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Obama's Debt-Ceiling Scare Tactics

The Social Security 'coffers' are very far from running dry.

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Last week President Obama made an alarming statement to the nation's senior citizens. He told CBS Evening News anchor Scott Pelley he couldn't guarantee that $20 billion in Social Security checks will go out on Aug. 3, the day after the government would go into default if it doesn't raise the debt ceiling. "[T]here may simply not be the money in the coffers to do it," Mr. Obama said.

This statement completely overlooks the existence of the Social Security Trust Fund. Moreover, government redemption of the bonds in that trust fund does not breach the debt ceiling.

That doesn't mean that we don't have a problem. Failure to raise the debt limit by the end of this month will result in the government having to live within its means. That means the current level of expenditures would need to fall by about 25% immediately, or an amount that came to $60 billion in May alone.

But let us imagine the unimaginable: No agreement is reached, and the federal government must cut a quarter of its expenditures. Where will the reductions hit? Will we stop servicing the national debt? Not paying the interest due on the debt would result in significant punishment from international financial markets, making the future cost of servicing the debt much greater.

Since such a move is highly unlikely, the cuts must come from domestic government programs. An across-the-board cut of 25% in all government programs would do the trick but would wreak havoc on Medicaid and Medicare. Alternatively, restoring appropriations to 2001 levels would also suffice.

But what about Social Security? Here are the facts. Social Security revenues come from a 12.4% payroll tax, capped at $106,800, which is split evenly between employers and employees.

In 1983, reforms were adopted that changed the system's tax-rate schedules and imposed an income tax on the Social Security benefits of higher-income individuals. As a result, every year from 1984 through 2009 Social Security revenues exceeded payments to beneficiaries.

President Obama recently stated that he can't guarantee retirees will receive their Social Security checks in August if the House and Senate can not reach an agreement on reducing the deficit.

Congress spent these surpluses, and the U.S. Treasury issued the Social Security Trust Fund special bonds, which can be redeemed whenever the Social Security system has a current account deficit. In 2010, the Social Security system ran its first current account deficit since 1983, and for the first time since the reforms the deficit was covered by redeeming Trust Fund bonds.

By law the Treasury is bound to redeem any bonds presented to it by the Social Security Administration. And when the Treasury does, total government debt subject to the debt limit falls by the amount of the redemption—thus freeing up the Treasury's ability to issue new bonds equal in amount to the redeemed Trust Fund bonds.

Therefore, meeting Social Security obligations in August, September and all future months in this fashion would add nothing to the gross government debt subject to the debt limit. Not, at least, until the $2.4 trillion Trust Fund is exhausted in 2038.

If issuing Social Security checks does nothing to immediately affect the debt limit, how is it possible that Social Security would be at the top of the expenditure cut list?

The reason is simple and stems from the constitutional question that arose from a federal program in which all citizens were required to participate. In Helvering v. Davis (1937), the Supreme Court upheld Social Security's constitutionality because "The proceeds of both [employee and employer] taxes are to be paid into the Treasury like internal-revenue taxes generally, and are not earmarked in any way."

As a result, the federal government can apply the revenues collected from Social Security payroll taxes, and the income taxes collected on benefits collected from higher-income individuals, to any government liability.

So, when the president says that thanks to the debt ceiling "there may simply not be the money in the coffers" to send out the $20 billion in August Social Security checks, he either does not understand the way the system works, or the administration intends to spend the money on something else.

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