

March 2007

SOCIAL SECURITY REFORM

Greater Transparency Needed about Potential General Revenue Financing



Highlights of [GAO-07-213](#), a report to congressional committees

Why GAO Did This Study

Absent reform, Social Security’s financing gap will grow until currently scheduled benefits can no longer be paid in full. Recent reform proposals often include general revenue (GR)—a major change that can have significant implications for the budget as a whole. This report addresses these issues: (1) What information is available about GR in recent proposal scorings by Social Security’s Office of the Chief Actuary (OCACT)? (2) What common mechanisms, especially GR mechanisms, are used to increase program revenue? (3) What are the implications of GR for the trust fund and the federal budget? We have prepared this report under the Comptroller General’s statutory authority to conduct evaluations on his own initiative as part of a continued effort to assist Congress in addressing the challenges facing Social Security.

What GAO Recommends

GAO recommends that the Commissioner of SSA direct OCACT to include a summary presentation of its analysis to facilitate comparisons of reform proposals especially with respect to use of GR and federal budget implications. SSA suggested that a table showing how each provision affects the actuarial deficit would be helpful. GAO agrees but remains of the view that a table that can clearly and quickly communicate both trust fund effects and federal budget implications is needed.

www.gao.gov/cgi-bin/getrpt?GAO-07-213.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Susan J. Irving at (202) 512-9142 or irvings@gao.gov.

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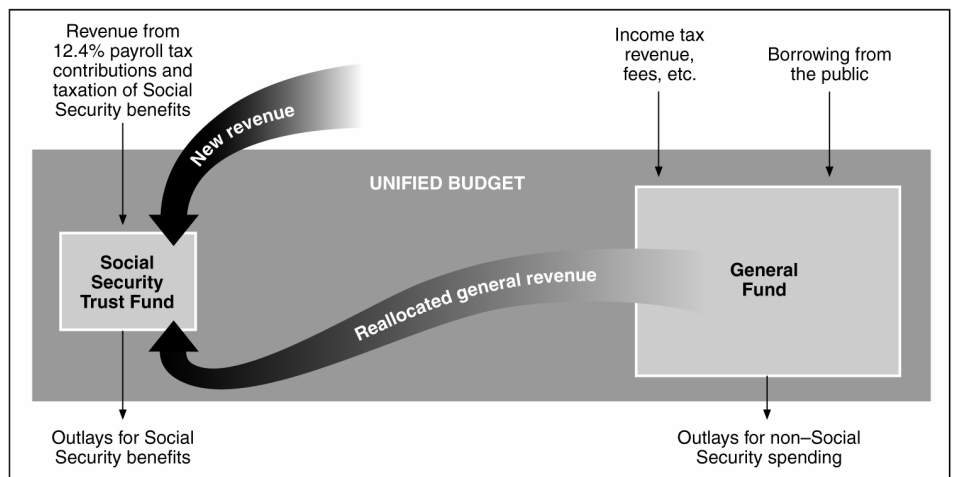
What GAO Found

Although focused on the trust fund, OCACT scoring memos are also the primary source of information on how proposals would impact the federal budget. Memos provide information on GR use and its effects, but experts said comparing proposals on this element presents challenges, requiring extensive efforts to understand complex tables shown at the end of the memos.

Fourteen of 17 proposals GAO reviewed provided GR (1) as needed to maintain trust fund solvency or (2) as specified by formula, amount, or source. Nine of the 17 achieved “sustainable solvency” under OCACT’s definition using the first approach. This type of unlimited transfer poses the greatest potential risk to the federal budget, especially when combined with benefit guarantees. In proposals reviewed, amounts of GR under both types of approaches ranged up to about twice program shortfall.

In all proposals using GR, the GR was reallocated from the non-Social Security budget. While any additional revenue to the trust fund will help solvency, unified federal budget effects depend on the type of revenue—whether it is new revenue (additional payroll tax revenue or GR that is new to the federal budget) versus reallocated GR. Absent other changes, new revenue would improve the long-term fiscal imbalance while reallocated GR would do nothing to address it. Although raising taxes (payroll or other) or cutting benefits would have tangible consequences for taxpayers and beneficiaries, e.g., less take-home pay or smaller benefit checks, the consequences of transfers from the non-Social Security budget in the form of reallocated GR are less likely to be clearly observable. Reallocated GR, however, is not free. Regardless of how GR is provided to Social Security, it must be paid for at some point. The question is when, and by whom.

New Revenue versus Reallocated General Revenue



Source: GAO.

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Abbreviations

CBO	Congressional Budget Office
CES	Committee on Economic Security
CPI	Consumer Price Index
GR	general revenue
HI	Hospital Insurance
IA	individual account
OASDI	Old-Age, Survivors, and Disability Insurance
OCACT	Office of the Chief Actuary
SSA	Social Security Administration

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United States Government Accountability Office
Washington, DC 20548

March 22, 2007

The Honorable Max Baucus
Chairman
Committee on Finance
United States Senate

The Honorable Herb Kohl
Chairman
The Honorable Gordon Smith
Ranking Member
Special Committee on Aging
United States Senate

The Honorable Charles B. Rangel
Chairman
The Honorable Jim McCrery
Ranking Member
Committee on Ways and Means
House of Representatives

The Honorable Michael R. McNulty
Chairman
The Honorable Sam Johnson
Ranking Member
Subcommittee on Social Security
Committee on Ways and Means
House of Representatives

Absent substantive reform, the gap between expected Social Security cash revenues and benefits that is expected to begin in 2017 will grow until the Social Security combined Old-Age Survivors and Disability Insurance (OASDI) trust fund¹ is exhausted and benefits at currently scheduled levels can no longer be paid in full. Under the 2006 intermediate Trustees' estimates, Social Security's long-term financial shortfall is estimated at

¹In this report, the combined OASDI Trust Funds are referred to as the Social Security trust fund. For more information on federal trust funds and other funds dedicated to specific programs, see GAO's report *Federal Trust and Other Earmarked Funds: Answers to Frequently Asked Questions*, [GAO-01-199SP](#) (Washington, D.C.: January 2001).

2.02 percent of total taxable payroll,² and its trust fund is projected to reach exhaustion in 2040.³ Since its inception in 1935, Social Security has been financed primarily by the payroll tax contributions of employers and employees. However, recent reform proposals have often used—and in some cases relied primarily on—general revenue financing⁴ to help address the program’s financial shortfall. Many of the reform proposals estimated (scored) by the Office of the Chief Actuary (OCACT) at the Social Security Administration (SSA) as achieving “sustainable solvency”⁵ for the trust fund would give Social Security significant amounts of general revenue as part of a package of modifications.

Such use of general revenue for Social Security would represent a major shift for this important and popular program. Since enactment in 1935, Social Security payroll taxes have been increased and benefits expanded, but the program’s financing framework has remained largely the same. The use of general revenue was proposed both before the actual creation of Social Security and during short-term financing crises in the 1970s and 1980s as an alternative to payroll tax increases, but Congress for the most part has rejected general revenue financing for Social Security. Use of general revenue would change the “self-supporting” nature of the program and has thus been controversial. Some have feared that such a shift would facilitate benefit expansion by undermining the fiscal discipline that requires limiting benefit outlays to trust fund balances; others have feared that use of general revenue would lead ultimately to a change from a universal program to a reduced, means-tested benefit. Since 1983, small

²For explanation of technical terms, see the glossary at the end of this report.

³Social Security’s financial condition has traditionally been measured separately from that of the rest of the budget by comparing the program’s expected revenues with expected costs over a 75-year timeframe. Estimates of the solvency of Social Security’s trust funds in this framework have been prepared by the Office of the Chief Actuary (OCACT) at the Social Security Administration (SSA) each year since 1941.

⁴As used in this report, *general revenue* refers to any revenue not derived from payroll tax contributions. (See text box.)

⁵When OCACT describes a proposal as modifying the program so that there is a positive trust fund ratio throughout the 75-year projection period and these ratios are stable or rising at the end of the period, this meets the definition of “sustainable solvency” in the 2006 Trustees’ Report.

amounts of general revenue from taxation of the Social Security benefits of upper-income retirees have been dedicated to the program.⁶

In the coming years, as the baby boom generation retires, the nation will face a daunting and unprecedented long-term fiscal challenge. GAO's long-term budget simulations show that current fiscal policy is unsustainable and, absent changes, will lead to an escalating spiral of federal deficits and debt.⁷ Social Security is not the major driver of the long-term fiscal challenge—the cost of government-financed health care is—but Social Security reform has the potential to affect not only the financial condition of the program's trust fund but also the financial condition of the Nation. As the reform debate resumes, it will be important to make transparent the implications of general revenue use not only for the trust fund but also for the federal budget as a whole.

This report seeks to answer the following questions: (1) What information is available about general revenue use in recent Social Security proposal scoring memos by OCACT and how can available information about general revenue use best be presented in order to facilitate comparison of reform proposals? (2) In recent Social Security reform proposals, what common mechanisms, especially general revenue mechanisms, are used to increase revenue to the program? (3) What are the implications of general revenue use for the trust fund and the federal budget?

To answer these questions, we reviewed relevant literature on Social Security and performed an in-depth analysis of 17 OCACT proposal scoring memos done from 2001 through 2006. These included all proposals

⁶The Social Security Amendments of 1983 require beneficiaries with income (defined as adjusted gross income plus tax-exempt bond interest plus one-half of Social Security benefits) of more than \$25,000 if single, and \$32,000 if married filing jointly, to include up to 50 percent of their benefits in their taxable income, beginning in 1984. Revenues from this provision are credited to the OASDI Trust Funds. The Omnibus Budget Reconciliation Act of 1993 required beneficiaries with incomes of more than \$34,000 if single, and \$44,000 if married filing jointly, to include up to 85 percent of their benefits in their taxable income, beginning in 1994. Revenues attributable to taxation of over 50 percent of Social Security benefits are credited to the Medicare Hospital Insurance (HI) trust fund. These levels are not adjusted for inflation or wage growth, so the percentage of beneficiaries paying tax on Social Security benefits is expected to rise in the future.

⁷GAO's long-term simulations assume that scheduled benefits for Social Security and Medicare's HI Trust Fund are paid through borrowing, that is, by using reallocated general revenue after program trust funds reach exhaustion. (See textbox, "New Versus Reallocated General Revenue in Social Security.") For more information on GAO's simulations, see <http://www.gao.gov/special.pubs/longterm/>.

scored as achieving long-range solvency. Where a proposal was scored in multiple years, we used the most recent scoring. We also interviewed selected federal budget experts representing a range of views on reform approaches and met with officials from OCACT and Congressional Budget Office (CBO) involved in proposal scorings. (See app. I for more details on our scope and methodology.)

We have prepared this report under the Comptroller General's authority to conduct evaluations on his own initiative, and it is intended to assist Congress in its deliberations on Social Security and retirement issues. The report is addressed to interested congressional committees.

We performed our work between May 2005 and December 2006 in accordance with generally accepted government auditing standards. We requested comments on a draft of this report from the Commissioner of Social Security and incorporated those comments as appropriate. (See "Agency Comments and Our Evaluation" and app. II.)

Results in Brief

Scoring memos prepared by OCACT usually serve as the basis for discussion of the financing changes—including any use of general revenue—contained in reform proposals.⁸ These memos focus on the impact of a proposal on the combined OASDI trust fund. Understanding the use of any general revenue in a given proposal, the proposal's impact on the federal budget, and how different proposals compare on these dimensions presents challenges. Although OCACT scorings have evolved in recent years to include estimates of a proposal's use of general revenue and the proposal's year-by-year impact on the federal budget, detailed information on these effects is available primarily in the complex technical tables at the end of the scoring memo.

In OCACT's recent scorings, five different mechanisms were used to provide general revenue to maintain the current Social Security program⁹

⁸While OCACT has primary responsibility for scoring reform proposals, CBO has more recently begun to publish long-term scorings of some proposals. OCACT and CBO scorings have both substantive and presentational differences including: different assumptions, baselines, and time periods covered. One particularly important difference is the use of different economic assumptions, which results in CBO having more optimistic estimates of current-law program finances.

⁹That is, maintain a modified pay-as-you-go social insurance program of defined benefits paid for primarily by payroll tax revenue.

or to a restructured Social Security system that included individual accounts (IA). These mechanisms can be characterized as providing for either unlimited or limited amounts of general revenue financing. The first mechanism provides for unlimited amounts of general revenue to be transferred to the trust fund as needed to maintain solvency (e.g., a 100 percent trust fund ratio). The other four mechanisms provide limited or defined amounts of general revenue through (1) general revenue transfers to the trust fund specified by formula or amount; (2) refundable tax credits, used to fund IAs; (3) dedication of estate tax revenue to the trust fund; and (4) redirection of Social Security benefit taxation revenue from Medicare's Hospital Insurance trust fund to the Social Security trust fund. Fourteen of the 17 proposals we reviewed used reallocated general revenue, most often to finance program restructuring, and 9 proposals used the mechanism of unlimited transfers as needed to achieve a specified trust fund ratio, which guaranteed "sustainable solvency" for the trust fund under OCACT's definition. (See text box for definition of "reallocated general revenue.") Three proposals did not use general revenue. Of the 17 proposals, 7 increased payroll tax revenues.

New versus Reallocated General Revenue in Social Security

In this report, “general revenue” in Social Security is defined as any revenue that does not derive from payroll tax contributions. In this framework, interest on trust fund assets is considered as deriving from payroll tax contributions.^a All other revenue to Social Security, including revenue from taxation of certain Social Security benefits, is classified as general revenue.^b This framework accords with the federal budget accounting perspective of our analysis. This conforms to the discussion of general revenue use in Social Security found on SSA’s history web site.^c

Although any additional payroll tax revenue would be new to the federal budget, general revenue may be either new to the federal budget as a whole or reallocated from other federal priorities.

- **New general revenue** is revenue that derives from a new source, that is, from a new tax or increase to an existing tax. For example, in 1983, the Social Security benefits of upper income retirees were made subject to income taxation, and the revenue from this new tax was dedicated to the Social Security trust funds. From a federal budget perspective, this change represented new general revenue at that time. This change has remained in place and constitutes a permanent form of general revenue in today’s Social Security program.
- **Reallocated general revenue** does not come from a new source. Rather, it is reallocated from existing revenue to the Treasury. Following World War II, reallocated general revenue was used to fund Social Security benefits for military personnel and also a small flat benefit for individuals who were at least age 72 in 1968 but not entitled to Social Security through their work history.

^aGAO’s definition of general revenue assumes that the interest rate used to credit the trust funds reflects the rates for long-term federal marketable government securities, as is the case under current law. The Department of Treasury determines the interest rate earned on trust fund balances for Social Security using a statutory formula that sets the interest rate equal, at the time of issue, to the average market yield on outstanding marketable government securities not due or redeemable for at least 4 years.

^bFrom a tax perspective, accounting treatments are more complex. For example, the earned income tax credit, a refundable tax credit available to certain lower income earners, was intended to help offset Social Security payroll taxes for those eligible. See GAO, Tax Administration: Earned Income Credit—Data on Noncompliance and Illegal Alien Recipients, GAO/GGD-95-27 (Washington, D.C.: Oct. 25, 1994).

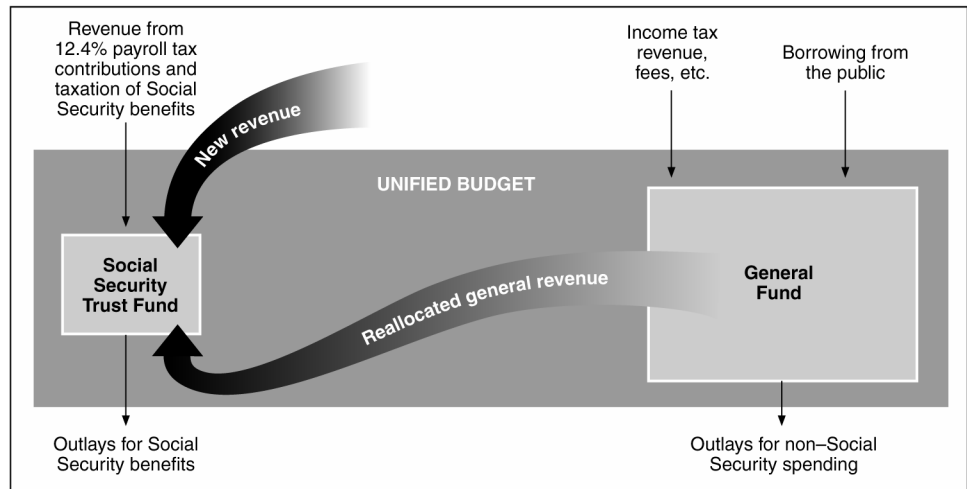
^cSee <http://www.ssa.gov/history/genrev.html>.

All proposals we reviewed were scored by OCACT as able to pay benefits as scheduled in that proposal over the 75-year period, but the effects on the federal budget shown in OCACT's technical tables varied widely. For example, the effect on debt held by the public ranged from an improvement of \$45 trillion to a worsening of \$41 trillion over the 75-year projection period.¹⁰ Unlimited transfers of reallocated general revenue as needed to achieve trust fund solvency—by definition—pose the greatest potential risk to the budget especially when combined with benefit guarantees. In the proposals we reviewed, amounts of general revenue transferred under this mechanism ranged up to about twice total program financial shortfall. Limited transfers, however, were also quite large, in some cases somewhat more than twice program shortfall.

From the trust fund perspective, any type of increased revenue the trust fund receives—new general revenue, reallocated general revenue, or increased payroll tax revenue—will improve the actuarial balance and increase the trust fund's capacity to pay benefits. From the budget perspective, however, new revenue from any source would improve the long-term fiscal imbalance while reallocated general revenue would do nothing to address it, all other things equal. (See fig. 1.) New revenue would have tangible consequences for taxpayers, e.g., less take-home pay, while reallocated general revenue is less likely to be clearly observable. Reallocated general revenue, however, is not free. Regardless of how general revenue is provided to Social Security, it must be paid for at some point. The question is when, and by whom.

¹⁰In constant 2005 dollars under OCACT's expected yield assumption. Estimates are based on OCACT scorings and represent change in debt levels compared to a baseline in which scheduled benefits are paid in full and no other changes are made. Estimates were not available for one of the plans reviewed.

Figure 1: New Revenue versus Reallocated General Revenue in Social Security Reform



Source: GAO.

Regardless of their views on reform, most budget experts we spoke with believed greater transparency was needed concerning the use of general revenue in reform proposals. In view of the long-term fiscal challenge facing the nation, some experts were especially concerned about proposals' use of reallocated general revenue for Social Security. As one of these experts emphasized, the public needs to understand that reallocated general revenue for Social Security is not "free." Reallocated general revenue would need to be paid for now or later through lower spending, higher taxes, and/or more debt.¹¹ Other budget experts viewed the use of reallocated general revenue as making possible a transition to a restructured Social Security system that would include IAs. These experts viewed the use of reallocated general revenue as a transition cost that would eventually be repaid to the budget as a whole.¹² Most experts we spoke with were concerned about the mechanism of providing for unlimited transfers of reallocated general revenue as needed to assure trust fund solvency. They noted that since this mechanism in effect

¹¹See GAO, *Options for Social Security Reform*, [GAO-05-649R](#) (Washington, D.C.: May 6, 2005).

¹²Advocates for these types of changes state that over time, the savings to the government (compared to paying currently scheduled benefits in full) will come to exceed the cost of funding individual accounts.

removes the possibility of trust fund exhaustion, it disables the trust fund's capacity to signal policymakers and the public of a need to take action.

In coming decades, our nation will face a serious long-term fiscal challenge that will put America's fiscal future at risk. Substantive reform of Social Security will involve hard choices. OCACT's valuable information and complex analyses could make an even greater contribution to the reform debate if they were more readily accessible to nonexpert users. To improve understanding of proposed changes to Social Security, GAO is recommending that the Commissioner of SSA direct the Office of the Chief Actuary to include a summary presentation of its analysis in future scoring memoranda that will enable policymakers and the general public to quickly and easily compare Social Security reform proposals especially with respect to proposed use of general revenue and implications for the federal budget as a whole. This type of presentational change would not require any additional analysis but could greatly facilitate comparison of proposals to one another.

SSA did not explicitly agree or disagree with our recommendation in its comments. In response to the recommendation, SSA noted that recent OCACT memos had added an additional table ("table d") that, SSA believes, already provides key information on general revenue use in proposals. SSA also expressed the view that a summary table showing the effects on the actuarial deficit of each proposal provision would be helpful. As our report had noted, this table has been included in some memoranda at the request of the proposal's sponsor.

While we agree with SSA that both the technical and summary table it describes add value, we remain of the view that OCACT needs to develop a new table that can clearly and quickly communicate both trust fund effects and federal budget implications of a proposal. Our report acknowledged the value and completeness of OCACT's analyses including those presented in "table d." The message of our report was not that OCACT needs to do additional analytic work. Our message was rather that OCACT's existing analyses need to be summarized and highlighted so that a proposal's implications for both the trust fund and the federal budget as a whole are immediately clear.

Background

When Social Security was enacted in 1935, the nation was in the midst of the Great Depression. About half of the elderly depended on others for their livelihood, and roughly one-sixth received public charity. Many had lost their savings. Social Security was created to help ensure that in the future the elderly would have adequate incomes in retirement and would

not have to depend on welfare. Instead, the new program would provide benefits based on the payroll tax contributions of workers and their employers. Today Social Security is much more than a retirement program. In 1939 Social Security coverage was extended to the dependents of retired and deceased workers and in 1956 to the disabled. Over one-third of beneficiaries receive benefits for reasons other than old age.¹³

Social Security Is One Part of the Long-Term Fiscal Challenge

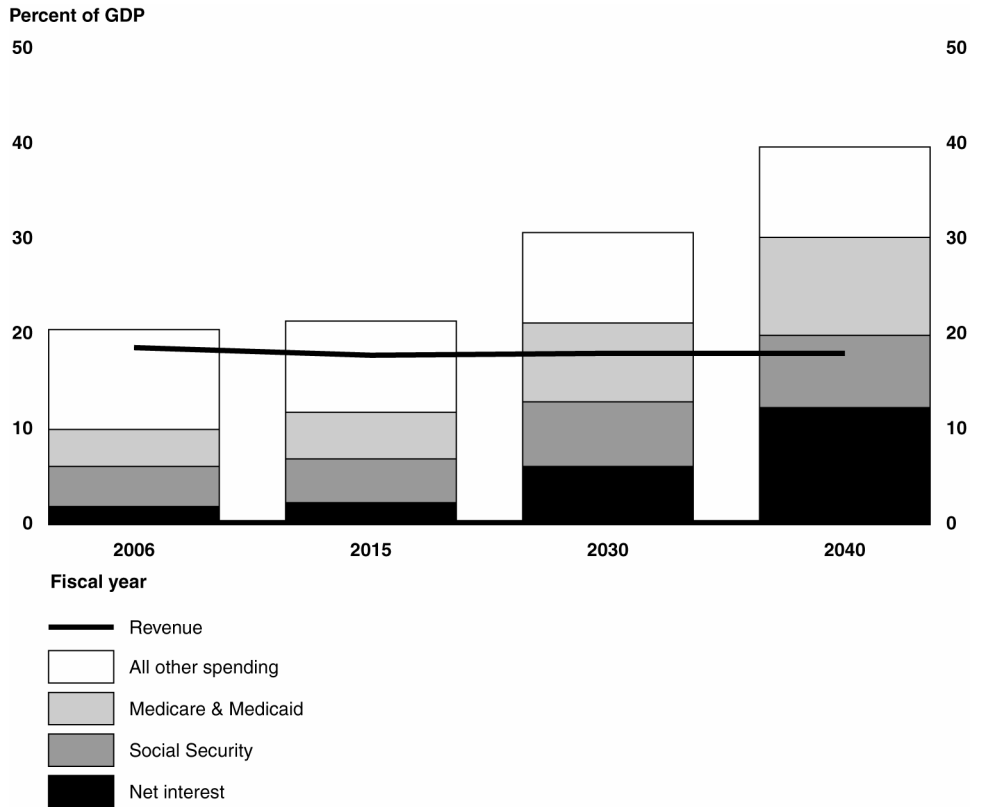
Our work on Social Security reform has emphasized the need for change not only because future program revenues are expected to fall short of what is needed to pay currently scheduled benefits in full but because Social Security, Medicare, and Medicaid taken together will consume an increasing share of the budget and the economy. To move into the future with no changes in federal health and retirement programs is to envision a very different role for the federal government. Little room would be left for other federal spending priorities such as national defense, education, and law enforcement. Absent changes in the structure of Social Security and Medicare, some time during the 2040s government would do nothing but pay interest on the debt and mail checks to retirees. Accordingly, substantive reform of Social Security and health programs remains critical to recapturing our future fiscal flexibility.

Overall, the federal budget is facing unsustainable deficits and debt. Our most recent long-term budget simulations provide a compelling illustration of how unsustainable the long-term fiscal outlook is under current policies.

As shown in figure 2, the long-term outlook under plausible assumptions is bleak. A demographic shift will begin to affect the federal budget in 2008 as the first baby boomers become eligible for Social Security benefits. Over time, this shift will cause spending for federal health and retirement programs including Social Security to swell. Long-term commitments for these and other federal programs will drive a massive imbalance between spending and revenues that cannot be eliminated without difficult policy choices and ultimately significant policy changes.

¹³For more information on the Social Security program, see GAO, *Social Security Reform: Answers to Key Questions*, [GAO-05-193SP](#) (May 2005).

Figure 2: Composition of Spending as a Share of GDP Assuming Discretionary Spending Grows with the Economy After 2007 and All Expiring Tax Cuts Are Extended



Source: GAO's January 2007 analysis.

As figure 2 shows, contrary to popular perception, although Social Security grows in size, it is not the major driver of the long-term fiscal challenge. Spending for Medicare and Medicaid is expected to grow much faster. Many specific solutions have been proposed for Social Security, but approaches to reducing health care cost growth remain elusive. Moreover, addressing federal programs such as Medicare and the federal-state Medicaid program will need to involve changes in the health care system of which they are a part. This will be a societal challenge affecting all age groups. While Social Security reform alone cannot eliminate the long-term fiscal challenge, the likely effects of reform on the nation's fiscal future should be clearly understood and taken into account.

Social Security's Trust Fund and the Federal Budget

Social Security's benefit payments and program receipts are tracked in federal budget accounts that are known as trust funds. Trust funds are one type of mechanism created to account for receipts that are dedicated to a specific fund for a specific purpose.¹⁴ Social Security has two trust funds, the Old-Age Survivors Insurance (OASI) Trust Fund and the Disability Insurance (DI) Trust Fund. The combined OASDI trust fund comprises the financial resources of the Social Security system.¹⁵ Social Security has a permanent appropriation that permits the payment of benefits as long as the relevant trust fund account has a sufficient balance.

Social Security's outlays are limited to trust fund balances, but the program's outlays and revenues are also part of the federal unified budget. Today, Social Security payroll tax revenues exceed benefits. In 2005, the Social Security trust fund paid \$530 billion in benefit payments and administrative costs and took in \$608 billion in cash revenues, leaving a cash surplus of about \$78 billion.¹⁶ By law, the Social Security trust fund must invest any cash surpluses in interest-bearing federal government securities. Throughout its history, Social Security has invested mostly in a special type of nonmarketable securities that, like debt held by the public, are guaranteed by the full faith and credit of the U.S. government. Treasury borrows the cash from Social Security's surplus to pay for other government expenses, and this use of Social Security's excess cash revenues reduces the amount Treasury would otherwise need to borrow from the public to finance other federal programs.¹⁷ (See fig. 3).

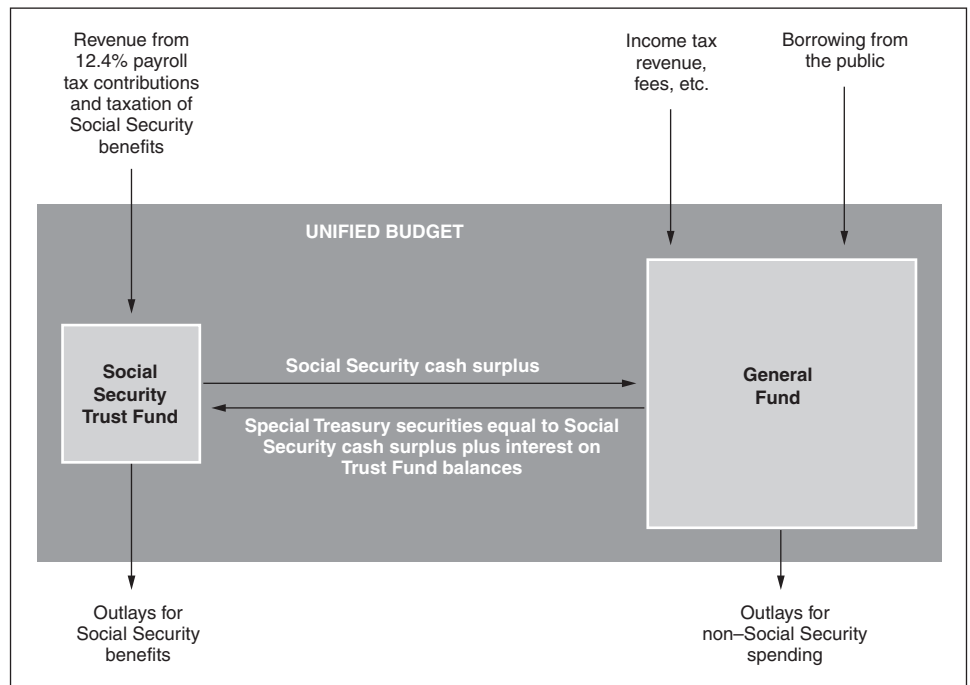
¹⁴In contrast to private trust funds, the federal government does not have a fiduciary responsibility to the trust fund beneficiaries. Congress can raise or lower future trust fund collections and payments by changing existing laws.

¹⁵In this report, the combined OASDI Trust Funds are referred as the Social Security trust fund. For more information on federal trust funds and other funds dedicated to specific programs, see [GAO-01-199SP](#).

¹⁶Total receipts to the combined trust funds, including \$94 billion in interest income, were \$702 billion in calendar year 2005.

¹⁷If Treasury could not borrow from the Social Security trust fund, it would have to borrow more in the private capital market and pay interest in cash to finance current budget policy. However, Treasury still has to pay the trust fund interest on these securities. For a more detailed discussion of the temporary trust fund buildup and how it interacts with the federal unified budget, see GAO, *Social Security Financing: Implications of Government Stock Investing for the Trust Fund, the Federal Budget, and the Economy*, [GAO/AIMD/HEHS-98-74](#) (Washington, D.C.: Apr. 22, 1998).

Figure 3: Social Security Flows Today



Source: GAO.

These excess cash revenues, however, will begin to diminish in 2009, one year after the oldest members of the baby boom generation first become eligible for Social Security old age benefits. This downturn in the Social Security cash surplus—the difference between payroll taxes and benefits paid—will begin a squeeze on the rest of the budget that will worsen in the coming years, making less cash revenue available for other federal priorities. By 2017 trust fund cash revenues will be inadequate to pay currently scheduled benefits in full, and the Social Security trust fund will need to redeem trust fund assets from the Treasury. To pay the trust fund, Treasury will need to provide cash from general revenues in exchange for those trust fund securities. This can come only through increased revenue, increased borrowing from the public, reduced spending in the rest of the government, or some combination of these. While the trust fund is redeeming its securities, it will continue to pay full benefits, but the redemptions will reduce overall federal budgetary flexibility.

Our Framework for Evaluating Reform Proposals

As we have said previously, Social Security reform proposals will need to be evaluated on a number of criteria. Our work on various aspects of this important program has emphasized that Social Security reform is about more than solvency. To evaluate reform proposals, we have suggested that policy makers should consider three basic criteria:

1. the extent to which the proposal achieves sustainable solvency and how the proposal would affect the economy and the federal budget;
2. the balance struck between the twin goals of individual equity (rates of return on individual contributions) and income adequacy (level and certainty of benefits);¹⁸ and
3. how readily such changes could be implemented, administered, and explained to the public.

Our first criterion of sustainable solvency reflects the need to look at Social Security reform both in terms of its trust fund and in the larger context of the federal budget as a whole. It is different from OCACT's definition, which is focused solely on the trust fund, for which they are responsible.

From a micro perspective, projected trust fund balances can provide a vital though imperfect signaling function for policymakers about underlying fiscal imbalances in covered programs. Tracking the estimated future balances makes it possible in turn to estimate how much more funding is needed to pay for the benefits scheduled in current law. A shortfall between the long-term projected fund balance and projected costs can signal that the fund, either by design or because of changes, is collecting insufficient monies to finance currently scheduled future payments. This signaling device can eventually prompt policymakers to action.

From a macro perspective, however, program solvency measures such as the trust fund exhaustion date and the actuarial balance calculation provide no information about the broader question of program sustainability—that is, the capacity of the future economy and the federal

¹⁸See GAO, *Social Security: Program's Role in Helping Ensure Income Adequacy*, GAO-02-62 (Washington, D.C.: Nov. 30, 2001. For a discussion of individual equity issues, see GAO, *Social Security: Issues in Comparing Rates of Return with Market Investments*, GAO/HEHS-99-110 (Washington, D.C.: Aug. 5, 1999).

unified budget to pay program benefits over the long run. When a program is not fully self-financed, as is the case with Social Security, projected accumulated trust fund balances do not necessarily reflect the full future cost of existing government commitments. Accordingly, trust fund balances are not an adequate measure of Social Security's sustainability. The critical question is whether the Nation and the government as a whole can afford the benefits in the future and at what cost in terms of other claims on scarce resources. Extending a trust fund's solvency without reforms to make the underlying program more sustainable over the long term can obscure the warning signals that trust fund balances provide, thereby creating a false sense of security and delaying needed program reform.

Evaluating proposals is a complex task involving trade-offs between competing goals. Reform proposals should be evaluated as packages that strike a balance among individual reform elements and important interactive effects between these elements. The overall evaluation of any particular reform proposal depends on the weight individual policy makers place on each criterion.

Social Security Financing Has Evolved, but Payroll Taxes Remain the Principal Financing Mechanism

Since its establishment in 1935 Social Security has been financed primarily by payroll taxes contributed equally by employers and employees. Both tax rates and benefits have changed over time, but Congress has generally rejected proposals for including general revenue in financing Social Security benefits. Payroll tax rates have increased, from a total of 2 percent of taxable payroll in 1937—when payroll taxes were first collected—to 12.4 percent today. Benefits have also been expanded to include workers' families and the disabled.

The question of whether some general revenue should be used to minimize the burden of payroll taxes has been debated since the program's inception. The Committee on Economic Security (CES), tasked by President Roosevelt with designing the program, believed that expected benefit payments would exceed expected payroll tax revenues beginning about 1965 and at that time general revenue should be used to fill the gap. Under this financing arrangement, the general revenue share was ultimately expected to reach about one-third of total revenues. President Roosevelt rejected the idea of using general revenue in program financing. He endorsed payroll tax financing on the grounds that it would ensure the new program would be "self-supporting." A perceived link between benefits and payroll tax contributions would, he believed, serve to preserve the program in the future. Using general revenue would make the

program welfare—in President Roosevelt’s words, “the dole by another name.”

President Roosevelt’s financing approach envisioned the buildup of a reserve fund that would serve to fund benefits in the long term, but objections were made to this approach. Some believed that the existence of a large reserve fund would lead to higher benefit levels or other increased government spending; others objected to the underlying concept of prefunding benefits which they believed would lock in specific levels of support for aged beneficiaries in the future. Congressional changes to the program that expanded benefits and postponed scheduled payroll tax increases put the program on a pay-as-you-go basis, that is, revenues from current workers in a given year pay for the benefits of current beneficiaries in that year.

Nevertheless, the issue of whether general revenue should be used to supplement payroll tax financing has recurred throughout Social Security’s history. During short-term financing crises in the late 1970s and early 1980s, proposals were made for general revenue use. At that time some opposed this use of general revenue believing that it would obscure the true cost of the program and lead to benefit expansion. Reform legislation passed in 1983 did include permanent use of some general revenue by imposing a new income tax on the Social Security benefits of upper income retirees and dedicating that tax to the trust fund.¹⁹ Although the income thresholds were not indexed to inflation, amounts of revenue to Social Security from this source have been and remain small relative to total program tax revenue.

Since the legislation passed in 1977 and 1983, a temporary build up of trust fund assets has caused Social Security to temporarily deviate somewhat from pay-as-you-go financing. This occurred in part because the large baby boom generation makes the size of the workforce large relative to the beneficiary population. As the baby boom generation retires and is replaced by a workforce that will grow less rapidly than in the past, trust fund assets will be redeemed to pay benefits, but these assets plus payroll tax revenues will eventually be insufficient to pay currently scheduled benefits in full. To deal with this structural imbalance, many proposals have included the use of general revenue to supplement payroll tax

¹⁹Since Social Security benefits had previously been untaxed, this was seen by some as a benefit cut.

financing—often in large amounts relative to total financing and over extended time periods. For example, both proposals made by President Clinton in 1999 and reform models put forward in 2003 by the Commission to Strengthen Social Security established by President George W. Bush included the use of general revenue.

OCACT Scoring Memos Are Primary Source of Information on Reform Proposals, but Detailed Tables Are Difficult to Use for Understanding General Revenue and Federal Budget Effects

OCACT scoring memos are the primary source of information on recent Social Security reform proposals. Since the mid-1990's, OCACT has scored a wide variety of comprehensive reform proposals. Each proposal modifies the OASDI program using one or several of the following provisions that: (1) reduce benefits, e.g. through changes to indexing formulas and/or other methods; (2) increase benefits for special populations; (3) raise revenue through payroll tax increases; (4) use general revenue financing through a range of mechanisms (not always specified as general revenue); (5) invest trust fund assets through government investment in marketable securities; or (6) change the current structure of the program by creating IAs.²⁰ The format of these scoring memos has evolved over time, partially in response to feedback from users. More recent scoring memos are available on OCACT's web site.²¹ In addition, OCACT has begun to post estimates of many of the stand-alone provisions that have been suggested to modify the Social Security program and improve its financial status. Many of these are also included in the various comprehensive proposals.

OCACT's scoring memos typically emphasize two important summary measures: (1) the change to actuarial balance and (2) ability of the trust fund to meet obligations throughout the 75-year period and beyond, an indicator of "sustainable solvency" as defined by OCACT.²² In recent years, sustainable solvency as defined by OCACT has become the standard by which reform proposals are measured. When OCACT evaluates a reform proposal as meeting the definition of sustainably solvent, the proposal

²⁰For a more detailed discussion see [GAO-05-649R](#) and GAO, *Social Security Reform: Implications of Different Indexing Choices*, [GAO-06-804](#) (Washington, D.C.: Sept. 14, 2006).

²¹<http://www.ssa.gov/OACT/solvency/index.html>.

²²When OCACT describes a proposal as modifying the program so that there is a positive trust fund ratio throughout the 75-year projection period and these ratios are stable or rising at the end of the period, this meets the definition of "sustainable solvency" in the 2006 Trustees' Report.

sponsor often highlights this point in press statements and other statements. This measure, however, considers only trust fund effects and not the effect of the proposal on the federal budget.²³

To discover crucial information on a proposal's general revenue use and federal budget effects, a user of OCACT's scoring memos must consult the detailed tables at the end of the memo. The type and amount of information included in the tables has increased over time. Current tables are generally comprehensive in presenting a proposal's financial effects. Columns display year-to-year changes in the financial operations of the trust fund and the unified budget as well as the cashflow between the trust fund and the general fund of the U.S. Treasury. For those plans that include either government or IA investment in equity markets, OCACT publishes two sets of tables, one reflecting "expected-yield" assumptions on investments and a second set reflecting "low-yield" assumptions. A few of the scoring memos we analyzed included other tables that provide insight into general revenue use. One of these tables shows the impact of each individual provision on the long-range actuarial balance (as a percentage of payroll). This table shows to what extent a single provision, by itself, either improves or worsens the actuarial balance.²⁴

Budget experts we spoke with agreed that the tables had evolved and now provide more information but they also said that the tables are difficult to use and take much effort to understand. In particular, they said that the "information is not reader-friendly" and "key estimates of general revenue are not highlighted and it is not always clear if there is a specified source for the general revenue." Our analysis of 17 recent scoring memos generally confirmed this assessment. Policymakers and the public may have a difficult time comparing how different plans get to sustainable solvency and the implications for the rest of the budget, future deficits, and debt held by the public. Similarly, the 1999 and 2003 Technical Panels on Assumptions and Methods, convened by the Social Security Advisory Board, expressed concerns about consistency in presentation of information in scoring memos. One recommendation made by budget experts was for an up-front summary table with crucial information that a

²³On the other hand, our criterion for sustainable solvency measures the effect on the trust fund and includes evaluating how a proposal would affect the U.S. economy and the federal budget.

²⁴OCACT officials told us that this table was included only when specifically requested by the plan sponsor.

reader needs in order to compare plans. Although we found no agreement on precise content for the table, information about benefit cuts, tax increases, and general revenue could somehow be included.

OCACT staff told us that the principal purpose of their scorings was to show the effect of a proposal on trust fund solvency and not on the budget as a whole. They added that they were generally satisfied with the current format for scoring memos, noting that they had not received any negative feedback from users. They did agree that information could be more user-friendly and are considering ways to achieve this goal, for example through the inclusion of visuals. OCACT staff further noted that scoring proposals is resource-intensive. Although some scorings can take up to a year, others must be done under tight timeframes, e.g., when sponsors are planning to introduce legislation. They also told us that they have discussed options for a summary table with selected users but had not found any consensus on what information should be highlighted. OCACT staff emphasized that their scorings are and need to continue to be perceived as objective. In any case, OCACT staff did not think that the use of general revenue should be highlighted above other proposal changes.

More recently, CBO has developed the capacity to do long-term estimates of Social Security reform proposals and has completed five long-term scoring memos to date. OCACT and CBO scoring memos have key substantive and presentational differences. One particularly important difference is the use of different economic assumptions, which results in CBO currently having more optimistic estimates of current-law program finances. Although budget experts we spoke with generally thought that CBO scoring memos have been beneficial analytical tools, they also thought that OCACT scoring memos were likely to continue to be the primary source of information in any debate over reform proposals. Therefore, having OCACT scoring memos provide clear and easily accessible information on any use of general revenue and on the impact of any reform proposal on the broader budget remains important.

Recent Proposals Differ by Revenue Mechanism and Reform Approach Used, but Most Reallocate General Revenue and Aim to Increase Investment Returns

Almost all proposals we reviewed package multiple revenue options and/or benefit changes to achieve sustainable solvency, but they differ²⁵ in both the broad approach they take for dealing with the long-range solvency problem and the revenue mechanisms they use. Reform approaches can be divided into two broad categories: approaches that maintain the current structure, that is, a pay-as-you-go social insurance program of defined benefits paid for primarily by payroll tax revenue, and approaches that create a new structure that includes IAs.

Provisions that guarantee revenue to the Social Security trust fund can be classified as: reallocated general revenue mechanisms, payroll tax mechanisms, or new general revenue mechanisms (see Text Box). A reallocated general revenue mechanism is any provision that increases revenue to the program by redirecting existing general revenue expected under existing law to the trust fund. Payroll tax mechanisms directly change the amount of payroll taxes contributed and therefore increase payroll taxes flowing into the trust fund. A new general revenue mechanism would establish a new source of income to the general fund and dedicate it to the Social Security trust fund. Examples would be the creation of a national sales tax or increases in income or excise taxes with the revenue from any of these dedicated to the Social Security trust fund. None of the proposals we examined introduced new general revenues. All of them—although described and characterized in various ways—used only mechanisms that would reallocate general revenue and/or increase payroll taxes.

All 17 of the Social Security reform proposals we analyzed include at least one mechanism to increase revenue to Social Security and some use more than one mechanism.²⁶ Fourteen of the 17 proposals we examined would reallocate general revenue, that is, transfer existing revenue from the general fund; the other 3 proposals did not use general revenue.

The 14 proposals that used reallocated general revenue did so by means of five different mechanisms. These mechanisms can be characterized as

²⁵For analysis of benefit and revenue options described in terms of GAO's framework for evaluating Social Security reform plans, see GAO, *Options for Social Security Reform*, GAO-05-649R (Washington, D.C.: May 6, 2005).

²⁶Because some proposals were scored in multiple years or were not designed to achieve 75-year solvency, the universe of proposals discussed in this report is comprised of 17 proposals. Scorings can be found at <http://www.ssa.gov/OACT/solvency/index.html>.

providing for either unlimited or limited amounts of general revenue financing. The first mechanism provides for unlimited general revenue; the other four use varying means to provide limited or defined amounts of general revenue financing. Unlike plans with unlimited transfers to assure trust fund solvency, proposals with general revenue transfers limited by specified amounts, source, or formula, could be insolvent at some point in time if the actual financial condition of the program differs from the OCACT estimates.

Unlimited mechanism:

- **Unlimited general revenue transfers to the trust fund of whatever amount is necessary to maintain trust fund solvency (e.g., a 100 percent trust fund ratio).**²⁷ This mechanism is the most frequently used general revenue option. It is found in 9 of the 17 plans we examined. This provision usually states that general revenue transfers are to be made if, at any time, the combined OASDI trust fund ratio is projected to fall below 100 percent under the provisions of the plan.²⁸ Transfers of sufficient amount and timing will be made to prevent the trust fund from falling below 100 percent of the annual program cost. In simple terms, funds sufficient to pay projected benefits for the year, that is, to maintain solvency, would be transferred as needed from the general fund to the Social Security trust fund without regard to the amount. This provision alone guarantees program solvency under any circumstance because it provides the trust fund with an unlimited and open-ended draw on the general fund.²⁹

²⁷The trust fund ratio is a measure of the adequacy of the trust fund level. It is defined as the assets at the beginning of the year expressed as a percentage of the cost during the year. The trust fund ratio represents the proportion of a year's cost that could be paid with the funds available at the beginning of the year. Having a trust fund ratio of 100 percent or more—that is, assets at the beginning of each year at least equal to projected outgo during the year—is considered a good indication of a trust fund's ability to cover most short-term contingencies.

²⁸Most plans specify unlimited transfers to meet a 100 percent trust fund ratio, but one plan specifies transfers to maintain a 90 percent trust fund ratio. This trust fund ratio level still maintains solvency because the program can pay scheduled benefits when due.

²⁹In some cases, proposal sponsors suggest sources of non-Social Security program savings to help offset the costs to the general fund. However, the transfers to the trust fund would not be contingent on achieving the reductions in actual federal spending.

Limited mechanisms:

- **General revenue transfers specified by formula or amount.** Six plan sponsors propose using this mechanism, which specifies—in actual dollars, as a percentage of taxable payroll or using a formula—how much general revenue would be transferred to the trust fund in a given year. Transfers would be limited by these specifications. In other words, transfer amounts are made independent of the financial condition of the program as measured by the trust fund ratio).³⁰
- **“Refundable tax credits” for individual add-on accounts (or to individuals to offset account contributions).** Alone among the general revenue options discussed, under this mechanism revenue would not be transferred to the OASDI trust fund, but would be outlaid immediately—either to provide funding to individual add-on accounts or to offset the cost of those accounts. The four proposals using this option would either credit the general revenue directly to the workers’ add-on accounts (the amount would be determined by the plan’s provisions) or include the amount as a credit on the individuals’ income taxes to partially offset the payroll tax increase introduced to fund the account. Although in these proposals the add-on accounts would be financed outside of the current program—either entirely or partially funded using reallocated general revenue³¹—they would be considered part of a new Social Security system.
- **Dedication of revenue generated from the estate tax to the trust fund.** This revenue option would dedicate revenue from the estate tax to the Social Security trust fund to help finance the current structure. One proposal would permanently establish a tax of 45 percent on all estates of deceased taxpayers with taxable assets in excess of \$3.5 million (as in current law for 2009).³² The tax revenue would be dedicated to the OASDI trust fund instead of to the general fund.

³⁰Although plan sponsors sometimes propose spending cuts and/or assume revenue increases in non-Social Security programs to offset these general fund transfers; the transfers are not conditional on the savings/revenue increases being achieved and would be made regardless of the success of these changes.

³¹Plans may require individuals to contribute to the add-on account in order to receive credits.

³²Under current law (as of January 2007), the estate tax would be repealed for 2010 but would be restored with a lower exemption and a higher rate than in effect for 2009. Thus, compared to current law the estate tax in this proposal would be new revenue to the budget only in the year 2010 and reallocated revenue in all succeeding years.

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- **Redirection of those revenues from Social Security benefit taxation that now go to the Medicare Hospital Insurance (HI) trust fund to the OASDI trust fund.** Currently, up to 85 percent of an individual's or couple's OASDI benefits may be subject to federal income taxation if their income exceeds certain thresholds. The income tax revenue attributable to the first 50 percent of OASDI benefits is already dedicated to the Social Security trust fund, but the revenue associated with the amount between 50 and 85 percent of benefits is dedicated to the Medicare HI trust fund. Two proposals would dedicate all of the income from the tax on OASDI benefits to OASDI.

Reform plans with individual accounts may have indirect effects on income from benefit taxation. Proposal sponsors typically stipulate whether disbursements from individual accounts would be taxed like current Social Security benefits or not taxed at all. If account disbursements are considered OASDI benefits for income tax purposes, income to the trust fund could be greater (or smaller) in cases where the combined traditional benefit and account disbursement yields are greater (or lesser) than under current law. There would be similar implications for the HI trust fund if benefit taxation income is distributed as under current law. Plans that reduce the taxable traditional OASDI benefits and do not tax individual account distributions would lower trust fund revenue from this source.

Of the 17 proposals, 7 increase payroll tax revenue using one or more of the following four mechanisms:

- **Raise or eliminate the “taxable maximum limit” or “cap” on covered earnings³³ (with or without retaining the cap for benefit calculation).** Incorporated in five proposals, this is the most common mechanism for bringing in new payroll tax revenue. This mechanism would not change the 12.4 percent tax rate but would either increase the level of wages taxed or completely eliminate the cap so that all covered earnings are taxed. This latter option is similar to the Medicare HI payroll

³³SSA defines covered earnings to mean wages and self-employment earnings that are covered by the OASDI and/or HI programs. Under current law, all covered earnings are taxed at a rate of 2.9 percent for Medicare HI, but for OASDI only covered earnings up to a “taxable maximum limit” or “cap” are taxed at the 12.4 percent rate. This limits taxes as well as the earnings reflected in the benefit formula. The level of “taxable earnings” reflects only the portion of covered earnings that is at or below this cap. This taxable maximum limit is indexed annually for average wage growth and therefore it changes every year. In 2007, the cap is \$97,500.

tax of 2.9 percent, which applies to all covered earnings. SSA recently estimated that in 2005 about 84 percent of covered earnings were subject to the OASDI tax (i.e., were taxable) and projected decreases in the ratio of taxable wages to covered wages through 2015. After 2015, SSA expects this percentage to be held approximately constant at 82 percent of covered earnings. Four plans propose to increase the percentage of taxable earnings under the “cap” to a level between 87 and 90 percent of covered earnings. A fifth plan would completely eliminate the earnings cap and would tax all earnings at the 12.4 percent rate.

- **Increase the 12.4 percent payroll tax on taxable earnings.** Four plans propose raising payroll tax rates by between 1 and 3 percentage points. None of the plans we reviewed propose an immediate tax rate increase of 2.02 percentage points, the estimated increase needed to achieve 75-year solvency through year 2080.³⁴
- **Expand coverage to state and local government employees not currently covered.** Three plans would require those public employers not currently providing Social Security coverage to cover newly hired employees.³⁵
- **Tax covered earnings above the “cap” but at a lower tax rate (with or without retaining the “cap” for benefit calculation).** Two proposals apply a rate much lower than 12.4 percent, between 3 and 4 percent, to covered earnings above the established taxable maximum.

Some of the mechanisms to increase payroll tax revenue could also result in increased benefit costs. For example, proposals that raise or eliminate the “cap” on covered earnings or tax earnings above the “cap” may or may not include these wages when calculating benefits. If the wages are included in the benefit formula, benefit costs would increase in the future and the improvement in the actuarial deficit would be smaller than if the wages were not included in the benefit calculation. Expanding coverage to all state and local government workers would bring in additional payroll

³⁴However, significantly larger changes would be required to maintain solvency beyond 75 years.

³⁵About one-fourth of public employees do not pay Social Security taxes on the earnings from their government jobs. Extending coverage to include them could result in potentially significant transition costs for some of their state and local government employers. See GAO, *Social Security: Implication of Extending Mandatory Coverage to State and Local Government Employees*, [GAO/HEHS-98-196](#) (Washington, D.C.: Aug. 18, 1998).

tax revenue but would also increase the long-term benefit costs as newly covered earnings would entitle affected workers to the associated benefits.

None of the five general revenue mechanisms in the plans we examined would come from new revenue sources and hence would bring no new revenue to the federal budget; the four payroll tax mechanisms would bring new revenue to the budget as a whole. Table 1 categorizes the mechanisms in terms of this framework. The number in parentheses indicates the number of reform proposals that contain this mechanism.

Table 1: Revenue Mechanisms in Reform Proposals by New and Reallocated Revenue

	New Revenue	Reallocated Revenue
Limited, specified funding source	<ul style="list-style-type: none"> <i>Increase the 12.4 percent payroll tax (4)</i> <i>Raise or eliminate earnings cap for payroll tax (5)</i> <i>Tax earnings above the cap at a lower rate (2)</i> <i>Expand coverage to state/local employees not covered (3)</i> 	<ul style="list-style-type: none"> Redirect all revenue from taxation of OASDI benefits to OASDI trust fund (2) Dedicated estate tax^a (1)
Limited, no specified funding source		<ul style="list-style-type: none"> General revenue transfers specified by amount or formula^b (6) Refundable tax credits (4)
Unlimited, no specified funding		<ul style="list-style-type: none"> General revenue transfers as needed to maintain trust fund solvency (e.g., a 100% trust fund ratio)^o (9)

Source: GAO.

Notes: Payroll tax mechanisms are in italics. The number of reform proposals do not sum to 17 since some reform plans contain more than one revenue mechanism.

^aSunset provisions in the Economic Growth and Tax Relief Reconciliation Act of 2001 would result in the estate tax being treated in the budget as new revenue in 2010 (the only year that the tax is repealed under current law) and reallocated revenue in all succeeding years.

^bIn some cases, proposal sponsors suggest or assume sources of non-Social Security program savings or increases in revenue to help offset the costs to the general fund. However, the transfers to the trust fund in these proposals would not be contingent on achieving the estimated reductions in federal spending or increases in tax income on which transfer amounts are based.

Although there is no analytic link between the inclusion of IAs and the selection of a specific revenue mechanism, in our review we found that most of the time reallocated general revenue mechanisms are used to help structure a new Social Security system with IAs. On the other hand, payroll tax mechanisms are used about half the time to help finance the current program and about half the time in proposals creating a new system including IAs. Table 2 summarizes the reform approach and

revenue mechanisms used in reform plans. The numbers in parentheses indicate the number of reform proposals that contain a particular mechanism.

Table 2: Revenue Mechanisms in Reform Proposals by Reform Approach

	Maintain Current Structure	New Structure with IAs
General revenue mechanisms	<ul style="list-style-type: none"> • Unlimited general revenue transfers as needed to maintain solvency (e.g., a 100% trust fund ratio) (1) • Dedicated estate tax (1) 	<ul style="list-style-type: none"> • Unlimited general revenue transfers as needed to maintain solvency (e.g., a 100% trust fund ratio) (8) • General revenue transfers specified by amount or formula (6) • Refundable tax credit (4) • Redirect all revenue from taxation of OASDI benefits to OASDI trust fund (2)
Payroll mechanisms	<ul style="list-style-type: none"> • <i>Raise or eliminate earnings cap for payroll tax (3)</i> • <i>Increase the 12.4 percent payroll tax (2)</i> • <i>Tax earnings above the cap at a lower rate (1)</i> • <i>Expand coverage to state/local employees not covered (2)</i> 	<ul style="list-style-type: none"> • <i>Raise or eliminate earnings cap for payroll tax (2)</i> • <i>Increase the 12.4 percent payroll tax (2)</i> • <i>Tax earnings above the cap at a lower rate (1)</i> • <i>Expand coverage to state/local employees not covered (1)</i>

Source: GAO.

Note: Payroll tax mechanisms are in italics. The number of reform proposals do not sum to 17 since some reform plans contain more than one revenue mechanism.

Most proposals—15 of the 17 we reviewed—included provisions aimed at increasing revenue through investment in private markets. Two proposals used direct government investing in marketable securities through the current program structure and 13 created a new Social Security structure including individual accounts.³⁶ Investing in marketable securities creates the potential for improved returns but increases investment risk for the investing party (the government or individuals). Therefore, unlike reallocated revenue and payroll tax mechanisms, neither investment approach assures additional income.

Proposals for government investment of the trust fund anticipate returns that would increase revenue to the trust fund while in most IA proposals the benefit obtained from any increased returns would be credited to the individuals' accounts and generally included as part of the account distribution. Individual account proposals may redirect revenue from the

³⁶For GAO's discussion of the key issues to consider in comparing Social Security and private market rates of return, see [GAO/HEHS-99-110](#).

program or the federal budget but typically compensate for lost revenue through either across-the-board benefit cuts or “benefit offsets”³⁷ to currently-scheduled benefits. In these proposals, the “total benefit” from the new Social Security system consists of a combination of the traditional Social Security defined benefit (including any modifications/offsets) and the individual account distribution (including any modifications/offsets).

Some plans establishing IAs propose to guarantee benefit levels irrespective of actual returns; they are able to do this by using general revenue transfers. Guarantees would benefit account holders by partially or fully protecting them from risk. However, the increased benefits to account holders would create a corresponding cost for the federal government. Whenever an account fell short of promised benefits, the government—and, implicitly, taxpayers—would make up the difference.³⁸

Additional Revenue Improves Trust Fund Solvency but Effects on the Federal Budget May Differ Greatly

The effect of a reform proposal on federal budget balances and debt cannot be determined from its effect on trust fund solvency. The proposals we reviewed illustrate this. All plans included in our review were scored by OCACT as able to pay the plan’s benefits in full over the 75-year period. However, plans’ impact on the federal budget as a whole varied widely in the scorings. For example, the effect on debt held by the public ranged from an improvement of \$45 trillion to a worsening of \$41 trillion over the 75-year projection period.³⁹ The impact of a proposal package on the federal budget is shown in the year-by-year scoring of effects on unified deficits and debt that OCACT provides in its technical tables.

³⁷The purpose of benefit offsets is to compensate the trust funds for foregone taxes and to equitably distinguish between those who do, and those who do not, shift Social Security taxes to voluntary personal accounts. There are different methods for calculating the offset. For a more thorough discussion of offsets, see Virginia P. Reno, Michael J. Graetz, Kenneth S. Apfel, Joni Lavery, and Catherine Hill, eds., *Uncharted Waters: Paying Benefits from Individual Accounts in Federal Retirement Policy, Study Panel Final Report*, National Academy of Social Insurance (Washington, D.C.: January 2005), ch. 9.

³⁸For a discussion of issues raised by estimating guarantee costs, see CBO, *Evaluating Benefit Guarantees in Social Security* (Washington, D.C.: March 2006).

³⁹In constant 2005 dollars under OCACT’s expected yield assumption. Estimates are based on OCACT scorings and represent change in debt levels compared to a baseline in which scheduled benefits are paid in full through borrowing and no other changes are made. Estimates were not available for one of the plans reviewed.

That the impact on the trust fund and the impact on the budget as a whole can differ is not surprising. By definition, any increase in revenue provided to the trust fund—whether new general revenue, reallocated general revenue, or increased payroll tax revenue—will increase the trust fund’s capacity to pay benefits. Effects on the federal budget, however, depend on the type and amount of revenue and also on assumptions about payment of currently scheduled benefits.⁴⁰

We compare the impact of new and reallocated revenue on the budget and long-term fiscal outlook under two different assumptions about the payment of currently scheduled benefits beyond projected trust fund exhaustion in 2040.⁴¹ First, assume as OCACT does in its memos and GAO does in its long-range simulations, that currently scheduled benefits would be paid in full throughout the estimating period (i.e., borrowing would increase to fund the benefits). Under these assumptions—and assuming no other changes in spending and/or revenue—either new general revenue or additional payroll tax revenue would replace some of that borrowing and improve the long-term fiscal outlook. Reallocated general revenue equal to (or less than) the Social Security financial shortfall would have no impact on federal budget deficits, debt, or the long-term fiscal outlook. In amounts greater than the shortfall, reallocated general revenue would make the long-term outlook worse, all other things equal.

As an alternative, assume instead that benefit outlays will be limited to trust fund income once the trust fund has reached exhaustion in 2040.⁴² Under this alternative, federal budget balances would be the same through 2040 as under the first assumption, then improved over the longer term due to lower annual outlays and less borrowing.

⁴⁰In this section, as elsewhere in the report, our analysis follows that of OCACT in being limited to first order effects.

⁴¹For GAO analyses of reform proposals using multiple sets of assumptions, see *Social Security: Evaluating Reform Proposals*, [GAO/AMTD/HEHS-00-29](#) (Washington, D.C.: Nov. 4, 1999); *Social Security Reform: Analysis of Reform Models Developed by the President’s Commission to Strengthen Social Security*, [GAO-03-310](#) (Washington, D.C.: Jan. 15, 2003); and *Social Security Reform: Analysis of a Trust Fund Exhaustion Scenario*, [GAO-03-907](#) (Washington, D.C.: July 29, 2003).

⁴²The Trustees 2006 Report notes that even if a trust fund’s assets are exhausted, tax income will continue to flow into the fund. Present tax rates would be sufficient to pay 74 percent of scheduled benefits after trust fund exhaustion in 2040 and 70 percent of scheduled benefits in 2080. For an analysis of an illustrative assumption along these lines, see [GAO-03-907](#). This scenario was developed as an analytic tool, not a legal determination.

Under this “trust fund exhaustion scenario,” new revenue dedicated to Social Security early in the projection period would improve annual budget balances and extend the time period during which currently scheduled benefits could be paid in full. The new revenue would also reduce debt for most of the 75-year period.⁴³ Any amount of reallocated general revenue on the other hand would increase federal budget deficits, reduce budgetary flexibility, and increase debt held by the public relative to this alternative assumption of trust fund exhaustion. All else equal, the reallocated general revenue would provide additional income to the trust fund and make possible additional benefit outlays, but borrowing from the public would be needed to pay for these outlays.

Use of different time frames can also lead to different conclusions about the federal budget effects of additional revenue including reallocated general revenue. For example, some proposals that restructure the Social Security system to rely more on individual accounts—funded in part through a “carve-out” of current payroll tax revenues—use large amounts of reallocated general revenue at the outset to help make up the gap as benefit reductions from currently scheduled levels are phased in. Those favoring this approach to system restructuring may view the reallocated general revenue as a loan from the rest of the budget that will be paid back. Advocates for these types of changes point out that once the transition to the new system is complete, the cost of the Social Security program will have been reduced compared to paying currently scheduled benefits in full. Some favoring program restructuring have advocated use of an infinite horizon rather than the 75-year time frame traditionally used for actuarial assessment of the trust fund.⁴⁴ These analysts view 75 years as an arbitrary cut-off point. They note that the use of this horizon can be misleading where a gap between projected revenues and benefit payments continues to grow after the 75-year window, as is the case with the current program.

⁴³The effect on debt by the end of the period would depend on the amount of new revenue raised for Social Security. If this was equal to the 75-year Social Security shortfall in present value terms, debt by the end of the period would be the same as under the alternative assumption. This is because the additional new revenue would have been used to pay for additional benefit outlays of equal size. All else equal, debt at the end of the period would be lower relative to the trust fund exhaustion scenario if the new revenue exceeded program shortfall.

⁴⁴CBO uses a 100-year time frame for analysis.

Those who oppose using reallocated general revenue to achieve system restructuring include an emphasis on a shorter time frame in their analyses. They point to higher levels of federal spending and debt held by the public over at least the next several decades resulting from this approach to reform. These analysts emphasize that it is in this nearer time frame the baby boom generation will retire and the cost to the government will escalate dramatically, driven by demographics and compounded by federal spending on health. These analysts were concerned that revenue used for Social Security will not be available for Medicare and Medicaid, and absent changes in fiscal policy, spending on the three major entitlements will lead to unsustainable levels of debt long before Social Security restructuring will have reduced federal commitments for that program. These analysts called for a focus on the long-term federal budget problem as a whole and a search for solutions to Social Security's financing problems within that larger context.

In concept, the mechanism of unlimited reallocated general revenue as needed to assure trust fund solvency, used in 9 of the 17 proposals we reviewed, represents the largest potential draw on the federal budget. The amount of reallocated general revenue actually provided to the trust fund in these proposals would vary depending on the financial requirements of the Social Security program, and these would depend on the other proposal provisions. The other four general revenue mechanisms would use specified amounts of reallocated general revenues. That is, the amount of general revenue used would not vary according to the financial requirements of the Social Security program but would be dictated by the parameters of the mechanism, e.g., specified in current dollars or as a share of taxable payroll in specific years.

In terms of size, amounts of reallocated general revenue used by mechanisms in proposals we reviewed varied widely, ranging up to over 200 percent of total program financial shortfall. Estimates for general revenue deriving both from the mechanism of unlimited reallocated general revenue as needed to assure trust fund solvency and from specified general revenue transfer amounts were large in some cases. Table 3 shows amounts of reallocated general revenue by type of mechanism.

Table 3: Size of Reallocated General Revenue in Proposals Reviewed by Mechanism Used

	Mechanisms for reallocating general revenue	Amount		Number of proposals using mechanism
		As a share of 75-year program financial shortfall	As a percent of taxable payroll	
Unlimited	General revenue transfers as needed to maintain solvency (e.g., a 100% trust fund ratio)	Up to 184% ^a	Up to 3.5%	9
Limited	General revenue transfers to the trust fund specified by formula or amount	Up to 207%	Up to 4.0 %	6
	Refundable tax credits ^b	Up to 115%	Up to 2.2%	4
	Redirect all revenue from taxation of OASDI benefits to OASDI trust funds	22%-23%	0.4%	2
	Dedicated estate tax	27%	0.5%	1

Source: GAO analysis of OCACT scorings.

Notes:

The numbers shown in this table do not sum to 17 since some reform plans contain more than 1 revenue option.

As shown in this table, “program financial shortfall” is defined as the cost of achieving actuarial balance including the cost of an ending trust fund ratio of 100 percent.

Estimates shown are based on available information in OCACT scoring memos. In some cases, scorings for individual mechanisms were not shown separately.

Where account yields affected the amounts of general revenue a proposal would use, OCACT’s expected yield estimate was used.

^aBased on proposals reviewed as scored by OCACT under their expected yield assumption. Under OCACT’s low yield assumption, estimated amounts for this mechanism would range up to 245 percent of program shortfall.

^bNot transferred to the trust fund; used to fund individual add-on accounts.

Some of the budget experts with whom we spoke suggested an approach we did not find in any of the reform proposals we examined. These experts suggested that plans could establish a new source of general revenue and dedicate the new revenue to the Social Security trust fund. For example, they suggested that instead of payroll tax increases, income taxes could be raised or a value-added tax⁴⁵ instituted with all or part of the revenue dedicated to Social Security. Some of the budget experts we spoke with observed that any policy decision to introduce new revenues

⁴⁵A value-added tax is a tax levied at each stage of production or distribution on the value added to the product during that stage of production. Value-added taxes are now commonly used in many Western European countries as a source of revenue.

dedicated to a particular program could have implications for the capacity of the rest of the budget to deal with other fiscal challenges. Enactment of any new taxes for Social Security could affect the public's willingness to bear taxes to fund other important national priorities, such as Medicare. In addition, taxes may have effects on individuals' saving behavior and on labor supply, effects that are beyond the scope of this report.

Despite their differing views on reform approaches, budget experts generally either believed or advocated that some use of general revenue would be part of reform. Some of them were concerned about the use of reallocated general revenue for Social Security in view of the long-term fiscal challenge facing the nation. One emphasized that the public needs to understand that reallocated general revenue for Social Security is not "free." Reallocated general revenue would need to be paid for now or later through lower spending, higher taxes, and/or more debt.⁴⁶ Another expert expressed the view that general revenue would be needed to reduce the political pain involved in reform but cautioned that using general revenue for Social Security could mean an even larger share of federal resources committed to funding programs that serve the elderly in coming decades, further squeezing out other national priorities. Most experts expressed the view that greater transparency about the use of general revenue use in reform plans was needed.

Most budget experts with whom we spoke expressed concern about any provision of reallocated general revenue as needed for Social Security to assure trust fund solvency. These analysts, including some who generally do not find trust fund accounting meaningful, said that the signaling provided by the Trustees' projected trust fund exhaustion date has served a useful purpose by alerting policymakers and the public of the need for program reform. Providing for the use of reallocated unlimited general revenue transfers to achieve sustainable solvency would mean that the trust fund would never be projected to reach exhaustion. As a result, these analysts observed, the true costs of the program would become less transparent while at the same time the public might think that the Social Security financing shortfall had been resolved.

One expert was especially concerned that explicit guarantees that total payouts from accounts plus Social Security would be not less than currently scheduled benefit levels could prove expensive for the federal

⁴⁶See [GAO-05-649R](#) (Washington, D.C.: May 6, 2005).

budget. Such guarantees will likely add to the cost of the Social Security system, because individuals will have protection against downside risks but are allowed by a guarantee to benefit on the upside, this expert said. In earlier work we noted that any proposal that would guarantee benefits and rely on enhanced rates of return on individual accounts to finance long-term solvency may create an additional draw on general revenue that could serve to increase the deficit over the long term.⁴⁷ Four of the 17 proposals we reviewed for this report included this type of provision; 3 of the 4 also provided for unlimited transfers of reallocated general revenue to maintain trust fund solvency.

Conclusions

In coming decades, our nation will face a serious long-term fiscal challenge that will put America's fiscal future at risk. As we have said in our body of work on Social Security, substantive reform of this important program will involve hard choices that will need to modify the program's underlying commitments for the future. To do this—to achieve the goal of saving Social Security and making it sustainable for the future—reform will need to increase program revenues and/or decrease program expenses. These are the only options.

It may well be that some general revenue will be part of reform. If so, this would be a major substantive change. Considering both the long-term fiscal situation and the potential implications for Social Security, the use of any general revenue in proposals—reallocated or new—will need to be clearly understood by both policymakers and the general public.

Although OCACT's determination of "sustainable solvency" for a reform plan will remain an important threshold that plans will need to meet, it is not a sufficient benchmark in the context of the long-term fiscal outlook facing the United States. It is also an incomplete metric for comparing and evaluating reform plan financing implications. Given that most recent proposals use reallocated general revenue, a determination of trust fund solvency alone can be especially misleading. By definition a determination of trust fund solvency is not designed to and does not provide any information on how, when, or to what extent a plan is likely to worsen or improve the already daunting future federal fiscal imbalances. Clarity about these broader implications of any proposal will be essential as reform changes are debated.

⁴⁷ [GAO/AIMD/HEHS-00-29](#) (Washington, D.C.: Nov. 4, 1999).

Although raising taxes (payroll or other) or cutting benefits would have tangible consequences for taxpayers and beneficiaries, e.g., less take-home pay or smaller benefit checks, the consequences of transfers from the non-Social Security budget in the form of reallocated general revenue are less likely to be clearly observable. Reallocated general revenue, however, is not without cost. Regardless of how general revenue is provided to Social Security, it must be paid for at some point. The question is when, and by whom.

OACT scoring memos have played and will continue to play an indispensable role in the debate by analyzing how proposals would affect the trust fund's finances and in more recent years how proposals would affect the federal budget. OACT's valuable information and complex analyses could make an even greater contribution if they were more readily accessible to nonexpert users. It would be helpful for OACT to include near the beginning of each memo a summary of the relative contribution of each provision in a proposal package to trust fund solvency. In addition, OACT could devise a way to enable policymakers and the public to quickly and accurately grasp how the elements of a proposal, including any general revenue, work together to affect the trust fund and the overall federal budget. This type of presentational change would not require any additional analysis but could greatly facilitate comparison of proposals to one another.

We recognize that developing a summary that would be easily accessible to policymakers and the general public and perceived as fair by all participants in the reform debate will present challenges. The elements of reform proposals are likely to continue to evolve, and new formats and analyses may become necessary. We recognize that a balance will need to be struck between standardizing formats and allowing the information provided to continue to evolve with the debate. Nevertheless, a more standardized summary early on could make clear the relative contributions of benefit cuts and increased revenue from payroll and nonpayroll taxes. In addition, it could illuminate any use of general revenue and how use of such revenue is likely to affect the long-term budget outlook. This summary would be a presentational, not analytical, modification with major potential benefits to greater public understanding of proposed changes to this popular program that is important to virtually all Americans.

Recommendation for Executive Action

To improve public understanding of proposed changes to Social Security, we recommend that the Commissioner of SSA direct the Office of the Chief Actuary at SSA to include a summary presentation of its analysis in future scoring memoranda that will enable policymakers and the general public to quickly and easily compare Social Security reform proposals especially with respect to proposed use of general revenue and federal budget implications.

Agency Comments and Our Evaluation

In written comments (reprinted in app. II) on a draft of this report, SSA suggested that we should direct our recommendation to the Chief Actuary, not to the Commissioner. This change, SSA said, would target the entity that develops the analysis and would also be sensitive to the independence of the Chief Actuary.

As SSA stated in its comments, by legal mandate the Chief Actuary does report directly to the Commissioner. Because our recommendation concerns only the presentation of actuarial estimates—not any change in which estimates are developed nor in the analytical work required to develop them—we believe the recommendation as it stands recognizes and is appropriately sensitive to the independence of the Chief Actuary while at the same time reflecting the organizational structure of the Office of the Chief Actuary within SSA.

SSA did not explicitly agree or disagree with our recommendation in its comments. In response to the recommendation, SSA noted that recent OCACT memos had added an additional table (“table d”) that, SSA believes, already provides key information on general revenue use in proposals. SSA also expressed the view that a summary table showing the effects on the actuarial deficit of each proposal provision would be helpful. As our report had noted, this table has been included in some memoranda at the request of the proposal’s sponsor.

While we agree with SSA that both the technical and summary table it describes add value, we remain of the view that OCACT needs to develop a new table that can clearly and quickly communicate both trust fund effects and federal budget implications of a proposal. Our report acknowledged the value and completeness of OCACT’s analyses including those presented in “table d.” The message of our report was not that OCACT needs to do additional analytic work. Our message was rather that OCACT’s existing analyses need to be summarized and highlighted so that a proposal’s implications for both the trust fund and the federal budget as a whole are immediately clear.

Neither of SSA's two suggestions is fully responsive to this goal. SSA itself noted in its comments that "table d" is "somewhat complicated." With regard to the summary table showing how each provision affects the actuarial deficit, we agree that this table adds considerable value and can help facilitate certain types of comparisons across plans. It does not, however, make clear how each provision or the proposal as a whole would affect the federal budget. It is this kind of information, now available only to experienced users of OCACT memos, that needs to be made more accessible. Given the long-term fiscal challenge facing the Nation, the reform debate needs to take place not simply in the context of trust fund solvency but also in the larger context of the federal budget as a whole.

SSA also provided technical comments, which we incorporated as appropriate.

We are sending copies of this report to the Commissioner of Social Security as well as other interested parties. Copies will also be made available to others upon request. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>. Please contact Susan Irving at (202) 512-9142 or Barbara Bovbjerg at (202) 512-7215 if you have any questions about this report. Key contributors to this assignment were Jay McTigue, Joseph Applebaum, Jennifer Ashford, Linda Baker, Michael Collins, and Melissa Wolf.



Susan J. Irving
Director, Federal Budget Analysis,
Strategic Issues



Barbara D. Bovbjerg
Director, Education, Workforce,
and Income Security Issues

Appendix I: Scope and Methodology

To answer the questions in this report, we reviewed relevant historical documents and other literature on Social Security, including GAO reports and testimonies.¹ We undertook a review of the 26 OCACT proposal scoring memos done from 2001 through 2006, ultimately performing an in-depth analysis of 17 of those scoring memos.² We eliminated nine of the scoring memos either because they were proposals that were scored in multiple years or because they were not scored by OCACT as able to pay plan benefits in full throughout the 75-year period. Most of the 17 proposals were characterized by OCACT as meeting its definition of “sustainably solvent.” We also reviewed proposal scorings done by Congressional Budget Office (CBO) and met with officials from OCACT and CBO who were responsible for proposal scorings. To enhance our understanding of the relationship between Social Security and the federal budget, we interviewed selected federal budget experts from think tanks and other policy organizations who represented a range of views on reform approaches. Some of these experts were former officials of the Social Security Administration and/or Congressional Budget Office.

Our analysis, like the scorings of the Office of the Chief Actuary and recent scorings by CBO, is limited to first order effects of reform changes. Accordingly, second order effects of proposed reforms on the federal budget, such as effects on economic growth, are beyond the scope of this report. This report also does not address the effects of general revenue use on program equity. As discussed in other GAO work, the use of significant amounts of general revenue transfers could change program equity in ways that are difficult to quantify.³

¹In particular this report builds on GAO’s analysis of revenue options for reform as discussed in *Options for Social Security Reform*, [GAO-05-649R](#) (Washington, D.C.: May 6, 2005).

²Scorings can be found at <http://www.ssa.gov/OACT/solvency/index.html>.

³See [GAO-05-649R](#) and GAO, *Social Security: Distribution of Benefits and Taxes Relative to Earnings Level*, [GAO-04-747](#) (Washington, D.C.: June 15, 2004).

Appendix II: Comments from the Social Security Administration



SOCIAL SECURITY

The Commissioner

March 2, 2007

Ms. Barbara Bovbjerg
Director, Education, Workforce and
Income Security Issues
U.S. Government Accountability Office
Washington, D.C. 20548

Dear Ms. Bovbjerg:

Thank you for the opportunity to review and comment on the draft report, "SOCIAL SECURITY REFORM: Greater Transparency Needed about Potential General Revenue Financing" (GAO-07-213).

If you have any questions, please contact Candace Skurnik, Director, Audit Management and Liaison Staff, at (410) 965-4636.

Sincerely,

A handwritten signature in black ink, appearing to read 'Michael J. Astrue', written over a printed name.

Michael J. Astrue

Enclosure

SOCIAL SECURITY ADMINISTRATION BALTIMORE MD 21235-0001

COMMENTS ON THE GOVERNMENT ACCOUNTABILITY OFFICE (GAO) DRAFT REPORT, "SOCIAL SECURITY REFORM: GREATER TRANSPARENCY NEEDED ABOUT POTENTIAL GENERAL REVENUE FINANCING"(GAO-07-213)

Thank you for the opportunity to review and comment on the draft report. We appreciate your conducting this audit of the use of general revenue (GR) financing in Social Security reform proposals and the impact of this financing on the unified Federal budget.

Recommendation 1

To improve public understanding of proposed changes to Social Security, GAO recommends that the Commissioner of the Social Security Administration direct SSA's Office of the Chief Actuary (OCACT) to include a summary presentation of its analysis in future scoring memoranda that will enable policymakers and the general public to quickly and easily compare Social Security reform proposals especially with respect to proposed use of GR and federal budget implications.

Comment

We suggest that GAO revise the recommendation from suggesting that the Commissioner of Social Security direct OCACT to develop further analysis to a recommendation directed to the Chief Actuary. This would target the entity that actually develops the analysis in question, and would also be sensitive to the independence of the Chief Actuary. By legal mandate, the Chief Actuary of Social Security does report directly to the Commissioner. However, it is critical to the credibility of the actuarial estimates and analyses produced by OCACT that these be wholly objective and unbiased both in content and presentation. They should not be, nor appear to be, influenced or controlled by any other entity, even the Commissioner.

It should be noted that, for over a year, OCACT has been including an additional table "d" which provides the specific implications for the Old-Age, Survivors and Disability Insurance unfunded obligation of different provisions in the overall proposal. In particular, a separate column in the table has been provided indicating the extent to which GR transfers that do not represent new income to the government affect the unfunded obligation of the program. While somewhat complicated, this table does already provide much of what is called for by GAO. We do agree, however, that general inclusion of a simple table showing the effects on the actuarial deficit of each provision would be helpful.

Glossary of Terms

The majority of the definitions provided here are from the Social Security Administration, *The 2006 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds* (Washington, D.C.: May 1, 2006) and GAO, *A Glossary of Terms Used in the Federal Budget Process*, [GAO-05-734SP](#) (Washington, D.C.: September 2005).

Actuarial balance

The difference between the summarized income rate and the summarized cost rate over a given valuation period.

Actuarial deficit

A negative actuarial balance.

Assumptions

Values relating to future trends in certain key factors which affect the balance in the trust funds. Three sets of demographic, economic, and program-specific assumptions are presented in the annual Trustees' report.

- Demographic assumptions include fertility, mortality, net immigration, marriage, and divorce.
- Economic assumptions include unemployment rates, average earnings, inflation, interest rates, and productivity.
- Program-specific assumptions include retirement patterns, and disability incidence and termination rates.

The three sets of assumptions are described as follows:

- Alternative II is the intermediate set of assumptions, and represents the Trustees' best estimates of likely future conditions.
- Alternative I is characterized as a low cost set—it assumes relatively rapid economic growth, low inflation, and favorable (from the standpoint of program financing) demographic conditions.
- Alternative III is characterized as a high cost set—it assumes relatively slow economic growth, high inflation, and unfavorable (from the standpoint of program financing) demographic conditions.

In its estimates of reform proposals, OCACT uses the intermediate set of assumptions, which represents the Trustees' best estimates of likely future demographic, economic, and program-specific conditions.

Board of Trustees	A Board established by the Social Security Act to oversee the financial operations of the Federal Old-Age and Survivors Insurance Trust Fund and the Federal Disability Insurance Trust Fund. The Board is composed of six members, four of whom serve automatically by virtue of their positions in the federal government: the Secretary of the Treasury, who is the Managing Trustee, the Secretary of Labor, the Secretary of Health and Human Services, and the Commissioner of Social Security. The other two members are appointed by the President to serve as public representatives.
Constant dollars	Amounts adjusted by the consumer price index (CPI) to the value of the dollar in a particular year.
Cost rate	The cost rate for a year is the ratio of the cost of the program to the taxable payroll for the year. In this context, the cost is defined to include scheduled benefit payments, special monthly payments to certain uninsured persons who have 3 or more quarters of coverage (and whose payments are therefore not reimbursable from the General Fund of the Treasury), administrative expenses, net transfers from the trust funds to the Railroad Retirement program under the financial-interchange provisions, and payments for vocational rehabilitation services for disabled beneficiaries; it excludes special monthly payments to certain uninsured persons whose payments are reimbursable from the General Fund of the Treasury, and transfers under the interfund borrowing provisions.
Covered earnings	Earnings in employment covered by the Old-Age Survivors and Disability Insurance program.
Current dollar	“In current dollars” means valued in the prices of the current year. Amounts are expressed in nominal dollars with no adjustment for inflationary changes in the value of the dollar over time. The current dollar value of a good or service is its value in terms of prices current at the time the good or service is acquired or sold.
Debt held by government accounts	Federal debt owed by the federal government to itself. Most of this debt is held by trust funds, such as Social Security and Medicare. The Office of Management and Budget (OMB) contrasts it to debt held by the public by noting that it is not a current transaction of the government with the public; it is not financed by private saving and thus does not compete with the private sector for available funds in the credit market; and it does not represent an obligation to make payments to the public.

Debt held by the public	That portion of the gross federal debt held outside of the federal government. This includes any federal debt held by individuals, corporations, state or local governments, the Federal Reserve System, and foreign governments and central banks. Debt held by government accounts (intragovernmental debt) is excluded from debt held by the public. Debt held by the public is not the same as public debt or Treasury debt.
Exhaustion Date	As reported in the Trustees' Report and for the purposes of this report, the year in which the OASDI trust fund would become unable to pay currently-scheduled benefits when due because the assets of the fund were exhausted.
General fund of the Treasury	Funds held by the Treasury of the United States, other than receipts collected for a specific purpose (such as Social Security) and maintained in a separate account for that purpose.
General revenue	For a discussion of how it is defined for the purposes of this report, see page 6.
Income rate	Ratio of income from tax revenues on a liability basis (payroll tax contributions and income from the taxation of scheduled benefits) to the OASDI taxable payroll for the year.
Inflation	An increase in the volume of money and credit relative to available goods, resulting in an increase in the general price level.
Interest	A payment in exchange for the use of money during a specified period.
Interest rate	For the OASDI trust funds, interest rates on new public-debt obligations issuable to federal trust funds are determined monthly. Such rates are set equal to the average market yield on all outstanding marketable U.S. securities not due or callable until after 4 years from the date the rate is determined. The effective interest rate for a trust fund is the ratio of the interest earned by the fund over a given period of time to the average level of assets held by the fund during the period. The effective rate of interest thus represents a measure of the overall average interest earnings on the fund's portfolio of assets.
Long range	The next 75 years. Long-range actuarial estimates are made for this period because it is approximately the maximum remaining lifetime of current Social Security participants.

Maximum taxable limit	The limit or “cap” on covered earnings that are subject to the 12.4 percent payroll tax and that can be used in the benefit formula, thereby limiting the size of taxes and benefits. This “cap” is indexed annually for average wage growth and therefore it changes every year. In 2007, the taxable maximum limit is \$97,500.
Nominal dollar	See under Current dollar.
Outlay	The issuance of checks, disbursement of cash, or electronic transfer of funds made to liquidate a federal obligation. Outlays during a fiscal year may be for payment of obligations incurred in prior years (prior-year obligations) or in the same year. Outlays, therefore, flow in part from unexpended balances of prior-year budgetary resources and in part from budgetary resources provided for the year in which the money is spent. Total government outlays include outlays of off-budget federal entities, such as the Social Security trust fund.
Pay-as-you-go financing	A financing method where taxes are scheduled to produce just as much income as required to pay current benefits, with trust fund assets built up only to the extent needed to prevent exhaustion of the fund by random economic fluctuations.
Payroll taxes	A tax levied on the gross wages of workers.
Present value	The equivalent value, at the present time, of a future stream of payments (either income or cost). The present value of a future stream of payments may be thought of as the lump-sum amount that, if invested today, together with interest earnings would be just enough to meet each of the payments as they fell due. Present values are widely used in calculations involving financial transactions over long periods of time to account for the time value of money (interest). For the purpose of present-value calculations for this report, values are discounted by the effective yield on trust fund assets.
Solvency	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 OASDI program is considered solvent over any period for which the trust funds maintain a positive balance throughout the period.
Summarized balance	The difference between the summarized cost rate and the summarized income rate, expressed as a percentage of taxable payroll.

Summarized cost rate	The ratio of the present value of cost to the present value of the taxable payroll for the years in a given period, expressed as a percentage. This percentage can be used as a measure of the relative level of cost during the period in question. For purposes of evaluating the financial adequacy of the program, the summarized cost rate is adjusted to include the cost of reaching and maintaining a target trust fund level. Because a trust fund level of about 1 year's cost is considered to be an adequate reserve for unforeseen contingencies, the targeted trust fund ratio used in determining summarized cost rates is 100 percent of annual cost. Accordingly, the adjusted summarized cost rate is equal to the ratio of (a) the sum of the present value of the cost during the period plus the present value of the targeted ending trust fund level, to (b) the present value of the taxable payroll during the projection period.
Summarized income rate	The ratio of the present value of scheduled tax income to the present value of taxable payroll for the years in a given period, expressed as a percentage. This percentage can be used as a measure of the relative level of income during the period in question. For purposes of evaluating the financial adequacy of the program, the summarized income rate is adjusted to include assets on hand at the beginning of the period. Accordingly, the adjusted summarized income rate equals the ratio of (a) the sum of the trust fund balance at the beginning of the period plus the present value of the total income from taxes during the period, to (b) the present value of the taxable payroll for the years in the period.
Sustainable solvency	As defined by OCACT, sustainable solvency for the financing of the program is achieved when the program has positive trust fund ratios throughout the 75-year projection period and these ratios are stable or rising at the end of the period.
Taxable earnings	Wages and/or self-employment income, in employment covered by the OASDI and/or Hospital Insurance (HI) programs, that is under the applicable annual maximum taxable limit. For 1994 and later, no maximum taxable limit applies to the HI program.
Taxable payroll	A weighted average of taxable wages and taxable self-employment income. When multiplied by the combined employee-employer tax rate, it yields the total amount of taxes incurred by employees, employers, and the self-employed for work during the period.
Taxable wages	See under "Taxable earnings."

Trust fund

As discussed in this report, the OASDI trust funds are separate accounts in the United States Treasury in which are deposited the taxes received under the Federal Insurance Contributions Act and the Self-Employment Contributions Act, as well as taxes resulting from coverage of state and local government employees; any sums received under the financial interchange with the railroad retirement account; voluntary hospital and medical insurance premiums; and transfers of Federal general revenues. Funds not withdrawn for current monthly or service benefits, the financial interchange, and administrative expenses are invested in interest-bearing federal securities, as required by law; the interest earned is also deposited in the trust funds.

- Old-Age and Survivors Insurance (OASI). The trust fund used for paying monthly benefits to retired-worker (old-age) beneficiaries and their spouses and children and to survivors of deceased insured workers.
- Disability Insurance (DI). The trust fund used for paying monthly benefits to disabled-worker beneficiaries and their spouses and children and for providing rehabilitation services to the disabled.
- Hospital Insurance (HI). The trust fund used for paying part of the costs of inpatient hospital services and related care for aged and disabled individuals who meet the eligibility requirements. Also known as Medicare Part A.

Trust fund ratio

A measure of the adequacy of the trust fund level. Defined as the assets at the beginning of the year expressed as a percentage of the cost during the year. The trust fund ratio represents the proportion of a year's cost which could be paid with the funds available at the beginning of the year.

Unified budget

Under budget concepts set forth in the Report of the President's Commission on Budget Concepts, a comprehensive budget in which receipts and outlays from federal and trust funds are consolidated. When these fund groups are consolidated to display budget totals, transactions that are outlays of one fund group for payment to the other fund group (that is, interfund transactions) are deducted to avoid double counting. The unified budget should, as conceived by the President's Commission, take in the full range of federal activities. By law, budget authority, outlays, and receipts of off-budget programs (currently only the Postal Service and Social Security) are excluded from the current budget, but data relating to off-budget programs are displayed in the budget documents. However, the most prominent total in the budget is the unified total, which is the sum of the on- and off-budget totals.

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