Social Security:

A Program Worthy of Reform

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Our Generation is a membership-based nonprofit, nonpartisan advocacy organization founded in 2009 to research, educate and promote long-term free market solutions to today's public policy concerns.

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Background

Social Security is an entitlement program funded by tax dollars placed in a trust fund. An individual qualifies to receive benefits when a particular age is reached or because of other eligibility requirements. This New-Deal era program was signed into law by President Franklin D. Roosevelt as the Social Security Act on August 14, 1935 and has changed periodically since it began.[1] Taxes to fund the program were collected for the first time in January 1937 and one-time, lump-sum payments were made in January 1937. In January 1940, the program changed to provide for an annuity type of disbursement with regular ongoing monthly benefits.[2]

A poll by the American Association of Retired Persons (AARP) found that the Social Security program is the principal source of income for 50% of all older Americans.

Initially, the program only paid benefits to the primary worker, defined as a person who had a significant work history. However, by 1939, only four years after the law's enactment, Congress broadened the legislation to provide survivors' benefits for a retiree's spouse and children. In 1956, Congress broadened the law further to include disability benefits.[3]

Today, a growing number of Americans rely on the Social Security program as an income source when they reach an age where they can no longer work. In fact, an Our Generation poll of retired Americans found that more than one third rely on Social Security as their sole source of income.[4] Other studies indicate an even greater dependence on this government safety net. For example, the American Association of Retired Persons (AARP) found that Social Security is the principal source of income for half of all older Americans.[5] Keeping the Social Security program healthy and solvent is important for the retirement security of seniors and Congress should institute measures to ensure that this program can be depended on.

Many people lack an adequate understanding of how this vital program is funded. As a result, most think it is more solvent that it really is. Financial security for Social Security is needed, which includes real cash in the Trust Fund and transparency in how it is currently managed.This report by **Our Generation** demonstrates the inadequacies of the current funding system and proposes policy reforms that will strengthen the program.

Trust Fund Fallacy

Payroll taxes are the sole funders of the Social Security program. Employers and their employees pay a wage tax of 12.4 percent (6.2 percent divided equally)[6] up to an annual wage maximum of $118,100 in 2015.[7] This amount is collected and paid into the taxing jurisdiction by the employers after which it is deposited into one of two trust funds managed by the Department of Treasury: the Old-Age and Survivors Insurance trust fund created in 1937 and the Social Security Disability Insurance (SSDI) trust fund created in 1957. According to the Department of the Treasury website, these trust funds contain trillions of dollars; however, independent research like one conducted by the Foundation for Economic Education, tells a different story. These trust funds are nothing more than treasury accounts that lack the formalities of a true trust account.[8] To understand the value of the trust funds, it is necessary to first understand how the respective trust fund balances are calculated.

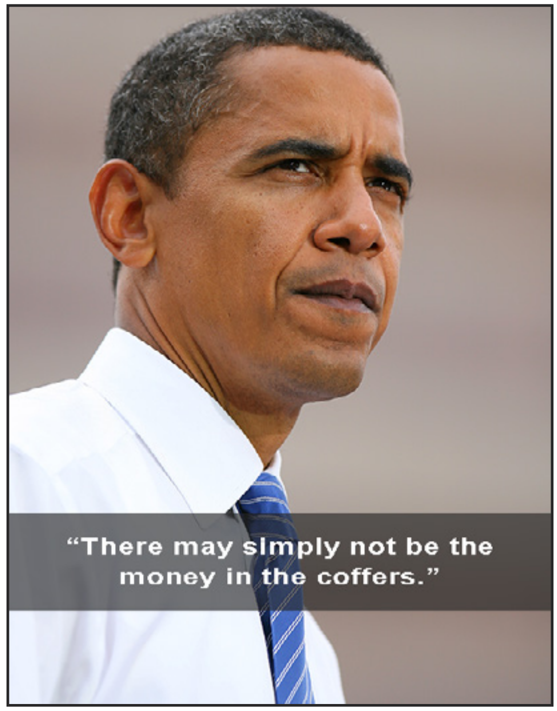
When government bureaucrats talk about the "trillions" in the trust fund, they are referring to the balance of unredeemed, non-marketable U.S. government debt securities, not unspent cash.

In 2011, Rep. Kevin Brady (R-TX), then-Chair of the Joint Economic Committee in the House of Representatives, issued a report revealing that the trust fund neither receives payments from taxpayers nor makes payments to beneficiaries.[9] Rather, the fund is an accounting device used to record transactions made on behalf of Social Security by the government.[10] The report went on to explain that the federal government records these transactions by increasing or decreasing the balance in the trust fund. The balance is federal debt, or more precisely, special issue non-marketable U.S. government debt securities. When payroll taxes exceed benefits, Social Security is said to "invest" its surplus in these securities and the balance goes up. Conversely, when benefits exceed payroll taxes, Social Security is said to "redeem" its investments in these securities to cover the deficit and the balance goes down.[11] When government bureaucrats talk about the "trillions" in the trust fund, they are referring to the balance of unredeemed, non-marketable U.S. government debt securities, not unspent cash. This method of accounting is not transparent and most taxpayers and beneficiaries have no idea what the real value of the trust fund is. The trust fund has a positive balance in the trillions, but the government continues to run an annual budget deficit and has to borrow funds from other government programs to finance the government. **This is because the trust fund is simply billions of dollars worth of IOUs.[12]**

The United States credit rating is not what it used to be and will continue to get worse as our national debt exceeds more than 100 percent of the Gross Domestic Product (GDP). In 2008, the debt to GDP ratio was about 65 percent; by 2013, the debt to GDP ratio reached more than 100 percent.[13]

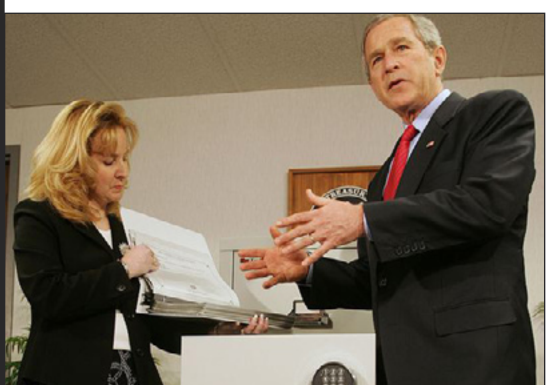
U.S. Treasury bonds have historically been the world's safest investment, allowing the government to borrow money at inexpensive rates.[14] These cheap rates also enabled the government to finance its operations, including entitlements like Social Security. However, in 2011, the S&P credit rating agency downgraded the United States' credit rating for the first time in history, the complete effect of which remains to be seen.[15] Now U.S. government debt has the potential to move from a safe inves-

-tment to a risky one. The government should not be allowed to borrow against money that is earmarked for a specific purpose, like the Social Security program, or the funds used to pay for Social Security benefits should be segregated from the rest of government debt. It is in taxpayers' best interest for U.S. Treasury bonds to remain a safe bet. What would happen if countries stopped buying U.S. debt? Would Social Security continue to pay out benefits? While is has not yet happened, it is not beyond the realm of possibility if countries no longer flock to U.S. debt as a safe bet.



No Real Money

The way the Department of Treasury manages the trust fund suggests that there is actual money in the trust fund. In fact, most American's believe there is an actual trust fund with money in it. Instead, there are IOUs to be paid with United States national debt or current taxes.[16] Where is the money going? To pay for politicians pet projects, like the National Cowgirl Hall of Fame and Museum in Fort Worth, Texas. The trust fund money is simply a fallacy; as soon as money comes into the trust fund it is spent on other government programs.



President George W. Bush visits the Office of Federal Debt and Accounting (Photo: Luke Frazza, AFP/Getty Images)

Politicians even admit that there is no real money in the Social Security trust fund. In 2005, President George W. Bush visited the Office of Federal Debt and Accounting, a federal government facility, and was shown a file cabinet of trust fund IOUs.[17] Upon seeing the file cabinet then President Bust told an AP reporter that, "A lot of people in America think there is a trust — that we take your money in payroll taxes and then we hold it for you and then when you retire, we give it back to you, ... But that's not the way it works ... [t]here is no trust 'fund' - just IOUs that I saw firsthand."

The last time the government shut down, President Obama was asked if Social Security checks and other government payments would go out on time. Barack Obama told CBS's Scott Pelley, "I cannot guarantee that those checks go out on August 3rd if we haven't resolved this issue. Because there may simply not be the money in the coffers to do it."[18] If there was a trust fund with a stockpile of reserves it would be no question that there was enough money to pay beneficiaries their $60 billion per month.[19] IOUs are not as safe as real cash or Treasury Bills, and beneficiaries would be better served if the Social Security Trust Fund contained money and not IOUs.

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Solvency Is a Myth

Many policymakers argue that even if Social Security spends more out of the trust fund than it collects through payroll taxes, the program will be solvent until 2033.[20] A new study debunks this myth. The Trustees' Report to Congress about the Social Security and Medicare programs reveals that the respective trust fund balances will grow until 2019, but program costs are projected to exceed income in 2020. If no action is taken to make the trust fund more solvent, the trust funds will be depleted by 2033. By 2033, the Social Security Administration (SSA) will only have money to cover around three-quarters of the benefits responsibilities.

Unless action is taken there will not be enough money 20 years from now to pay full benefits to retirees.

When the trust funds no longer have a balance, the news gets even worse after; at that time only tax revenue will be left to fund the program. Currently, U.S. demographics are moving toward more Social Security beneficiaries than there are workers to pay taxes. Social Security trust funds will only be able to cover three quarters of scheduled Social Security benefits through 2088.[21]

Social Security is in worse shape than many thought and both Harvard University and Dartmouth College have published research that corroborates this fact. In looking at the SSA's actuarial forecasts, the researchers found that SSA forecasts have been consistently overstating the financial health of the program's trust funds since 2000. One of the study author's, Gary King, explained to CNBC, "[Social Security] is going to be insolvent before everyone thinks."[22] Samir Soneji and Harvard doctoral candidate Konstantin Kashin went on to note, "Trustees Reports after 2000 all overestimated the assets in the program and overestimated solvency of the Trust Funds."[23]

Congressional Action

Entitlement programs such as Social Security and Medicare are often described as the "third rail" of politics, meaning politicians are often weary of cutting funding for fear of losing votes at the ballot box. However, in 1983, Congress found a way to make the program more solvent; they raised the retirement age. Traditionally, the full benefit age was 65 and early retirement benefits were first available at age 62 with a permanent reduction to 80 percent of the full benefit amount. Currently, the age that one begins receiving full benefits is 66 for people born in 1943-1954, and gradually rises to 67 for those born in 1960 or later.[24] However, unless action is taken there will not be enough money 20 years from now to pay full benefits to retirees. Politicians need to realize that the current program is broken and needs to be reformed otherwise retirees are put in a dire state of financial insecurity.

6 Proposals for Reform

Social Security beneficiaries need Social Security reform proposals that will not increase the retirement age, decrease benefits or increase taxes. The reforms outlined below if enacted could pave the way to more reforms in the future by making the program more solvent and transparent, two criticisms the current program faces.

1. Lock the Trust Fund.

Payroll taxes should be collected and only used to fund Social Security and administrative costs. Currently, this money is put into a so-called trust fund (which is really a slush fund) in order to create and sustain wasteful government projects. For example, it was Social Security dollars that financed the National Cowgirl Hall of Fame and Museum in Fort Worth, Texas. Social Security funds were also used to pay for the development of exhibits for the World Food Prize at the State Historical Society of Iowa in Des Moines.[25] Legislation like "The Social Security Lock Box," would go a long way to ensure that payments to Social Security are actually used to fund Social Security.[26] This legislation would reform the program by putting retirement savings into a fund that no one could access, and do what most of the voting public thinks is already done with their payroll tax money.

2. Replace IOUs With Cash.

For the last 30 years, Congress has raided the Social Security trust fund to the tune of $2.6 trillion. That's $2.6 trillion that fails to make it into the hands of our nation's retired workers, but instead feathers the nests of politicians. In addition, the total unfunded liabilities of the United States government exceeds any reasonable ability to pay. Beneficiaries need financial security and transparency for Social Security, The Trust Fund should be funded with real cash and not pledges to pay. Legislation like H.R. 219 introduced in the 112th Congress is needed to ensure that the trust fund is not an accounting gimmick and that the coffers are refilled after decades of raids by greedy politicians. H.R. 219 is needed to change the law so instead of IOUs, the Social Security Trust Fund would hold real money.

3. Trust Fund Debt Should be Counted as Part of National Debt.

Most Americans have a very hazy picture about the relative fiscal health of the Social Security program. In an effort to educate the public and increase transparency, Social Security reform legislation should include a section that states that any IOUs in the Social Security Trust Fund should be counted as part of the national debt. As Dr. Charles Krauthammer explained in the Washington Post, "In 2012, Social Security adds $165 billion to the deficit. Democrats pretend that Social Security is covered through 2033 by its trust fund. Except that the trust fund is a fiction, a mere 'bookkeeping' device, as the Office of Management and Budget itself has written. The trust fund's IOUs 'do not consist of real economic assets that can be drawn down in the future to fund benefits.' Future benefits 'will have to be financed by raising taxes, borrowing from the public, or reducing benefits or other expenditures.'[27] By keeping an accurate count of the programs debts this would do more to educate the American public about what is really in the Social Security Trust Fund.

4. Return Money Taken From the Trust Fund.

Legislation is also needed to shore up the solvency of the program by replacing money that has been taken from the trust fund. Congress needs to pass legislation that would replace the IOUs in the trust fund with real assets at a rate of 1 percent or 2 percent of the IOUs every year. At this rate the shock to the U.S. budget and financial system would not be too great. If this money was returned then this would go a long way to ensure the future payment of benefits to senior citizens who paid into the system receive their benefits. If no action is taken to preserve Social Security, then in the coming decades benefits could be cut by as much at 23 percent.[28]

5. Make Sure Social Security is Paid First.

In the event that the debt limit is reached, Social Security payments would be given priority when it comes to government expenditures.

6. Reform Social Security Disability Insurance.

The Social Security Disability Insurance (SSDI) program is taking an ever and ever larger slice of all Social Security spending.[29] In the 1950s, SSDI provided benefits only for permanently disabled workers over the age of 50 with a substantial work history. Today the criteria to qualify for benefits has expanded immensely and threatens puts even more pressure on federally financed entitlement programs. Skyrocketing SSDI spending represents the fastest-rising cost for Social Security and not the retiring Baby Boomers. Since 1991disability rolls have doubled and as well as spending on Disability Insurance since 2000.[30]

Federal policymakers and especially Congress need to look at ways to reform the program, which is slated to be insolvent in two years. In 1970, the Disability Insurance program could be financed with a payroll tax rate of only 0.8 percent of wages; today, the cost of SSDI has tripled relative to the 1970 level. Disability benefits now make up 18 percent of all Social Security costs, up from only 10 percent in 1990.[31] Part of the solution to rising SSDI costs is to tighten eligibility requirements to focus resources on the most disabled individuals, coupled with incentives to employers to keep disabled individuals working.

Conclusion

Social Security is a program worth saving. It is a program that retired Americans and seniors have come to rely on, and one they paid into over a long working history. Politicians would be wise to reform the Social Security program in meaningful ways, which include: reining in Social Security Disability Insurance, locking off the trust fund, replacing IOUs with real cash and increasing transparency.

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