Congressional Budget Office
Nonpartisan Analysis for the U.S. Congress

ANSWERS TO QUESTIONS FOR THE RECORD

Following a Hearing on

Social Security's Finances

Conducted by the Subcommittee on Social Security
Committee on Ways and Means
U.S. House of Representatives

JULY 10 | 2024

On June 4, 2024, the Subcommittee on Social Security of the House Committee on Ways and Means convened a hearing at which Phillip L. Swagel, the Director of the Congressional Budget Office, testified about Social Security's finances.[1] *After the hearing, Chairman Ferguson and Congressman Feenstra submitted questions for the record. This document provides CBO's answers. It is available at* www.cbo.gov/publication/60478.

Chairman Ferguson's Question About the Growth of Inflation-Adjusted Social Security Benefits

Question. You state in your written testimony that "initial annual Social Security benefits—that is, the real (inflation-adjusted) benefits that people receive in the first full year that they claim them—grow over time in a scheduled-benefits scenario because real earnings are expected to continue to rise." Could you describe what this increase has looked like across income levels? How does the growth in initial annual benefits affect average lifetime benefits across income levels?

Answer. Under a scheduled-benefits scenario (in which Social Security continues to pay benefits as scheduled under current law regardless of the status of the program's trust funds), average initial scheduled benefits for retired workers increase over time, even with the effects of inflation removed, for people across the income distribution.[2] For example, for both the quintile (one-fifth) of households with the highest lifetime earnings and the quintile with the lowest lifetime earnings, initial benefits are larger, on average, for retired workers born in the 1990s than for retired workers born in earlier decades (see Figure 1). Measured in 2024 dollars, average initial annual benefits for retired workers in households with the highest lifetime earnings rise from $28,880 for those born in the 1950s to $43,660 for those born in the 1990s, an increase of 51 percent. For retired workers in households with the lowest lifetime earnings, average initial annual benefits increase by 57 percent—from $10,980 for people born in the 1950s to $17,250 for those born in the 1990s.

That increase in initial benefits for retired workers contributes to an increase over time in average lifetime benefits for people in all earnings quintiles. Other factors, such as longer life expectancy, also contribute to the rise in average lifetime benefits.

Congressman Feenstra's Question About the Effects of a Payroll Tax Increase on the Economy

Question. Director Swagel, you state in your testimony that "trust fund balances would be sufficient to pay scheduled benefits through 2098 if payroll tax rates were increased immediately and permanently by about 4.4 percentage points (before the effects of such changes on the economy are accounted for)." How would an immediate and permanent payroll tax rate increase of 35 percent harm the economy?

Answer. Raising the payroll tax rate for Social Security by 4.4 percentage points would increase that tax from 12.4 percent of earnings to 16.8 percent, a rise of 35 percent.[3] An immediate and permanent increase of that size would cause the economy to grow more slowly than CBO now projects. The tax increase would slow economic growth by decreasing the supply of labor; to a lesser extent, it would boost growth by increasing private investment.

The reduction in economic growth because of the decrease in the supply of labor would be the net result of two countervailing factors. Most earners would see an increase in the marginal tax rate on their earnings (the percentage of an additional dollar of earnings that they pay in taxes). On the one hand, those workers would have an incentive to work fewer hours because other uses of their time would become relatively more attractive. On the other hand, they would also have an incentive to work more hours because having less after-tax income would require additional work to maintain the same standard of living. CBO estimates that, on balance, the

1. Testimony of Phillip L. Swagel, Director, Congressional Budget Office, before the Subcommittee on Social Security of the House Committee on Ways and Means, *Social Security's Finances* (June 4, 2024), www.cbo.gov/publication/60281.

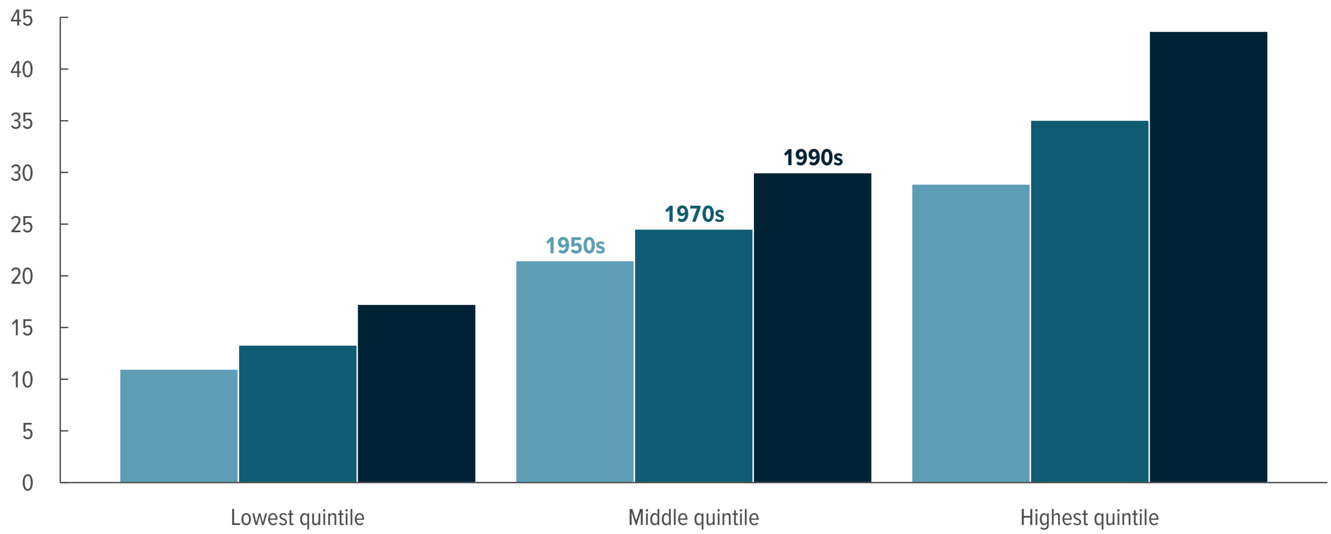
2. Section 257 of the Deficit Control Act requires CBO to project spending for certain programs, including Medicare and Social Security, under the assumption that they will be fully funded—and thus able to make all scheduled payments—even if the trust funds associated with those programs do not have enough resources to make full payments. See sec. 257(b)(1) of the Balanced Budget and Emergency Deficit Control Act of 1985, Public Law 99-177 (codified at 2 U.S.C. § 907(b)(1)).

3. The payroll tax rate for Social Security is generally 12.4 percent of earnings up to a maximum annual amount ($168,600 in 2024). Workers and their employers each pay half; self-employed people pay the entire amount.

Figure 1.

Average Initial Annual Benefits for Retired Workers Under the Scheduled-Benefits Scenario, by Earnings Quintile and Birth Cohort

Thousands of 2024 dollars



Data source: Congressional Budget Office. See www.cbo.gov/publication/60281#data.

A quintile contains one-fifth of households ranked by lifetime household earnings. Under the scheduled-benefits scenario, Social Security pays benefits as scheduled under current law regardless of the status of the program's trust funds.

second effect would be smaller than the first and that people would, on average, reduce the number of hours they worked, thus slowing economic growth compared with the growth CBO currently projects.

At the same time, a higher payroll tax rate would increase the federal government's revenues, thus reducing the budget deficit from the amounts in CBO's baseline projections. In CBO's assessment, the resulting decrease in government borrowing would increase the amount of resources available for private investment, which in turn would boost economic growth. That increase in growth would be smaller than the reduction in growth resulting from the decrease in the supply of labor.

Raising the payroll tax rate would have other effects on the economy. For instance, it would create an incentive for employers and employees to change their mix of compensation, shifting from taxable compensation, such as wages and salaries, to nontaxable compensation, such as employment-based health insurance.

Congressman Feenstra's Question About How Additional Spending for Social Security Would Affect the Economy

Question. The CBO projects that if Social Security paid benefits as scheduled, outlays for the program would equal 5.2 percent of GDP in 2024 and 6.7 percent at the end of the long-term, 75-year window. How would further increasing costs relative to current law affect the economy?

Answer. The economic effects of additional federal spending for Social Security (compared with the amounts in CBO's baseline projections) would depend on the size and distribution of the benefit increase that caused the additional spending and on the way the spending increase was financed.[4] A large increase in spending would have both short-term and long-term

4. For a discussion of the budgetary and economic effects of decreasing Social Security benefits, see Congressional Budget Office, *The Long-Term Budget Outlook Under Alternative Scenarios for the Economy and the Budget* (July 2023), www.cbo.gov/publication/59233.

effects on the economy and would significantly increase budget deficits and federal debt held by the public. A small increase in spending would have more modest effects.

In the short term, a large and sudden increase in Social Security payments would boost the overall demand for goods and services; increase consumer spending; and decrease the amount people would save for retirement, on average. As a result, economic growth would accelerate, and the economy would be larger than CBO currently projects for several years after the increase in Social Security spending. The decrease in retirement savings and other factors would put upward pressure on interest rates. In addition, depending on economic conditions at the time of the spending increase, the Federal Reserve might raise interest rates to offset inflationary pressures in an effort to achieve its long-term goal of 2 percent inflation.

In the long run, however, economic output would be smaller than CBO currently projects, for three main reasons. First, the supply of labor would shrink. Second, private investment would decline as some people chose to save less while they were working because of expectations about how larger Social Security benefits would affect their income and spending in retirement. Third, private investment would decline further because of larger budget deficits and an associated increase in federal borrowing, which would raise interest rates and reduce economic output compared with interest rates and output in CBO's current projections.

The economic effects would differ for people depending on their wealth and employment status. Social Security beneficiaries with little or no wealth would immediately increase their spending. Most beneficiaries with wealth would also increase their spending, but by a smaller percentage than the percentage increase in spending for those with little or no wealth. A sudden, large increase in benefits would also cause changes in employment. Some workers would choose to work fewer hours and would perhaps choose to receive Social Security benefits sooner because of their reduced need for earnings and savings.

In addition, lifetime spending would increase for most people, on average, and lifetime hours worked would decline. Compared with income levels in CBO's projections, those changes would be larger for people with lower lifetime income than for people with higher lifetime income. Changes in lifetime spending would stem not only from the direct effects of an increase in Social Security benefits but also from macroeconomic effects that would reduce wages in the long run. On average, lower wages and fewer hours worked would partially offset the direct effect of increased benefits on people's lifetime spending.

The increase in Social Security benefits and the associated effects on the economy in the long run would generally increase income and wealth for generations born earlier and decrease income and wealth for generations born later. In particular, later generations would experience the associated reduction in economic output for a longer time than earlier generations would.

The economic effects of an increase in spending for Social Security would also depend partly on whether the increase was financed through higher taxes, reductions in other spending, additional federal borrowing, or some combination of those approaches.[5]

5. For a discussion of how the means of financing an increase in government spending affects the economy, see Jaeger Nelson and Kerk Phillips, *The Economic Effects of Financing a Large and Permanent Increase in Government Spending*, Working Paper 2021-03 (Congressional Budget Office, March 2021), www.cbo.gov/publication/57021.