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HEADLINE: Surplus of confusion over Social Security;
What do the budget projections mean? Benefits are safe, but the political fallout could be significant.

BYLINE: Eric Black; Staff Writer

BODY:

RSEC: A projection that the federal government will need to spend some of the Social Security surplus for non-Social Security purposes clearly is not good news for the retirement insurance program _ but probably not as dire as some media accounts and political rhetoric may imply.

The Congressional Budget Office (CBO) said, in a report officially released Tuesday, that a shrinking federal surplus will require using about \$9 billion this year from the Social Security surplus for ordinary government spending. Additional spending from the surplus will be required in two of the next three years.

To understand what that means, it might help to explain some of the things that it doesn't mean:

It doesn't mean: that the government will spend on its favorite programs money that would otherwise be used to pay Social Security benefits. On the contrary, Social Security has all the funds it needs to pay all scheduled benefits every year through 2016, projections show. In fact, as they have since the early 1980s, Social Security payroll taxes, plus interest that Social Security is accruing on its trust fund, generate far more than the program pays out in benefits. The difference is the Social Security surplus: this year an estimated \$163 billion. When news reports say that the government probably will need to dip into Social Security funds, they refer only to the Social Security surplus.

It also doesn't mean: that the **Social Security trust fund** will be credited with any less than the full value of the annual surplus. By law, Social Security trustees are required to invest the entire surplus in U.S. Treasury bonds. Or, to put it another way, the U.S. Treasury borrows the surplus from Social Security with a promise to pay it back later, with interest.

The master plan, created in 1983, is for Social Security to build up its reserves in the trust fund while it is running a surplus, then cash in those reserves to postpone insolvency for about 20 additional years. According to current projections, the **Social Security trust fund**, currently \$1.17 trillion, will grow to more than \$6.5 trillion and will provide Social Security with funds to pay all promised benefits through 2038. At that time, the trust fund would be exhausted and Social Security would be able to pay only about three-fourths of promised benefits.

History of spending

All of this ignores the argument made by many conservatives that the **Social Security trust fund** is nothing but an accounting gimmick with no real assets, only government IOUs.

But on paper at least, the entire Social Security surplus is added to the trust fund every year, no matter what the government does with the money that it borrows.

In fact, the spending of the borrowed Social Security surplus on non-Social Security expenses is nothing new. During the era of big federal deficits during the 1980s and early 90s, the federal government generally used all the money that it borrowed from Social Security and had to borrow still more money from the bond-buying public.

During these years, the amount the government owed to Social Security and the amount it owed to the public were both growing at alarming rates. Between 1981 and 1996, the total federal debt quintupled from less than \$1 trillion to more than \$5 trillion.

During this bleak run-up, it began to seem unimaginable that the government would ever get its debt under control, or that the government would be in a position to pay off the bonds in the **Social Security trust fund** when they came due.

But the miraculous economic boom of the 1990s came to the rescue. The economy stimulated tax receipts and reduced some categories of government spending. That, along with some fiscal discipline, reduced the federal deficit for six consecutive years before eliminating it in 1998.

For each of the past three fiscal years, the Treasury was able to buy back a small portion of the debt owed to public bondholders.

'Social Security first'

In his 1998 State of the Union message, President Bill Clinton coined the slogan "save Social Security first," and in some ways set the stage for last week's news. Clinton's phrase had a few meanings. One was that Congress shouldn't consider using the new projected surpluses for big tax cuts or ambitious new spending initiatives until it addressed Social Security's long-term solvency problems. Clinton started work on a Social Security rescue plan, but serious progress was preempted by the impeachment imbroglio.

In the short-term, "save Social Security first" came to mean that 100 percent of the Social Security surplus should be used to pay down the non-Social Security portion of the national debt, rather than used for tax cuts or ordinary spending.

The principle is not without logic. If the non-Social Security debt could be dramatically reduced _ or even eliminated _ before 2016, it would greatly improve the prospects that the government could pay off the trillions of dollars it will owe to Social Security between 2016 and 2038 without imposing crushing burdens on young workers in those years.

In 1999 and 2000, the still surging economy led to projections of breathtaking multi-trillion-dollar future surpluses, which seemed to free Washington from the restraints that had been imposed on it by Clinton's slogan. When President Bush on June 7 signed the tax cut that he had advocated, projections showed that the government could afford the tax cut and still keep the pledge to use the Social Security surpluses for debt reduction.

That's the line that shifted on Bush during the past week. First, the White House Office of Management and Budget released projections that Bush could just barely avoid spending Social Security surplus funds this year.

Then congressional analysts reported a slightly more pessimistic conclusion. Updating its 10-year forecast released Tuesday to include the impact of the tax cut and the slumping economy, the CBO concluded that \$9 billion of the Social Security surplus would be used this year for ordinary government spending and additional infusions would be needed in 2003 (\$18 billion) and 2004 (\$3 billion).

Political ramifications

The political effects could turn out to be large if Democrats can convince the public that Bush's tax cut unwisely jeopardized the healthy balance sheet that he inherited from Clinton.

But if the current CBO projections turn out to be accurate, the effect on Social Security looks small. The CBO projects that, including a \$2 billion overall surplus in 2002, Bush would spend a net of \$28 billion in Social Security surplus funds during the next four years out of a total Social Security surplus of \$733 billion during those years. And the CBO projects that the White House could be back into compliance with the pledge for the seven following years, which is as far as their projection goes.

The CBO still shows the debt owed to the public falling every year during the next 10 years and declining from \$3.3 trillion now to \$876 billion in 2011. The CBO calculates that that would retire all of the public debt available for redemption during those years.

If things turn out that way, the logic of the pledge _ to reduce the non-Social Security debt in preparation for the years when the country will have to redeem its debt to Social Security _ would not be affected much.

But the threat to Social Security could grow, depending on how things go in the economy and in Congress.

The CBO bases its projections on currently appropriated spending trends. It ignores policy changes, such as the addition of a proposed Medicare drug benefit, any increases in education and defense spending, for which there is wide bipartisan support. If the CBO projections are correct, but Congress adds costly initiatives without offsetting cuts, it will reduce the money available to pay down public debt.

Finally, if this week's downward revision of trend lines turns out to be the first of many, the effect on Social Security's prospects for the years 2016 to 2038 could become large.

_ Eric Black is at eblack@startribune.com.

Calculating the federal debt

The total federal debt is a combination of the bonds that the government must repay to Social Security, the debt that it owes to public creditors and other miscellaneous obligations. Using the Social Security surplus to pay down the non-Social Security debt now could make it easier for the government to pay off the **Social Security Trust Fund** bonds, which it must start doing in about 15 years to keep Social Security solvent.

Money owed in billions

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| | Actual | Projected | | | | |
|--|--------|-----------|------|------|------|------|
| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |

Social Security

| | | | | | | |
|-------------------|---------|---------|---------|---------|---------|---------|
| Trust Fund | \$1,007 | \$1,170 | \$1,346 | \$1,536 | \$1,740 | \$1,964 |
|-------------------|---------|---------|---------|---------|---------|---------|

Debt held

| | | | | | | |
|-----------|---------|---------|---------|---------|---------|---------|
| by public | \$3,410 | \$3,294 | \$3,138 | \$2,983 | \$2,797 | \$2,572 |
|-----------|---------|---------|---------|---------|---------|---------|

| | | | | | | |
|--------|---------|--------|---------|---------|---------|---------|
| Other# | \$1,212 | \$1,28 | \$1,372 | \$1,463 | \$1,557 | \$1,658 |
|--------|---------|--------|---------|---------|---------|---------|

Gross Federal

| | | | | | | |
|--------|---------|---------|---------|---------|---------|---------|
| Debt## | \$5,629 | \$5,752 | \$5,856 | \$5,982 | \$6,094 | \$6,194 |
| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |

Social Security

| | | | | | | |
|-------------------|---------|---------|---------|---------|---------|---------|
| Trust Fund | \$2,206 | \$2,468 | \$2,750 | \$3,053 | \$3,376 | \$3,722 |
|-------------------|---------|---------|---------|---------|---------|---------|

Debt held

| | | | | | | |
|-----------|---------|---------|---------|---------|-------|-------|
| by public | \$2,300 | \$1,976 | \$1,601 | \$1,165 | \$930 | \$876 |
|-----------|---------|---------|---------|---------|-------|-------|

| | | | | | | |
|--------|---------|---------|---------|---------|---------|---------|
| Other# | \$1,770 | \$1,883 | \$1,997 | \$2,115 | \$2,235 | \$2,352 |
|--------|---------|---------|---------|---------|---------|---------|

Gross Federal

| | | | | | | |
|-------|---------|---------|---------|---------|---------|---------|
| Debt# | \$6,276 | \$6,326 | \$6,348 | \$6,333 | \$6,541 | \$6,949 |
|-------|---------|---------|---------|---------|---------|---------|

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Includes money owed to funds for Medicare, military retirements and other obligations.

Some totals differ because of rounding.

- Source: Congressional Budget Office

GRAPHIC: CHART



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