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

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SUMMARY

The costs of the social security program, both its benefits and administrative expenses, are financed by a tax on wages and self-employment income. Commonly referred to as FICA and SECA taxes (because they are levied under the *Federal Insurance and Self-Employment Contributions Acts*), these taxes flow each day into 15,000 depository accounts maintained by the Government with financial institutions across the country. Along with many other forms of revenues, social security taxes become part of the Government's operating cash pool. This cash pool comprises the U.S. Treasury. In effect, once these taxes are received, they become indistinguishable from other monies the Government takes in. They are accounted for separately through the posting 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 hold money. 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 "written off" the trust funds.

Generally speaking, the securities posted to any Federal trust fund represent "permission to spend." As long as a trust fund has a balance of securities posted to it, 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 loans it out. As long as the account shows a balance, the depositor can write checks that the bank must honor. When more social security taxes are received than spent, the balance of securities posted to the social security trust funds rises. Simply put, these balances, like those of a bank account, represent a promise, a form of IOU from the Government that if needed to pay social security benefits, the Government will obtain resources in the future equal to the value of the securities. The surplus taxes themselves are then used for any of the many functions of Government.

DISCUSSION

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 payrolls and self-employment income (FICA and SECA taxes). More than 95 percent of the work force is required to pay them. The FICA tax is levied on a worker's earnings and is paid both by employees and employers; the SECA tax is levied on self-employment income. Investment and other forms of nonwork income are not taxed. Both the FICA and SECA rates have three components: one for Old Age and Survivors Insurance (OASI), a second for Disability Insurance (DI), which together comprise what is commonly thought of as social security, and a third for the Hospital Insurance (HI) portion of medicare. In 1993, the OASDI portion is levied on earnings up to $57,600 (the HI portion is levied up to $135,000). The bases rise annually to reflect increases in average earnings in the economy.

Social Security and HI Tax Rates Under Current Law (in percent)

		Employee rate				Combined
Year	OASI	DI	OASDI	HI	Total	employee/ employer
1990	5.60	.6	6.20	1.45	7.65	15.3
2000	5.49	.71	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 percent 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 each day into 15,000 depository accounts maintained by the Government with financial institutions across the country. Along with many other forms of revenues, social security taxes become part of the Government's operating cash pool. This cash pool comprises the U.S. Treasury. In effect, once these taxes are received, they become indistinguishable from other monies the Government takes in. They are accounted for separately through the posting 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. 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.

Estimated Social Security Surplus ($s in billions)

CY	Taxes	Outgo	Difference (Surplus)
1993	328	309	19
1994	355	326	30
1995	374	343	31
1996	396	362	34
1997	416	382	34

Source: 1993 Social Security Trustees' Report. (table III B.4.)

When more social security taxes are received than spent, the money does not sit idle in the Treasury, but is used to finance other operations of the Government. The surplus is then reflected in a higher balance of securities being posted to the trust funds. Simply put, these balances, like those of a bank account, represent a promise--a form of IOU from the Government that, if needed to pay social security benefits, the Government will obtain resources in the future equal to the value of the securities.

Aren't the Securities Posted to the Trust Funds the Same Sort of Financial Assets That Individuals and Other Entities Buy?

Yes, but what confuses people is that they often see these securities as assets for the Government. When an individual buys a Government bond, he or she has established a financial claim against the Government. When the Government posts a security to one of its own accounts, it hasn't purchased anything or established a claim against some other person or entity. It is simply creating an IOU from one of its account to another. Hence, the building up of Federal securities in a Federal trust fund--like that of social security--is not a means in and of itself for the Government to accumulate assets. It certainly has established claims against the Government for the social security system, but the social security system is part of the Government. Those claims are not resources the Government has at its disposal to pay future social security benefits.

What Then is the Purpose of the Trust Funds?

Generally speaking, the securities posted to any Federal trust fund represent "permission to spend." As long as a trust fund has a balance of securities posted to it, 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 loans it out. As long as the account shows a 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 at the time. The fact that this money is not set aside for social security purposes does not dismiss 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 themselves do not hold financial 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 having trust funds for social security is that they represent a long-term commitment of the Government to the program. While the funds do not hold "resources" that the Government can call on to pay social security benefits, the balances of 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? Doesn't the Treasury Department Maintain Accounts for Them as Well?

The Treasury Department maintains accounts for all Government programs. The difference is that many other programs, particularly those not accounted for through trust funds, 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 them. 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 securities, the Treasury Department has "budget authority" to expend funds for them.

Another difference is that a trust fund account earns interest, since it is comprised of Federal securities. 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 4 years or longer. This interest is credited to the trust funds twice a year (on June 30 and December 31) by posting 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 the budget and from calculations of the budget deficit. In large part this was done to prevent social security from masking the size of the deficit and to protect it from budgetary cuts. It was based on the supposition that Congress would act *differently* in trying to achieve deficit-reduction targets 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 statement or 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 is received and spent by the Government, 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 reaching budget totals. 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?

The fact that surplus social security taxes are used by the Government to meet other financial commitments does not necessarily mean that the Government has more money to spend than it would have if these receipts were not available. 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, social security taxes were raised in 1977 to shore up the program's financing, but the following year Congress enacted reductions in income taxes to offset the impact of these hikes. Similarly, the Earned Income Tax Credit (EITC), which reduces incomes taxes or permits a refundable credit to be paid to low-income workers with children, 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 now. Thus, whether these surplus taxes are allowing the Government to spend more is a matter of conjecture.

Are Surplus Social Security Taxes Allowing the Government To Borrow Less From the Public?

Today, the Government is spending more than it is taking in through taxes, and it covers the shortfall by borrowing money. No single activity of the Government determines the size of this shortfall. To say surplus social security taxes are reducing the amount that must be borrowed assumes that all other 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 over the past decade have contributed to reductions in other taxes, or kept other taxes from rising, they may have added little to the Government's total revenues. By the same token, when social security taxes are smaller than the program's spending--as they were for all but 5 fiscal years after 1957 and through 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 currently allowing the Government to borrow less from the public than it otherwise would is conjecture.

Isn't There Some Way To Actually Save the Social Security Surpluses?

Perceiving that surplus social security taxes simply give the Government more money to spend, people sometimes ask why they can't be invested in stocks or bonds. They feel that this would really save the money for the future.

Actually, 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 1993, the system's taxes will amount to an estimated $328 billion; its expenditures, $309 billion). At their peak in 2015, the balances of the social security trusts funds are expected to equal only 3 years' worth of payments.[1] Thus, the future costs of the system, as is the case today, will largely be met through future taxation. The promise of future benefits rests primarily on the Government's ability to levy taxes in the future, not on the balances of the trust funds.

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[1]Based on the intermediate forecast in the 1993 Social Security Trustees' report.

The more immediate concern about investing the surplus taxes elsewhere is that doing so would reduce the Government's revenues. The question this raises is how the Government would make up the loss. What other taxes would take their place, what spending would be cut, or would the Government simply borrow more money from the financial markets? In a sense, the idea of investing surplus social security taxes in private investments is only half a proposal.

If, the Government borrowed money from the financial markets to replace the surplus social security taxes it no longer would be receiving, it simply would be putting money into the financial markets with one hand and taking it back with another. Thus, 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 in response to having fewer social security dollars, it would not have to borrow any new funds (or it would borrow less than the full amount of social security money it diverted to the financial markets). This presumably would result in a net increase in savings in the economy. The bottom line is that it is not simply how surplus social security taxes are invested that determines whether or not real savings is created. It is the steps that fiscal policymakers take to reduce the Government's overall draw on financial markets that really matter.

FOR ADDITIONAL READING

U.S. Congress. House. 1993 annual reports of the trustees of the old-age, survivors and disability insurance, hospital insurance, and supplementary medical insurance trust funds. 103d Cong., 1st. sess. House documents 103-63, 103-64, and 103-65. Washington, U.S. Govt. Print. Off., 1993.

U.S. Library of Congress. Congressional Research Service. The social security surplus: a discussion of some of the issues. CRS Report for Congress no. 88-709 EPW, by David Koitz. Washington, 1988. 48 p. For shorter discussion, see: Social security tax debate: a fact sheet. CRS Report for Congress no. 92-894 EPW, by David Koitz and Geoffrey Kollmann. Washington, 1992.

----- Social security: investing the surplus. CRS Report for Congress no. 91-129 EPW, by Geoffrey Kollmann. Washington, 1991. 37 p.

----- Medicare financing. CRS Report for Congress no. 91-517 EPW, by David Koitz. Washington. 1991. 86 p. (For shorter discussion, see: The financial outlook for medicare, CRS Report for Congress no. 93-606 EPW.)