

Congressional Budget Office

Nonpartisan Analysis for the U.S. Congress



**ANSWERS TO QUESTIONS
FOR THE RECORD**

Following a Hearing on

Social Security's Finances

Conducted by the
Committee on the Budget
United States Senate

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On July 12, 2023, the Senate Committee on the Budget convened a hearing at which Phillip L. Swagel, the Director of the Congressional Budget Office, testified about Social Security's finances.¹ After the hearing, Chairman Sheldon Whitehouse, Ranking Member Chuck Grassley, and Senator Ron Wyden submitted questions for the record. This document provides CBO's answers. It is available at www.cbo.gov/publication/59378.

Senator Whitehouse's Question About the Economic Effects of a New Tax on Higher-Income People and Increases in Social Security Benefits for Retirees

Question. If Congress were to enact a Social Security tax on the incomes of very wealthy people, for whom each additional dollar of income is more likely to be saved than spent, to fund Social Security benefits for all retirees, who are more likely to spend than save, what would the effect on the economy be from accounting for the distribution of the revenue to Social Security beneficiaries? Please discuss the situation under current law where benefits would be limited to payable benefits after insolvency, rather than following CBO's baseline convention that assumes scheduled benefits would be paid despite the lack of legal authority.

Answer. In a recent report, CBO estimated the economic and budgetary effects of limiting Social Security benefits to what is payable from dedicated funding sources following the projected exhaustion of the combined Old-Age, Survivors, and Disability Insurance (OASDI) trust funds in fiscal year 2033.² (Although there are two trust funds that are legally separate, in some of its analyses, CBO considers them as combined trust funds.) Under that payable-benefits scenario, the required reduction in total annual Social Security benefits after the trust funds' balances reach zero amounts to 25 percent in 2034 and increases to 28 percent in 2053, relative to the amounts in CBO's long-term budget projections (known as the extended baseline). For its analysis, CBO assumed that all

existing and new OASDI beneficiaries would experience the same percentage reduction in benefits as the overall percentage reduction.³

In the short term, the decline in Social Security benefit payments would cause consumer spending to decrease, savings to increase (as some people save more for retirement), and overall demand for goods and services to decline. The near-term result would be less output than in the extended baseline projections in which scheduled payments are assumed to be made. In the long term, output would be greater than it is in the extended baseline, mainly as a result of three factors: an increase in the supply of labor, an increase in private investment following an increase in private savings, and an increase in the quantity of funds available for private investment following a reduction in borrowing by the federal government.

A policy that would instead increase Social Security benefits above amounts that would be payable from the trust funds under current law would have the opposite effects. In the short term, the increase in Social Security payments would cause consumer spending to increase, savings to decrease (as some people save less for retirement), and overall demand for goods and services to increase. As a result, output would be greater in 2034 and 2035 than it would be if payments were limited to payable benefits. In the long term, output would be less, mainly as a result of three factors: a decrease in the supply of labor, a decrease in private investment following a decline in private savings, and a decrease in the amount of funds available for private investment following an increase in borrowing by the federal government.

If the Congress considered enacting a new tax or increasing existing taxes, the Joint Committee on Taxation would provide the estimates of the effects of that proposed change to the tax code.

Although CBO would not be the source of such an estimate, the agency can offer the following general assessment of the effects of a policy that would extend the Social Security tax to higher incomes—for example, by taxing annual earnings in excess of the maximum taxable amount under current law (\$160,200 in 2023).

1. Testimony of Phillip L. Swagel, Director, Congressional Budget Office, before the Senate Committee on the Budget, *Social Security's Finances* (July 12, 2023), www.cbo.gov/publication/59354.

2. Congressional Budget Office, *The Long-Term Budget Outlook Under Alternative Scenarios for the Economy and the Budget* (July 2023), www.cbo.gov/publication/59233.

3. For more details about the legal issues related to exhaustion of a trust fund, see Barry F. Huston, *Social Security: What Would Happen If the Trust Funds Ran Out?* Report RL33514, version 34 (Congressional Research Service, September 28, 2022), <https://tinyurl.com/3v5t6a28>.

The boost to revenues from such a policy would increase dedicated funding for Social Security and increase benefit payments relative to a scenario in which benefits are reduced after the combined trust funds' balances reach zero. Such a policy would affect the economy in the short term by altering overall demand and in the longer term by affecting people's incentives to work and save.

In CBO's assessment, overall demand would probably increase following the increase in benefit payments and the increase in taxes on earnings for high-income individuals. Specifically, the increase in benefit payments would increase spending by retirees, relative to the payable-benefits scenario. When combined with higher taxes on earnings among high-income individuals, the increase in benefit payments would reduce hours worked by nonretirees and cause some people to retire earlier than they would have under the payable-benefits scenario. The reduction in hours worked and higher taxes would reduce nonretirees' after-tax income and spending. In CBO's assessment, the increase in spending by retirees would probably be larger than the decrease in spending by nonretirees, thereby increasing overall demand. However, ultimately the net effect of the policy change on the economy in the short term would depend on how the policy was implemented and the state of the economy when the policy change occurred.

In the longer term, the increase in benefits and the higher taxes would reduce the supply of labor and reduce savings and investment. Over time, those reductions would slow economic growth and reduce the overall size of the economy, which would have negative effects on most households, including many that will not have earnings above the maximum taxable amount under current law.

Senator Grassley's Question About the Effects of Social Security on the Federal Budget and Debt

Question. How does Social Security affect the federal budget and federal debt?

Answer. Most public discussion and reports about the federal budget address the unified budget, which encompasses all the activities of the federal government, including activities related to the Social Security program. Since 2010, Social Security outlays have exceeded dedicated revenues (receipts from the Social

Security payroll tax and some of the income taxes on Social Security benefits). CBO estimates that in fiscal year 2023, outlays will exceed revenues by \$145 billion, increasing the unified budget deficit by that amount. In CBO's projections, the shortfall in the Social Security program grows, thus contributing to the projected growth in unified deficits.⁴

Social Security revenues are credited to the program's two trust funds—one for Old-Age and Survivors Insurance (OASI) and one for Disability Insurance (DI). In addition to tax revenues, the trust funds also receive interest payments on the Treasury securities they hold. Those interest payments are intragovernmental: They are recorded in the budget as outlays from the general fund of the Treasury and as income to the trust funds, with no net effect on the unified deficit.

Social Security affects different measures of the debt differently. Debt held by the public, which consists mainly of Treasury securities, is a measure that indicates the extent to which federal borrowing affects the availability of private funds for other borrowers. It is the measure of debt that CBO uses most often in its reports on the budget. Debt held by the public is less than it would have been without Social Security, because over the life of the program, total dedicated revenues have exceeded outlays. The trust funds' balances are not counted in debt held by the public, but because they are invested in Treasury securities, they are included in the measures of gross federal debt (the sum of debt held by the public and debt held by government accounts) and debt subject to limit (the limit is a statutory ceiling that applies to gross federal debt, with some small exceptions). At the end of June 2023, the two Social Security trust funds held a total of \$2.9 trillion in Treasury securities.

The trust funds serve as accounting mechanisms to link the program's income with corresponding expenditures. When a trust fund receives income that is not immediately needed to pay benefits or cover other expenses, the Treasury issues Government Account Series (GAS) securities totaling that amount to the fund and then uses the extra cash to finance the government's activities, just as it uses other revenues. As a result, the government

4. For CBO's most recent 10-year trust fund projections, see Congressional Budget Office, "10-Year Trust Fund Projections" (supplemental material for *An Update to the Budget Outlook: 2023 to 2033*, May 2023), www.cbo.gov/data/budget-economic-data#5.

borrow less from the public than it would without that extra net income, given a fixed amount of revenues and outlays. The reverse happens when a trust fund's income falls short of its outlays; the fund returns the GAS securities to the Treasury, which then must borrow from the public to come up with the resources with which to make payments to Social Security beneficiaries.

The balance of a trust fund is a measure of the historical relationship between the program's income and outlays. That balance (in the form of GAS securities) is an asset for the individual program but a liability for the rest of the government. Trust funds have legal meaning in that their balances are a measure of the amounts that the government has the legal authority to spend for certain purposes under current law, but they have little relevance in an economic or budgetary sense unless the balance of the funds falls to zero. (In CBO's projections, the OASI trust fund is exhausted in fiscal year 2032 and the DI trust fund is exhausted in calendar year 2052.)

For certain budget enforcement purposes, budget accounts are divided into two categories: on-budget and off-budget. By law, the budget authority, outlays, and revenues of most programs are on-budget—that is, they are included in budget totals—and on-budget activities are subject to the normal budget process and to budget enforcement procedures. Social Security, like the Postal Service, is classified as off-budget. Most activities for off-budget programs are not subject to caps, sequestration, or reporting and enforcement procedures under the Statutory Pay-As-You-Go Act of 2010 (often called S-PAYGO). Budget resolutions (the Congress's budget plan) generally exclude off-budget programs.

Senator Grassley's Question About the Differences Between the Shortfalls Projected by CBO and the Social Security Trustees

Question. CBO and the Social Security Trustees each produce estimates of Social Security's finances, and while both of you project a shortfall that will need to be addressed soon, you differ on the exact size of the problem. What are some of the reasons for the differences in your projections?

Answer. CBO and the Social Security trustees each produce independent projections of the financial status of the Social Security system. In both projections, Social

Security faces a significant financial challenge, though the magnitudes of the expected shortfalls in the trust funds over the next 75 years differ.

A feature of CBO's work is that the demographic and economic forecasts used for its projections of Social Security's finances are consistent with those used in the agency's baseline projections and for other purposes.

In 2019, CBO published a report that examined the differences between CBO's and the trustees' projections of key demographic and economic factors and how those differences contributed to the difference in projections of the Social Security system's finances.⁵ According to the report, CBO projected larger shortfalls in Social Security's finances, and the difference stemmed mainly from differences in four key factors: projections of the population, components of growth in gross domestic product (GDP), earnings subject to Social Security payroll taxes, and real interest rates (that is, interest rates adjusted to remove the effects of inflation).

In CBO's assessment, differences in those four key factors remain the principal reasons why CBO projects a larger financial shortfall than the trustees do.

- CBO projects lower fertility rates and larger increases in life expectancy than the trustees do. As a consequence, CBO's projection of the ratio of the population age 65 or older to the working-age population is larger than the trustees' projection. With relatively more people eligible for benefits and fewer of working age, CBO's projection includes a larger financial shortfall than does the trustees' projection.
- CBO projects slower growth of nominal GDP than the trustees project.
- Over the long term, CBO projects that the share of earnings subject to Social Security payroll taxes will be smaller than the trustees expect, so projected payroll tax revenues are lower.
- Over the long term, CBO projects lower interest rates than the trustees do. The large future gaps between outlays and revenues are therefore weighted more heavily in CBO's present-value calculations

5. Congressional Budget Office, *CBO's Long-Term Social Security Projections: Changes Since 2018 and Comparisons With the Social Security Trustees' Projections* (December 2019), www.cbo.gov/publication/55914.

than in the trustees' calculations, which contributes to CBO's projection of a larger shortfall. (A present value expresses a flow of current and future income or payments in terms of an equivalent lump sum received or paid today.)

Another difference between CBO's and the trustees' projections of the Social Security system's finances involves projections of revenues from income taxes paid on Social Security benefits. The statutory thresholds above which Social Security benefits are subject to income tax—\$25,000 for single filers and \$32,000 for joint filers—are not indexed for inflation. Therefore, in both CBO's and the trustees' projections, those revenues increase as a percentage of GDP over time. However, CBO assumes that the income thresholds for the various tax rate brackets in the individual income tax will generally increase with inflation, as specified under current law. By contrast, the trustees assume that beginning in 2033, as a result of future legislative changes, those income thresholds increase by more than the rate of inflation—rising in line with average wages. That assumption reduces the trustees' projection of revenues from taxation of benefits.

In addition, the modeling approaches that CBO and the trustees use differ. Even if the projections of key demographic and economic factors and revenues from income taxes paid on Social Security benefits were the same, differences in projections of program finances would remain.

Senator Wyden's Questions About the Fundamentals of Trust Fund Accounting

Question. How do the Social Security Trust Funds reserves appear on the Federal balance sheet?

Answer. The balances of the OASI and DI trust funds represent assets for the individual OASI and DI programs but liabilities for the rest of the federal government. Those amounts are included in the Treasury's reported total for debt that is subject to the statutory limit on federal borrowing (that limit is often referred to as the debt ceiling).

Question. Cash-flow surpluses in Social Security—when tax revenues and accumulated interest exceed outgoing benefit payments—are required by Section 201 of the

Social Security Act (42 U.S.C. §401) to be immediately invested in interest-bearing U.S. Treasury securities. How does this investment practice appear on the Federal balance sheet? How does this investment practice affect the Federal Government's borrowing practices?

Answer. In years when Social Security's dedicated revenues exceed its outlays, the Treasury retains those surpluses and issues GAS securities totaling that amount to the trust funds, increasing intragovernmental debt. Those surpluses enable the government to borrow less from the public to finance budget deficits than it otherwise would, so there is no net increase in debt subject to the limit on federal borrowing. In years when outlays exceed dedicated revenues but the trust funds have positive balances, the associated amount of borrowing from the public is larger than it otherwise would be, assuming no change in other federal revenues and outlays.

Question. Has the Federal Government ever not paid back the Trust Funds, even late?

Answer. No. All securities held by the Social Security trust funds have been redeemed as required by law.

Question. When Treasury securities held by the Social Security Trust Funds are redeemed, how does the redemption appear on the Federal balance sheet?

Answer. When a trust fund redeems a security, the Treasury makes a cash payment from the general fund to the trust fund. That exchange of securities for cash is an intragovernmental transaction and therefore has no net effect on total federal assets or liabilities.

Question. Do trust fund operations draw on other Federal resources? Please explain why.

Answer. A trust fund is an accounting mechanism that links income designated for a specific purpose with corresponding expenditures. A positive trust fund balance indicates that a program's income (including interest income credited to the trust fund) has, over the life of the program, exceeded the program's expenditures. Most Social Security income is from dedicated revenue sources: the Social Security payroll tax and some of the income taxes on Social Security benefits. However, over the life of the program, the trust funds

have received more than \$250 billion in transfers from the general fund, most of which were made to offset a 2 percentage-point reduction in the payroll tax in calendar years 2011 and 2012.

Question. Under budgeting rules, the Congressional Budget Office is required to assume that full scheduled benefits will continue to be paid by borrowing from the General Fund once trust fund reserves are depleted. Under federal law, if the trust funds were to be depleted, are the Social Security and Medicare trust funds permitted to borrow from the General Fund?

Answer. The Social Security and Medicare trust funds do not have the legal authority to borrow from the general fund.

Senator Wyden’s Question About Immigration Reform and Trust Fund Solvency

Question. During previous immigration reform discussions, CBO has estimated that passing immigration reform would substantially increase the solvency of the trust funds without increasing revenue or cutting benefits, is that correct? Can you expand on why that is the case?

Answer. The revenues to and outlays from the Social Security trust funds depend on the size and composition of the U.S. population (more specifically, the relevant population for the calculation of Social Security payroll taxes and benefits). The growth of that population is determined by births, deaths, and net immigration.

In CBO’s projections, net immigration flows become an increasingly important driver of overall population growth. Population growth that is driven increasingly by immigration could translate into a larger labor force than would exist absent the immigration-driven increases in population. In 2021, 25- to 54-year-olds—the age group with the highest rate of labor force participation—made up a greater share of the foreign-born population than of the native-born population.

A larger labor force would increase total economic output and tax revenues. A smaller labor force would have the opposite effects. The effect of immigration on the labor force and thus Social Security’s finances (through increasing payroll tax receipts) depends on the legal status of those immigrants and their work authorization status. The

effect of immigration reform on solvency would depend on which types of immigrants were affected by reform and whether reform increased or decreased their numbers. In assessing the effects of immigration reform on Social Security’s finances, CBO considers the anticipated effect of reforms on people with the following legal statuses:

- Lawful permanent residents are authorized to work, responsible for paying taxes, and eligible for Social Security benefits. They must meet eligibility requirements, such as those related to past earnings, to receive Social Security benefits. An increase in lawful permanent residents would result in more workers and thus higher payroll tax revenues. Eventually those workers would be eligible to claim benefits, which would increase Social Security outlays, but on net, an increase in lawful permanent residents would improve the financial status of the program.
- Legal temporary residents (such as migrants employed through temporary work visa programs) are also eligible for Social Security benefits if they meet the eligibility requirements, such as those related to past earnings. As with lawful permanent residents, an increase in legal temporary residents who are working and paying taxes would improve the Social Security system’s finances.
- Foreign-born people without legal status are generally ineligible for Social Security benefits because they usually are not authorized to work in the United States. However, some people without legal status are authorized to work and may be eligible for Social Security benefits. Section 208(d) of the Immigration and Nationality Act allows the Department of Homeland Security to provide employment authorization, subject to certain restrictions, to asylum applicants who are not otherwise eligible to work. The Administration, by rule, allows certain recipients of Deferred Action for Childhood Arrivals to receive employment authorization.⁶ Some people work without legal authorization and pay taxes but generally do not receive benefits. The effects of immigration reform on the number of people who currently do not have legal status and their interactions with the Social Security system would be complex and would depend on how reform affected their employment and eligibility for future benefits.

6. Congressional Budget Office, *The Foreign-Born Population, the U.S. Economy, and the Federal Budget* (April 2023), www.cbo.gov/publication/58939.