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SOCIAL SECURITY AND THE TAX CUT:

A Response to the Concord Coalition

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On June 18, 2002, the Concord Coalition issued a short discussion of a Center analysis initially issued last August and revised this April. The Center's analysis relied upon the Social Security actuaries' estimate of the size of the Social Security financing deficit, Congressional Budget Office estimates of the cost of the tax cut enacted last year (when the tax cut is phased in fully), and standard CBO and GAO methods for projecting the long-term effects of tax and spending policies. The Center's analysis found that if all elements of the tax cut are made permanent, the revenue loss from the tax cut will be more than twice as large over the next 75 years as the 75-year shortfall in the Social Security trust fund.[1] (Social Security's financial status is traditionally measured over a 75-year period.)

The Concord Coalition's short piece argued that this type of analysis sets back the cause of Social Security reform; it says that "defenders of the status quo take this [i.e., the Center's finding] to mean that all we need to do to fix Social Security is to scale back the tax cut." Concord stated that "Defenders of the *status quo* pose a false choice to the American public when they imply that all that's needed to fix Social Security is an open line to the Treasury."

In an initial version of this paper, Concord mistakenly implied that our analysis itself advocated such a course. This is not the case — our paper explicitly rejected such a course and stressed that Social Security reform is necessary — and Concord quickly revised its paper to correct this problem. But the Concord piece continues to challenge the analytic basis and usefulness of our comparison of the size of the tax cut to the size of the Social Security shortfall. As the follow discussion indicates, we believe the comparison is not only analytically sound but is helpful — rather than harmful — in advancing the causes of both fiscal responsibility and Social Security reform. Furthermore, we believe that in its zeal to counter any suggestion that scaling back the tax cut could substitute for Social Security reform, the Concord piece inadvertently made statements inconsistent with past Concord positions and current efforts to promote fiscal responsibility.

We should note at the outset that we are longstanding admirers of — and frequent collaborators with — Concord. In recent years, the Center on Budget and Policy Priorities and

[1] Richard Kogan, Robert Greenstein, and Peter Orszag, "Social Security and the Tax Cut: The 75-Year Cost of the Tax Cut Is More than Twice as Large as the Long-Term Deficit in Social Security" Center on Budget and Policy Priorities, updated April 11, 2002, based on this year's report of the Social Security trustees; available at http://www.cbpp.org/4-9-02socsec.pdf.

the Concord Coalition have jointly conducted a number of Congressional and media briefings and conferences on issues related to fiscal policy and fiscal responsibility. The concerns that underlie our analysis of the tax cut and the Social Security shortfall reflect this focus on the need for fiscal responsibility. The discussion that follows covers the following four points.

- The Center strongly agrees with Concord that changes in Social Security are necessary to reduce Social Security's claims over time on the budget, and that cancelling part of the tax cut cannot substitute for such action. The Center analysis, as well as other Center publications, are clear on this point.

- It is extremely unlikely that any legislative package can pass Congress that restores Social Security solvency entirely through Social Security benefit cuts and/or payroll tax increases — in other words, without the infusion of some revenue from the rest of the budget. The budget cuts or payroll tax increases that would be required are simply too large for such a plan to be politically viable. This is evidenced by the fact that every significant Social Security solvency proposal introduced on Capitol Hill — including proposals that Concord itself has praised — involve general revenue transfers, as do the proposals of the President's Social Security Commission. Yet because of the tax cut, there are no longer any unused revenues in the rest of the budget to transfer. The Center's paper calls for shelving some provisions of the tax cut not yet in effect and transferring some revenue to Social Security as part of a larger Social Security reform package, since reform packages *cannot survive* without such transfers and since simply assuming such transfers without taking steps to finance them would be fiscally irresponsible. (We would note that we are not aware of any significant player in the Social Security debate who has misused our analysis to claim that we should maintain the status quo on Social Security and simply cancel the tax cut instead.)

- We disagree with Concord's contention that a comparison of the long-term costs of the tax cut to the long-term shortfall in Social Security has "no practical significance." The comparison serves two quite useful practical purposes. It explains the size of the tax cut in a way that is immediately understandable. In addition, by demonstrating that those claiming that the tax cut is modest and affordable but the Social Security shortfall is massive are mistaken (or disingenuous), the analysis highlights the magnitude of the revenue losses that will result from the tax cut when the tax cut is fully in effect.

- Finally, the Concord piece argues that our method of calculating long-term costs is not meaningful or the best way to calculate such costs. We disagree. To measure Social Security's shortfall, we use the standard method used by the Office of the Chief Actuary at the Social Security Administration and by the Social Security Trustees. To measure the cost of the tax cut beyond the next ten years, we use the same method for projecting long-term costs that virtually all budget experts do, including the Congressional Budget Office and the General Accounting Office.

The Need for Social Security Reform

Concord's principal policy objection to the Center's analysis is that it believes "defenders of the status quo" will take our analysis to mean that Congress should repeal or scale back the tax cut, use the savings to ensure Social Security solvency, and make no changes in Social Security itself. We agree that such a course of action would be irresponsible; our analysis is explicit on this point. While noting that the Social Security shortfall over the next 75 years equals about 40 percent of the cost of the tax cut over the same period, our paper warns:

> "We should emphasize that we would not recommend canceling 40 percent of the tax cut and placing all of the freed-up resources in Social Security. The nation will face serious financial strains when the baby boomers retire in large numbers. The long-term financing shortfall in Medicare is larger than that in Social Security, and the nation also is likely to face needs in the decades ahead that will require resources in other areas, including areas relating to children, the environment, the large number of Americans without health insurance, the lack of a Medicare prescription drug benefit, and the uncertain costs of homeland security, as well as other problems that inevitably will arise in the future but that we cannot foresee today. *A balanced long-term fiscal policy is likely to entail some changes in Social Security to reduce its future claims on the budget, rather than simply providing it with whatever resources are needed from the rest of the budget to close its entire long-term financing shortfall.* Providing resources from the rest of the budget to close a portion (rather than all) of the Social Security shortfall, however — in conjunction with other Social Security reforms — is likely to be essential if any reform plan to restore long-term solvency is to have hope of being enacted. Otherwise, the Social Security benefit cuts and payroll tax increases that will be required as part of any solvency plan are likely to be too large for such a plan to be *politically viable*" (emphasis added).

We emphasized in our paper that any savings generated by scaling back the tax cut should *not* simply be transferred in full to Social Security. There are many unmet needs, including saving for the future, that would warrant consideration as potential uses of the revenue saved by scaling back the tax cut. Moreover, some contribution to the long-term budget problem will necessarily have to come from Social Security itself. In a subsequent paper published by the Center, an analysis by economists Peter Diamond and Peter Orszag, we returned to this point. This paper labels as "fiscally reckless" the notion of simply closing the entire Social Security shortfall through general revenue transfers.[2]

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[2] The paper by Diamond and Orszag states: "A claim of long-term [Social Security] balance that is heavily dependent on substantial, unspecified general revenue transfers, however, raises questions of credibility....Congress could erase the long-term deficit in Social Security without any other changes simply by legislating that the Trust

The increases in the cost of Social Security benefits in future decades might not be unaffordable by themselves if there were no other pressures on the budget. CBO projects that the costs of Social Security will grow by 1.9 percent of GDP as the baby boomers retire and then level off. If the government were to pay off most of the debt held by the public so that it no longer had to pay significant interest on the debt (currently running at 1.7 percent of GDP), the interest savings by themselves would almost cover the increase in the costs of Social Security. *But there are many other pressures on the budget, in addition to Social Security.* The combined costs of Medicare and Medicaid will grow from 3.4 percent of GDP in 2000 to 15.2 percent of GDP in 2075, according to CBO.[3] In addition, there are other national needs that are not currently being met. A key problem with the tax cut, which Concord has emphasized in other contexts, is that it makes it much harder to repay debt and reduce these interest costs in anticipation of these large demographic pressures.

The Tax Cut, General Revenue Transfers, and Social Security Solvency

The Concord piece suggests that comparing the cost of the tax cut to the Social Security shortfall is dangerous: people will use the comparison to defend the Social Security status quo, Concord fears, making Social Security reform harder to achieve.

This could occur. But we believe that analyses such as ours are more likely to facilitate Social Security reform than to impede it.

- Virtually no policymaker or political party is willing even to discuss Social Security proposals that would restore long-term solvency without *some* general revenue transfers. Virtually every major proposal of recent years, including even the austere proposal introduced by Reps. Jim Kolbe and Charles Stenholm and praised by Concord, includes general revenue transfers. These plans reflect political reality: the Social Security benefit cuts or payroll taxes required to restore Social Security solvency in the absence of any general revenue transfers are simply too large to be politically acceptable. (In some cases — as with the proposals of the President's Commission to Strengthen Social Security, the Social Security plan advanced by the House Majority Leader Dick Armey, and the plan proposed by House Social Security Subcommittee chair Clay Shaw — the general

Fund would be able to draw upon general revenue as needed to finance scheduled benefits. If no other budget changes were made, such legislation would raise serious questions about how the general revenue transfers could be financed when the need arrived....Given the current budget outlook, simply assuming the availability of such large transfers is highly problematic and could be regarded as fiscally reckless." Peter A. Diamond and Peter R. Orszag, "Reducing Benefits and Subsidizing Individual Accounts: An Analysis of the Plans Proposed by the President's Commission to Strengthen Social Security," Center on Budget and Policy Priorities and The Century Foundation, June 2002.

[3] See "A 125-year picture of the Federal Government's Share of the Economy, 1950 to 2075," CBO, June 14, 2002.

revenue transfers are massive and, in our view, much too large to be fiscally responsible.)

- It seems evident that no reform plan can pass that does not include general revenue transfers. But in the aftermath of the tax cut, the expected defense and homeland security spending increases, decreases in revenue collection forecasts, and other factors, there may be no surpluses left outside Social Security from which such transfers can be made.

- This creates three broad possibilities, the first two of which are quite disturbing: 1) that policymakers will avoid taking any action on Social Security reform for years to come; 2) that policymakers will pass Social Security legislation that includes substantial general revenue transfers *without taking any steps in the rest of the budget to create room for the transfers* (this is the approach the Armey and Shaw plans take); or 3) that policymakers will take steps in the rest of the budget to free up such resources and transfer some (or all) of the freed-up resources to Social Security.

- Our analysis proposes the third, and the only fiscally responsible, one of these courses: it suggests scaling back some elements of the tax cut that are not yet in effect and that would affect only high-income individuals and dedicating some of the freed-up resources to Social Security, in conjunction with reforms in Social Security itself.

Targeted general revenue transfers to Social Security can be accomplished. Since 1983, a portion of federal income tax receipts has been transferred each year to the Social Security Trust Fund. (These income tax receipts are generated by counting a portion of Social Security benefits as taxable income for higher-income beneficiaries.) Congress could follow a similar course by, for example, reforming rather than repealing the estate tax and dedicating a specified portion of the preserved estate tax revenues to the Social Security Trust Fund. The Kolbe-Stenholm bill also contains a proposal of this type: it would index federal benefit and tax code provisions currently tied to the Consumer Price Index by a measure that rises more slowly than the CPI and then transfer all resulting savings to the Social Security Trust Fund each year.

In its June 18 paper, Concord seems to object to such an approach; it appears to argue against using any general fund revenue to help restore Social Security solvency. That position is both impractical — as noted, no reform plan that lacks any general revenue transfers appears even to be discussable — and is inconsistent with past Concord positions in praising proposals such as the Kolbe-Stenholm plan that include some general revenue transfers. In any case, we believe that while general revenue transfers should be neither the entire nor the principal part of plans to restore Social Security solvency, limited general fund transfers are essential to facilitate Social Security reform.

"No practical significance"?

The Concord paper contends that a comparison of the cost of the tax cut to the size of the Social Security shortfall "is of no practical significance." There are, however, at least two practical reasons for making such a comparison.

- One is to point out that, in many cases, the same people who maintain the tax cut is easily affordable also assert that the shortfall in Social Security is so huge that drastic changes need to be made in Social Security. One purpose of our analysis is to show that a person cannot hold both views at the same time — that if one views the Social Security shortfall as a serious matter, one must also be concerned about the fiscal implications of the tax cut in coming decades. Concord, to its credit, does not hold both views. It has vigorously opposed the tax cut because of its large costs.

- Another purpose of this comparison is to put the size of the tax cut into context for the general public. People do not have to deal with millions, billions, or trillions of dollars in their daily lives and so may have a hard time picturing how expensive the tax cut is. Saying it costs "$1.7 trillion counting interest over ten years" is accurate but not immediately understandable to many Americans. The Center has written a number of analyses that discuss the cost of the tax cut and look for ways to bring home its dimensions.[4] The comparison in our analysis — that over the long term, the tax cut would cost more than twice as much as the shortfall in Social Security — is a practical way to bring home the magnitude of the tax cut's cost.

Analytic Issues

The Concord piece raises analytic concerns about the method we use of comparing the cost of the tax cut to the size of the Social Security shortfall. Concord argues that what matters is Social Security's annual cash-flow balance, *not* its 75-year actuarial balance. The Concord piece consequently criticizes our comparison of the total cost of the Social Security shortfall over 75 years to the total cost of the tax cut.

The Center's comparison of the long-term Social Security shortfall and the cost of the tax cut follows standard and widely accepted methods in the field for measuring and comparing long-term costs. The principal measure that the highly respected Office of the Chief Actuary at the Social Security Administration uses to evaluate Social Security reform proposals is not the effect of such proposals on the program's annual cash flow balances, but rather their effect on the program's 75-year actuarial balance. The figures provided in the Center's analysis for the

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[4] See, for example, "The Cost of the Tax Cut Compared With the Costs of Various Federal Agencies," Center on Budget, April 17, 2002.

size of the Social Security shortfall are the widely used 75-year shortfall figures taken directly from the most recent report of the Social Security actuaries and trustees. (It also may be noted that the Social Security actuaries have concluded the best way to express the long-term Social Security imbalance in dollar terms is to present the imbalance in terms of its "present value." This is what our analysis does, using the actuaries' estimates.)

Similarly, in estimating the long-term cost of the tax cut, we used the standard methodology that CBO and GAO employ in projecting the long-term costs of tax and spending policies. We use CBO and Joint Committee on Taxation estimates of the cost of the tax cut in 2011 if all of the provisions of the tax cut are extended. We then use the standard method that CBO and GAO use in their long-term budget forecasts, which is to assume that such costs will remain constant in future decades as a share of the Gross Domestic Product. We also express the long-term costs of the tax cut both as a share of GDP and in "present value." This, too, is the standard practice that CBO and GAO have followed. It also is the approach typically used by prominent fiscal policy experts, such as Alan Auerbach of the University of California at Berkeley and William Gale of the Brookings Institution.

Saving for the Future

Concord also raises a second, and more important, point here. It argues that scaling back the tax cut would be of no help to Social Security unless the preserved revenues are saved rather than quickly spent. Concord sees a risk that if the tax cut were scaled back, none of the savings would be retained for the future. Instead, all of the savings might be used for other current needs.

This is the most significant issue the Concord piece raises. The tax cut itself is evidence for the proposition that it is politically hard to save for the future. Yet "throwing in the towel" — and concluding that it is impossible to preserve savings achieved by scaling back the tax cut or instituting spending reductions — is premature. It also is inconsistent with the work and pronouncements over the years of the Concord Coalition itself, which has striven mightily to build surpluses.

- For four consecutive years (1998 through 2001), the government ran surpluses but enacted relatively little in the way of spending increases or tax cuts. As a result, these surpluses paid down the publicly held debt — that is, they were saved for the future. The publicly held debt declined from 46.1 percent of the Gross Domestic Product in 1997 to 32.7 percent in 2001.

- Both political parties continue to say they desire to return to surpluses that are at least as large as the Social Security surplus. While there is certainly grounds for skepticism, there is no reason that Concord or the Center should abandon the goal of running surpluses before the baby boomers retire, to help cover the costs that will occur during their retirement.

- Because it makes clear policy sense to run surpluses now, it also makes analytic sense to calculate the degree to which various policies would decrease surpluses (as last year's tax cut did) or could restore or increase surpluses (as scaling back parts of the tax cut could), particularly if a share of the resulting revenues are dedicated to the Social Security Trust Fund and there is agreement — backed by budget enforcement mechanisms — to make these funds unavailable for other uses.

- Finally, Concord's strong opposition to the tax cut because of its great cost is consistent with the notion underlying the Center's analysis that efforts to preserve surpluses and save them for the future (such as by using them to pay down debt) should be made. If Concord believes Congress will never run surpluses and pay down debt, why did it object to the tax cut, which was billed by its advocates as the preferred way to consume projected surpluses? In Concord's positions both on the tax cut and on spending measures, Concord has consistently plugged for fiscal restraint and saving projected surpluses.[5] While Concord's critique of the Center's analysis may imply that saving surpluses is not possible, Concord's strong track record and policy positions over the years indicate that Concord, like us, believes that preserving surpluses — and having government save for the future — are goals that are achievable and should be pursued.

[5] See, for example, "Don't Squander the Surplus: Reform Social Security and Medicare First," Concord Coalition, Aug 15, 1999.