**Insolvency does not mean massive benefit cuts or financial burden**

**None 'None** [None; None; None;   
 What Does Social Security Insolvency Mean? | American Enterprise Institute - AEI; None; https://www.aei.org/op-eds/what-does-social-security-insolvency-mean/; Accessed 06-22-2024; cut by AI] \*double quotes converted to single quotes

By Andrew G. Biggs The Dispatch February 21, 2023 The current controversy over cutting Social Security benefits is driven by a single fact: The Social Security program is projected to be insolvent in little more than a decade unless Congress takes remedial action. But what does insolvency mean for Social Security? Back in 1935, Social Security was set up to resemble a private pension plan. While the legal niceties are a bit complex, what Americans would see is that they pay taxes into Social Security while working, and in return they qualify for benefits in retirement or if they become disabled. President Franklin Roosevelt established this setup to differentiate Social Security as an “earned benefit” from what we today would refer to as “welfare,” which generally is funded from income taxes.  Dedicated Social Security taxes, Roosevelt said, “are politics all the way through. We put those payroll contributions there so as to give the contributors a legal, moral, and political right to collect their pensions and their unemployment benefits. With those taxes in there, no damn politician can ever scrap my social security program. Those taxes aren’t a matter of economics, they’re straight politics.” President Franklin Delano Roosevelt was, if nothing else, a canny politician. Attempts to reduce Social Security are not countered merely with arguments based upon need, but upon the perceived unfairness of cutting benefits that Americans understandably believe they have paid for. Along with this citizen-level relationship with the system, Social Security’s finances were set up differently than most other government programs. While, say, the Defense Department is funded each year based upon Congress’ perceived needs and priorities, Social Security is legally empowered to pay only the benefits affordable via its dedicated revenue sources—mostly payroll taxes, with a small amount coming from income taxes  levied on retirement benefits—and the balances in Social Security’s retirement and disability trust funds. At the same time, so long as the Social Security trust funds are solvent, the program will automatically pay the benefits to which Americans are entitled without annual approval from Congress.  The Social Security trust fund balances are themselves built upon surpluses of payroll taxes paid in prior years. The surpluses, which occurred from 1984 through 2009, are invested in special-issue non-tradable U.S. Treasury bonds. The trust fund bonds earn interest at market rates, which is reinvested into additional bonds, and these bonds can be redeemed when necessary to allow Social Security to pay full benefits. Those redemptions began in 2010, when Social Security began collecting less in dedicated taxes than it needed to pay full promised benefits. Today, the Social Security trust funds have a remaining balance of about $2.8 trillion, and Social Security’s trustees project that those balances will be exhausted somewhere around 2035.  It is at that point that Social Security will be “insolvent.” As defined in the 2022 Social Security Trustees Report, “A program is solvent at a point in time if it is able to pay scheduled benefits when due with scheduled financing. For example, the [Old-Age, Survivors, and Disability Insurance] program is solvent over any period for which the trust funds maintain a positive level of asset reserves.” Because Social Security was set up as a self-financing program, it has no legal authority to call upon additional revenues to pay full benefits once the trust funds have run dry. And without that legal authority, benefits would be cut across the board by about 20 percent in 2035—-for rich and poor, for the retired and disabled, for new and existing beneficiaries alike. In following years, cuts would grow larger. That is what the law says. And when you hear people say that Social Security can never add to the national debt, it is more or less this letter-of-the-law perspective that they are adhering to. Once the trust funds run out, benefits would be cut to the levels payable with existing taxes and so no additional borrowing is authorized or needed.  However, there is another way of looking at Social Security that focuses less on financial structures and legal rules and more on the economics. In this viewpoint, which is largely how agencies such as the Congressional Budget Office and economists look at the program, Social Security is one federal program among many. Payroll taxes come into the government and benefits flow out, but their effect on the economy depends on how they merge with everything else the federal government does. For this reason, the CBO and other agencies tend to view the federal government’s activities on a “unified budget basis,” in which Social Security taxes and outlays are merged with the rest of the federal budget. The flow of money through the redemption of Social Security’s trust fund bonds doesn’t play a role here, since revenues to Social Security are canceled out by the costs to the Treasury of paying off those bonds.  From this perspective, Social Security solvency, while having legal importance, carries less financial and economic weight. To illustrate, consider that in 2034, the final projected year of solvency for the Social Security trust funds, the program will cost the federal government 5.9 percent of gross domestic product. Of that, Social Security’s dedicated taxes—meaning, payroll taxes and income taxes levied on benefits—would cover 4.8 percent of GDP, with transfers of general tax revenue obtained via the redemption of trust fund bonds covering the remaining 1.1 percent of GDP.  Now fast forward to 2035, the year in which the trust fund becomes insolvent. Social Security’s cost remains 5.9 percent of GDP and its dedicated tax revenues remain at 4.8 percent of GDP. The only difference is that, with exhaustion of the trust fund, Social Security lacks the legal right to the 1.1 percent of GDP in general tax revenues it received in 2034. But the federal government’s ability to provide those transfers will not have disappeared. And if Congress voted to continue transferring those funds even after the trust fund ran dry, then Social Security could continue paying full benefits.  In this government-wide perspective, neither the cost of Social Security nor the federal government’s ability to bear that cost change very much when Social Security becomes insolvent. The only thing that changes is that Social Security would no longer have the legal right to call upon federal resources over and above its own dedicated taxes. Whether the federal government should nevertheless continue transferring those additional funds is a public policy argument, not an economic one. Continuing such transfers would prevent a 20 percent across-the-board cut in Social Security benefits, hardly a trivial matter. On the other hand, Social Security’s political strength has long stemmed from it being seen as a free-standing, self-financing program in which participants become entitled to “earned benefits” via their work and contributions. This is a very different situation than with a public employee pension in state government, where the redemption of private stocks and bonds held in pension funds brings in resources from outside the government to pay benefits without burdening the government or taxpayers. The exhaustion of a public employee pension fund would leave the state with a massive new financial burden which, in certain causes, might push the government into insolvency. While having the Social Security trust fund does not make it easier for the federal government to pay Social Security benefits, the converse is that not having a Social Security trust fund would not make it harder to pay benefits. In either case, Congress is transferring general tax revenues to Social Security and could, subject to the federal government’s resources, continue to do so. Social Security’s insolvency, then, has important legal ramifications. And how that insolvency is addressed could alter how Americans view the Social Security program, which has been seen as an “earned benefit” but could come to be seen as closer to “welfare” if significant outside funds are injected into the program. But neither of these important facts should lead observers to conclude that the **insolvency** of Social Security would in fact lead to massive benefit cuts or an increased financial burden on the federal government as a whole. Weekly analysis from AEI’s Economic Policy Studies scholars Thank you for your submission.