

BRIEF ANALYSIS

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Facts about Social Security

By Matt Moore

Social Security reform has emerged as one of the defining issues of the 2000 election. Proposals to “save” Social Security have fueled an onslaught of criticism and praise of the current system — some accurate, some in the neighborhood and some not even close. A number of myths and half-truths about Social Security have clouded the dialogue.

Fact #1: The System Is in Trouble. Social Security is structured as a pay-as-you-go system. That means today’s workers pay the benefits for today’s retirees. And when today’s workers retire, they will depend on future workers to pay their benefits. However, due to longer life expectancies and falling birthrates, the number of people working and paying taxes has been falling relative to the number cashing benefit checks.

In 1940, there were 42 workers per retiree; today there are three. By 2040 there will be only two [see Figure I]. This means higher taxes for future workers. Social Security’s revenues will fall short of outlays by \$7 billion (in present value terms) in 2015, ballooning to a deficit of more than \$300 billion in 2039 [see Figure II]. According to Social Security’s own trustees, by 2039 Social Security will be able to pay only 72 percent of promised benefits, requiring either benefit cuts of almost a third or a 50 percent tax hike on future workers.

Fact #2: The Social Security Trust Fund Cannot Pay Benefits. Social Security is based on pay-as-you-go financing. Every dollar collected by the payroll tax is immediately spent — either on current benefits or on other programs. No money is invested in real assets. Nothing is saved.

Most countries with pay-as-you-go retirement systems don’t have trust funds. The United States does have one, but it only exists to perform a record-keeping function. Every Social Security benefit check is written on the U.S. Treasury. Every payroll check sent to Washington is sent to the U.S. Treasury. The trust fund does not actually collect taxes, nor does it pay benefits.

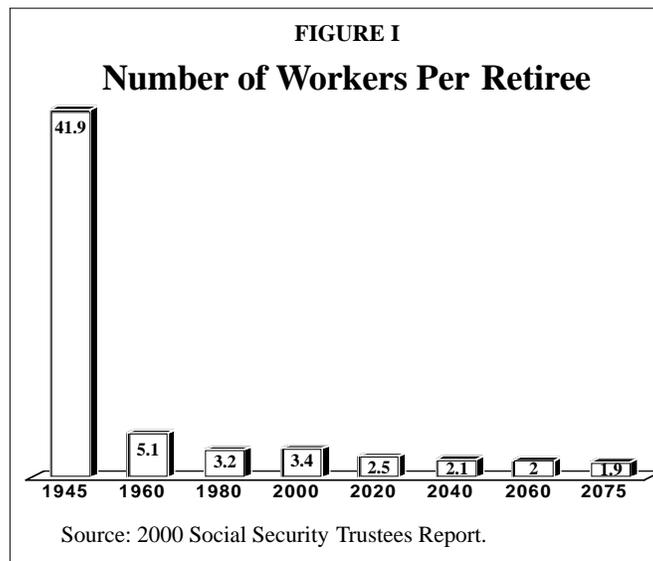
Technically, it holds interest-bearing bonds that represent the accounting surplus of payroll taxes collected minus benefits paid. But those bonds are not counted as part of the government’s outstanding debt. The Social Security trustees cannot sell the bonds on Wall Street or to a foreign investor — they can only be returned to the Treasury. In this sense, the bonds are nothing more than IOUs the government has written to itself.

Every asset of the trust fund is a liability of the Treasury. Summing accounts over both government agencies, the balance is zero. The only way the Treasury can write a check is if it first collects taxes or borrows money.

If the trust fund was simply abolished, no private bondholders would suffer,

and the government would not be relieved of any of its existing obligations or commitments. The late economist Robert Eisner suggested that we abolish the trust fund, or double or triple the number of IOUs it holds. Either option would allow us to get on to the real problem: how is the Treasury going to pay the government’s bills?

Fact #3: Benefits Are Not Guaranteed. Exactly what rights to Social Security benefits does a worker have? In two major cases, *Helvering v. Davis* (1937) and *Flemming v. Nestor* (1960), the Supreme Court ruled that individuals have no legal claim to Social Security in the way, say, they have a claim to their private pensions or to their 401(k)s.



As a result, Congress can reduce Social Security benefits at any time. Indeed, it already has by raising the retirement age (leading to fewer benefit checks) and imposing a special tax on benefits. Workers have no projected right in Social Security benefits simply because they have paid Social Security taxes.

Fact #4: Social Security Is a Poor Investment. A worker's rate of return is based on the amount of money paid into the system, the worker's monthly benefit and life expectancy. Since Social Security is skewed to help those with lower incomes, people with higher wages tend to get a lower return than those with lower wages. However, some of this progressive tilt is offset because lower-wage workers generally have shorter life expectancies (and receive fewer benefits) and longer working lives (and pay taxes longer). A person who starts his working life immediately after high school and works from age 18 to age 67 will pay into the system for 49 years; however, Social Security only credits individuals for their 35 highest earning years. Extra taxes paid by those who begin working early do not earn additional benefits.

In general, workers born before World War II paid significantly less in taxes than they will receive in benefits – and can expect a higher rate of return than subsequent generations. By contrast, baby boomers can expect a rate of return of less than 2 percent, and Generation Xers can expect less than 1 percent. Children born today can expect a rate of return from Social Security of almost zero, assuming that the program can pay full promised benefits.

Fact #5: Reform Works. Social Security's pay-as-you-go structure is ill-equipped to deal with the demo-

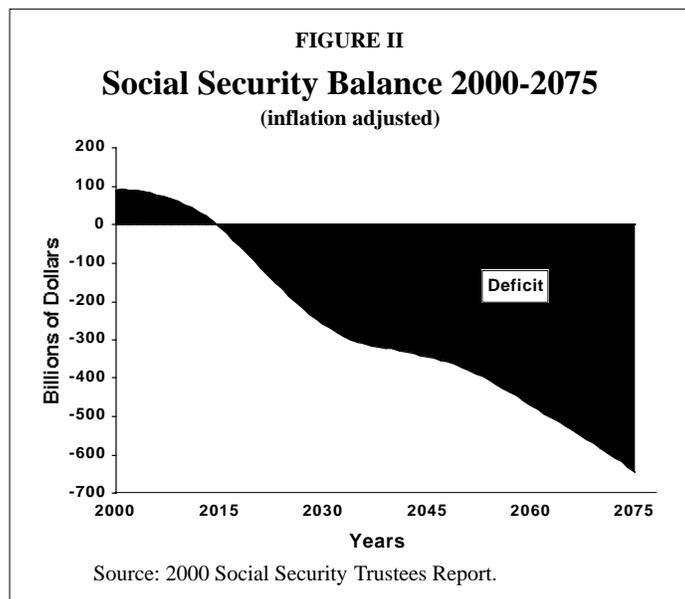
graphic trends that have emerged in developed nations around the world. Longer life expectancies and shrinking birthrates, coupled with the retirement of the baby boomers, make the system's long-term solvency impossible without oppressive tax increases on future workers or benefit cuts on future retirees. A system that divorces us from the pay-as-you-go system, such as one with personal retirement accounts, could provide future retirees with a benefit that could provide them choice, control and security in their retirement, while protecting the government's long-term solvency.

Moreover, we know a retirement system based on personal accounts will work. Before 1983, federal law allowed state and local government officials to opt out of Social Security. More than five million government employees remain outside the system today. In 1981 employees of Galveston, Brazoria and Matagorda counties in Texas set up a private pension alternative to Social Security. Even though the cost of the pri-

vate alternative to the employee and employer are virtually the same as Social Security, the benefits are much greater. In addition, privatized systems are operated in a number of countries, including Singapore, Australia and a number of Latin American and South American countries.

Conclusion. Social Security is a complex issue. The rhetoric often makes it difficult for the average interested citizen to understand or get involved in the issue. For help in dispelling the fog and the myths about Social Security and Social Security reform, you can visit the NCPA's Web site at <http://www.mysocialsecurity.com>.

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