

General Revenue Financing of Social Security:
Has the Time Come?¹

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Abstract

As the depletion date for the Social Security Trust Fund approaches, policymakers have contemplated multiple Social Security reform plans. We argue that as time passes without meaningful reform efforts, general revenue financing for Social Security – at least for a period of time – becomes increasingly likely. We also argue that access to general revenue financing of some sort will likely be necessary to ensure that the program remains solvent even if economic projections prove too optimistic. We present implementation options for using general revenues that policymakers can consider in advance, along with a conceptual analysis of the efficiency and equity consequences of such proposals.

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I. Introduction

The depletion date for the Social Security Trust Fund is fast approaching. Under the Social Security Trustees' intermediate scenario (Social Security Office of the Chief Actuary 2024), the reserves in the combined Old Age and Survivors Disability Insurance (OASDI) Trust Fund will be depleted in 2035. Subsequently, Social Security tax revenues will be sufficient to fund only around 83 percent of benefits (OACT 2024).² There is no roadmap to guide the Social Security Administration or Treasury about how such benefit cuts should occur – whether through delayed payments, immediate across-the-board cuts, or the like, and certainly no precedent for benefit cuts of this magnitude – creating substantial uncertainty about future benefits.

We argue that as time passes without meaningful reform efforts, general revenue financing for Social Security – at least for a period of time – becomes increasingly likely. We begin by reviewing institutional details – including the projections for the OASDI Trust Fund and the policy options as the Trust Fund's depletion date approaches – in Section II. We argue that the magnitude of the changes to OASDI benefits and/or taxes required prior to the depletion date is increasingly unrealistic, for two reasons.

First, Section II demonstrates that the magnitude of the required tax and/or benefit changes is larger than historical changes in the Social Security program have been. Second, Section III shows that even if changes occur of the magnitude required to eliminate the 75-year actuarial deficit, the Trust Fund runs a strong risk of running out of reserves due to stochastic fluctuations in receipts and outlays: since 2020 the Trust Fund's reserves have been decreasing and are projected to continue doing so, implying that absent larger changes to taxes and/or benefits than have generally been envisioned, the program will not have a "buffer stock" of assets to weather larger-than-expected future deficits. The lack of a large Trust Fund will imply the system may face repeated threats of exhaustion. We use novel simulations to illustrate this point.

As general revenue financing approaches a near-inevitability, in Section IV we present implementation options that policymakers can consider, including the use of general revenues temporarily or in perpetuity. Our aim is to provide a starting point for policymakers to build upon in creating more specific and realistic plans to address the looming shortfall. We present a conceptual analysis of the efficiency and equity consequences of such proposals. Section V concludes.

II. Rectifying the Upcoming Trust Fund Depletion

² Our discussion throughout this paper focuses on OASDI—the combined DI and OASI programs—rather than just OASI. Congress has in the past reallocated funds between the two trust funds and we assume they would do so again if necessary. Viewed separately, the OASI Trust Fund is projected to be depleted in 2033 under the intermediate scenario, whereas the DI trust fund is projected to remain solvent throughout the 75-year horizon.

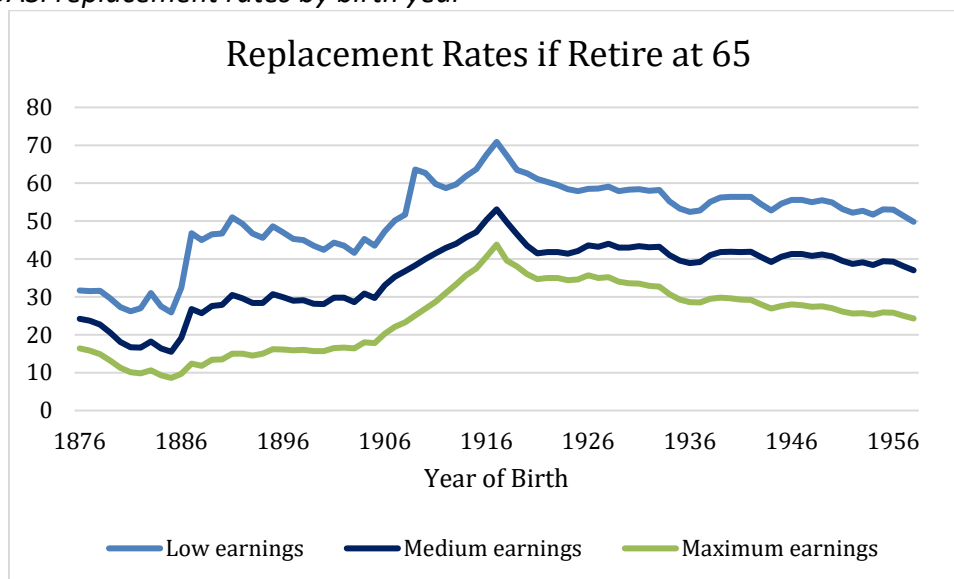
The adjustments required to restore solvency to the Social Security system are large by any measure. We begin by considering changes to benefits and then turn to changes in taxes.

A. Large and immediate cuts in benefits appears highly unlikely

The Trustees estimate that, if solvency is restored entirely through benefits cuts, it would take an immediate and permanent 21 percent cut in benefits relative to baseline to restore solvency over 75 years.³ If action is not taken until the depletion year of 2035, we estimate that benefit cuts required to restore 75-year solvency (through 2108) would be larger—about 25 percent. Alternatively, if no action is taken and benefits are cut each year to match revenues, the benefit cut in 2034 would be 19 percent, rising to 28 percent by 2078 (under the intermediate scenario).

We believe that Congress is highly unlikely to allow such large and immediate benefit cuts. In Social Security’s history since 1936, benefits have been cut significantly only once: In 1977, policymakers corrected a mistake in the formula used to adjust benefits for inflation, creating the so-called “notch” babies—people born between 1917 and 1921—who received lower benefits than those born just a few years or even months earlier. This resulted in a large cut for newly-retiring workers—about 20 percent over 6 years—as illustrated in Figure 1 below, but existing retirees were unaffected.

Figure 1. *OASI replacement rates by birth year*⁴



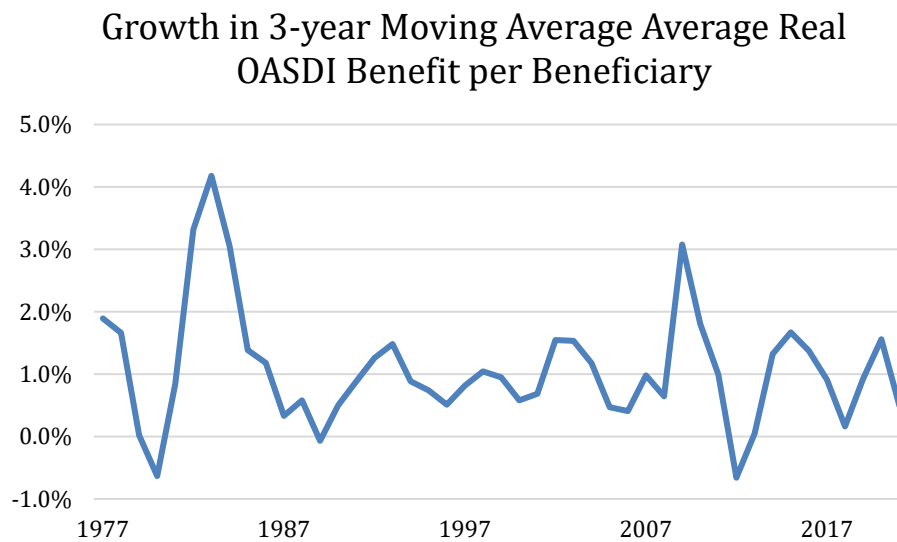
Source: Trustee Report, 2023.

³ The Trustees have two measures of solvency—the increase in financing necessary to have reserves equal to one-year’s worth of expenses at the end of 75 years, and the increase in financing necessary to have reserves be depleted in the 75th year.

⁴ Since OASI benefits are determined by the same formula as OASDI benefits, we consider these interchangeably for simplicity. Similarly, we consider the combined OASDI Trust Fund, rather than addressing the OASI and DI Trust Funds separately, both for simplicity and because of the historical transfers between the two; however, similar qualitative considerations would apply if we considered the OASI Trust Fund in isolation.

However, Figure 2 shows that in Social Security’s history, benefits for the retiree population as a whole have never declined by nearly as large a percentage as would be required to right the projected imbalance of taxes and benefits at the depletion date. Since 1977 – the year of the Notch legislation that created the largest percentage changes in the program’s history – the maximum decrease in 3-year moving *average* beneficiary-wide real benefits over is just 0.7 percent, which occurred in 2012—perhaps reflecting early retirements during the Great Recession.

Figure 2. *Average Social Security Benefit Growth Rates, 1977-2021*



Source: OACT 2023; Authors’ calculations.

Indeed, real per-beneficiary benefits have never decreased over any five-year period in the program’s history, likely because those near retirement age – and their political advocates – demand years of planning for any potential reductions in benefits. The 1983 reforms did include sizable benefit cuts, including an immediate 6-month delay in the COLA that decreased benefits for existing retirees by about 1.75 percent, but the largest cut—the delay in the retirement age from 65 to 67, did not begin until the year 2000 and then was phased in gradually over a 22 year period. This suggests to us that much of the adjustment in the near term will be on the revenue side, to which we turn next.

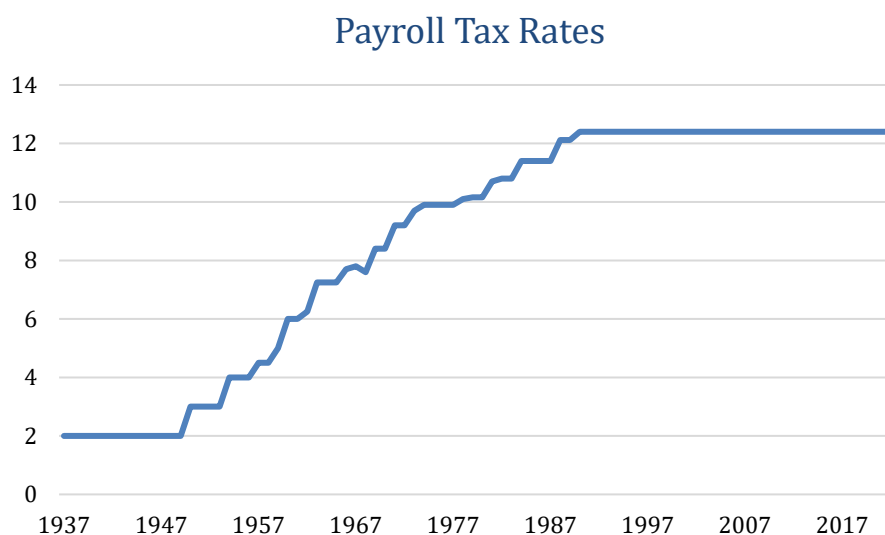
B. Large and immediate increase in payroll tax highly unlikely

Alternatively, financing the gap entirely through payroll tax increases that begin immediately would also require seemingly unrealistic increases in revenues – a 28 percent increase if enacted immediately according to in the latest projections of the Trustees. This could be accomplished in a number of ways, such as implementing a 3.5 percentage point increase in the

OASDI payroll tax, or by taxing all payroll – both below and above the current maximum taxable earnings level – and simultaneously raising the payroll tax rate by around 1 percentage point.⁵ If action were not taken until 2034, the increase in the payroll tax would be larger – about 4.4 percent of payroll to keep the system solvent through 2108, according to our calculations.

However, Figure 3 shows that the largest historical changes in payroll taxes have been much smaller. Over one year, the U.S. saw increases of 1 percent of payroll in 1950, 1954, 1960, 1963. Over a two year period, the maximum payroll tax rate increase was 1.5, which occurred in 1960. Over six years, of the largest increase were 2.8 percent of payroll, in 1963 and 1964, respectively. The payroll tax has been fixed at 12.4 percent since 1990. We therefore believe that it appears unlikely for payroll taxes to increase by 3.6 percentage points even over four or five years.

Figure 3. *OASDI payroll tax rates by year, 1937-2022*



OACT, nd. <https://www.ssa.gov/oact/progdata/oasdiRates.html>

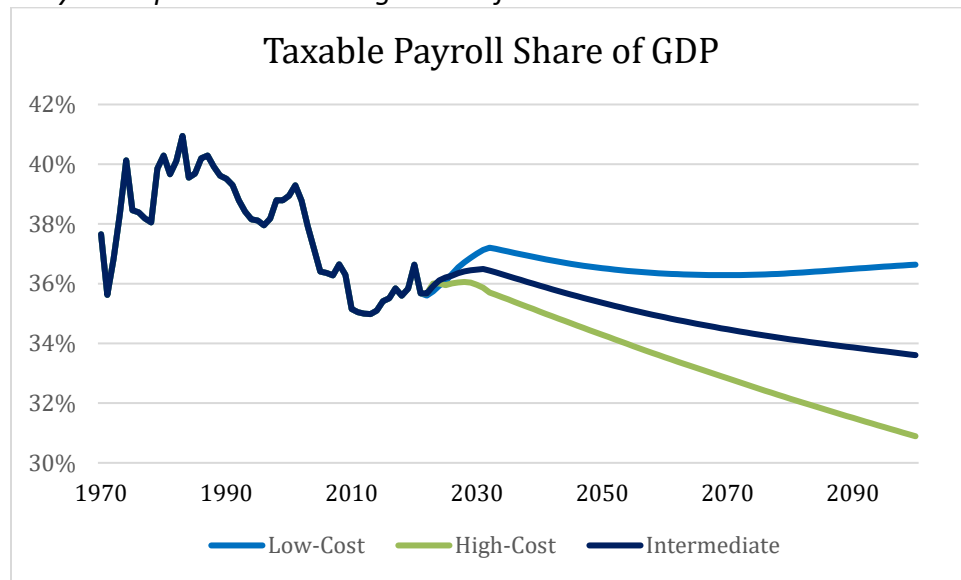
Large changes in payroll taxes would be required to fund the financing gap in part because the payroll tax base represents an increasingly small share of Gross Domestic Product (GDP), as shown in Figure 4A. This decline reflects a number of factors, including the rising share of compensation accounted for by employer-provided health insurance, the relabeling of labor income by high-income workers as capital income (Smith et al., 2021) and increasing inequality in the distribution of wages (Gould and Kandra, 2022). Figure 4B illustrates the effects of relabeling and increasing inequality, as the percentage of taxable earnings above the OASDI maximum taxable earnings level has secularly increased. Subjecting earnings above the taxable maximum to Federal Insurance Contributions Act (FICA) taxes could address some of these

⁵ To achieve this level of savings, the additional taxes paid by individuals would not result in higher Social Security benefits. If, alternatively, the higher wage base counted towards the benefit calculation using the current formulas, the additional payroll tax needed would be about 1.6 percent of payroll. https://www.ssa.gov/oact/solvency/provisions/charts/chart_run128.html

problems, but this would leave the non-labor income of higher-income earnings – a key source of increasing inequality (Smith et al, 2021) – untouched.

Figure 4. Taxable Payroll Over Time

4A. Taxable Payroll Represents Declining Share of GDP



Source: Trustees Report, 2023.

4B. Share of Earnings Above Taxable Maximum Has Experienced Secular Increase



Source: Social Security Annual Statistical Supplement, 2023, Table 4.B1

Changes that appear more politically realistic would only forestall asset depletion a few years. For example, a one percentage point payroll tax increase starting in 2025 would delay the depletion date from 2034 to 2039 in the intermediate scenario, but only from 2032 to 2034 in the high-cost scenario. However, even changes of this magnitude appear politically unlikely within the next few years.

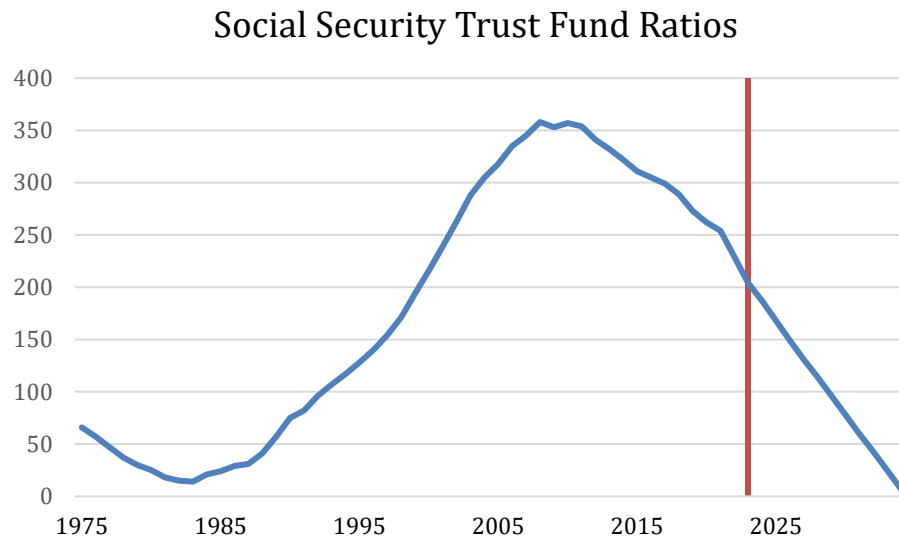
III. Taking Uncertainty into Account

Focusing only on OACT's central predictions of the path of future benefits and taxes—their intermediate set of assumptions—ignores a crucial issue: uncertainty in these predictions, which means that, even if the Trust Fund were solvent under one set of projections, it could easily become insolvent should the economy evolve differently than assumed.

The issue of uncertainty is likely to be more important going forward than it has been in the past. Benefits were not indexed to inflation until 1975, which provided some buffer for worse-than-expected economic outcomes. But after benefits were indexed, and before there was a large trust fund built up, the program was more vulnerable to economic conditions. Indeed, the projected depletion of the trust fund that led to the last major reform to Social Security in 1983 was the result of recessions in 1980 and 1981: The Trustees predicted in 1979—before the onset of the 1980 recession—that the program would be solvent through 2032; by the time of the 1982 Trustees Report publication, insolvency was predicted to occur within the next year or so (Sheiner and Nabors, 2023).

The reforms of 1983 were intended to keep the Social Security system solvent for 75 years, which required building up a large trust fund in anticipation of the retirement of the baby boom generation. At its peak in 2008, the Trust Fund Ratio – the percentage of annual costs that could be paid out of the trust fund—was 358. (Figure 5). That ratio is now about 200 and falling quickly.

Figure 5. *Social Security Trust Fund Ratios, 1975-2034*

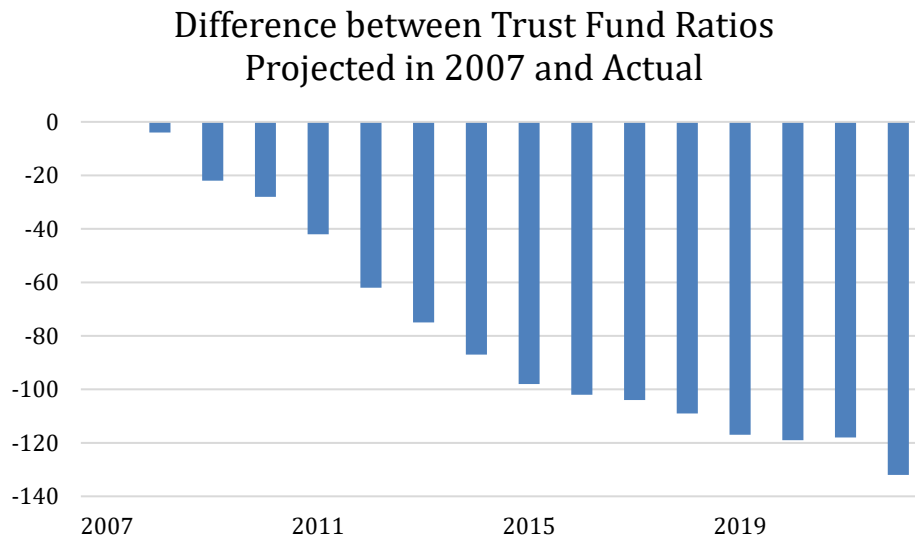


The size of the Trust Fund was key to getting through the Great Recession without having to worry about asset depletion. Figure 6 shows how the forecasts of the Trust Fund Ratio in the 2007 Trustees projection differed from the actual Trust Fund ratios. The errors were small at first but mounted quickly. After 9 years, the error was about 100 percent, which means that if, prior to the recession, the system had been projected to be in a steady state with a constant Trust Fund ratio of 100 percent, an event like the Great Recession would lead to asset depletion in just 9 years.

In the event, in 2007 the Social Security system was projected to have rising assets through 2015—it was not in a steady state—so it would have taken longer for the assets to have been depleted. We estimate that, if the Trust Fund Ratio had been 100 percent in 2008—the ratio that is deemed sufficient for the system to be “solvent” by the Trustees—the assets in the Social Security Trust Fund would have been depleted by 2023.

This experience suggests that, in order to provide enough cushion for the Social Security system to be solvent through one event like the Great Recession over a 75-year period, it would be preferable to aim for a Trust Fund ratio on the order of 200, rather than 100. And, of course, this would require some way to rebuild the Trust Fund when the ratio fell below 200.

Figure 6. *Projections Errors for Trust Fund Ratios from 2007 Trustees Report*

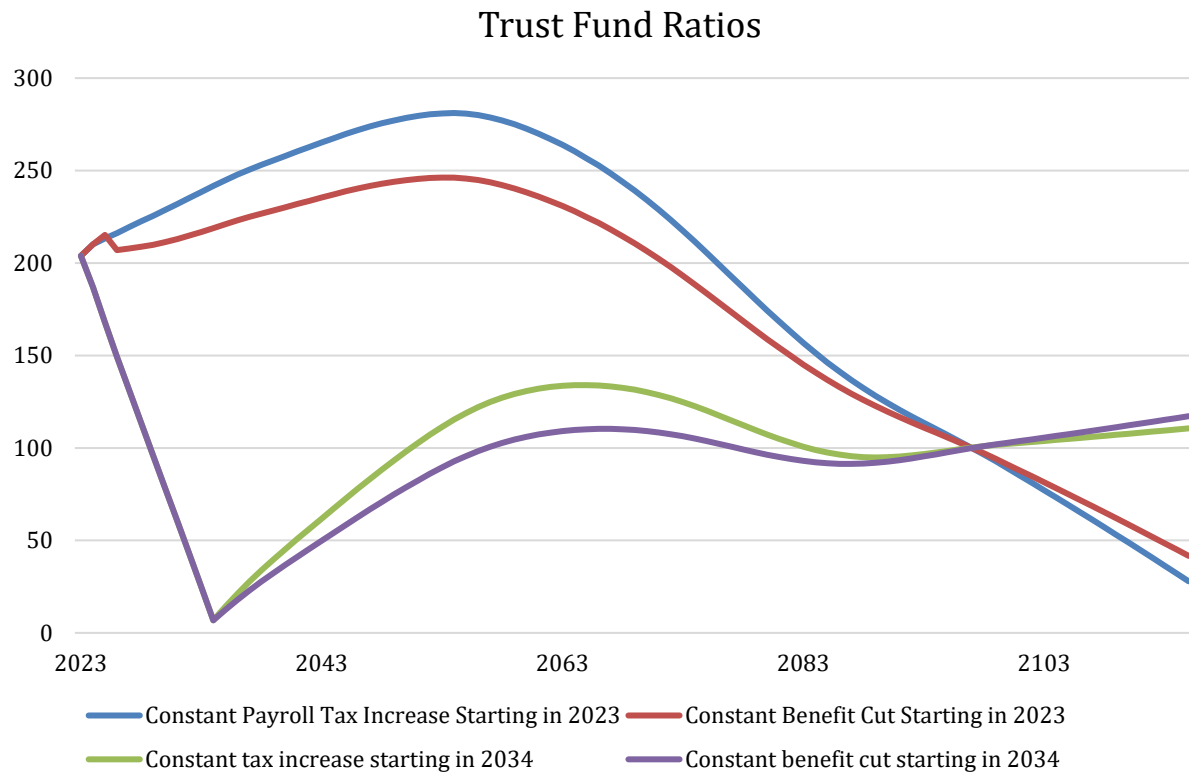


Source: 2007 and 2023 Trustees Reports.

Figure 7 shows our estimates of the Trust Fund ratio under four scenarios that each achieve solvency over 75 years: (1) Raise payroll taxes by a constant percent of payroll starting in 2023; (2) Cut benefits by a constant percentage starting in 2023; (3) Raise payroll taxes by a constant percentage of payroll starting in 2034 (and assuring solvency through 2108); (4) Cut benefits by a constant percentage starting in 2034. (The constant payroll tax and benefit increases have difference implications for the trust fund, because since benefits are increasing as a share of payroll taxes over time, measures that specify a constant benefit have smaller effects on trust fund balances in the near term and greater effects further out.)

Acting earlier rather than later has a distinct advantage, in that it does not allow the trust fund assets to be depleted. Even if action is taken in 2034 to achieve 75-year solvency under the SSA's intermediate scenario, the trust fund ratio would take almost 2 decades to reach 100 percent, and would peak at just 125 percent for the tax increase scenario and 110 percent for the benefit cut scenario.

Figure 7. Simulated Trust Fund Ratios under Intermediate Assumptions



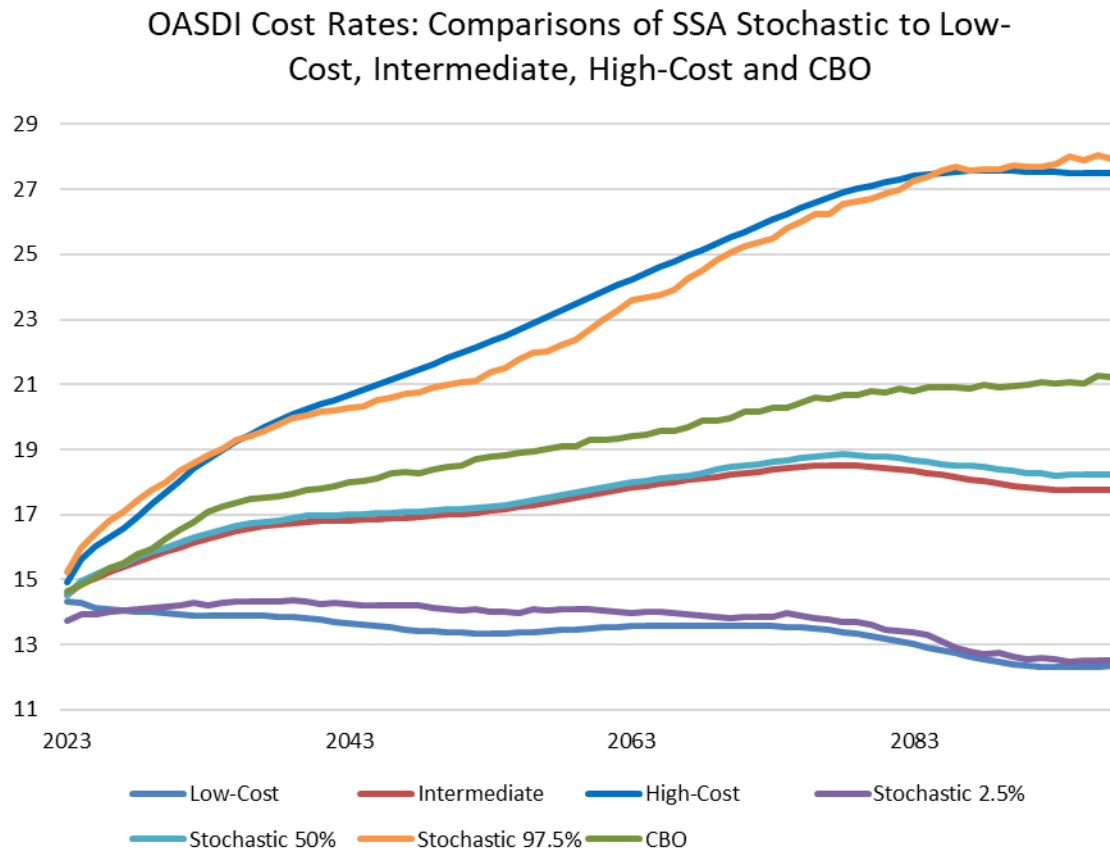
Source: Authors' calculations based on 2023 Trustees Report data.

Uncertainty about Timing and Magnitude of Imbalances Going Forward

The experience during the Great Recession provides some sense of the types of uncertainties that can occur over a short period of time. Uncertainty is even larger over the long term, as it results not just from business cycles but also from more enduring structural changes in the economy.

To gauge this uncertainty, OACT produces not only a central, intermediate-cost prediction of OASDI's finances, but also low-cost and high-cost scenarios. To explain the meaning of the low-cost and high-cost scenarios, Figure 8 shows that under OACT's projections, the high-cost and low-cost scenarios are similar to the 2.5th and 97.5th percentiles of the probability distribution of outcomes in their stochastic projections. These probability distributions are based on the assumption that the Intermediate Scenario represents the middle of the distribution of outcomes.

Figure 8. *OACT Stochastic Simulation Results in Comparison to Low-, Intermediate-, and High-Cost Scenarios*

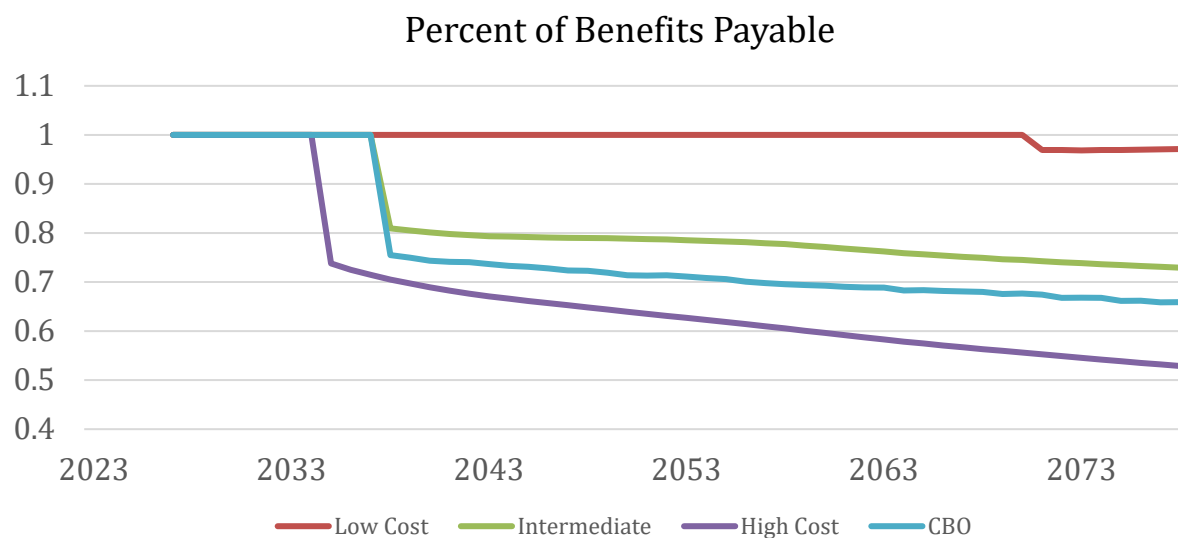


Source: OACT 2023; CBO 2023.

To maintain solvency under the high-cost scenario would require much larger benefit reductions than those we considered in Section II. For example, to maintain solvency for 75-years under the high-cost scenario entirely through payroll tax increases or benefit cuts would require an immediate and permanent 7.7 percentage point increase in payroll taxes or a roughly 35 percent decrease in benefits.

Moreover, the high-cost scenario may be more likely than the SSA stochastic model suggests, because there is disagreement among analysts about the central tendency for the Social Security system. For example, Figures 8 and 9 show that the CBO baseline scenario is much more pessimistic than SSA's intermediate scenario.

Figure 9. *CBO Baseline Scenario in Comparison to OACT Low-, Intermediate-, and High-Cost Scenarios*



Source: CBO (2023) and OACT (2023).

Due to such uncertainty, future financing crises are quite possible even if we raise taxes and/or cut benefits by the amounts that OACT or CBO have calculated. Assuming that the Trust Fund continues to be rapidly depleted in the coming years because no action is taken in the near term, we will lack a buffer stock of assets in the Trust Fund to insulate against stochastic fluctuations in tax receipts or benefit payments. Of course, it is possible that the CBO and SSA assumptions are too pessimistic—we could have a surge of productivity, perhaps from Artificial Intelligence, for example, or continued strength in immigration, that would improve the system’s long-term outlook. In that case, the Trust Fund would build up more assets than anticipated, which would also have political repercussions. We return to that issue below.

We perform simulations to illustrate the consequences of uncertainty. We assume in these simulations that tax increases begin in 2026 (the earliest date which appears feasible, although still unlikely):

1. The tax increase is sufficient to maintain Trust Fund solvency for the following 75 years under the intermediate assumptions, 3.7 percentage points under our rough calculations.⁶
2. The tax increase is sufficient to maintain Trust Fund solvency for 25 years under the intermediate assumptions, 2.7 percentage points under our rough calculations.

Figure 10 illustrates the Trust Fund ratios – defined as the ratio of assets to benefits – by year under each of the above two scenarios. When implementing a tax increase that aims for 75-

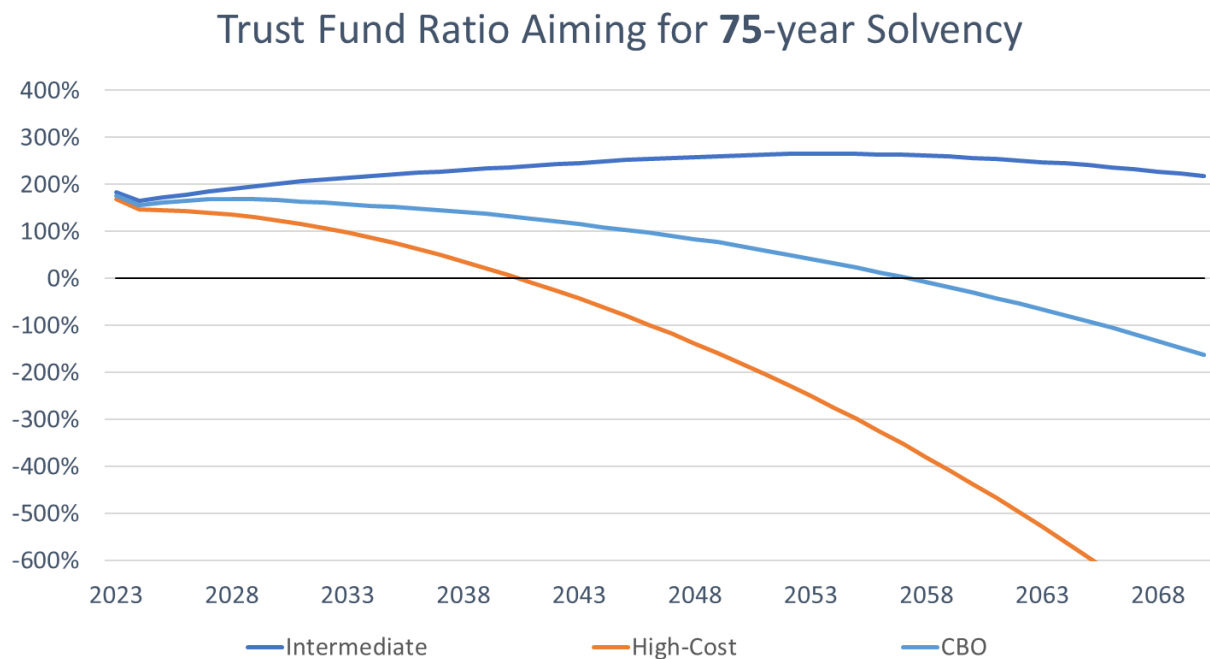
⁶ Solvency is defined as the Trust Fund having a ratio of assets to benefits greater than or equal to 1. For this exercise, we assume that events unfold until 2026 as expected under CBO and the Trustees Assumptions.

year solvency, the Trust Fund in fact becomes insolvent by 2047 and depleted by 2059 under the CBO assumptions. Under the high-cost assumptions, it becomes insolvent by 2034 and depleted by 2042.

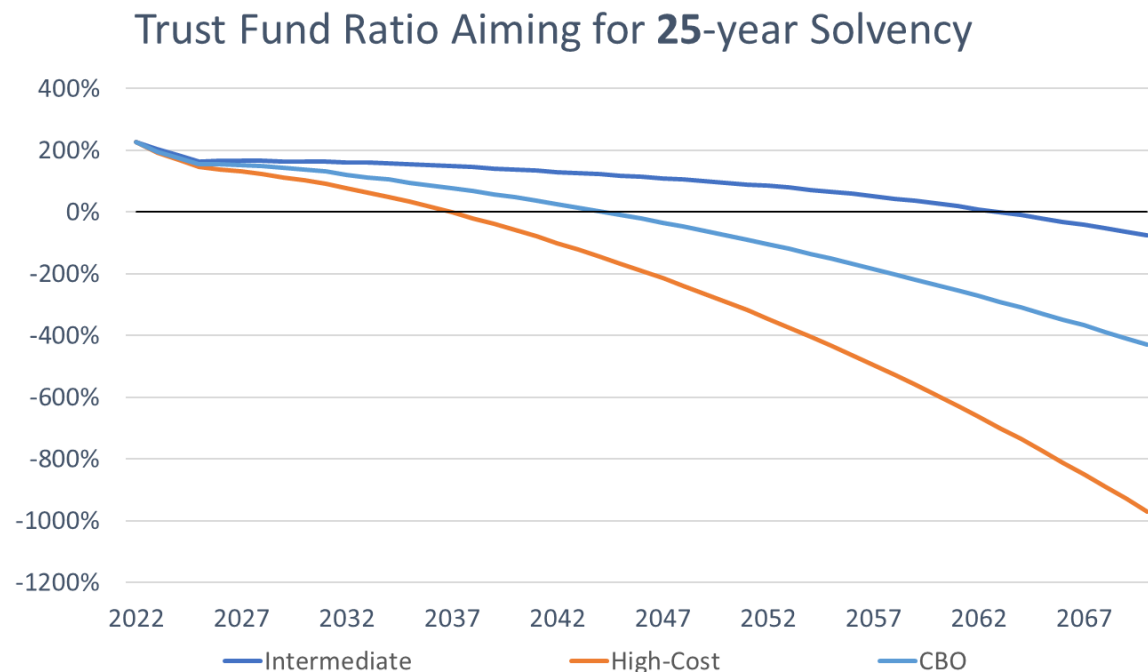
When implementing a tax increase in 2026 that only aims for 25-year solvency, the Trust Fund becomes insolvent by 2035 and depleted by 2045 under the CBO assumptions, while under the high-cost assumptions, the Trust Fund becomes insolvent by 2031 and depleted by 2037.

Figure 10. *Trust Fund Ratio Under Alternative Tax Increases*

10A. Payroll tax increase sufficient to maintain Trust Fund solvency for 75 years under OACT intermediate-cost assumptions



10B. Payroll tax increase sufficient to maintain Trust Fund solvency for 25 years under OACT intermediate-cost assumptions



Source: OACT, 2023; CBO, 2023; authors' calculations.

Note: Recall that solvency is defined as having a Trust Fund Ratio of 100.

In short, pay-as-you-go financing may be unstable in the coming decades. The lack of a large Trust Fund implies that we may face repeated threats of exhaustion. This is welfare-relevant for several reasons. First, uncertainty about Social Security benefits has substantial welfare consequences (Poterba, Peterson Institute 2021). Second, cyclical downturns will lead to financing problems, requiring tax increases or benefit cuts during recessions – exacerbating recessions and increasing the variance of income over time. This is particularly true in a political climate in which the salience of Social Security benefits makes this issue ripe for political brinkmanship.

Two potential solutions to this issue seem undesirable. First, building up another Trust Fund large through tax increases or benefits cuts to avoid this would require one generation to “overpay” for Social Security. Second, including automatic adjustments in a reform – such as benefit cuts or taxes changing automatically when solvency is threatened would lead to procyclical fiscal policy with tax increases and/or benefit cuts during recessions, uncertainty about program parameters, and a path of policy over time that violates tax smoothing arguments for keeping taxes and benefits relatively constant over time due to the convexity of deadweight costs (Auerbach, 2014).

IV. Exploring the Use of General Revenues

Our analysis of the history of benefit cuts and tax increases suggests that it is possible we will increase payroll taxes a bit or slowly phase in larger payroll tax increases and/or benefit cuts to create breathing room for the Trust Fund. The closer the depletion date grows, the more likely we believe that tax changes would realistically be part of the solution. Benefit changes would necessarily be concentrated among beneficiaries who, by definition in this hypothetical scenario, would not have long to plan for potentially substantial cuts in their retirement income. By contrast, hypothetical tax changes such as raising the payroll tax rate up to the maximum taxable earnings level would be spread throughout a much larger population – thus dulling their average impact, per dollar of income, on the affected population. Nonetheless, uncapping the payroll tax rate above the maximum taxable earnings could have dramatic effects on the after-tax income of affected individuals.

However, it seems highly unlikely that we will institute payroll tax changes and/or benefit cuts in the next decade that would be sufficient to resolve the imbalances over the next few decades, let alone achieve 75-year solvency or build up a sufficient trust fund to ensure against future solvency threats. Furthermore, action is unlikely to be taken soon, and so the trust fund seems likely to get fairly close to depletion.

As a result, it seems quite likely we will need and, indeed, will enact policies that include an infusion of general revenues into the Social Security system. To be clear, we are not necessarily arguing that this is the welfare-optimal solution – indeed we provide a list of pros and cons below – but rather believe that this solution ought to be taken seriously as a feasible and potentially acceptable solution given realistic political constraints in the coming years.

We believe that general revenue financing will present a plausible solution for several reasons. First, it addresses Trust Fund asset depletion without large, sudden tax increases or benefit changes. Second, it therefore reduces the current degree of uncertainty surrounding the implications of the prospective depletion of the Trust Fund and the uncertainty around the possibility of frequent future funding crises with pay-as-you-go financing. As a result, it promises to reduce uncertainty in incomes as well as the variance of tax rates over time, consistent with tax smoothing arguments. Third, general revenue financing can be combined with other alternatives including tax increases and/or benefit cuts and can therefore be used as a supplement to close any remaining Trust Fund financing gaps after enacting politically feasible reforms to taxes and/or benefits. Fourth, general revenue financing is already implicitly assumed by CBO in deficit and debt projections; thus, allowing Social Security to rely on general revenues would have no effect on projected debt and deficits under current law.

Defining General Revenue Financing: General revenue financing can take many forms, and it is worth starting to consider the various possibilities now. In our view, general revenue financing includes any policies under which some Social Security benefits are financed by revenue streams other than those that are currently dedicated to the Social Security Trust fund (mostly payroll taxes and income taxes collected on Social Security benefits). We discuss Temporary

General Revenue Financing—which we define as Social Security borrowing general revenues, but ultimately repaying that debt with payroll tax increases or benefit cuts—below.

One form of general revenue financing is to simply allow Social Security benefits to be paid out of the General Account. There are several ways to structure this. For example, Congress could enact a law that says that any imbalances between Social Security dedicated revenues and benefit costs be made up of general revenues. This would ensure that all Social Security benefits are paid, regardless of the state of the economy, while also maintaining a trust fund out of which the majority of the benefits are paid. (We discuss below the political rationale for maintaining a Trust Fund).

Alternatively, Congress could specify that some share – say 70 percent or 75 percent --of benefits be paid from the Trust Fund, and the remaining 25 percent-30 percent from General Revenues. This type of approach would not provide the same assurances that revenues would always be sufficient to finance benefits.

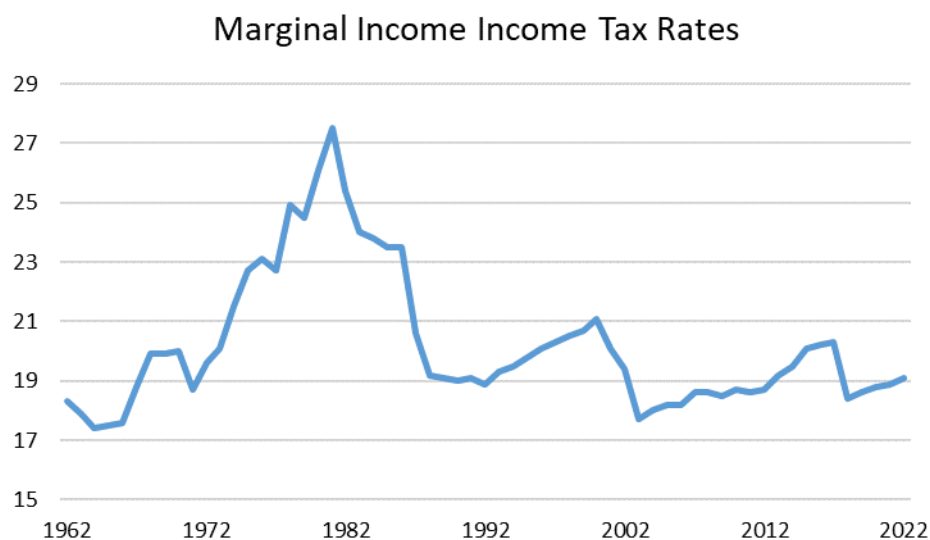
Another approach would be to dedicate additional sources of tax revenue to the trust fund – for example, some have advocated assigning revenues from the Net Investment Income Tax to the Trust Fund, while others have proposed dedicating estate tax revenue to the Trust fund. These approaches would likewise still make the Social Security system vulnerable to worse-than-expected economic outcomes and would require a sufficiently large trust fund in order to ensure long-run solvency. Finally, Congress could provide a *one-time, permanent* transfer of \$10 trillion to the Trust Fund, which would allow it to stay solvent until 2060 under the intermediate scenario.⁷ Or, Congress could provide a smaller transfer to create a buffer while also boosting payroll taxes and cutting benefits.

A second issue concerns the financing of those “general revenues.” The general revenue transfers could, in principle, be financed by spending cuts or increase in other taxes. For example, income taxes could be increased by enough to fund the imbalances in Social Security. We noted above that, if action is not taken until 2034, it will require about a 4.4 percentage point increase in the payroll tax to achieve solvency under the Trustees’ intermediate assumption. This translates into about 1.6 percent of GDP.

And, although payroll tax rates have not changed dramatically over the course of 1-5 years, marginal income tax rates have varied substantially from year to year. (see Figure 11) This suggests that there is perhaps scope for changes in non-payroll taxes to rise to finance Social Security benefits.

⁷ Some people advocate such a transfer and then allowing the Trust Fund to invest in equities. A discussion of that approach is beyond the scope of this paper.

Figure 11. Marginal Income Tax rates.



Source: CBO, 2019.

However, over the past 56 years, the maximum increase in revenues as a result of legislation has been just 1 percent of GDP, and even this degree of increase has been rare (the Revenue and Expenditure Control Act of 1968 and the Tax Equity and Fiscal Responsibility Act of 1982).⁸ Still, an increase in income taxes could contribute meaningfully toward improving Social Security finances—even though, in the near term, it appears more likely that income taxes will be cut rather than raised.

In the short run, we think it is likely that the government will finance part of Social Security benefits with debt. But eventually, our country will have to address our long-term budget challenges. General revenue financing allows a wider range of policy changes to be used—including income tax increases and spending cuts in other parts of the budget.

Recent plans for OASDI financing – such as Hillary Clinton’s 2016 campaign proposal or Bernie Sanders’ 2020 campaign proposal, both of which proposed using capital taxes (among other sources) to fund OASDI – have arguably moved a step in this direction by proposing financing mechanisms that do not rely exclusively on payroll taxes. We note the legal and practical distinction between introducing financing not based on payroll taxes – as in these campaign proposals – and introducing general revenue financing; however, from an economic, unified budget perspective both would move toward financing options that rely both on payroll and capital taxes.

Temporary General Revenue Funding

⁸ <https://home.treasury.gov/system/files/131/WP-81.pdf>

Another option would involve funding the Trust Fund partially with general revenues only on a *temporary* basis. For example, Duggan (2023) proposes allowing Social Security to borrow from the General Fund, just as state UI trust funds do, with the repayments to be made over time as tax increases and benefit cuts phase in.

An alternative would be to *lend* the Trust Fund a large sum to be repaid slowly over time with incremental benefit cuts and/or payroll tax increases. Such transfers would not affect the deficit or debt held by the public under a unified budget perspective but would affect the total debt subject to the debt limit. We emphasize that once such transfers have been made – whether a permanent infusion or a temporary loan – it would likely set a precedent for future such transfers that erode the distinction between general revenues and the Trust Fund, in the limit making the distinction immaterial in practice.

Efficiency and Equity Arguments for Using General Revenues

We consider several efficiency and equity arguments for using general revenues. As capital income accounts for a large portion of increasing US inequality since the 1970s, raising payroll taxes alone – particularly if these payroll tax increases apply to earnings below the maximum taxable earnings level – is limited as a tool to combat inequality. Raising taxes on consumption, non-wage income, and/or wealth could help in this regard. Changing spending in other areas of the budget would likewise expand the set of instruments available to combat the OASDI imbalances. More broadly, the best way to address our long-term fiscal challenges is through spending cuts and tax increases that have the smallest effect on welfare (where welfare depends not just on efficiency but also on distributional considerations). The wider the set of instruments examined, the better the choices are likely to be, and thus expanding the set of choices from benefit cuts and payroll taxes may lead to better outcomes.

Broadening the financing of Social Security to include general revenues might also prove beneficial if the Trustees projections prove too pessimistic. The cordoning off of Social Security in the budget makes it more likely that the political response to unexpectedly large trust fund balances would be to raise Social Security benefits or cut payroll taxes. There would likely be better uses of the funds, so a system that included some revenue financing might end up with a better allocation of taxes and spending. The legislation allowing general revenue funding to make up any imbalances in Social Security would prevent this misallocation, because if the imbalances proved smaller than expected, general revenue financing would be less than expected.

Arguments Against Using General Revenues

There are several valid arguments against using general revenues to fund OASDI. First, allowing the use of general revenues also allows the program to be funded with debt, at least in the near term, sticking the bill with future generations and raising intergenerational equity issues.

Whether this is desirable depends on one's views on the optimal path of debt.

Second, and relatedly, the prospect of using general revenue financing would relieve political pressure to address long-run fiscal problems. The financing crises created by the Trust Fund add a degree of urgency to reform efforts. Moreover, as the Trustees Report notes, acting now to change benefits and/or taxes spreads costs across more generations, which is more efficient from a tax-smoothing perspective and arguably more fair from an intergenerational perspective.

Third, some argue that the use of general revenue financing would jeopardize political support for the program, because it would be harder to argue that beneficiaries have already "paid" for their benefits. However, public discourse does not focus on this in the context of Medicare Part B, which is financed by general revenues. Furthermore, the link between wages and benefits would remain under general revenue financing, meaning it would likely still appear that beneficiaries "paid" for their benefits.

But general revenue financing, and in particular, explicit deficit financing, might make the program more vulnerable to cuts. It could be argued that such cuts could push toward means testing, potentially unraveling some public support for the program. However, this must be weighed against the prospect of substantial cuts in benefits as we approach financing crises under the current system of payroll tax financing.

V. Conclusion

From an efficiency and equity standpoint, general revenue financing has pros and cons. However, given the quandaries policymakers realistically face, we argue that in the coming years, reforms to address shortfalls in the OASDI Trust Fund are likely to focus increasingly on general revenue financing. Not only are tax increases or benefit cuts unattractive to eliminate projected intermediate-case shortfalls, the feasible choices are even starker if we must build a sufficient buffer stock to insulate against uncertainty in the future path of OASDI Trust Fund actuarial balances.

We therefore believe that now would be an opportune time for policymakers to begin considering plans for general revenue financing. This will give policymakers time to design such plans in the most effective way possible, as they drift closer to the precipice of a financing crisis.

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