COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET

President's Proposed Transfers to Social Security and Medicare: Explanation of A Budget Gimmick

The President's budget proposes to allocate 57 percent of projected 15-year unified budget surpluses to Social Security trust funds.[1, 2] The budget would allocate another 14 percent to the Medicare Hospital Insurance (HI) trust fund. The budget performs magic! In the first five years (FY 2000-2004), it turns $827 billion in projected unified budget surpluses into over $1.5 trillion in new financing. (See figure 1.)

The President's proposal to transfer some of the unified budget surpluses to the Social Security and Medicare trust funds have political, not economic, impact. That's because the proposal does not affect government resources. Instead, it changes government accounting by adjusting trust fund balances upward and recorded unified budget surpluses downward. The overall proposal to dispose of unified surpluses, however, would have economic consequences. Relative to doing nothing, it would reduce budget surpluses, national savings, and potential economic gains.

The Administration and its supporters argue that this proposal is necessary to keep Congressional Republicans from enacting a large tax cut. In the same breath, the Administration claims that the proposal would free up resources for additional spending on its priorities. How can one proposal do both?

The Numbers

The unified budget surplus or deficit reflects the government's fiscal impact on the economy. Calculating the federal budget surplus is easy:

Total Fed. Revenues – Total Fed. Expenditures = Unified Surplus (+) or Deficit (-)

By law, Social Security and Hospital Insurance (HI) payroll taxes[3] finance Social Security and Medicare HI expenditures. The Internal Revenue Service collects these taxes from employers and deposits them to the Treasury general fund. The Treasury credits the Social Security and Medicare HI trust funds with estimated payroll tax receipts and other income (including interest earnings on trust fund balances), and debits the trust funds for benefits payments and other expenses.

When income credited to a government trust fund exceeds expenses charged to the fund, fund balances grow. These balances are invested in non-marketable Treasury securities and earn interest at the Treasury rate. The general fund keeps the surplus cash and the trust funds get Treasury securities equal to total excess income (payroll taxes plus other income less program expenditures).

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[1] The Social Security trust fund actually consists of two trust funds: the Old Age and Survivors Insurance (OASI) trust fund and the Disability Insurance (DI) trust fund. These are commonly referred to as the OASDI, or Social Security, trust fund.
[2] The Administration's claim of allocating 62 percent to Social Security and 15 percent to Medicare is based on projected surpluses of $4.5 trillion for 2000-2014, but projected surpluses in the budget are $4.9 trillion.
[3] Social Security and Medicare Hospital Insurance payroll taxes are collected under the Federal Insurance and Compensation Act (FICA).

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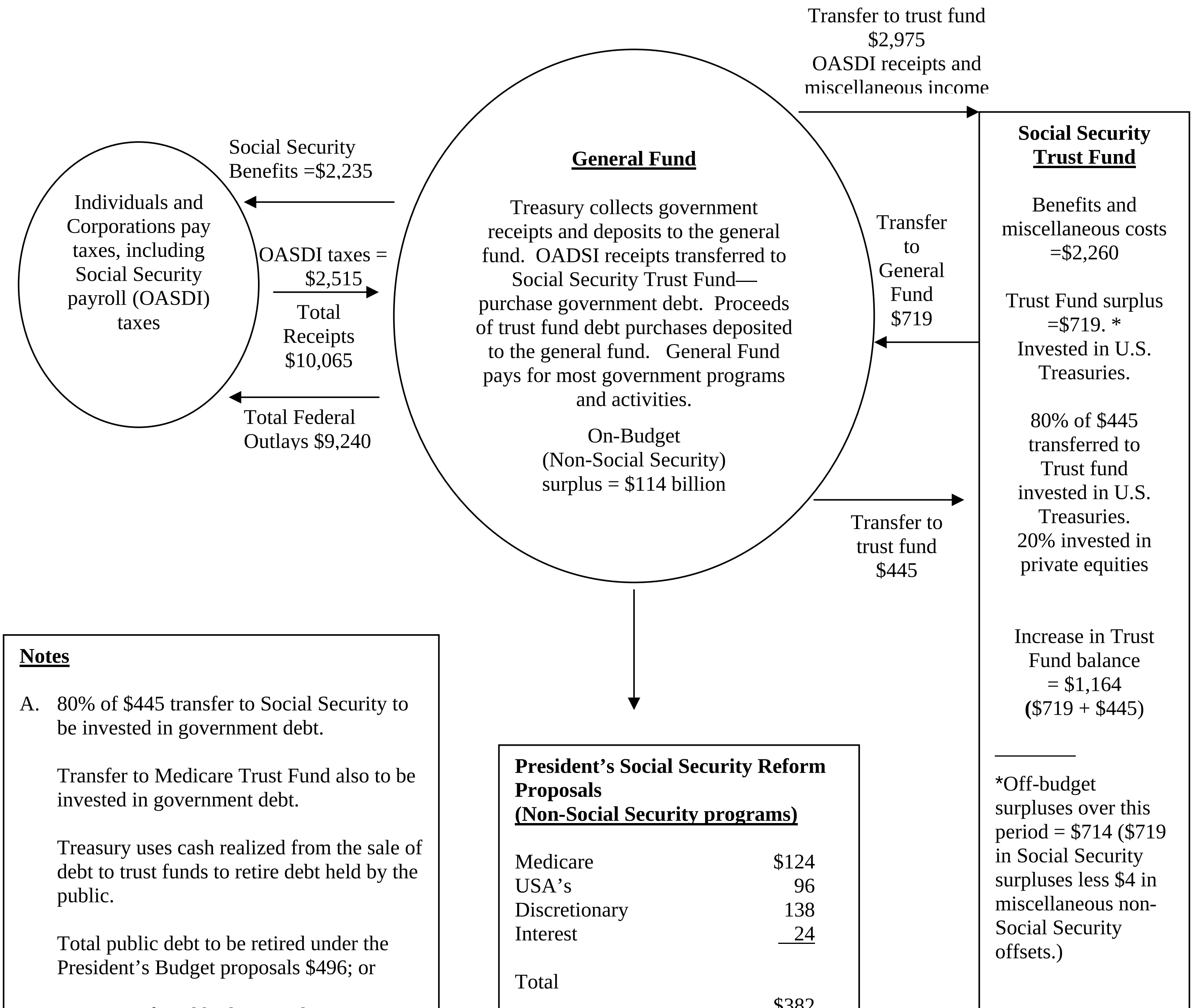
Figure 1. It's Magic! $827 Billion Surplus Produces over $1.5 Trillion in New Initiatives

(FY 2000-2004: $ billions)



Notes

A. 80% of $445 transfer to Social Security to be invested in government debt.

Transfer to Medicare Trust Fund also to be invested in government debt.

Treasury uses cash realized from the sale of debt to trust funds to retire debt held by the public.

Total public debt to be retired under the President's Budget proposals $496; or

- 60% of total budget surpluses
- 70% of Social Security Trust Fund Surpluses

B. $827 billion surplus produces $1,541 in total new commitments—

- $1,159 Social Security; plus
- $382 All Other

President's Social Security Reform Proposals
<u>(Non-Social Security programs)</u>

Medicare	$124
USA's	96
Discretionary	138
Interest	24
Total	$382
Memo: Transfer to Social Security Trust Fund	$445
Total On-Budget Plus Off-Budget Surpluses	$827

Social Security Trust Funds

Social Security payroll taxes and other income currently exceed benefit payments. In 1998, the surplus was $99 billion. The budget projects it will grow to $158 billion in 2004. Over the five-year period, FY 2000-2004, surpluses will total a projected $719 billion. By the end of 2004, projected Social Security trust fund balances reach $1.57 trillion. (See table 1.)

Table 1: Social Security Trust Funds Income, Disbursements, and Balances
($ Billions)

	2000	2001	2002	2003	2004	5-yr total
Payroll tax receipts	465	483	502	522	543	2,515
Other income	77	84	91	100	109	461
Total Income	542	566	593	622	652	2,976
Less:						
Benefits and other disbursements	411	431	450	471	494	2,256
Equals:						
Surplus	131	136	143	151	158	719
Memo:						
End-of-Yr. Fund balances	984	1,119	1,262	1,413	1,571	N/A

Source: *President's FY 2000 Budget*

On- v. Off-Budget Surpluses and Deficits

The budget is divided into on- and off-budget components. Social Security transactions effectively comprise the off-budget component. (See table 2.)

When the government runs unified budget deficits, Treasury issues debt to the public to pay for expenditures in excess of receipts. When the government runs unified budget surpluses, Treasury does not have to refinance all publicly held debt securities when they mature. Publicly held debt declines largely by the amount of unified surpluses. Absent the Administration's Social Security reform proposal and ignoring unrelated transactions, publicly held debt would decrease $827 billion and annual interest costs would fall from $243 billion to $173 between 1998 to 2004.

Table 2: President's FY 2000 Budget (not including Social Security Reserve proposal)
($ Billions)

	2000	2001	2002	2003	2004	5-yr total
On-budget deficit(-)/surplus(+)	-12	0	44	31	50	114
Off-budget surplus	130	134	142	151	158	714
Unified budget surplus	117	134	187	182	208	827

Source: *President's FY 2000 Budget*

In 1983, Social Security reforms raised payroll taxes beyond levels necessary for a strict "pay-as-you-go" system. This was designed to capture some of the productive output of a baby boomer-rich labor force and ease the burden on future taxpayers once the boomers retired. Social Security surpluses would reduce publicly held debt and interest costs. That would be equivalent to "saving" the surpluses. Thus, Social Security surpluses would strengthen government's future ability to provide benefits once the surpluses stopped.

But these positive benefits cannot be achieved when the rest of the budget does not balance; an outcome complicated by Social Security's budgetary status. Until 1969, Social Security and other trust funds were excluded from the budget. Since then, they have been included in unified budget totals. Because the unified budget aims to be comprehensive of government's activities, it properly includes Social Security.

Social Security's financial transactions require a long-term perspective–current surpluses compensate for projected deficits beginning over a decade from now. The annual budget process, however, focuses on near-term deficits and surpluses. To help insulate Social Security's financial flows from annual budget deliberations and short-term goals, Congress and the President have enacted protective budget process legislation. The1990 Budget Enforcement Act (BEA) Social Security provisions are the most recent. They designate Social Security receipts and disbursements as "off-budget" and require exclusion of those amounts for the purposes of the President's budget, the Congressional budget, and the Balanced Budget Emergency and Deficit Control Act (Gramm-Rudman-Hollings.[4] The FY 2000 President's budget (like every budget proposed since 1990) demonstrates that the attempt to fence off (or hide) Social Security surpluses from the political debate has been unsuccessful.

The President's Proposal

The President's budget proposes to allocate the unified budget surplus to new spending, new tax expenditures, and "transfers" to the Social Security and Medicare trust funds (see table 3). Under this proposal, recorded unified budget surpluses would disappear, on-budget deficits would increase sufficiently to offset off-budget (Social Security) surpluses, and Social Security and Medicare trust fund balances would grow.

Table 3: President's FY 2000 Budget Deficits (-) /Surpluses (+)
($ Billions)

	1999	2000	2001	2002	2003	2004	5-Yr. Total: 2000-2004
Off-budget surpluses*	121	130	134	142	151	158	714
On-budget deficits/surpluses:	-42	-12	0	44	31	50	114
Proposed adjustments:							
Transfer to Social Security		-85	-70	-92	-90	-109	-445
Transfer to Medicare		-18	-20	-28	-27	-30	-124
USAs		-14	-16	-22	-21	-24	-96
Add'l discretionary spending			-26	-41	-36	-34	-138
Add'l interest costs**		-0	-2	-4	-8	-10	-24
Total Adjustments	0	-117	-134	-187	-182	-207	-827
Adjusted on-budget deficits	-42	-130	-134	-142	-151	-158	-714
Unified Total***	79	0	0	0	0	0	0

* Social Security surpluses, effectively. Table 2 shows Social Security surpluses of $719 billion.
** The proposal would achieve $496 billion in reduction in publicly held debt. Absent the proposal (the baseline assumption), publicly held debt would decline $827 billion. These amounts represent additional interest costs resulting from the proposal.
*** Totals may not add due to rounding.
Source: *President's FY 2000 Budget*

[4] The Postal Service is also off-budget, but its activities in most years are less than $500 million.

Over the five-year period FY 2000-2004, the President's proposal would save 63 percent of projected surpluses attributable to Social Security for Social Security ($445 billion of the $719 billion in projected Social Security surpluses), of which $73 billion would be invested in private stocks.

Under the President's proposal, publicly-held debt declines by the sum of the transfers to Social Security and Medicare, less expenditures representing stock purchases ($445+124-73= $496). Amounts invested in Treasury securities are not needed immediately to pay benefits, but stock purchases would use up cash that otherwise could be used to pay down publicly-held debt. The resulting $496 billion reduction in publicly-held debt is less than the $827 billion reduction ($714+114) that would be achieved under current law.

Standard accounting practices would reflect the transfers to Social Security and HI trust funds as outlays to the general fund and receipts to the trust funds (or as inter-governmental transfers that have no impact on the public). If receipts to the trust funds were recognized, they would offset the transfers and leave the unified surplus unchanged. But if transfers are not recorded as receipts to the trust funds, the Administration could not claim credit for extending trust fund solvency. Consequently, the Administration will have to change budget accounting practices to reflect only one side of the transfer transaction (outlays only, no receipts) or publish adjusted surplus numbers. The Administration has not yet specified the exact accounting mechanism. No matter what the mechanism, "true" unified surpluses (total receipts from the public less total outlays to the public) would be unaffected.

The Double Count

The Administration proposes to credit the Social Security and Medicare HI trust funds for amounts transferred from the unified budget surpluses ($445 billion and $124 billion, respectively). These credits would be in addition to any credits the trust funds would receive under current law. Additional balances would extend the trust funds' solvency (from 2008 to 2020 for the HI trust fund and from 2032 to 2055 for Social Security).

In Social Security's case, the trust fund would be credited with the full amount of its surpluses, or $719 billion. Social Security trust fund balances would increase $1,164 billion ($719 + 445). Similarly, the HI trust fund would be credited with payroll tax and other income, plus the $124 billion in transfers. Thus, the proposed $569 billion transfer to the Social Security and Medicare trust fund would double count the same resources–that is, income already credited to Social Security.

The transfers would not create new resources. Nor would they affect debt held by the public. That's because "true" unified budget surpluses (total receipts less total outlays), not cosmetically adjusted surpluses, affect the level of publicly held debt. Since the transfers themselves do not affect receipts from the public or outlays to the public, they would have no economic impact. But they would increase gross debt. In 2001, the President's proposal would cause debt subject to limit to exceed the statutory debt ceiling.

The Political Fallout

The Administration and its supporters argue their proposal is necessary to preserve any of the projected unified surpluses and reduce debt. There is some truth to the Administration's defense of its gimmick. Congress, like the Administration, and notwithstanding the 1990 BEA, tends to focus on unified budget surpluses or deficits, not on-budget surpluses and deficits.

This "ends-justifies-the-means" argument, however, would carry more weight if the Administration proposed transfers equal to projected off-budget surpluses. Unfortunately, the President's budget shows that projected on-budget surpluses would not be adequate to fund proposed new spending and tax expenditures.

Instead of fencing off surpluses for debt reduction, the budget provides a green light for congressional Republicans to use the amounts the Administration chose not to "save" for Social Security for their (Republican) priorities (e.g., tax cuts). So far, however, Republicans seem to limit tax cut proposals to projected on-budget surpluses.

No Pain, No Gain

Social Security and Medicare reform are politically difficult. The Administration's proposals aggravate the situation. By inflating Social Security and Medicare trust funds, the Administration reduces apparent financing problems for these programs and relieves pressure for reform. Administration claims of trust fund solvency through 2055 could make it more difficult to convince the voting public (most of whom will be dead by then) of the need for any program changes. Absent pressure from constituents, politicians won't feel compelled to pass reform legislation that is bound to alienate powerful interest groups.

Trust fund balances are inadequate measures of the future economic burdens Social Security and Medicare pose. Balances represent earmarks against future government income, but statutory benefit levels determine program costs.

The Administration's proposal to increase Social Security and HI trust fund balances does not change the economic burden imposed by promised benefits. Focusing on trust fund solvency is tantamount to worrying about whether to use cash, a check, or a credit card instead of deciding whether the desired purchase costs too much. Social Security and Medicare benefit levels and general standards of living will determine whether the programs are affordable to the future taxpayers, not trust fund balances.

Recent experience rather dramatically has improved the long-term budget outlook. Absent Social Security and Medicare reform, however, persistent and growing deficits recur. Government will be forced to reduce spending for other programs, raise taxes, or borrow to meet current law commitments. Trust fund balances will have absolutely no effect on those choices.

Note the budget could have proposed to credit the trust funds with sufficient funds to keep them solvent indefinitely. That accounting adjustment, like the Administration's proposed smaller credits, would recognize explicitly the expected level of resources that will be needed to fulfill current benefit promises. But it would not contribute one dime toward meeting those commitments.

Support for the Status Quo

The Administration's proposal makes it easier for those who support the current structure of Social Security to argue in favor of incremental changes. The additional resources resulting from the extra transfer, together with assumed earnings from stock investments, would reduce the estimated long-term actuarial deficit from 2.19 to 1.2 percent of taxable payroll. (This means an immediate payroll tax increase of 1.2 percent would bring the program into 75-year actuarial balance.) Actuarial balance, like trust fund solvency, provides limited insight into the affordability of the program when viewed in a larger budget context.

Similarly, transfers to the Medicare HI program could decrease pressure for reforms by delaying exhaustion of the trust fund until 2020, 12 years beyond the current estimate. In 1997, Congress and the President created a bipartisan commission charged with making recommendations to reform Medicare. That commission is due to report March 1, 1999. The commission appears unlikely to agree on a single approach to reform. The President's proposed transfer could make that failure more palatable and provide cover for policy makers to avoid addressing this program for several more years, a delay we can ill-afford.

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