Common Sense on Social Security

As politicians and pundits debate what to do about the exploding federal deficit, the Social Security Trust Fund will be an easy target. Dire predictions about the future of the fund will create pressures to reduce Social Security benefits. In fact Social Security currrently has a $2.6 trillion surplus, has not contributed at all to the federal debt, and minor corrections will be enough to keep the fund solvent indefinitely. Let's not be confused by the hype!

Note: The decision to reduce 2010 FICA taxes in order to stimulate the economy considerably alters some of the calculations below, especially if the cuts are continued indefinitely, as -- given political realities -- they probably will. This will radically reduce the long-term viabililty of Social Security.

The struggle over Social Security begins again! In advance of the full report of the president's bipartisan National Commission on Fiscal Responsibility, scheduled for release on December 1, 2010, co-chairs of the commission—former Wyoming Senator Alan Simpson and former chief of staff for Bill Clinton, Erskine Bowles—have released their own proposals for controlling the US government deficit. Their proposal correctly includes recommendations for controlling the coming explosion in Medicare and Medicaid, which will render the federal deficit uncontrollable.

But to the extent that their proposal implies that the Social Security program is partially responsible for the US deficit, they reinforce a widespread misunderstanding of the program. In fact, Social Security is a separate program that has from its inception completely paid for itself, still has $2.6 trillion in assets for future expenditures, and will not run out of money until about 2037 … even if Congress does nothing. It has played no role in causing the US deficit. Lumping Social Security in with Medicare and Medicaid—as most "experts" involved in the discussion do—obscures the reality and may lead to the crippling of the most important source of our financial security as we age.

A Brief History of Social Security

During the height of the Great Depression and at the urging of President Franklin D Roosevelt, Congress created Social Security to protect the elderly from the worst ravages of poverty. [1]   Roosevelt's vision was as simple as it was profound: All the elderly must be protected from the ravages of poverty and ensured enough income for a reasonable standard of living. Due to political opposition to welfare programs and increases in the budget, however, Roosevelt sold the program as a retirement investment program that would not add to the federal budget. As we shall see, this has led to perpetual confusion, since although the Social Security program does not add to the budget, it is not a pension fund at all but an income transfer program from one generation to another.

Initially, the tax rate on gross wages was 1% each for employees and employers; the current rate is 6.2% of payroll each for employees and employers. Maximum earnings subject to social the security tax are now $106,800 (indexed to inflation), meaning that all wages over that amount and all other income (eg investment income) are not taxed. Maximum monthly benefits are now over $2,300.

Much of the confusion around Social Security comes from a misunderstanding of the “trust fund” created so that any surplus would be placed in a designated fund to be managed by the US Treasury. In 1983, funds in the trust were almost depleted, so Congress—recognizing the demands that the baby-boomer generation would place on the system when they began to retire in 2006—significantly increased the rate of the payroll tax to its current level so that contributions coming in would far exceed benefits paid out and the assets of the trust fund would be prepared for the boomers. The trust fund has now accumulated $2.6 trillion in assets (and still growing).

The Current Debate: Is Social Security Running Out of Money?

Whether one believes that Social Security is in imminent danger of “running out of money” depends primarily upon one’s understanding of the trust fund. Administered by the US Treasury, the fund’s $2.6 trillion has been invested in US Treasury bonds—essentially loaned to the government that has folded it into its regular budget. Like all other securities, these bonds are promises by the seller (in this case the US government) to repay the investment, plus interest. And as with all other such investments, the actual money is being used elsewhere: there is no stash of $2.6 trillion sitting around someplace waiting to be distributed.

Those who maintain that Social Security is “running out of money” view these bonds as promises of the government to the government and, therefore, as meaningless pieces of paper. Then-president GW Bush, for instance, said in 2005, Some in our country think that Social Security is a trust fund—in other words, there's a pile of money being accumulated. That's just simply not true. The money—payroll taxes going into the Social Security are spent. They're spent on benefits and they're spent on government programs. There is no trust. [2]

Such a view, however, depends on repudiating the US government's commitment to repay its loans. All bonds issued by the Treasury—whether to a private buyer or the Social Security trust fund—are backed by the full power of the government. Under federal law the US Treasury has the obligation to repay its debt to the Social Security trust fund. In other words, it's not that the Social Security trust fund that's broke; the issue is whether the US government is so broke that it repudiates its legal debts.

If one views the US Treasury bonds as worthless pieces of paper, then, yes, Social Security is running out of money. If the government repudiates its debts to the Social Security funds that workers have paid into the fund for the past 75 years, then, yes, Social Security is running out of money. But if we take the US government at its word and consider the trust fund a legal obligation, then, no, Social Security, with $2.6 trillion in assets, is far from running out of money.

Since the government has already spent the $2.6 trillion the government debt to Social Security is related to the federal deficit. It's not surprising that so many in Congress want to raid the fund: As Willie Sutton famously answered when asked why he robbed banks, "That's where the money is!"

Is Social Security an Investment Retirement Program?

The other significant argument against the program is that, since the source of Social Security benefits is the contributions of current workers, the program is inherently unfair to the young who must support the old. This argument depends upon interpreting Social Security as a retirement investment program that is using high premiums on current workers for payments to previous "investors," essentially an elaborate Ponzi scheme. But President Roosevelt's political argument to the contrary, Social Security is not, and never has been, a retirement investment program. Rather it has always been "social insurance," meaning that current taxes on everyone are used to pay benefits to the elderly and some others who can't work.

Why isn't the Social Security program like a pension fund?

- An actual pension investment fund takes premiums in, invests those, and—*on the basis of prior premiums contributed*—pays benefits to those who have paid in. Any such retirement program must always have enough money invested so that it could pay off allfuture benefits it's committed to pay even if it stopped taking in premiums today. In accountant-speak there should be no "unfunded liability." But Social Security has always had an "unfunded liability." It has always depended upon current contributions to make current payments. If one were to consider it an investment insurance program, its current unfunded liability would be $5.3 trillion. [3] So the program has never been even close to being an investment retirement program.

- Due to overhead in a straightforward insurance program, beneficiaries' benefits must be less than their contributions (plus interest). In the first decades of the Social Security program, however, those already working paid less by the time of their retirement than later workers would … sometimes far more. The first monthly check of $22.54, for instance, was issued in 1940 to Ida May Fuller, who had been paying into the program for only three months (contributing a total of $24.75). She lived to be 100 and collected $22,888.92 in benefits. Clearly, this has not been an insurance program in the usual sense.
- In an insurance plan, one's benefits are proportional to one's contributions. But Social Security was designed in part to be an anti-poverty income redistribution program, paying proportionately more to low-income workers than to high-income workers. As an anti-poverty program, it has been highly effective. Without Social Security almost half of the elderly would live below the poverty line rather than the current figure of 8%, the lowest of any age group.

So What's the Problem?

Due to the current recession, Social Security is for the first time (fiscal year 2010) paying out more in benefits than it receives in contributions. Official projections by both the Social Security Administration (SSA) and the Congressional Budget Office (CBO) expect contributions to again exceed benefits by 2014 and remain positive until 2017, after which time it will again reverse and payment will exceed contributions.

These calculations, however, consider only the *contributions* coming into the system and ignore the interest the US Treasury bonds pay into the trust fund. Again according to both SSA and CBO, *total* income now exceeds payments, and will continue to exceed payments until 2025. Even if Congress does nothing, the trust fund will not be depleted until 2037. Of course, financial predictions that far into the future depend upon several unpredictable variables, primarily the American economy (the better the economy, the more contributions) and immigration (the more young immigrants, the more contributions).

So there is a real problem in Social Security. If we continue the program just as it is, the trust fund will probably be depleted in about 25 years. If we wait until then to take corrective action, much painful approaches will be necessary. But if we make relatively minor adjustments now, Social Security can continue as essentially the same program it is. Yes, action should be taken now, but there is no “immediate crisis” as many critics suggest.

Securing Social Security

Increasingly, over the last several years, young people have been bombarded with messages that Social Security is on life-support and—despite their regular FICA [4] payments—there will be nothing left when they are old enough to retire. Social Security is broke beyond repair and will not be available when they retire, so why should they be taxedto support the elderly? Given the propaganda, it’s a wonder the program still has the overwhelming public support it does.

But ensuring the long-term health of Social Security program would not be difficult. As these things go, it’s a straightforward issue.

First, it’s important to recognize that the primary problem with Social Security funding is that wages for all but the richest have stagnated over the past thirty years. When Social Security was adjusted in 1983, Congress took into account the coming baby-boomer bulge but incorrectly assumed rising wages with rising productivity, in which case no adjustments would be necessary now. So, one possibility would be policies to restore this balance between the groups benefitting from rises in productivity. Such balance could be achieved by raising taxes on the wealthy to a level similar to what they were fifty or even thirty years ago … which could, of course, solve Social Security problem immediately.

Raising the limits on the income subject to the FICA tax is one such approach. FICA is a regressive tax, requiring a higher percentage of wages from lower-income workers than from the more affluent. Surprising some liberal, Simpson and Bowles suggested just that: raising the limit on income subject to payroll tax from the current $106,800 to $190,000. There is no reason, of course, that any wages should be exempt from this tax, so removing the limit altogether would make more sense.

Of course, the wealthiest among us do not receive most of their income from wages but from return on investments. Not only is this income taxed at a lower rate than wages, it's also not subject to FICA taxes at all. (Currently lower- and middle-income workers pay FICA taxes at a rate more than 27,000 times greater than the hedge fund managers who recently made $3 billion in a year.) The fairest approach, then, would be to require the FICA tax on all income. The Social Security trust fund would be overwhelmed by surplus indefinitely.

Such a proposal "raises taxes," however, making it extremely unlikely to be accepted by even the full commission, much less Congress. Much more likely to be accepted are Simpson and Bowles's recommendations to cut benefits by raising the age of retirement from the current 66 [5] to 69 and the age of early retirement from 62 to 64. These provisions, however, are not to go into effect until so far in the future that they probably won't affect the 2037 deadline. It should be noted that such a rise in the retirement age would cut overall benefits by nearly 50% from what they would have been under the original retirement age of 65.

We must be especially careful about one frequently mentioned proposal that is included in Simpson and Bowles's report: reducing or eliminating payments to wealthy retirees. On the face of it, such action seems to make sense. But it's a dangerous proposal.

As mentioned above, social insurance programs like Social Security provide benefits to everyone regardless of income and are, therefore, highly popular in any culture even among the relatively wealthy. At the same time, however, most social insurance programs are also anti-poverty programs because—proportionate to income—they preferentially benefit the poor.

Other benefit programs—such as Food Stamps, Temporary Assistance to Needy Families (TANF), Section 8 housing vouchers, Medicaid and others—are "public assistance" programs, meant only for those below a certain income. These programs' pay-outs are naturally lower than similar social insurance programs that provide benefits to everyone. But precisely because public assistance programs are exclusively for lower-income groups, support for them is far weaker than for social insurance programs. That support tends to divide along partisan lines, often becoming a political football. Politicians find it effective to rail against “give-away programs” for the poor and support is also weak among those working-class people who make too much to qualify for the program but see their taxes supporting the “less deserving.”

Moreover, while social insurance benefits tend to rise with inflation, public assistance benefits tend to be cut over the years because of political maneuvering. While social insurance programs are generally easy to apply for and receive benefits from, public assistance programs become difficult-to-traverse bureaucratic mazes as more and more program time, energy, and money are spent making sure that no one is getting benefits who shouldn’t. While social insurance programs are almost immune to the political winds, public assistance programs are always in danger.

Attractive and painless as it seems, reducing Social Security benefits for the wealthy will gradually move the program in the direction of a public assistance program, making it more likely that benefits will be further reduced. Although appearing quite reasonable, the proposal to cut benefits to the wealthy would be the beginning of the end of Social Security.

How About Medicare?

Unlike Social Security, Medicare poses a true financial threat to the fiscal health of our country. The US currently spends twice as much per capita on health care as most other industrialized countries (about 17% of our entire GDP), and costs rise every year. Our population is ageing and health care costs per person over sixty-five are over three times as much as for working-aged people and over five times as much as for children.

The Medicare program itself, however, is not the problem. It is, in fact, the most efficient part of the US health care system with an administrative overhead of 5.6% in 2008 (compared to 13.3% for private insurers. Rather, the overall costs of medical care in the United States are the problem. Without reforms in the entire medical care system, Medicare (and Medicaid) will be expenses that the government budget will not be able to accommodate. (Nor, even in the absence of Medicare, will the society in general be able to afford the private insurance premiums needed to finance its health care expenses?) For political reasons, however, our country is unlikely to do much about rising health care costs until absolutely forced to … which in all probability is not far off.

Future Directions

Lumping Social Security's minimal threat and Medicare's real threat to the US government's financial viability is ultimately a political tactic of obfuscation. Even Bowles and Simpson's recommendations make it clear that their proposed changes in Social Security will not affect the budget deficit. Social Security is not in any immediate crisis. This concern over the financial implications of the program is only the latest attempt to recast the debate to weaken and eventually eliminate the program.

Roosevelt's vision was both brilliant and momentous: provide a modicum of financial security for all whose work life is past and finance it by a tax on those currently working. It has been stunningly successful, reducing elderly poverty to the lowest of any age cohort in our country. Our vision for the future must include both parts of Roosevelt's vision. Social Security is a vital program; two-thirds of the elderly receive more than half of their income from Social Security. Asking the wealthier members of our society to contribute in the same measure as everyone else would ensure that Social Security remains a public good for future generations rather than a privatized pension plan that will leave the elderly poor.

The debate over the future of Social Security will greatly intensify over the next months, and will usually be linked menacingly to the budget deficit. There will be much talk about needing to lower benefits and raise the retirement age, especially with a more Republican Congress. One of our responses must be to inject some truth about the program into the debate, to shine some light on what the danger is and is not. We must recognize the fear mongering for what it is, know what is at stake, remember that a drastic overhaul is not necessary, and suggest the straightforward steps to maintain Roosevelt's original vision.