healthy economy.

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