
Executive Summary

As recently as 1988, the Social Security Trustees' Report projected that the OASDI trust fund would reach \$11.8 trillion by the year 2030. But by 1994, the Trustees' Report projected a maximum trust fund balance of only \$3 trillion by 2030, and the projected date by which the trust fund will run out moved up nineteen years to 2029. *This represents a loss of \$8.8 trillion, or three-fourths of the balance, in only six years.* Financing for the baby boom generation's retirement and beyond is clearly in trouble.

Perhaps this is why while 46 percent of people between the ages of 18 and 34 believe there are UFOs, only one-fourth believe Social Security will exist when they retire.

What caused the rapid dwindling of the trust fund? First, the U.S. economy has performed more poorly than projected in 1988. The last recession, combined with expectations of slower future growth, has caused almost one-quarter of the payroll tax base to evaporate.

Second, Social Security is making promises it cannot possibly keep, committing to benefit levels much higher than historical levels. For its first three decades, Social Security replaced about one-third of the average worker's salary in retirement. Today, Social Security promises to replace 42 percent, a real increase of about a third over the system's historical role. Benefits of the companion program, Medicare, will grow at an even more alarming rate.

The revenues necessary to support the rapid growth of Social Security and Medicare will claim almost 15 percent of the U.S. economy within the next 35 years, giving the federal government even greater control over the productive resources of Americans than it already has.

Social Security must be fixed, but unfortunately the possible solutions involve counterproductive economic effects and faint political likelihood:

- Eliminating the Social Security and Medicare deficits through *payroll tax increases* would require a doubling of the current 15.3 percent payroll tax in the next 35 years. Covering the deficits through *increases in personal income taxes* would require an across the board 75 percent increase by 2030. However, damaging economic effects from higher tax rates would nullify any real progress toward raising more revenue.
- Closing the Social Security and Medicare deficits by *reducing other spending* would require a cut equal to 1.6 percent of GDP in 2030, which would take the entire defense budget and much nondefense discretionary spending by 2030.
- Eliminating the Social Security deficit by *reducing benefits* would require that benefits increase by only 4 percent over the next 25 years, instead of the current projected increase of 25 percent. Over the next 75 years, instead of doubling in real terms, benefits would increase by one-third.
- *Privatizing Social Security* by allowing people to opt out of the system is often touted as a desirable fix, but still leaves the problem of paying current benefits. Because Social Security is a pay-as-you-go system, any reduction in current payments would endanger current beneficiaries.

Boosting U.S. economic growth is the painless way to brighten Social Security's financial picture. Increasing U.S. economic growth by a half percentage point would cut the long-run Social Security deficit by 25 percent, and boosting growth by a full percentage point would cut that deficit in half. Coupled with a slower rate of benefit growth and incentives for private savings, the baby boom generation's retirement can be secure.

The Social Security trust fund has lost a projected \$8.8 trillion since 1988, a full three-fourths of the trust fund balance.

Boosting U.S. economic growth is the painless way to brighten Social Security's financial picture.

SALVAGING SOCIAL SECURITY: The Incredible Shrinking Trust Fund and What We Can Do About It

A recent poll found that while 46 percent of people between the ages of 18 and 34 believe there are UFOs, only one-fourth believe Social Security will exist when they retire.¹ Social Security faces an uncertain future, and turmoil over Social Security will only intensify as the baby boomers begin to reach retirement age. But despite this unparalleled lack of faith in the system, Social Security remains politically untouchable.

Although the facts and figures clearly document the impending financial disaster, members of the recent Kerry-Danforth Commission on Entitlement and Tax Reform failed to reach any agreement. More recently, empty claims about "protecting" Social Security helped derail passage of a balanced budget amendment. In the political arena, Social Security today seems even more of a sacred cow than ever.

But surely even sacred cows should get veterinary treatment when they are ill. The government admits that Social Security is headed for big financial trouble, and its forecasts have turned decidedly bearish. In the past, outside analysts generally relied upon the government's pessimistic scenario, instead of its intermediate, or "best guess," as a more realistic gauge of the system's long-run condition. Now, however, the "best guess" is as bad or worse than previous pessimistic forecasts. Without major surgery, the coming taxpayer bailout of Social Security will dwarf the savings and loan fiasco.

This study examines the prospects of Social Security today and over the next 75 years. The term "Social Security" refers to the retirement, survivors and disability programs contained in the Social Security Act. Although there are two separate trust funds, one for the Old-Age and Survivors Insurance (OASI) program and the other for Disability Insurance (DI), this study, following common practice, combines them into one trust fund (OASDI).

The study first analyzes the reasons behind the recent deterioration in the system's financing. Next, it looks at the substantial burden that OASDI will place on the economy and workers in the future. Although the main focus is Social Security, the financial status of the other major (and related) government retirement program—Medicare—is also explored. Finally, the study evaluates several alternate ways to deal with Social Security's problems, including tax increases, spending cuts, and stimulating economic growth.

Social Security's Latest Crisis

After passage of the 1983 Social Security Amendments, Americans were told not to worry about Social Security. Changes recommended by the Greenspan Commission, enacted by Congress, and signed into law by President Reagan, were to "have restored the financial soundness of the OASDI program for many years into the future."² The Trustees proclaimed that Social Security would be able to pay benefits for the next 75 years.³

Introduction

Without major surgery, the coming taxpayer bailout of Social Security will dwarf the savings and loan fiasco.

Table 1**Disappearing Social Security Trust Fund**

¹Year the OASDI trust fund reaches its maximum balance in nominal dollars.

²Year the OASDI trust fund reaches its maximum balance in real dollars.

³Year the OASDI trust fund exhausts all of its Treasury bonds.

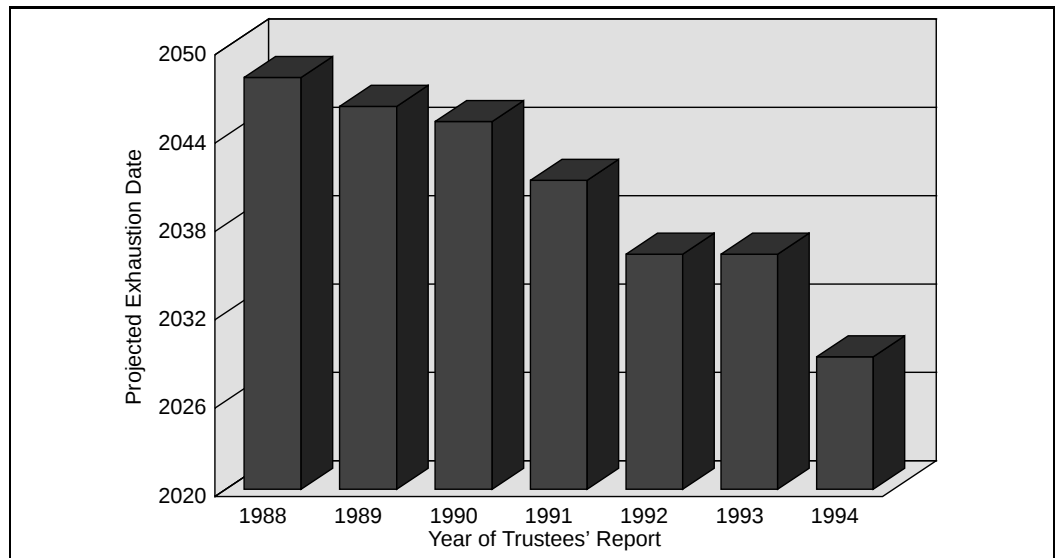
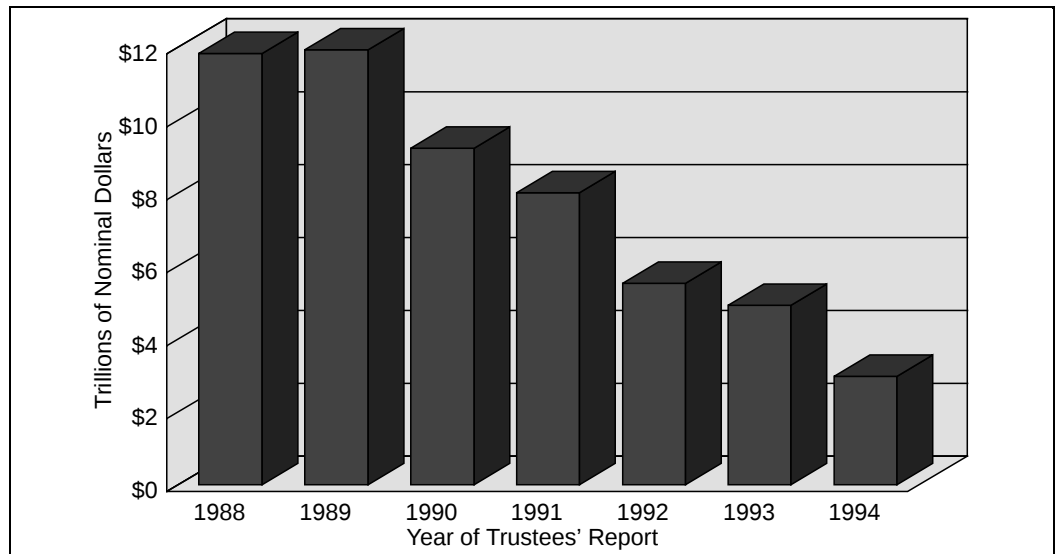
Trustee's Report	Balance (bil.)	Year ¹ Reached	Balance (bil. \$1994)	Year ² Reached	Year ³ Runs Out
1988	\$ 11.8	2030	\$ 3.3	2020	2048
1989	\$ 11.9	2030	\$ 3.5	2020	2046
1990	\$ 9.2	2025	\$ 2.9	2020	2045
1991	\$ 8.0	2025	\$ 2.5	2020	2041
1992	\$ 5.5	2025	\$ 1.9	2020	2036
1993	\$ 4.9	2025	\$ 1.7	2020	2036
1994	\$ 3.0	2020	\$ 1.3	2015	2029

Optimism strengthened during the rest of the 1980s as a robust economy produced more tax revenue than had originally been forecast. In 1988, the Trustees projected that the Social Security trust fund would reach a maximum of \$11.8 trillion by the year 2030, and would not run out of money until 2048.⁴

Since then, however, the trust fund has been shrinking at an alarming rate. As Table 1 shows, the 1994 Trustees' report forecasts a maximum OASDI trust fund balance of only \$3 trillion to be reached in 2020. In other words, *three-fourths of the balance projected only five years earlier has vanished. And the projected date at which the trust fund will be exhausted has moved up nineteen years to 2029.* [See Figures 1 and 2.]

Figure 1**Date the Social Security* Trust Fund is Projected to Run Out**

**"Social Security" refers to the combined Old-Age and Survivors Insurance and Disability Insurance Programs (OASDI).

**Figure 2****Maximum Social Security Trust Fund Balance**

The Trustees now warn that financing for the baby boom generation's retirement and beyond is in trouble.⁵ In Social Security jargon, the system is no longer in "close actuarial balance."⁶ In contrast to their 1983 report, which estimated that revenues would basically equal costs, the Trustees now expect costs to exceed revenues by an average 2.13 percent of taxable payroll over the next 75 years.⁷

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Why the Social Security Trust Fund Disappeared

What could explain this rapid dwindling of the Social Security trust fund? Comparisons between the 1988 and 1994 Trustees' Reports point up two main causes. First, the U.S. economy has performed more poorly than projected in 1988, leading to a smaller payroll tax base and revenues. Second, current estimates of future Social Security benefits are much higher than they were in 1988.

After a period of strong, sustained growth, the U.S. economy began to stall in the late 1980s and slid into recession in the summer of 1990. Recovery from the 1990-91 recession has been weak by historical standards. Even more ominous, private and government economists forecast long-term real growth in the range of 2 to 2.5 percent, well below the average 3.2 percent experienced between 1946 and 1988.

Recession and below par growth have taken their toll on the economy and, accordingly, on tax revenues. *Since 1989, the U.S. economy has lost almost \$1.3 trillion in real GDP relative to the trend of the 1980s.*⁸ And Clinton administration forecasts of future growth imply that the economy will fall another \$2.6 trillion behind where it should be by the end of the decade. [See Figure 3.] Because federal revenues amount to about 19 percent of GDP, the government has foregone \$200 billion in revenue since 1989, and stands to lose another \$600 billion through the rest of the decade.

The outlook in 1988 was much brighter. As Table 2 shows, the Social Security trustees were forecasting higher real GDP growth, higher real wages and lower

Slower Economic Growth

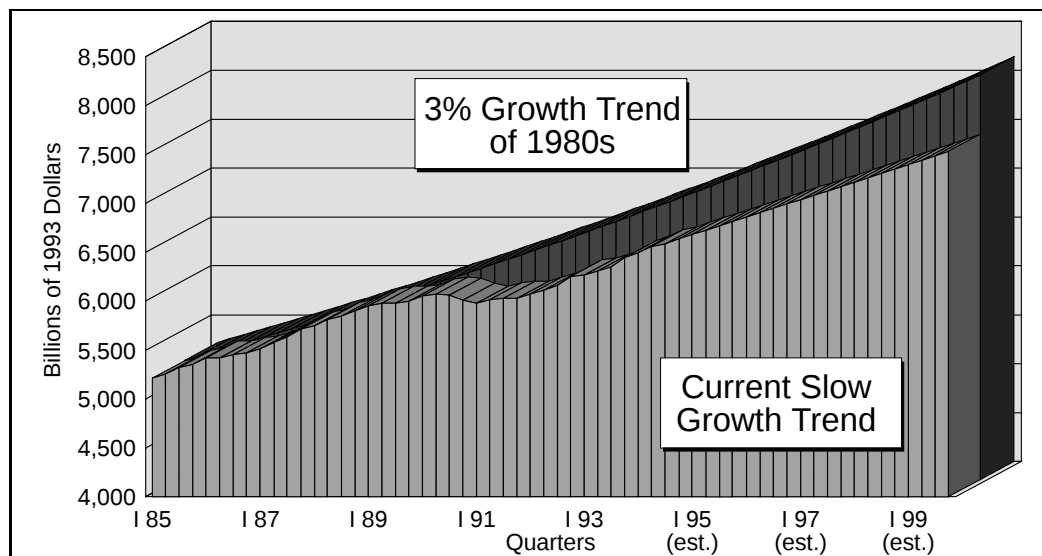


Figure 3
U.S. Real GDP Growth,
1985-1999 (projected)

Table 2

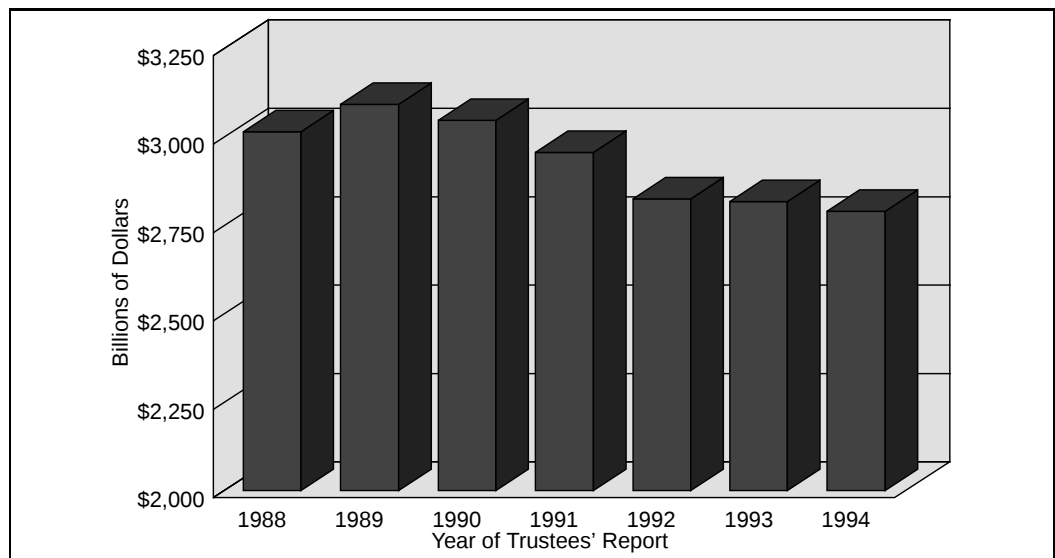
**Economic Forecasting
Error in 1988
Trustees' Report
(Intermediate
Assumptions)**

	Real GDP		Real Wages		Inflation		Unemployment	
	1988 TR	Actual	1988 TR	Actual	1988 TR	Actual	1988 TR	Actual
1988	2.5%	3.9%	0.9%	0.8%	3.9%	4.0%	6.0%	5.5%
1989	2.8%	2.5%	1.1%	-0.5%	4.5%	4.8%	6.2%	5.3%
1990	2.9%	1.2%	1.1%	-0.4%	4.3%	5.2%	6.1%	5.5%
1991	2.8%	-0.7%	1.3%	-0.2%	4.2%	4.0%	6.0%	6.7%
1992	2.7%	2.6%	1.7%	2.3%	4.0%	2.9%	5.9%	7.4%
1993	2.6%	3.0%	1.6%	-0.5%	4.0%	2.8%	5.8%	6.8%
Average	2.7%	2.1%	1.3%	0.3%	4.2%	4.0%	6.0%	6.2%

employment than were actually realized. The last two are particularly important because they determine the payroll base on which Social Security taxes are collected.⁹ As Figure 4 shows, the 1988 Trustees' report projected that taxable payroll in 1994 would be just over \$3 trillion. However, the 1994 report estimates taxable payroll at just under \$2.8 trillion. *Due to this 7.5 percent drop in the tax base, Social Security lost roughly \$70 billion in payroll tax revenues between 1988 and 1994.*

Figure 4

**Estimated 1994
Taxable Payroll
(Intermediate
Assumptions)**



The 1988 Trustees' report also was more optimistic about the longer run. In particular, the Trustees' expected the economy and real wages to grow about a half percentage point faster than they are forecasting today. [See Table 3.] Because the results of diminished growth compound over time, *forecasts of taxable payroll and tax revenue in the 1994 report are up to 23 percent lower over the next 65 years than they were in the 1988 report.*¹⁰ [See Figure 5.]

Table 3

**Comparison of
Longer-Run Economic
Forecasts Between
1988 and 1994
Trustees' Reports
(Intermediate
Assumptions)**

	Real GDP		Real Wages		Inflation		Unemployment	
	1988 TR	1994 TR	1988 TR	1994 TR	1988 TR	1994 TR	1988 TR	1994 TR
2000	2.2%	2.1%	1.4%	0.9%	4.0%	3.9%	6.0%	6.0%
2010	1.9%	1.7%	1.4%	1.1%	4.0%	4.0%	6.0%	5.9%
2020	1.9%	1.3%	1.4%	1.0%	4.0%	4.0%	6.0%	6.0%

Trustees' assumptions are from the 1988 OASDI Report, Table 10, Alternative II-B, and the 1994 OASDI Report, Table II.D.1.

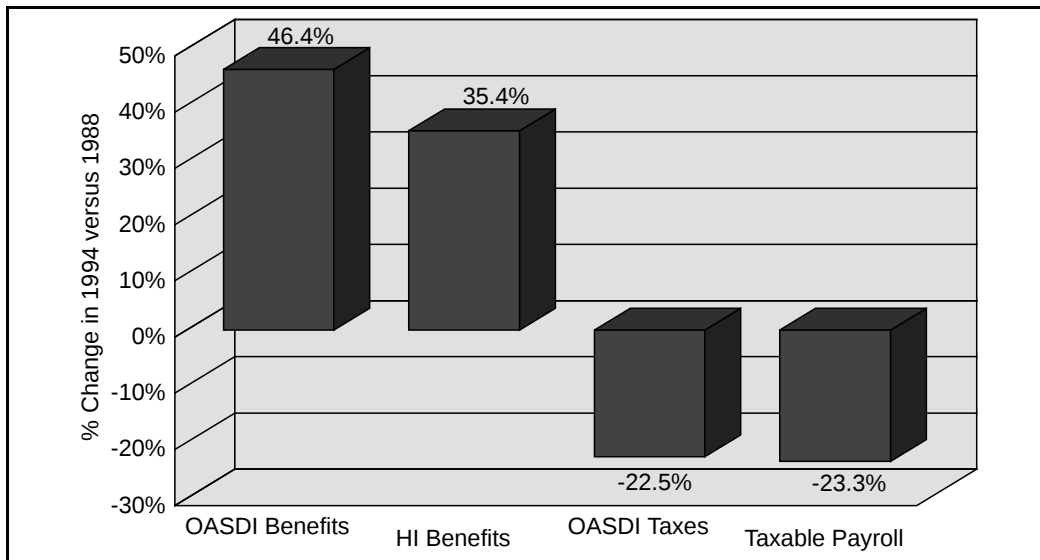


Figure 5
Change in Long-Run
Forecasts Between
1988 and 1994
Trustees' Reports

HI refers to the Hospital Insurance program, or Medicare Part A.

Even more dramatic than the consequences of recent U.S. economic downsizing are forecasts of higher Social Security benefits. *Projected payout of retirement, survivor and disability benefits are up to 46 percent higher in the 1994 Trustees' report than they were in the 1988 report.* This upward revision is even higher than the revision for Medicare's Hospital Insurance program.

The dramatic increase in OASDI program costs is puzzling and unsettling. A change in economic assumptions is not the explanation. Both reports assume the same long-run rate of inflation. If anything, the forecast of lower real wages should lead to lower costs over the long run because benefits depend upon wages.¹¹ Lower real wages mean lower lifetime earnings and, therefore, a smaller Social Security benefit.

Changes in demographic assumptions also are not enough to explain the increase. Although the 1994 report assumes that more people will be collecting benefits, the increase could account for perhaps 10 percent of the higher benefit estimate.¹² Lastly, the Congress has not enacted any benefit increases.

Cost overruns of up to 46 percent with no legislative change, minimal demographic changes, and revised economic assumptions that should work in the opposite direction are troubling, and underscore just how tenuous government forecasts are.

Higher Benefits

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Trust Fund Myths

In other words, trust fund assets are nothing more than government IOUs.

Even if the Trustees' report still projected a trust fund balance of \$11 or \$12 trillion, Social Security would be in trouble. The truth is that Social Security is now, always has been, and without some fundamental change will continue to be, a pay-as-you-go, tax and transfer program. Payroll taxes are collected from current workers and transferred to Social Security beneficiaries as monthly benefit checks. If payroll taxes exceed benefit payments, the Treasury Department credits the excess to Social Security as a government bond. If payroll taxes fall short of benefit payments, Treasury cashes enough of these government bonds to cover the deficit.

In other words, trust fund assets are nothing more than government IOUs. When Social Security needs to start cashing in its bonds, the federal government must either raise taxes, cut government spending, borrow or do a combination of all three to redeem these bonds. In the future, these budget maneuvers will become quite large and have significant economic and political ramifications. For example, according to the 1994 Trustees' report, bond redemptions will amount to \$227 billion in 2020 and over \$1 trillion in 2035.

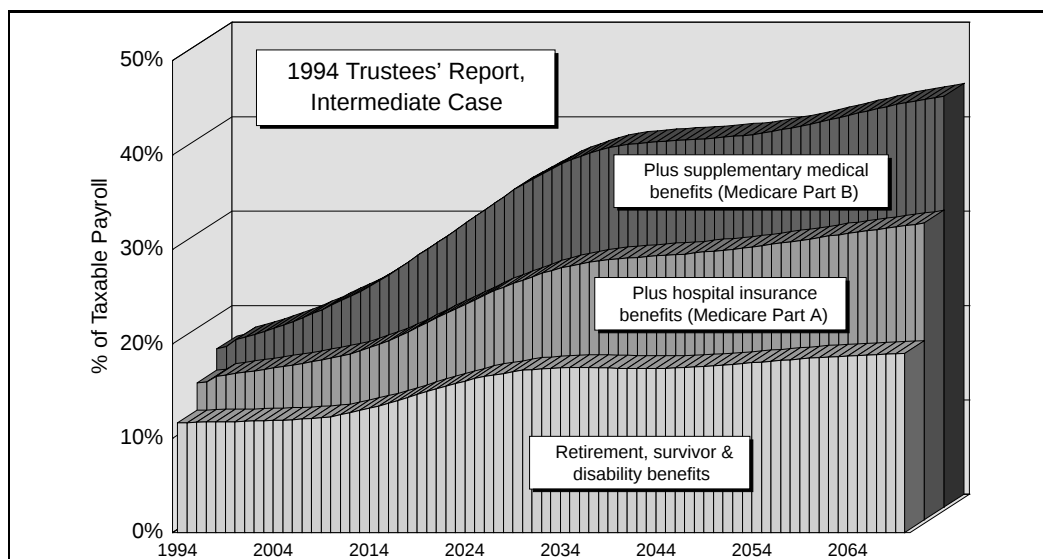
The recent disappearance of the trust fund adds further urgency to the need to fix Social Security and underscores the reason policy makers should get away from using the trust fund to gauge the system's financial status.

Social Security's Claim on U.S. Resources

A truer measure of Social Security's financial condition is the amount of resources that must be transferred from the rest of the economy (workers) to retirees and other beneficiaries. The best estimate of this claim is future program costs as a percent of taxable payroll or gross domestic product (GDP).¹³

According to the 1994 Trustees' report, retirement, disability and survivor benefit payments will rise from 11.6 percent of taxable payroll today to 12.3 percent by 2010 when the baby boom generation begins to retire. Benefits will continue to grow, reaching 17.5 percent of taxable payroll by 2035. [See Figure 6.] Because the

Figure 6
Social Security and Medicare Benefits as a Percent of Taxable Payroll



portion of the payroll tax dedicated to Social Security is 12.4 percent, additional funding must come from somewhere else beginning around 2015.¹⁴

Although the primary focus of this study is the retirement and disability programs, medical benefits promised to Social Security beneficiaries will put an even greater strain on U.S. resources. These benefits come under the heading of Medicare which consists of two parts. Part A pays hospital bills for retired and disabled workers and is financed through a 2.9 percent payroll tax.¹⁵ About one-fourth of Part B, which pays doctor and other outpatient bills, is financed through premiums collected from beneficiaries. The remaining three-fourths comes out of general revenues.

Unlike their Social Security forecasts, the Trustees have been forecasting severe Medicare financing problems for some time. The 1994 report projects that costs for Part A will more than triple from 2.9 percent of taxable payroll today to 5.2 percent in 2010 to 9.8 percent in 2035. Part B costs will quintuple from 2.2 percent of taxable payroll today to 5.9 percent in 2010 to 10.8 percent in 2035.

The tremendous expansion of these two retirement programs will require giving the federal government even greater control over the productive resources of Americans than it already has. Measured against GDP, the Trustees project that Social Security outlays will rise from 4.8 percent of GDP today to 6.7 percent by 2030 while Medicare spending will more than triple from 2.5 percent to 8 percent. In other words, *cash and medical benefits for Social Security beneficiaries will claim almost 15 percent of the U.S. economy within the next 35 years.* [See Figure 7.]

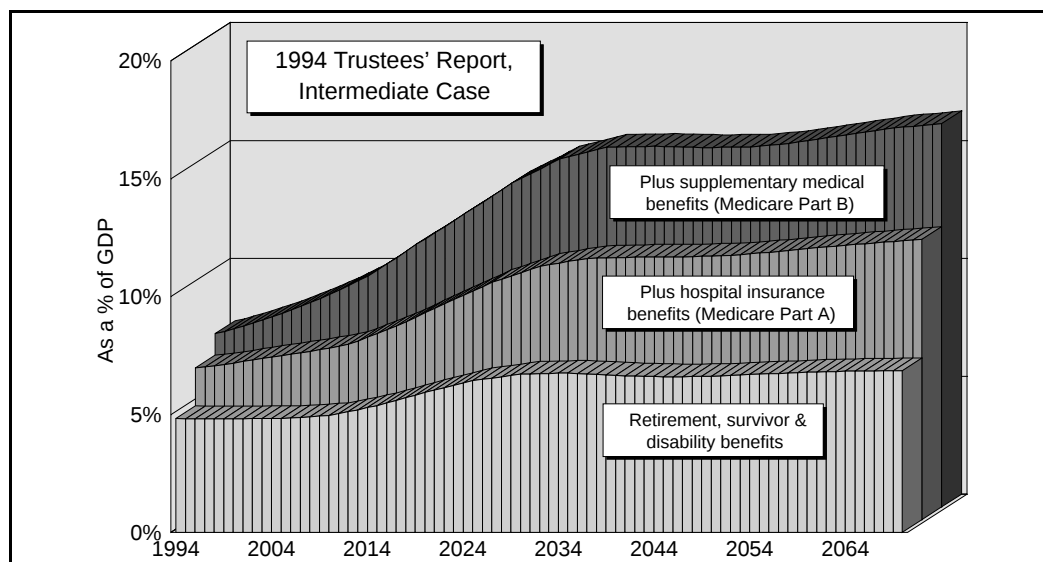


Figure 7
Social Security & Medicare Benefits as a Percent of GDP

Dealing With Future Social Security Deficits (1): Tax Increases

Social Security and Medicare deficits will become quite large compared either to taxable payroll or GDP. When payroll taxes and the revenue from taxing Social Security benefits become insufficient to cover promised benefits, the Social Security and Hospital Insurance trust funds will start to cash in Treasury bonds. To redeem those bonds, the federal government will either have to raise taxes, cut spending elsewhere or increase the national debt. Although the trust fund for Medicare Part B receives an automatic infusion of general revenues to meet program obligations, its ever-growing needs also will mean higher taxes, spending cuts or more borrowing. [See Figures 8 and 9.]

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Figure 8
Social Security and Medicare Deficits as a Percent of Taxable Payroll

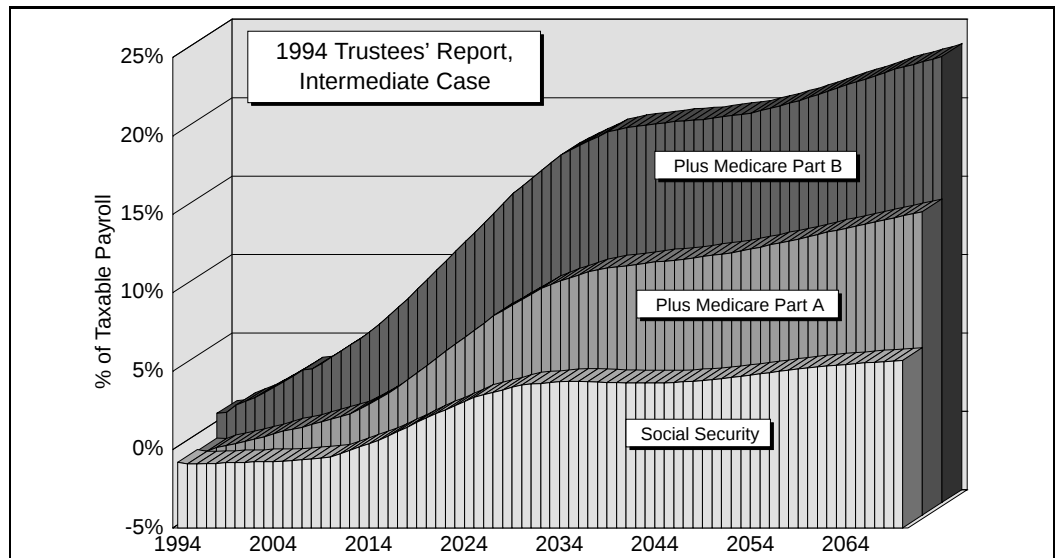
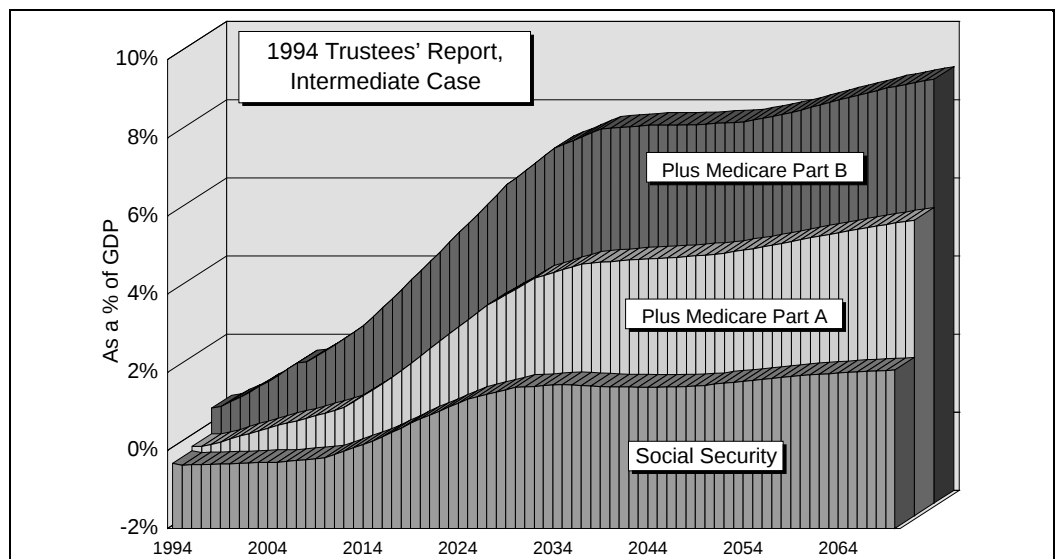


Figure 9
Social Security and Medicare Deficits as a Percent of GDP



Suppose mounting Social Security and Medicare deficits were to be met solely through increases in the payroll tax—as in the past. How high would payroll tax rates have to go? Currently, payroll tax rates for both programs total 15.3 percent—12.4 percent for Social Security and 2.9 percent for Medicare. As Table 4 shows, by 2030, 4.1 percentage points would have to be added to cover Social Security benefits, and another 11.4 percentage points would be needed for Medicare. In other words:

- Eliminating the projected Social Security deficit would require increasing the current 15.3 percent payroll tax by over 25 percent in the next 35 years.
- Eliminating projected Medicare deficits as well would require a doubling of the payroll tax.¹⁶

Suppose mounting Social Security and Medicare deficits were to be met solely through increases in personal income taxes. Doing so might be justified to spread the burden across the entire population, instead of putting it solely on workers. But such tax rate hikes would be substantial. As Table 4 shows, covering the Social Security shortfall would require a 19-percent, across-the-board increase in tax rates by 2030. Covering the Medicare shortfall would require another 56-percent, across-the-board increase in rates. In other words:

Eliminating projected Social Security and Medicare deficits would require a doubling of the payroll tax.

	2010	2020	2030	2040	2050	2060	2070
Payroll Tax Increases¹							
Social Security	-0.5%	2.0%	4.1%	4.3%	4.4%	5.2%	5.7%
Medicare Part A	1.9%	3.4%	5.3%	6.7%	7.3%	7.8%	8.7%
Medicare Part B ²	2.8%	4.6%	6.1%	6.6%	6.5%	7.0%	7.5%
Total	4.3%	10.1%	15.6%	17.5%	18.2%	20.0%	21.8%
Income Tax Increases³							
Social Security	-2.2%	9.5%	18.9%	19.2%	19.6%	22.5%	24.2%
Medicare Part A	11.3%	19.7%	29.1%	34.3%	36.0%	38.2%	41.4%
Medicare Part B ⁴	12.8%	20.7%	27.3%	28.6%	27.6%	29.0%	30.5%
Total	21.9%	49.9%	75.3%	82.1%	83.2%	89.8%	96.0%
Spending Cuts as a % of GDP⁵							
Social Security	-0.2%	0.8%	1.6%	1.6%	1.7%	1.9%	2.1%
Medicare Part A	1.0%	1.7%	2.5%	2.9%	3.1%	3.2%	3.5%
Medicare Part B	1.1%	1.8%	2.3%	2.4%	2.3%	2.5%	2.6%
Total	1.9%	4.2%	6.4%	7.0%	7.1%	7.6%	8.2%

- Eliminating projected Social Security deficits would require increasing the current 15-percent income tax bracket to 18 percent; increasing the 28-percent bracket to 33 percent; the 31-percent bracket to 37 percent; the 36-percent bracket to 43 percent and the 39.6-percent bracket to 47 percent in the next 35 years.¹⁷
- Eliminating projected Medicare deficits as well would require increasing the 15-percent bracket to 26 percent; the 28-percent to 49 percent; the 31-percent bracket to 48 percent; the 36-percent bracket to 56 percent and the 39.6-percent bracket to 62 percent in the next 35 years.

Increase in Payroll Tax Rate				
		Revenue Gain as a % of GDP:		
Percentage Point Increase	% Change in GDP	Expected	Actual	Actual/Expected
2%	-1.1%	0.9%	0.7%	-25.1%
4%	-2.3%	1.8%	1.3%	-26.6%
10%	-6.1%	4.6%	3.1%	-31.5%
15%	-9.5%	6.9%	4.4%	-35.9%
Across-the-Board Increase in Individual Income Tax Rates				
		Revenue Gain as a % of GDP:		
Percentage Increase	% Change in GDP	Expected	Actual	Actual/Expected
10%	-3.6%	0.9%	0.1%	-84.6%
30%	-10.9%	2.6%	0.2%	-92.2%
50%	-18.2%	4.3%	0.0%	-99.8%
80%	-29.3%	6.8%	-0.8%	-111.5%

According to the FY1995 Budget federal receipts will equal 19.1 percent of GDP in 1999. Of that, Social Security and Medicare payroll taxes amount to 7 percent of GDP and individual income taxes to 8.5 percent.

Table 4

Closing Social Security & Medicare Deficits Through Tax Increases or Spending Cuts

¹Percentage point increase in the Social Security payroll tax rate needed to eliminate the annual operating deficit.

²Excludes the current level of general revenue funding which amounted to 1.6 percent of taxable payroll in 1994.

³Percentage across-the-board increase in personal income tax rates needed to eliminate the annual operating deficit. Calculated as a surtax, it assumes federal income taxes would otherwise amount to 8.5 percent of GDP.

⁴Excludes the current level of general revenue funding which amounted to 0.7 percent of GDP in 1994.

⁵Reductions in other federal spending as a percent of GDP needed to eliminate the annual operating deficit.

Table 5

Long-Run Economic Effects from Payroll & Income Tax Increases

Starting from a Cobb-Douglas production function, the derivation for a loss in private GDP due to a change in the payroll tax rate is:

$\%dGDP = ((1-t_1')/(1-t_1))^{0.3-1}$
where t_1 is the old tax rate on labor and t_1' is the new rate. The derivation for a loss in private GDP due to a change in the income tax rate is:

$\%dGDP = ((1-t_1')/(1-t_1))^{0.3*((1-t_c')/(1-t_c))^{0.60616-1}}$
where t_c is the old tax rate on capital and t_c' is the new tax rate. Personal taxes make up 54 percent of the marginal tax rate on labor and 26 percent of the marginal tax rate on capital. Federal taxes make up 80 percent of personal income taxes.

Detrimental Economic Effects

Damaging economic effects from higher tax rates would nullify any real progress toward reducing these deficits, however. As Table 5 shows, doubling the payroll tax would cause the economy to contract by 9.5 percent. As a result, 36 percent of the expected gain in payroll tax revenues would be lost due to lower total revenues. Raising the expected amount of revenue would require payroll tax rate increases one-third to one-half higher than those that ignore economic effects.¹⁸

Financing Social Security and Medicare deficits through higher income taxes would produce even worse repercussions. Even a 10-percent increase in rates would lose almost as much revenue as it would gain. Using income tax increases to address Social Security and Medicare deficits would simply cause Americans to run faster and faster only to lose ground.

Dealing with Future Social Security Deficits (2): Cut Other Spending

Another alternative to combating Social Security and Medicare deficits would be to reduce spending elsewhere. Federal spending now amounts to 22.3 percent of GDP, and Social Security and Medicare account for one-third of that total. Although the Clinton administration forecasts that total federal spending will decline slightly as a share of GDP until 1999, Social Security and Medicare will continue to grow. As Table 6 shows, even if other programs keep the same budget shares, federal spending will still climb to 28 percent of GDP in the next 35 years.

Table 6
Federal Outlays as a
Percent of GDP

*Assumes that budget shares from 2000 on will stay the same as those projected for 1999 in the Clinton administration's FY1995 budget.

	Defense*	Nondefense*	OASDI	Medicare	Other*	Total
1994	4.2%	4.0%	4.8%	2.5%	6.7%	22.3%
2000	3.0%	3.4%	4.8%	3.1%	6.8%	21.2%
2010	3.0%	3.4%	5.0%	4.8%	6.8%	23.1%
2020	3.0%	3.4%	5.9%	6.5%	6.8%	25.7%
2030	3.0%	3.4%	6.7%	8.0%	6.8%	28.0%
2040	3.0%	3.4%	6.7%	8.6%	6.8%	28.6%
2050	3.0%	3.4%	6.6%	8.6%	6.8%	28.5%
2060	3.0%	3.4%	6.8%	9.0%	6.8%	29.0%

Eliminating Social Security and Medicare deficits would require the entire defense budget plus a good portion of nondefense discretionary spending by 2030.

As Table 4 shows, other federal programs would have to be cut by an amount equal to 1.6 percent of GDP in 2030 to close the Social Security deficit. Medicare deficits would require cuts in other spending equal to another 4.8 percent of GDP. In other words:

- Eliminating projected Social Security deficits would take about half the defense budget by the year 2030.
- Eliminating Medicare deficits as well would require the entire defense budget plus a good portion of nondefense discretionary spending by 2030.

Dealing with Future Social Security Deficits (3): Slowing Benefit Growth

A third alternative to eliminating the Social Security deficit is to slow the growth in future benefits. Most of Social Security's financing problem is because the government is making promises it cannot keep. These inflated promises have their origin in the 1972 Social Security Amendments.

Before 1972, Congress periodically adjusted Social Security benefits to reflect increases in prices and wages. The result was that an *average wage* worker received a benefit that equaled between 30 and 35 percent of his or her final wage.¹⁹ [See Figure 10.] In other words, Social Security replaced about one-third of the average worker's salary in retirement. The remaining two-thirds were to come from private pensions and individual savings.

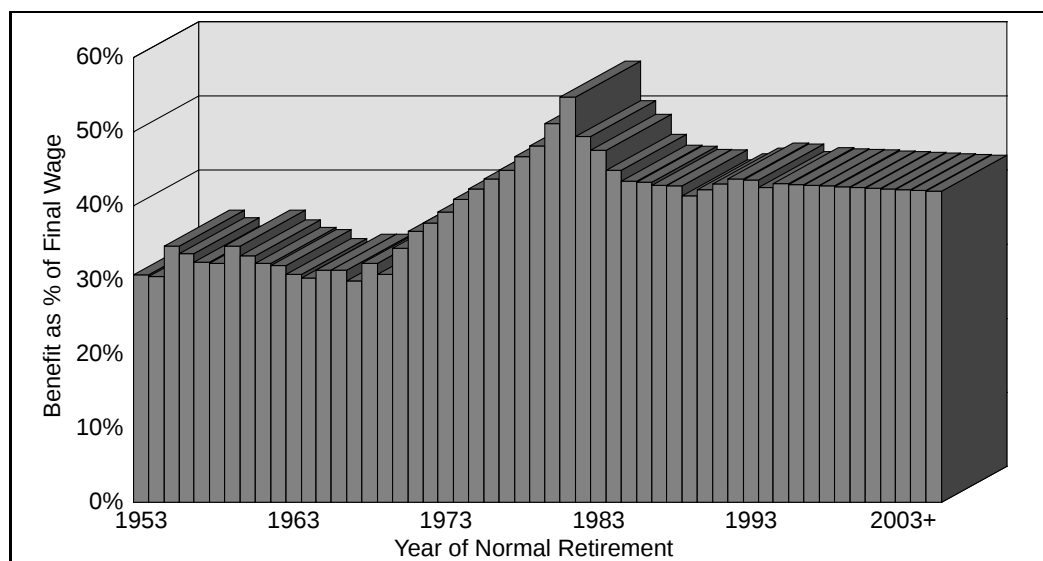


Figure 10
Social Security
Replacement Rate for
Average-Wage Worker,
Normal Retirement Age

Presidential politics, however, led to dramatic benefit increases in the early 1970s.²⁰ To depoliticize Social Security, the Congress instituted a benefit formula that would automatically adjust benefits for changes in wages and prices. Unfortunately, flaws in the 1972 Amendments caused benefits to rise much more rapidly than intended. While analysts quickly recognized the problem, a remedy did not come about until the 1977 Amendments. And the run up in benefits was allowed to continue for a few more years after that. As a result, an average-wage worker retiring in 1981 received a benefit equal to 55 percent of his or her final wage.

More importantly, while the 1977 Amendments contained a fix, they also permanently increased the generosity of Social Security. Instead of returning the replacement rate for the average wage worker to its historical value of 30 to 35 percent, the new benefit formula would replace about 42 percent of the average wage. In other words, *benefits were increased by roughly one-third in real terms at the very time the system's financial viability was weakening.* As a result, Social Security continues to make promises it will be unable to fulfill. [See Figure 11.]

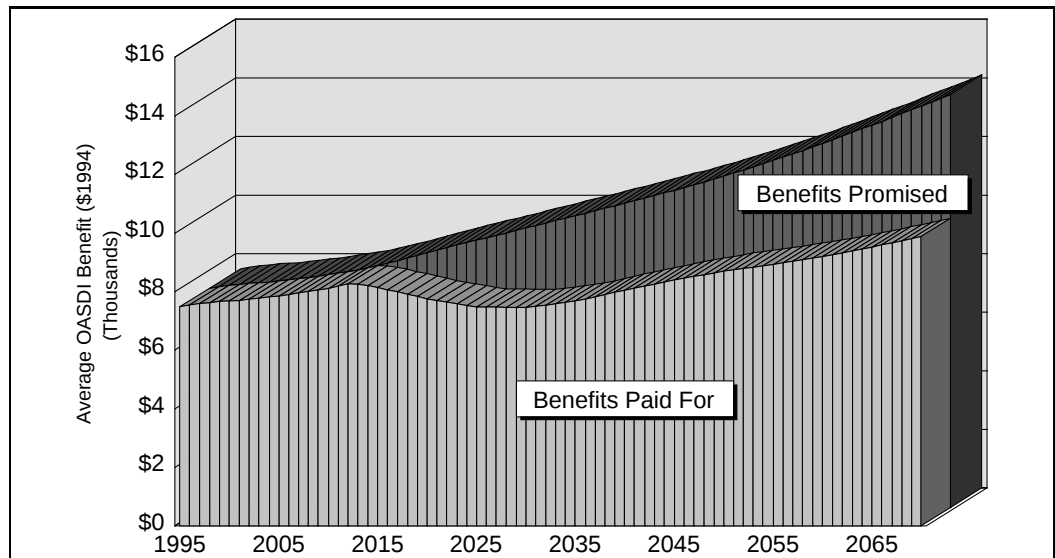
Suppose the Social Security deficit were to be eliminated by paring back future promises to what can be financed without tax increases or cuts in other programs. As Table 7 shows, the average of all Social Security benefits to be paid out in 1995 will be \$7,494. Adjusting for inflation, that average benefit will rise to \$8,976 by 2020

Most of Social Security's financing problem is because the government is making promises it cannot keep.

... the 1977 Amendments ... permanently increased the generosity of Social Security.

Figure 11

Average Social Security Benefit: Promised vs Paid



and almost double by 2070. To eliminate the Social Security deficit, the growth in real benefits would have to be slowed beginning about 2013. [See Figure 12.] On average, Social Security would pay out 14 percent less compared with what is currently promised by 2020, and up to 30 percent less by 2070. In other words:

- Eliminating the Social Security deficit would require that benefits, on average, increase by 4 percent in real terms instead of 20 percent over the next 25 years. Over the next 75 years, instead of doubling in real terms, benefits would increase by one-third.

Slowing the growth in real benefits could be accomplished in any number of ways. Last year two majority members of the House Ways and Means Committee put forth such proposals.²¹ One approach is to change the benefit formula to lower replacement rates gradually over time.²² Another is to raise the age at which someone is eligible for full retirement benefits.²³

Table 7

Average Social Security Benefit Under Present Law and if Benefits Reduced to Eliminate Deficit*

Year	Present Law:		Benefits Reduced to Eliminate the Deficit*		
	Average Benefit (\$ nominal)	Average Benefit (\$ 1994)	Average Benefit (\$ nominal)	Average Benefit (\$ 1994)	% Benefit Reduction
1995	\$ 7,732	\$ 7,494	\$ 7,732	\$ 7,494	0.0%
2013	17,083	8,357	16,880	8,258	-1.2%
2015	18,840	8,521	18,016	8,149	-4.4%
2020	24,144	8,976	20,870	7,759	-13.6%
2025	30,704	9,382	24,448	7,470	-20.4%
2030	39,033	9,803	29,696	7,458	-23.9%
2035	49,536	10,226	37,176	7,674	-25.0%
2040	62,832	10,661	47,476	8,055	-24.4%
2045	79,674	11,111	60,274	8,405	-24.3%
2050	101,423	11,625	75,914	8,701	-25.2%
2055	129,424	12,193	94,806	8,932	-26.7%
2060	165,440	12,811	118,818	9,201	-28.2%
2065	211,337	13,451	149,695	9,527	-29.2%
2070	269,664	14,107	188,924	9,883	-29.9%

*Average Social Security benefit is total OASDI benefit payments divided by OASDI beneficiaries under the intermediate projections in the 1994 Trustees' Report. Benefits are OASDI outgo less 0.8 percent for administrative costs. Real average benefits are nominal benefits deflated by the projected Consumer Price Index.

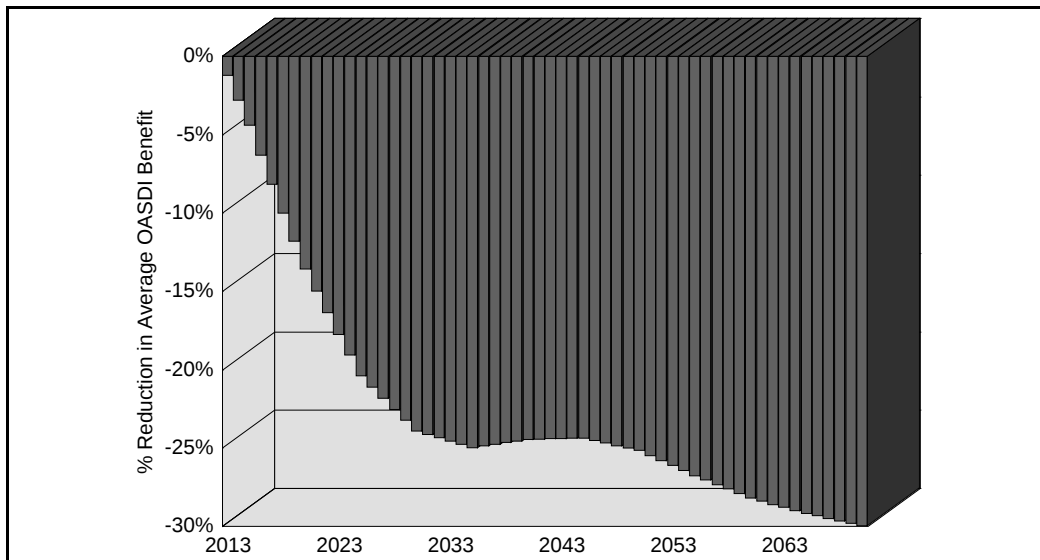


Figure 12
Average Social Security
Benefit Reduction To
Avoid a Tax Increase

Two other often-mentioned ways to reduce benefits should be avoided, however. Reducing annual cost-of-living-adjustments (COLAs) penalizes people who live longer without correcting the real problem of overgenerous benefits promised to future retirees. Reform should aim at slowing the real growth in the *initial* benefit and protecting it from inflation after that. The second approach is really a tax increase parading as a benefit cut. Taxing Social Security benefits does nothing to reduce Social Security spending. What it does do, particularly under the current taxation method, is to penalize people who earn income from saving and investment or work.²⁴

Whatever the final shape of Social Security reform, it should honor benefits earned under the existing system. In other words, the current benefit formula should continue to apply to wages on which payroll taxes have already been paid. Reform would only affect benefits accruing to future wages. Because the benefits of current retirees and those who are about to retire would be fully protected, this approach would not cut Social Security!

Medicare deficits are much worse than those of Social Security. Although not addressed here, the dramatic benefit reductions that would be needed to eliminate deficits really call for a comprehensive overhaul of the program.

Taxing Social Security benefits does nothing to reduce Social Security spending. What it does do . . . is penalize people who earn income from saving and investment or work.

Dealing with Future Social Security Deficits (4): Privatization

Another alternative attracting attention is privatization. Various proposals argue for allowing workers to opt out of the Social Security system. Opting out would consist of giving up the claim on some or all future benefits for a reduction in payroll taxes now.

In theory this is fine. In practice there are problems. The fact is that almost all payroll tax revenue is being used to pay benefits today. As Table 8 shows, the 1994 report projects that tax revenue into the Social Security trust fund will exceed outlays until 2012 by an average \$30 billion a year. Rebating these surpluses back to workers would amount to a payroll tax cut of about 0.75 percent. For an average wage worker, contributions to a private saving account from this reduction would total \$4,362 between now and 2012.

Whatever the final shape of Social Security reform, it should honor benefits earned under the existing system.

Table 8
Near-Term Social Security
Surpluses
1994 Trustees' Report,
Intermediate Forecast

	Surplus ¹ (\$ billions)	As % of Taxable Payroll	Rebate to Average Worker ²
1995	\$ 27	0.92%	\$ 232
1996	28	0.91%	238
1997	29	0.89%	244
1998	30	0.88%	250
1999	30	0.83%	248
2000	32	0.84%	262
2001	33	0.82%	268
2002	33	0.78%	266
2003	34	0.76%	272
2004	36	0.76%	285
2005	38	0.75%	299
2006	37	0.70%	290
2007	36	0.64%	280
2008	35	0.58%	267
2009	33	0.52%	252
2010	31	0.46%	235
2011	18	0.26%	140
2012	4	0.06%	31
Total	\$ 545		\$ 4,362

¹Surplus is income from payroll taxes and the taxation of Social Security benefits less OASDI outlays.

²The Trustees estimate that the average Social Security wage in 1995 is \$25,196, rising to \$55,790 in 2012.

Encouraging people to opt out by lowering their payroll taxes above and beyond short-term surpluses still leaves the problem of current benefits.

Moreover, these projections are based on the intermediate forecast which assumes slow, but steady growth into the future. A recession between now and the year 2000 would erase even these modest surpluses.

Encouraging people to opt out by lowering their payroll taxes above and beyond short-term surpluses still leaves the problem of current benefits. Cutting benefits to those who now receive them, or who are about to receive them, is politically and morally unacceptable. And as Table 5 shows, replacing payroll taxes with higher income taxes would do greater damage to the economy.

This is not to say that privatization is unfeasible. That benefits must be reduced from currently projected levels is inevitable. This reduction could be made more palatable by combining it with increased saving incentives such as expanded Individual Retirement Accounts and private pensions which, in turn, would decrease reliance on Social Security.

Table 9
Effect of Various
Alternatives on the Social
Security Deficit by 2035

Increase OASDI payroll tax rate from 12.4% to 16.5%	Reduce 2/3 to 3/4 of OASDI deficit
19% across-the-board increase in individual income tax rates	Reduce OASDI deficit by 10%
Reduce non-Social Security spending by 1.6% of GDP	Eliminate OASDI deficit
Average OASDI benefit is \$7,674 instead of \$10,226	Eliminate OASDI deficit
Boost long-run growth rate by one percentage point	Cut OASDI deficit in half

Dealing with Future Social Security Deficits (5): Boost Economic Growth

Unlike the previous alternatives, boosting economic growth is a painless way to brighten Social Security's financial picture. As discussed earlier, the growth slowdown experienced since 1988 has significantly contributed to the financial deterioration of the system. Moreover, the U.S. economy is on a long-run growth path that is about one percentage point below its 1946-1988 experience. Returning the U.S. economy to trend would eliminate a large portion of the Social Security deficit.

Increasing U.S. economic growth is well within the realm of possibilities. In a recent study,²⁵ we examined tax policy over the last forty years and found that it does affect the economy, although not always in the way policy makers envision.²⁶ Recent tax policy, which has led to tax rates on labor and capital that are near historic highs, definitely contributed to the economic slowdown. Conversely, lowering marginal tax rates on labor and capital, through any number of means, could easily return the U.S. economy to its long-run path and restore financial health to Social Security.

- Boosting U.S. economic growth by a half percentage point would cut the long-run Social Security deficit by 25 percent. Boosting growth by a full percentage point would cut that deficit in half.²⁷

Boosting economic growth is a painless way to brighten Social Security's financial picture

Conclusion

Americans and their elected representatives face tough choices over Social Security. Social Security is promising to pay out far more in benefits than it will collect in revenues over the coming decades. Medicare's imbalance is far worse.

Looming deficits mean substantial tax increases or spending cuts in the future. Increasing taxes is not a viable solution, because negative economic effects will offset some or all of the expected revenue gains. [See Table 9.] Reducing spending elsewhere could provide some relief, but there are limits to how much other federal programs, such as defense, can be cut.

Reform of Social Security benefits is inevitable, and hopefully will occur in a gradual, reasoned manner. Overgenerous benefits resulting from imprudent changes to the program in the 1970s must be scaled back. However, future retirees should be given plenty of advance notice, and current retiree benefits should be protected. Greater incentives for private saving would help fill the gap as less reliance is placed on Social Security to provide retirement income.

Finally, policy makers should take immediate action to put the U.S. economy back on its long-run growth path. A faster-growing economy, with its increased payroll taxes today and into the future, would go a long way toward solving Social Security's troubles.

Boosting U.S. economic growth by a full percentage point would cut the long run Social Security deficit in half.

Appendix

Table A-1

Comparison Between 1988 and 1994 Trustees' Reports:
Intermediate Assumptions (\$ bil.)

Year	OASDI Outgo			OASDI Income			Medicare Part A Outgo			Medicare Part A Income			Taxable Payroll		
	1994 TR	1988 TR	% Change	1994 TR	1988 TR	% Change	1994 TR	1988 TR	% Change	1994 TR	1988 TR	% Change	1994 TR	1988 TR	% Change
1994	325	335	-3.0%	347	379	-8.4%	108	95	14.0%	101	91	11.5%	2,790	3,015	-7.5%
1995	342	347	-1.4%	369	403	-8.5%	118	103	14.3%	107	96	11.0%	2,934	3,207	-8.5%
1996	361	369	-2.2%	389	429	-9.4%	128	112	14.0%	113	103	10.2%	3,082	3,413	-9.7%
1997	381	389	-2.1%	410	456	-10.1%	139	122	14.3%	119	109	9.2%	3,249	3,630	-10.5%
1998	401	410	-2.2%	431	485	-11.1%	152	132	15.5%	125	116	8.0%	3,418	3,852	-11.3%
1999	424	431	-1.6%	454	515	-11.9%	166	142	16.6%	132	123	7.4%	3,603	4,088	-11.9%
2000	448	454	-1.3%	480	548	-12.4%	181	154	17.5%	140	131	7.3%	3,805	4,339	-12.3%
2001	474	480	-1.3%	507	582	-12.9%	198	166	19.4%	148	138	6.9%	4,018	4,602	-12.7%
2002	503	507	-0.8%	536	618	-13.2%	216	178	21.0%	157	147	6.9%	4,247	4,881	-13.0%
2003	533	536	-0.6%	567	656	-13.6%	235	192	22.4%	166	156	6.5%	4,492	4,177	-13.2%
2004	565	567	-0.3%	601	697	-13.7%	256	207	23.7%	176	165	6.5%	4,756	5,491	-13.4%
2005	599	601	-0.3%	637	740	-13.9%	278	222	25.0%	187	176	6.6%	5,039	5,824	-13.5%
2010	818	802	2.0%	849	987	-14.0%	409	319	28.1%	250	234	6.9%	6,667	7,736	-13.8%
2015	1,166	1,056	10.4%	1,115	1,303	-14.4%	615	459	34.1%	332	307	8.2%	8,689	10,149	-14.4%
2020	1,674	1,374	21.9%	1,447	1,703	-15.0%	906	673	34.6%	435	398	9.2%	11,188	13,177	-15.1%
2025	2,346	1,775	32.2%	1,868	2,220	-15.9%	1,326	991	33.8%	568	516	10.1%	14,340	17,074	-16.0%
2030	3,177	2,296	38.4%	2,417	2,899	-16.6%	1,911	1,425	34.1%	741	671	10.5%	18,466	22,195	-16.8%
2035	4,172	2,973	40.3%	3,131	3,788	-17.3%	2,668	1,973	35.3%	964	875	10.2%	23,816	28,946	-17.7%
2040	5,352	3,842	39.3%	4,044	4,938	-18.1%	3,594	2,644	35.9%	1,249	1,140	9.6%	30,719	37,713	-18.5%
2045	6,875	4,946	39.0%	5,201	6,423	-19.0%	4,737	3,482	36.1%	1,609	1,482	8.6%	39,460	49,035	-19.5%
2050	8,910	6,346	40.4%	6,669	8,350	-20.1%	6,186	4,571	35.3%	2,070	1,925	7.5%	50,506	63,691	-20.7%
2055	11,672	8,136	43.5%	8,550	10,867	-21.3%	8,108	6,009	34.9%	2,663	2,503	6.4%	64,582	82,806	-22.0%
2060	15,273	10,436	46.4%	10,969	14,159	-22.5%	10,717	7,913	35.4%	3,428	3,258	5.2%	82,654	107,817	-23.3%

Figures come from the 1988 *Annual Report of the Board of Trustees' of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*, Washington, DC: U.S. Government Printing Office, May 1988, Tables G2 and G3; and the 1994 *Annual Report of the Board of Trustees' of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*, Washington, DC: U.S. Government Printing Office, April 1994, Tables III.B.1, III.B.4.

Year	OASDI Outgo	OASDI Income	OASDI Deficit	Medicare Part A Outgo	Medicare Part A Income	Medicare Part A Deficit	Medicare Part B Outgo	Medicare Part B Premiums
1994	325	347	22	108	101	-7	62	17
1995	342	369	27	118	107	-11	69	20
1996	361	389	28	128	113	-15	78	19
1997	381	410	29	139	119	-20	86	21
1998	401	431	30	152	125	-27	96	24
1999	424	454	30	166	132	-34	108	25
2000	448	480	32	181	140	-41	120	26
2001	474	507	33	198	148	-50	135	28
2002	503	536	33	216	157	-59	152	29
2003	533	567	34	235	166	-69	170	30
2004	565	601	36	256	176	-79	193	48
2005	599	637	38	278	187	-91	219	55
2010	818	849	31	409	250	-159	391	98
2015	1,166	1,115	-51	615	332	-283	630	158
2020	1,674	1,447	-227	906	435	-471	921	230
2025	2,346	1,868	-478	1,326	568	-758	1337	334
2030	3,177	2,417	-760	1,911	741	-1,170	1898	474
2035	4,172	3,131	-1,041	2,668	964	-1,704	2,572	643
2040	5,352	4,044	-1,308	3,594	1,249	-2,345	3,342	835
2045	6,875	5,201	-1,674	4,737	1,609	-3,128	4,272	1,068
2050	8,910	6,669	-2,241	6,186	2,070	-4,116	5,453	1,363
2055	11,672	8,550	-3,122	8,108	2,663	-4,554	7,109	1,777
2060	15,273	10,969	-4,304	10,717	3,428	-7,289	9,455	2,364
2065	19,868	14,073	-5,795	14,234	4,409	-9,825	12,573	3,143
2070	25,754	18,043	-7,711	18,881	5,665	-13,216	16,402	4,101

Table A-2
Social Security and
Medicare Projections
1994 Trustees' Report,
Intermediate Assumptions
(\$ bil.)

Figures come from the 1994 *Annual Report of the Board of Trustees' of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*, Washington, DC: U.S. Government Printing Office, April 1994, Tables III.B.1, III.B.4 and the 1994 *Annual Report of the Board of Trustees' of the Federal Supplementary Medical Insurance Trust Fund*, Washington, DC: U.S. Government Printing Office, April 1994, Table I.C4.

Table A-3

**Social Security and
Medicare Projections
1994 Trustees' Report,
Intermediate Assumptions
(as % of taxable payroll)**

¹Excludes interest income.

²A negative number indicates a surplus of revenue after outgo. A positive number indicates a deficit. Deficits are shaded.

Estimates are based on data provided in the 1994 *Annual Report of the Board of Trustees' of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*, Washington, DC: U.S. Government Printing Office, April 1994, Tables III.B.1, III.B.4 and the 1994 *Annual Report of the Board of Trustees' of the Federal Supplementary Medical Insurance Trust Fund*, Washington, DC: U.S. Government Printing Office, April 1994, Table I.C4.

	INCOME ¹			OUTGO			DEFICITS ²		
Year	OASDI	+Part A	+Part B	OASDI	+Part A	+Part B	OASDI	+Part A	+Part B
1994	12.4%	15.4%	16.0%	11.6%	14.5%	16.7%	-0.8%	-0.9%	0.7%
1995	12.6%	15.5%	16.2%	11.7%	14.6%	17.0%	-0.9%	-0.9%	0.8%
1996	12.6%	15.9%	16.5%	11.7%	15.2%	17.7%	-0.9%	-0.7%	1.2%
1997	12.6%	15.9%	16.6%	11.7%	15.4%	18.0%	-0.9%	-0.6%	1.4%
1998	12.6%	15.9%	16.6%	11.7%	15.5%	18.3%	-0.9%	-0.4%	1.7%
1999	12.6%	15.9%	16.6%	11.8%	15.6%	18.6%	-0.8%	-0.3%	2.0%
2000	12.6%	15.9%	16.6%	11.8%	15.8%	18.9%	-0.8%	-0.1%	2.3%
2001	12.6%	15.9%	16.6%	11.8%	15.9%	19.3%	-0.8%	0.0%	2.7%
2002	12.6%	15.9%	16.6%	11.8%	16.1%	19.7%	-0.8%	0.2%	3.1%
2003	12.6%	15.9%	16.6%	11.9%	16.3%	20.1%	-0.8%	0.4%	3.5%
2004	12.6%	15.9%	17.0%	11.9%	16.4%	20.5%	-0.8%	0.5%	3.5%
2005	12.6%	15.9%	17.0%	11.9%	16.6%	20.9%	-0.8%	0.6%	3.9%
2010	12.7%	16.1%	17.5%	12.3%	17.5%	23.4%	-0.5%	1.5%	5.9%
2015	12.8%	16.2%	18.1%	13.4%	19.4%	26.7%	0.6%	3.2%	8.6%
2020	12.9%	16.4%	18.5%	15.0%	21.9%	30.1%	2.0%	5.5%	11.6%
2025	13.0%	16.6%	18.9%	16.4%	24.3%	33.6%	3.3%	7.7%	14.7%
2030	13.1%	16.7%	19.3%	17.2%	26.1%	36.4%	4.1%	9.4%	17.2%
2035	13.1%	16.8%	19.5%	17.5%	27.3%	38.1%	4.4%	10.5%	18.6%
2040	13.2%	16.8%	19.5%	17.4%	27.8%	38.7%	4.3%	11.0%	19.1%
2045	13.2%	16.9%	19.6%	17.4%	28.2%	39.0%	4.2%	11.3%	19.4%
2050	13.2%	16.9%	19.6%	17.6%	28.6%	39.4%	4.4%	11.7%	19.8%
2055	13.2%	17.0%	19.7%	18.1%	29.3%	40.3%	4.8%	12.4%	20.6%
2060	13.3%	17.0%	19.9%	18.5%	30.1%	41.5%	5.2%	13.1%	21.6%
2065	13.3%	17.1%	20.0%	18.8%	30.8%	42.7%	5.5%	13.7%	22.6%
2070	13.3%	17.1%	20.1%	19.0%	31.4%	43.6%	5.7%	14.4%	23.4%

	INCOME ¹			OUTGO			DEFICITS ²		
Year	OASDI	+Part A	+Part B	OASDI	+Part A	+Part B	OASDI	+Part A	+Part B
1994	5.2%	6.7%	6.9%	4.8%	6.4%	7.4%	-0.3%	-0.2%	0.4%
1995	5.2%	6.7%	7.0%	4.8%	6.5%	7.4%	-0.4%	-0.2%	0.5%
1996	5.2%	6.7%	7.0%	4.8%	6.5%	7.6%	-0.4%	-0.2%	0.6%
1997	5.2%	6.7%	7.0%	4.8%	6.6%	7.7%	-0.4%	-0.1%	0.7%
1998	5.2%	6.7%	7.0%	4.8%	6.6%	7.8%	-0.4%	0.0%	0.8%
1999	5.2%	6.7%	7.0%	4.8%	6.7%	7.9%	-0.3%	0.0%	1.0%
2000	5.2%	6.7%	7.0%	4.8%	6.8%	8.1%	-0.3%	0.1%	1.1%
2005	5.1%	6.6%	7.1%	4.8%	7.1%	8.8%	-0.3%	0.4%	1.8%
2010	5.1%	6.7%	7.3%	5.0%	7.4%	9.8%	-0.2%	0.8%	2.6%
2015	5.1%	6.7%	7.4%	5.4%	8.2%	11.1%	0.2%	1.5%	3.7%
2020	5.1%	6.7%	7.5%	5.9%	9.2%	12.4%	0.8%	2.5%	4.9%
2025	5.1%	6.7%	7.6%	6.4%	10.1%	13.7%	1.3%	3.4%	6.1%
2030	5.1%	6.7%	7.7%	6.7%	10.8%	14.8%	1.6%	4.1%	7.1%
2035	5.1%	6.6%	7.7%	6.8%	11.1%	15.3%	1.7%	4.4%	7.6%
2040	5.0%	6.6%	7.6%	6.7%	11.1%	15.3%	1.0%	4.5%	7.7%
2045	5.0%	6.5%	7.6%	6.6%	11.1%	15.2%	1.6%	4.6%	7.7%
2050	5.0%	6.5%	7.5%	6.6%	11.2%	15.3%	1.7%	4.7%	7.8%
2055	4.9%	6.5%	7.5%	6.7%	11.4%	15.5%	1.8%	4.9%	8.0%
2060	4.9%	6.4%	7.5%	6.8%	11.6%	15.8%	1.9%	5.2%	8.3%
2065	4.8%	6.4%	7.4%	6.8%	11.7%	16.1%	2.0%	5.4%	8.6%
2070	4.8%	6.3%	7.4%	6.9%	11.9%	16.3%	2.1%	5.6%	8.9%

Table A-4

**Social Security and Medicare Projections
1994 Trustees' Report,
Intermediate Assumptions
(as % of GDP)**

¹Excludes interest income.

²A negative number indicates a surplus of revenue after outgo. A positive number indicates a deficit. Deficits are shaded.

Estimates are based on data provided in the *1994 Annual Report of the Board of Trustees' of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*, Washington, DC: U.S. Government Printing Office, April 1994, Tables III.B.1, III.B.4 and the *1994 Annual Report of the Board of Trustees' of the Federal Supplementary Medical Insurance Trust Fund*, Washington, DC: U.S. Government Printing Office, April 1994, Table I.C.4.

Endnotes

1. Associated Press, "Generation X Believes UFOs but Laughs at Social Security," *Washington Times*, September 27, 1994, p. A7.
2. *1983 Annual Report of the Board of Trustees' of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*, Washington, DC: U.S. Government Printing Office, June 1983, p. 84.
3. The Trustees are the Secretary of the Treasury, who is Managing Trustee, the Secretary of Health and Human Services, and the Secretary of Labor. Two public trustees, appointed by the Congress, were added in 1985.
4. *1988 Annual Report of the Board of Trustees' of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*, Washington, DC: U.S. Government Printing Office, April 1994, Table G2, p. 141.
5. *1994 Annual Report of the Board of Trustees' of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*, Washington, DC: U.S. Government Printing Office, April 1994, pp. 26-28.
6. Close actuarial balance means that average program costs roughly equal average program revenues over the next 75 years. Actuaries of the Social Security Administration compute income and program costs, each as a percent of taxable payroll for 66 valuation periods. The first valuation period is the next ten years. Each succeeding period becomes longer by one year, with the last period consisting of the next 75 years. Long-run close actuarial balance means that the average difference between income and program costs over 75 years is less than 5 percent of costs.
7. This amounts to 14 percent of OASDI costs as a percent of taxable payroll, well in excess of the close actuarial balance defined in the previous endnote.
8. These estimates of lost GDP are expressed in 1993 dollars.
9. The Social Security tax base, or "taxable payroll," is the total amount of wages and salaries that are below the wage limit (currently \$61,200) for workers that are covered by Social Security. The Trustees estimate taxable payroll in 1993 to be \$2,653 billion. In comparison, total U.S. wages and salaries in 1993 were \$3,370 billion.
10. Appendix Table A-1 compares estimates of Social Security income, outgo, and taxable payroll between the 1988 and 1994 Trustees' Reports.
11. The Social Security benefit formula selects the highest 35 years of earnings on which a retiring worker paid payroll taxes. It then indexes each year's actual earnings for the growth in average wages from that year to the year when the worker turned age 60, and determines the average indexed monthly earnings (AIME). For workers who reach age 62 in 1994, the basic monthly benefit, or primary insurance amount (PIA), equals 90 percent of the first \$422 of AIME, plus 32 percent of AIME between \$422 and \$2,545, plus 15 percent of AIME over \$2,545.
12. The 1988 Trustees' Report projected 74.8 million OASI beneficiaries and 8.1 million DI beneficiaries by the year 2060 under Alternative II-B. The 1994 report projected 80.4 million OASI beneficiaries and 11.2 million DI beneficiaries by the year 2060 under the intermediate assumptions.
13. Appendix Tables A-2, A-3 and A-4 show yearly estimates for income, outgo and deficits in nominal dollars and as a percent of taxable payroll and GDP.
14. Nominally, the employer and employee each pays a tax rate of 6.2 percent up to a wage limit, currently \$61,200. Income taxation of Social Security benefits provides a few extra tenths of a percent of taxable payroll.
15. Nominally, employer and employee each pay a tax rate of 1.45 percent. Until 1990, the Medicare wage limit was the same as that of Social Security. The 1990 tax bill raised the base to \$125,000 and the 1993 tax bill removed the limit altogether.
16. For Social Security, $(0.153+0.041)/0.153 = 1.27$. Plus Medicare, $(0.153+0.041+0.114)/0.153 = 2.013$.
17. The computation for the 15 percent bracket is as follows: $15\% + 15\% \cdot .019 = 17.9\%$.
18. For example, if 35 percent of revenues are lost due to negative economic effects, a five percentage point payroll tax rate increase would actually have to be a 7.69 percentage point increase, or $(0.05/(1-0.35) = .0769)$.
19. An "average wage worker" is someone who earned the average wage as computed by the Social Security Administration throughout his or her working career. SSA estimates the average wage, which is used to index various parts of the benefits formula and determine annual taxable wage limits, to be \$25,196 in 1995.

20. For a discussion see Martha Derthick, *Policymaking for Social Security*, Washington, DC: The Brookings Institution, 1979, pp. 339-368.
21. The members were Ways and Means Committee Chairman Dan Rostenkowski (D-IL), and Social Security Subcommittee chairman Jake Pickle (D-TX). For a discussion of their proposals see Stephen Entin, "Reforming Social Security in a Pro-Growth Manner," Submission to the Bipartisan Commission on Entitlement and Tax Reform, Washington, DC: Institute for Research on the Economics of Taxation, August 1994.
22. There are endless ways to change the indexing method of the bend points or earnings histories or change the replacement factors to slow the growth in real benefits.
23. Under current law the normal retirement age will rise from age 65 to 66 for those reaching age 62 between 2000 and 2005, and to rise from age 66 to 67 for those reaching age 62 between 2017 and 2022.
24. Under current law, singles with between \$25,000 and \$34,000 in income and couples filing joint returns with between \$32,000 and \$44,000 must include in adjusted gross income (AGI) 50 cents in Social Security benefits for every dollar of income over those threshold amounts. The maximum included in AGI is 50 percent of the Social Security benefit. Singles with incomes over \$34,000 and couples with incomes over \$44,000 must include 85 cents in benefits for every dollar of AGI over the thresholds, up to a maximum 85 percent of benefits.

Marginal tax rates on other income are substantially higher for those in the phase-in range. For example, at the lower thresholds, someone normally in the 15% tax bracket would face an effective marginal rate of 22.5%; someone in the 28% bracket would face an effective rate of 42%. For those at the higher thresholds, someone in the 28% bracket faces an effective rate of 51.8%.
25. *Looking Back to Move Forward: What Tax Policy Costs Americans and the Economy*, TaxAction Analysis Policy Report No. 127, Institute for Policy Innovation, September 1994.
26. For example, the U.S. economy experienced sustained periods of robust growth after the tax cuts of 1964 and 1981 which significantly lowered marginal rates. Tax bills which raised taxes, as in 1968, 1977, and 1990, or tried to redistribute the tax burden, as in 1969, 1976, and 1986, were often followed by recession or periods of slow growth. See *Looking Back to Move Forward*, *ibid*.
27. The Trustees' Reports include sensitivity analysis showing what would happen to the 75-year actuarial balance if various assumptions in the intermediate forecast were changed one at a time. If real wage growth was increased by 0.5 percent, the average difference between revenues and costs over 75 years would drop from -2.13 percent of taxable payroll to -1.58 percent. See the 1994 *OASDI Trustees' Report*, pp. 134-135.

Gary Robbins is President of Fiscal Associates, an Arlington, VA-based economic consulting firm, and John M. Olin Senior Research Fellow of IPI. Mr. Robbins has developed a general equilibrium model of the U.S. economy that specifically incorporates the effects of taxes and government spending. He was Chief of the Applied Econometrics Staff at the U.S. Treasury Department from 1982 to 1985. He served as assistant to the Under Secretary for Tax and Economic Affairs from 1981 to 1982, and as Assistant to the Director of the Office of Tax Analysis from 1975 to 1981. Recent publications include IPI Policy Report #124: *Putting Capital Back to Work for America*, and IPI Policy Report #127: *Looking Back to Move Forward: What Tax Policy Costs Americans and the Economy*. Mr. Robbins' articles and analysis frequently appear in the financial press. He received his master's degree in Economics from Southern Methodist University.

Aldona Robbins, Vice President of Fiscal Associates and Bradley Senior Research Fellow of IPI, has extensive experience with public and private retirement programs. As senior economist in the Office of Economic Policy, U.S. Department of the Treasury from 1979 to 1985, Dr. Robbins performed staff work for the Secretary in his capacity as Managing Trustee of the Social Security trust funds. Recent publications include IPI Policy Report #126: *Neutral Cost Recovery: Investing for Growth, Not Planning for Taxes*, and IPI Policy Report #128: *Putting the Economy Back on the Growth Track: Six Steps to "Upsize" the Economy*. She received a master's degree and doctorate in Economics from the University of Pittsburgh.

About the Authors

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