Backgrounder

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Reversing the Bush Tax Cuts Would Not Fix Social Security

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Repealing the President's tax cuts to pay for Social Security would reduce economic growth, make Social Security an even worse deal for workers than it is already, and fail to address the growing problem of entitlement spending. Beyond these shortcomings, repealing the tax cuts would not even fix Social Security's finances.

The Bush Tax Cuts

In 2001 and 2003, President George W. Bush signed into law two tax cuts that saved taxpayers hundreds of billions of dollars: the Economic Growth and Tax Reduction Reconciliation Act of 2001 and the Jobs and Growth Tax Reduction and Reconciliation Act of 2003.

American companies responded to the tax cuts by employing more workers and investing in more capital equipment, beginning almost the moment lower taxes became law. The unemployment rate peaked in June 2003 at 6.3 percent, began dropping in July, and has since held steady at around 5.5 percent—lower than the average unemployment rates for the 1970s, 1980s, and 1990s. Growth of the gross domestic product (GDP) accelerated sharply in the third quarter of 2003 after the tax cut was enacted and since then has remained above average.

In short, the President's tax cuts boosted the economy, accelerating growth and increasing employment. Almost 3 million jobs have been created since the 2003 tax cuts.

Talking Points

- The Bush tax cuts increased employment and strengthened Social Security's finances. A straightforward repeal would actually worsen Social Security's finances.
- Repealing the Bush tax cuts would cut employment by 174,000 jobs per year and reduce GDP by $14.3 billion per year. Ironically, repealing the Bush tax cuts to "save" Social Security would discourage other retirement savings.
- Raising taxes now—for example, by repealing the Bush tax cuts—to "save" Social Security would not eliminate the need for future tax increases to "save" Social Security.
- Forcing workers to pay more money into Social Security in return for the same benefits would make Social Security an even worse deal for them than it already is. Even more workers would receive a negative rate of return, and all workers would receive a lower rate of return for their payments into the system.

This paper, in its entirety, can be found at: *www.heritage.org/research/taxes/bg1844.cfm*

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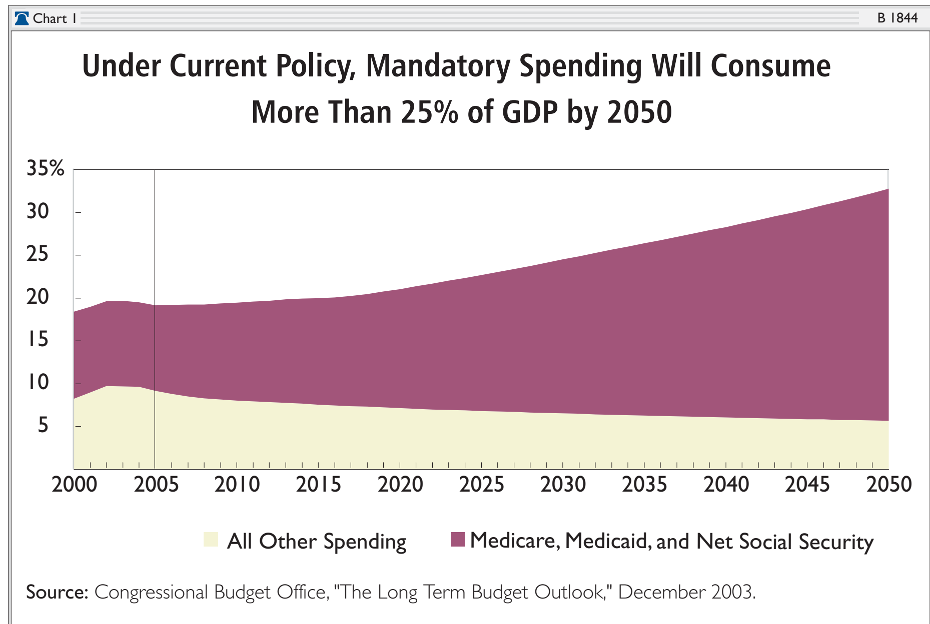
Repealing the Tax Cuts: A Misguided Proposal



Source: Congressional Budget Office, "The Long Term Budget Outlook," December 2003.

A straightforward repeal of the Bush tax cuts would have the opposite effect and would actually make Social Security's finances worse than they are today. Repealing the tax cuts would slow economic growth and eliminate future job opportunities. With less money coming in from payroll taxes, Social Security's current revenue surplus would shrink more quickly than it would with the Bush tax cuts still in place. Social Security is currently projected to begin running a cash-flow deficit in 2017 and $100 billion annual deficits in 2022.[1] Repealing the Bush tax cuts would cause Social Security's trust fund to run dry more quickly, leading to either significant benefit cuts (as required under current law) or additional tax increases to pay for promised benefits.

As an alternative to straightforward repeal, some have proposed that, for the first time in Social Security's history, general fund revenues be used to keep the ailing system solvent. For example, former Social Security Commissioner Robert M. Ball has proposed bringing back the estate tax (currently scheduled to disappear for one year in 2010) to pay for Social Security.[2]

However, funding Social Security with general revenues would be a major step toward letting entitlement spending completely overwhelm the federal budget. As Chart 1 shows, entitlement spending is set to explode in coming decades. Demolishing the wall between Social Security and the general fund—without substantial reform to bring down Social Security's long-term costs—would crowd out other spending or force further tax increases.

The Economic Effects

Analysts at the Heritage Foundation's Center for Data Analysis (CDA) sought to estimate the economic effect of raising taxes to pay for new spending. Using Global Insight's U.S. Macroeconomic Model, they simulated an $87 billion increase in personal income taxes in 2004, which is comparable to a partial repeal of the Bush tax cuts.[3] The CDA simulation increased personal income tax rates and taxes on capital gains and dividends.

Not surprisingly, a tax increase of that magnitude would increase the cost of labor in the economy and thereby affect jobs. The CDA study found that an $87 billion increase in personal income taxes would reduce potential employment by an average

1. Social Security Administration, *The 2005 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*, March 23, 2005, pp. 3 and 178, Table VI.F7, at *www.socialsecurity.gov/OACT/TR/TR05/tr05.pdf* (April 11, 2005).
2. Jonathan Weisman, "Competing Visions for Social Security," *The Washington Post*, February 24, 2005, p. A1.
3. These estimates are preliminary and subject to change. The methodologies, assumptions, conclusions, and opinions in this report are entirely the work of Heritage Foundation analysts. They have not been endorsed by and do not necessarily reflect the views of the owners of the model.

of 174,000 jobs per year over the next four years relative to the baseline. These lost jobs would decrease the short-term solvency of the Social Security trust fund by reducing tax revenue.

There are also spillover effects on economic growth. Increasing personal income taxes would reduce U.S. GDP, a broad measure of economic activity, by an average of $14.3 billion per year over the next four years.

Overall, raising personal income taxes would have a major impact on U.S. households. In total, U.S. households would have $52 billion less in disposable income per year. Ironically, this decline in income would discourage personal saving and make worse the very problem that Social Security is intended to fix—workers retiring with insufficient savings.

A Worse Deal for Workers

A worker's savings, pension (if any), and Social Security benefits make up the bulk of his or her total retirement security. Not only would repealing the Bush tax cuts for Social Security's sake reduce workers' savings, but it would also make Social Security a worse deal than it is today.

Social Security is a poor investment and a bad deal for the vast majority of workers who pay into it. It offers most workers a rate of return on their contributions that is several times lower than what they could get from the most conservative investments, even assuming that retirees live long lives. For example, single men and women who die before retirement receive nothing for their Social Security taxes. For this reason, black men as a group have an especially low rate of return. On average, black men paying into Social Security receive back less than their payroll taxes—a negative rate of return.[4] Younger workers who are just now entering the workforce also face the likelihood of a negative rate of return.

Forcing workers to pay more money into Social Security in return for the same benefits would make Social Security an even worse deal for them than it already is. Even more workers would receive a negative rate of return, and all workers would receive a lower rate of return for their payments into the system.

Things would become even worse if repealing the Bush tax cuts did not permanently fix Social Security and future tax hikes became necessary to fund the same level of benefits. Regrettably, this is a likely scenario.

Raising Taxes Is Not a Fix

Social Security's financial ailments are structural and cannot be permanently fixed by merely raising taxes to a level that would fund the system by relying on early trust fund accumulations. Currently, the system is in a cash-flow surplus, which means that every year it takes in more money in taxes than it pays out in benefits. However, these extra funds do not really accumulate. Instead, the government spends the extra funds and reimburses the Social Security trust fund with special Treasury bonds, which are really just IOUs committing the government to pay back the money at a later date.

According to the Social Security trustees, the system will begin to run a negative cash flow in 2017. To pay the promised benefits, it will need to cash in the government's IOUs, and the money to pay them will have to come from somewhere—higher general revenue taxes (e.g., income taxes), lower government spending, or more government debt. Because of the way in which the trust fund operates, raising taxes by enough to make the system solvent in net terms would only delay the date when Social Security's cash flow becomes negative. Future tax increases or benefit cuts would still be on the table.

Conclusion

President Bush's 2001 and 2003 tax cuts stimulated investment and expanded employment, adding some strength to the Social Security system in the process. Extending these tax cuts permanently would help to lock in these gains and spur further economic expansion. In contrast, a straightforward repeal of the President's tax cuts would harm both the economy and Social Security.

4. William W. Beach and Gareth E. Davis, "Social Security's Rate of Return," Heritage Foundation *Center for Data Analysis Report* No. 98–01, January 15, 1998, at *www.heritage.org/Research/SocialSecurity/CDA98-01.cfm*.

However, even a repeal that directed the additional revenues into Social Security would not set the system on a stable fiscal footing for future generations. Instead, repealing the tax cuts would harm the economy, cost jobs, and lower other retirement savings, and Social Security would still need future tax hikes to stay solvent.

Making Social Security more expensive—for example, by raising taxes—would also make the program a worse deal for workers than it already is. Compared to the sort of reform that the President has proposed, repealing the Bush tax cuts is an extremely poor way to address Social Security's problems.

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