HUFFPOST BUSINESS

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Confused Thinking on Social Security

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Is Social Security a program that is independent of the federal budget ("off budget") or one that is intimately linked to the federal budget (the "unified budget" perspective)? Writers on Social Security appear to constantly switch between the two alternative perspectives on the program's finances, which ends up confusing rather than illuminating readers. Allan Sloan's recent column in the *Washington Post* is a case in point.

Mr. Sloan writes that

> We can make the trust fund as big as we want by putting in general revenues, as we're doing this year, or by simply stuffing new Treasury securities into it [*Note: "unified budget" perspective here*]. But the cash flow shortages [*"off budget" perspective here*] tell us that Social Security's problems are now in the present, not in the future [*No, references to cash-flow shortages are valid only under the "off-budget" perspective. But under it, the Trust Funds are meaningful as Social Security assets, which implies that the problem is not in the present*].
>
> A $2.6 trillion trust fund stuffed with Treasury securities makes a lot of people feel good [*"off budget" perspective here*]. But no matter how big the trust fund is, the cash flow deficit means taxpayers are going to have to borrow -- heavily -- to cover beneficiaries' checks [*"unified budget" perspective here*].
>
> The trust fund is now irrelevant in financial terms [*"unified budget" perspective here*], although it retains moral and some legal force. Cash is king. As always.

Cash is not king, confusion is.

If Social Security is viewed as an "off budget" program, its Trust Fund represents a valid funding source. It consists of trust fund loans to the federal government of past surplus payroll taxes that the federal government will repay with "full faith and credit." Since the program's payroll and other tax revenues are dedicated to it, its financial condition and sustainability can be judged by comparing projected revenues plus the trust fund's value with projected Social Security benefits. Under the "off budget" perspective, even if dedicated revenues are falling short of promised benefits, that "cash flow shortfall" is not a problem because the trust fund (which equals the federal government's liability to Social Security) will allow benefit payments to continue under current laws for a long time -- until 2036 under the Trustees' latest projections.

The program's past payroll tax surpluses were, by law, invested in special issue Treasury securities, which can be redeemed to pay for benefits when revenues from dedicated taxes fall short of promised benefits. But when pundits such as Mr. Sloan mention the possibility of providing "*new*" federal transfers to Social Security -- beyond redemptions of the existing trust fund -- the "off-budget" attribute is negated and the "unified budget" perspective becomes relevant; under the latter, Social Security is one among equals across the entire slate of federal government programs and the term "cash flow shortfall" is rendered meaningless. "New" government transfers can plug any holes in dedicated taxes relative to benefit outlays. In that case it is not valid to question whether government transfers would "solve" the program's "cash flow shortfall" as Mr. Sloan does. They will, by construction. Under the unified budget perspective, the only valid "cash flow shortfall" is the federal government's annual deficit.

Note that the Social Security Trust Funds are *not* financially irrelevant -- even under the "unified budget" perspective because they authorize the automatic payment of promised benefits despite the "cash flow shortfall" of dedicated revenues compared to promised benefits. Thus, they provide fodder for liberals to argue that there's no need to reform the system for another couple of decades.

According to the Trustees, if the federal government simply owed Social Security about $21 trillion rather than the $2.6 trillion it owes today, there would be no long-term funding problem for Social Security under the "off-budget" perspective. Liberals would love to see policymakers simply make that ledger entry granting the required spending authority to Social Security. (And it would have the added benefit of putting Mr. Sloan out of the business of sowing confusion in people's minds.)

But perhaps a different ledger entry would achieve even more: Let us recognize that past excess payroll taxes relative to benefit outlays (past Trust Fund surpluses under the "off budget" perspective) have been spent on other government programs. Grants of additional spending authority for Social Security must ultimately be paid out of today's and future taxpayer resources so making them whole is not really possible. Let us also recognize that the provision of such grants -- which now increasingly appear in Social Security reform proposals -- makes the "off budget" perspective economically irrelevant. Note that this is different from saying that the Trust Funds themselves are irrelevant.

So policymakers should be encouraged to make the reverse ledger entry -- to simply wipe out the Trust Funds entirely. That change might deliver the sorely needed sense of urgency to the debate on Social Security reforms -- as is currently happening for Medicare which has very few government IOU's in its trust fund.