

CRS Report for Congress

Received through the CRS Web

Social Security: Where Do Surplus Taxes Go and How Are They Used?

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Summary

Most of the costs of the Social Security program are financed by the payroll taxes workers pay on their wages and self-employment income. A smaller amount is financed by part of the income tax some recipients pay on their Social Security benefits. These taxes are paid to the federal government and, along with other forms of revenue, become part of the government's operating cash pool, commonly referred to as the U.S. treasury. Once received, they become indistinguishable from other monies the government takes in. The trust funds receive credit for these monies in the form of federal securities issued to the Social Security trust funds. When more Social Security taxes are received than spent, the balance of securities posted to the Social Security trust funds rises. However, the trust funds do not hold the money; they are simply accounts. Similarly, benefits are not paid from the trust funds, but from the treasury, and as with Social Security receipts, the money used is indistinguishable from that used to make other government expenditures. The treasury simply uses whatever funds it has on hand. As the checks are paid, the payments are reflected by deducting an equivalent amount of federal securities from the trust funds.

Generally speaking, the federal securities issued to any federal trust fund represent "permission to spend." As long as a trust fund has a balance of such securities, the Treasury Department has legal authority to keep issuing checks for the program. In a sense, the mechanics of a federal trust fund are similar to those of a bank account. The bank takes in a depositor's money, credits the amount to the depositor's account, and then lends it out. As long as the account shows a balance, the depositor can write checks that the bank must honor. The trust fund balances, like those of a bank account, represent a form of IOU, a promise that, when money is needed to pay Social Security benefits, the government will obtain resources equal to the value of the securities. The surplus taxes themselves are commingled with all other sources of government revenue and used for any of the many functions of government.

¹ This is a revision of a report originally created by former CRS analyst David Koitz.

A Few Basics About Social Security Financing

Financing to cover the costs of the Social Security program (both its benefits and administrative expenses) is provided by flat-rate taxes levied on earnings. The FICA (Federal Insurance Contributions Act) tax is levied on a worker's earnings and is paid both by employees and employers. The SECA (Self-Employment Contributions

Act) tax is levied on earnings from self-employment. More than 95% of the work force is covered by Social Security and therefore must pay FICA or SECA taxes. Income not derived from work is not covered by Social Security and is exempt from these taxes. Both the FICA and SECA rates have three components: one for Old Age and Survivors Insurance (OASI), another for Disability Insurance (DI), the two of which together comprise what is commonly thought of as Social Security, and a third for the Hospital Insurance (HI) portion of Medicare. In 2002, the OASDI portion is levied on earnings up to \$84,900. This maximum level of taxable earnings rises annually to reflect increases in average wages in the economy. The HI portion is levied on all earnings. In addition, the Social Security and Medicare Hospital Insurance trust funds are financed by income taxes some recipients pay on their Social Security benefits.

CY	Employee rate				Total	Combined employee/ employer
	OASI	DI	OASDI	HI		
2002 ¹	5.30	.9	6.20	1.45	7.65	15.3

The rate for the self-employed is the same as the combined employee/employer rate; however, only 92.35% of net self-employment earnings is taxable and half of the taxes so computed is deductible for income tax purposes.

Where Do Surplus Social Security Taxes Go?

Contrary to popular belief, Social Security taxes are not deposited into the Social Security trust funds. They flow into thousands of depository accounts maintained by the government with financial institutions across the country. Along with other forms of revenues, Social Security taxes become part of the government's operating cash pool, or what is commonly referred to as the U.S. treasury. Once these taxes are received, they become indistinguishable from other monies the government takes in. They are accounted for separately through the issuance of federal securities to the Social Security trust funds (which basically involves a series of bookkeeping entries by the Treasury Department) but the trust funds themselves do not receive or hold money.² They are simply accounts. Similarly, benefits are not paid from the trust funds, but from the treasury. As the checks are paid, securities of an equivalent value are removed from the trust funds.

Does This Mean That the Government Borrows Social Security Taxes?

Yes. When more Social Security taxes are received than spent, the money does not sit idly in the treasury, but is used to finance other operations of the government or buy

² P.L. 103-296 requires the Secretary of the Treasury to issue "physical documents" to the trust funds. Under prior practice, trust fund securities were only recorded electronically.

up outstanding federal debt held by the public. The surplus is then reflected in a higher balance of federal securities posted to the trust funds. These securities, like those sold to the public, are legal obligations of the government. The balances of the Social Security trust funds represent what the government has borrowed from the Social Security system (plus interest). Like those of a bank account, the balances represent a promise that if needed to pay Social Security benefits, the government will obtain resources equal to the value of the securities. The Social Security trustees project that the balances of the trust funds will be almost \$1.4 trillion by the end of CY 2002. (See the following table.)

Projected Social Security Trust Funds' Income, Outgo, and End-of-Year Balances (\$s in billions)					
Calendar Year	Tax Income	Interest Income	Total Income	Outgo	End-of-year balance
2002	\$ 545	\$ 80	\$ 624	\$ 465	\$1,372
2005	638	115	752	525	1,994
2010	818	196	1,014	708	3,382
2015	1,037	289	1,326	996	5,021
2020	1,302	377	1,679	1,427	6,484
2025	1,629	427	2,056	1,993	7,220
2030	2,038	406	2,444	2,667	6,712
2035	2,550	289	2,839	3,426	4,531
2040	3,184	52	3,236	4,273	294

Source: 2002 Social Security Trustees' Report, April 9, 2002.

What is the Nature of the Federal Securities Issued to the Trust Funds?

They are very similar to the federal securities that individuals and other entities buy. While generally the securities issued to the trust funds are not marketable, they earn interest at market rates, have specific maturity dates, and by law represent obligations of the U.S. Government. What often confuses people is that they see these securities as *assets* for the government. However, unlike most assets that represent a financial claim against some other person or entity, when the government issues a security to one of its own accounts, it is basically creating an IOU from one of its accounts to another. Hence, the building up of federal securities in federal trust funds — like those of Social Security — is not a means in and of itself for the government to accumulate assets. It certainly establishes claims against the government for the Social Security system, but the system is part of the government. Those claims are not resources that the government has at its disposal to pay future Social Security benefits.

Then What is the Purpose of the Trust Funds?

Generally speaking, the federal securities issued to any federal trust fund represent “permission to spend.” As long as the trust fund remains credited with a positive balances of securities, the Treasury Department has legal authority to keep issuing checks for the

program. In a sense, the mechanics of a federal trust fund are similar to those of a bank account. The bank takes in a depositor's money, credits the amount to the depositor's account, and then lends it out. As long as the account shows a positive balance, the depositor can write checks that the bank must honor. In Social Security's case, its taxes flow into the treasury, and its trust funds are credited with federal securities. The government then uses the money to meet whatever expenses are pending. The fact that this money is not set aside for Social Security purposes does not diminish the government's responsibility to honor the trust funds' account balances. As long as they have balances, the Treasury Department must continue to issue Social Security checks. The key point is that the trust funds do not hold resources to pay benefits; rather, they provide authority for the Treasury Department to use whatever money it has on hand to pay them.

The significance of the trust funds is that they represent a long-term commitment of the government to the Social Security program. While the funds do not hold "resources" that the government can call on to pay Social Security benefits, the balances of federal securities posted to them represent and have served as financial claims against the government — claims on which the treasury has never defaulted, nor used directly as a basis to finance anything but Social Security expenditures.

Is This Trust Fund Arrangement Really Different From That Used by Other Programs of the Government?

The Treasury Department maintains accounts for all government programs. However, many programs, particularly those not accounted for through trust funds, are required to get their operating balances, i.e., their permission to spend, through the annual appropriations process. Congress must pass legislation (an appropriations act) each year giving the Treasury Department permission to expend funds for these programs' outlays. In technical jargon, this permission to spend is referred to as "budget authority." For many programs accounted for through trust funds, annual appropriations are not needed. As long as their trust fund accounts show a balance of federal securities, the Treasury Department has "budget authority" to expend funds for their outlays.

Another difference is that, because it consists of federal securities, a trust fund account earns interest. In the case of the Social Security trust funds, the interest is equal to the prevailing average rate on outstanding federal securities with a maturity of four years or longer. This interest is credited to the trust funds twice a year (on June 30 and December 31) by issuing more securities to them. So in effect, a trust fund account can automatically build future "budget authority" for the program, but other accounts, dependent on annual appropriations, cannot.

Does Taking Social Security Out of the Federal Budget Change Where the Surplus Taxes Go?

Legislation enacted in 1990 (the Budget Enforcement Act, included in P.L. 101-508) removed Social Security taxes and benefits from calculation of the budget totals. In large part this was done to prevent Social Security from masking the size of federal budget deficits and to protect it from benefit cuts motivated by budgetary concerns. It was based on the supposition that Congress would act *differently* in trying to reduce budget deficits if Social Security surpluses were not counted in reaching the budget totals, i.e., that

Congress would ignore Social Security in devising the Nation's overall fiscal policies. *It was not done to change where Social Security taxes go.* The federal budget is not a cash management account. It is simply a summary of what policymakers want the government's financial flows to be during any given time period. Whether this summary is presented in a unified or fragmented form will not in and of itself change how much money the government receives and spends, and it will not alter where federal tax receipts of any sort go. Social Security taxes will go into the treasury regardless of whether the program is counted in the budget. Social Security taxes will go elsewhere only if Congress decides they will go elsewhere.

Are Surplus Social Security Taxes Giving the Government More Money to Spend?

Just because surplus Social Security taxes are used by the government to meet other financial commitments does not necessarily mean that it has more money to spend than it otherwise would. Decisions about Social Security and the finances of the rest of the government have not been made in isolation of one another and those decisions have had overlapping influences. Increases in Social Security taxes may have made it more difficult for Congress to raise other forms of taxes. For instance, in 1977 Social Security taxes were raised to shore up the program's financing, but the following year Congress enacted reductions in income taxes to offset the impact of these rate increases. Similarly, the Earned Income Tax Credit (EITC), which reduces incomes taxes or permits a refundable credit to be paid to low-income workers, is intended in part to offset the Social Security tax bite. Hence, other taxes might have taken the place of the surplus Social Security taxes if Social Security tax rates were lower than they are. Thus, whether these surplus taxes are allowing the government to spend more is largely conjecture.

Are Surplus Social Security Taxes Allowing the Government to Reduce Its Publicly-Held Debt?

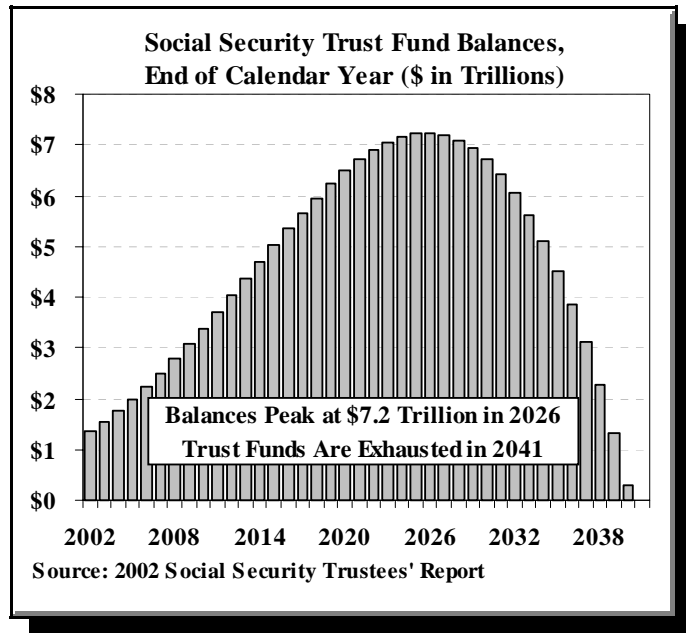
Today, the government has outstanding debts to the public totaling approximately \$3.5 trillion. When the Treasury Department takes in more than it spends, the excess receipts automatically are used to retire this debt. In other words, budget surpluses have the effect of reducing the outstanding amount of the government's past borrowing from the public.

No single activity of the government determines the amount of a budget surplus. To say surplus Social Security taxes are reducing the amount of the government's publicly-held debt assumes that all other past spending and taxation decisions have been made without any regard for Social Security's income and outgo, and vice versa. If increases in Social Security taxes in the past caused other taxes to be reduced or kept from rising, they may have added little to the government's total revenues. By the same token, when Social Security's taxes are less than its expenditures — as they were for all but five fiscal years from 1958 to 1984 — it is not clear that this shortfall causes the government to borrow more than it would otherwise. Government borrowing from the public is not clearly linked to any particular aspect of what the government does. It borrows as it needs to for whatever obligations it has to meet. Thus, whether surplus Social Security taxes are now allowing the government to reduce its publically held debt is largely conjecture.

Is There Some Way to Actually Save the Social Security Surpluses?

Perceiving that surplus Social Security taxes are being spent on other government programs rather than being saved, people sometimes ask why the surplus taxes cannot be invested instead in stocks or bonds. They feel that this would really save the money for the future.

In fact, the surplus Social Security taxes being collected today are not the means through which much of the future cost of the system will be met. Most of today's taxes are used to cover payments to today's retirees (in 2002 the system's taxes are estimated to be \$545 billion; its expenditures, \$465 billion). At their peak in 2026, the balances of the Social Security trust funds are expected to equal only 3.4 years' worth of payments. The promise of future benefits rests primarily on the government's ability to levy taxes, as is the case today, not on the balances of the trust funds.



The more immediate concern about investing the surplus taxes elsewhere is that doing so would reduce the government's cash pool. How would the government make up this loss? Would it raise taxes, cut spending, or simply keep its outstanding debt higher than it otherwise would be?

In a sense, the concept of investing surplus Social Security taxes in private investments is only half an idea. If the government borrowed from the public to make up the loss, it simply would be putting money into the markets with one hand and taking it back with the other. On balance, it would not have added any new money to the Nation's pool of investment resources. If, on the other hand, the government were to reduce its spending or raise other taxes to make up for the loss, the additional investment of surplus taxes in the private market presumably would result in a net increase in national savings. Thus, the basic issue is not whether real savings would be created if surplus Social Security taxes were invested in private markets; rather, it is how fiscal policymakers would react.

For additional CRS reading, see: Issue Brief IB98048, *Social Security Reform*, by Geoffrey Kollmann and Dawn Nuschler, Report 91-129; *Social Security: Investing the Surplus*, by Geoffrey Kollmann; and Report RL 30571, *Social Security Reform; the Issue of Individual versus Collective Investment*, by David Koitz. For a shorter discussion, see Report 95-543, *The Financial Outlook for Social Security and Medicare*, by Geoffrey Kollmann and Dawn Nuschler; Report 95-206, *Social Security's Treatment Under the Federal Budget: A Summary*, by Dawn Nuschler; and Report RS20165, *Social Security and Medicare "Lock Boxes,"* by David Koitz, Geoffrey Kollmann and Dawn Nuschler.