IRET Congressional Advisory

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DUCKING SOCIAL SECURITY IN THE STATE OF THE UNION ADDRESS

In his State of the Union Address, President Clinton proposed to increase the Social Security trust funds by crediting them with the interest saved by paying off the national debt. This is an accounting trick that ducks the issue of reforming Social Security. It is simply a pledge to pay more future benefits out of general revenues. It will perpetuate the system as a package of transfer payments from one generation to another, and will do nothing to convert it into a real saving program that would help the country grow.

Trust funds, smoke, and mirrors. The interest saved by paying down debt is part of the projected budget surplus. It is counted as being available to pay down more debt. In fact, it is given to the bondholders as part of the debt buy back. It is no longer in the possession of the federal government. Crediting the same saving to the trust funds is double counting, and is just an artificial inflation of the Treasury IOUs the trust fund is already stuffed with.

As the baby boom retires, Social Security's outlays will begin to exceed its current payroll tax revenues and its revenues from taxing benefits. When that happens, the Social Security Administration will call on Treasury to make up the shortfall "out of the trust fund".

But there is no money in the trust fund, just Treasury IOUs reflecting past Social Security surpluses that the government spent on other programs. The Treasury will have to get the actual money to pay the benefits by using other federal revenue (if the rest of the budget is in surplus), or by borrowing from the public, or by asking Congress to cut other spending, ***just as if the trust fund did not exist***.

The real agenda — no tax cut. The real agenda is never to have a real tax cut. The President's plan would not only keep income and payroll taxes unnecessarily high now in order to pay down the national debt to save future interest outlays. It would have to continue to keep income taxes high even after the interest outlays were reduced in order to continue the resulting general revenue surpluses to prop up Social Security. That is the only way the scheme can work. There would never be a significant tax cut, and there would never be Social Security reform.

<u>A FABLE</u>

"Happy seventh birthday, son!"

"Thank you Daddy. Can I go to college when I get older?"

"Sure son. In fact, I'll write you an IOU right now for $150,000!"

"And medical school?"

"O.K. I'll make that $300,000."

Ten years later the boy hands the IOU to the bursar to pay for his first college semester.

"Here's my tuition, sir."

"There's the door, sir. Don't slam it on your way out," says the bursar.

This could never really happen. No student dumb enough to think that Dad's unsupported IOU is the same as ready cash could pass the college boards. Yet that is what President Clinton hopes we will fall for when he called in the State of the Union Address for crediting the Social Security trust funds with the interest saved by paying down the national debt.

Institute for Research on the Economics of Taxation

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The trust funds are not money. The trust funds are just spending authority, permission from the Congress for the Treasury to keep the program afloat even after it begins to run operating deficits. The trust funds are a measure of how much Congress has decided to allow the system to overspend before coming back to Congress for a review of the program.

The trust funds are not saving. The trust funds do not help to create new factories, offices, farms, mines, or housing. The trust funds do not boost productivity, wages, and employment. The trust funds do nothing to make it easier for future workers to produce goods and services for their own needs and the needs of a rising number of retirees. Only real saving and investment can do that, and to encourage saving and investment, we need to have appropriate tax cuts and real Social Security reform.

The President is ducking a great opportunity to convert Social Security from a system of transfer payments into a system of real saving by each person for his or her own retirement. He is papering over Social Security's problems, not fixing them.

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Note: Nothing written here is to be construed as necessarily reflecting the views of IRET or as an attempt to aid or hinder the passage of any bill before Congress.