NEED TO KNOW

AMERICANS FOR PROSPERITY FOUNDATION

SOCIAL SECURITY
PART I: THE PATH TO INSOLVENCY

Social Security was created in 1935 to provide a floor of income for seniors, survivors, and the disabled. It has two parts. We usually think first of the Old Age and Survivors Insurance (OASI) program, which provides monthly checks to seniors in retirement. There is also the Social Security Disability Insurance (SSDI) program, which provides supplemental income to people who are restricted in their abilityto work, usually by a physical disability. Social Security is the single largest expenditure in the federal budget, costing over $800 billion in Fiscal year 2013 (1).

Social Security is funded primarily with payroll taxes, the Federal Insurance Contributions Act (FICA) taxes coming out of every worker's paycheck. The current rate is 12.4%, with 6.2% paid by the employer and 6.2 percent paid by the employee. Collected FICA taxes from current worker's pay for the benefits of current retirees and disabled individuals - any leftovers are put into the OASDI Trust Fund.

QUICK FACTS

- Over 54 million Americans receive some form of Social Security benefits
- Social Security by itself accounts for over 20 percent of the entire federal budget.

NOTABLE & QUOTABLE

"Unless we act, these immense demographic changes will bring the Social Security program to its knees. Without action, the benefits currently pledged under Social Security are a promise we cannot keep."

-The President's National Commission on Fiscal Responsibility and Reform

SOCIAL SECURITY'S FINANCIAL PROBLEMS

The program faces severe fincancial pressures, largely driven by changing demographics. People are living longer and therefore accepting benefits for more years. When the program was created, life expectancy was just over 70 years. Today it is 78 (2). There are also more people collecting benefits: the first wave of "baby boomers" has now reached retirement age. Finally, there are more people to support retirees today. Fifty years ago there were 16 workers paying into the program for every retiree taking out benefits. Now there are three. Soon there will be only two. Given these demographic pressures, it's no surprise that the system needs an overhaul.

Insolvency is not as far off in the future as some would suggest. In the past, payroll tax revenues were more sufficient to over benefit payments, and the OASDI Trust Fund accumulated over $2 trillion in assets over the years.

However, in 2013 Social Security will actually pay out more in benefits than it will receive in payroll tax revenues. Interest payments on the Trust Fund's assets will be high enough to prevent the program from losing money this year, but given the demographics outlined above, we know these shortfalls will only get worse in the coming years. According to the program's official actuaries, starting in 2023 the program will be losing money annually and drawing down the Trust Fund. In 2036 it will be out of money completely (3).

THE TRUST FUND IS MERELY CREATIVE GOVERNMENT ACCOUNTING

A closer look at the OASDI Trust Fund reveals that Social Security's insolvency happens not in 2036, but right here today. This is all because, by law, the Fund must invest all surpluses directly into special- issue Treasury bonds. Congress can then take the cash generated by the bonds and spend it on anything they please, which they have taken the liberty to do, spending every penny of surplus. The cash is gone, replaced with IOUs representing an interest in future government funds. Today the Trust Fund is filled with $2.6 trillion of these special bonds, and it is all money that the government owes to itself. What's worse, the Supreme Court has already ruled that individuals have no property rights to the future payments (4).

In other words, government can just ignore these future obligations. In truth, they don't even really exist.

Once we adjust for the fact that the government is merely paying interest to itself, a $70 billion annual Social Security surplus turns into a $50 billion shortfall.

The interest paid on the $2.6 trillion of special issue bonds in the Trust Fund comes from the Treasury General Fund revenues - the big pot of money we all fill every year with our income, corporate, and investment taxes. The government is paying interest to itself on money it owes itself in order to claim a Trust Fund surplus. General revenues are also responsible for making up for the shortfall due to this year's two percent payroll tax cut. Once we adjust for the fact that government is merely

paying interest to itself, a $59 billion Social Security surplus turns into a $50 billion shortfall (see table above). If this makes your head spin, don't worry; it's because it doesn't make sense. Only with accounting tricks and gimmicks can politicians claim that Social Security is fully funded.

SOCIAL SECURITY IS A BAD DEAL FOR WORKERS

In its current form, Social Security is a really bad deal for workers. Not only is every penny of payroll taxes spent on current beneficiaries or Congress's pet projects. But even if we treat Social Security like a typical pension fund (which it's not), the returns on workers' lifetime payroll tax investments are very low. Except for those with very low income, a typical worker's Social Security contributions will come back with returns of just 2 and 3 percent in retirement (5), far lower than long-run returns on the stock market of 6 to 7 percent (6).The deal gets worse for younger people - their returns will only be about 1.5 percent.

CONCLUSION

Social Security is badly broken. Creative government accounting is hiding the fact that the program is already sapping taxpayers' hard-earned dollars from the economy, on top of the payroll taxes we already pay. A massive demographic shift will severely stress the program's balance sheet in the coming years, but increasing payroll taxes, cutting benefits, or pursuing some combination of the two will only make a bad deal for workers even worse. Without reform, Treasury will have to transfer massive amounts of general revenues to pay for benefits promised to the disabled and the retirees. Taxes will increase or other parts of the budget will have to be sacrificed.

Over 63 million American receive some form of Social Security benefits.

Social Security by itself accounts for over 22 percent of the entire federal budget

Endnotes

1. OFFICE OF MANAGEMENT AND BUDGET, Historical Tables of the United States Budget, Table 3.2: Outlays by Function and Subfunction (February 2011) (online at http://www.whitehouse.gov/omb/budget/Historicals).
2. Elizabeth Arias, DIVISION OF VITAL STATISTICS, National Vital Statistics Reports: United States Life Tables, 2007, Centers for Disease Control and Prevention, at 48 (September 28, 2011) (online at http://www.cdc.gov/nchs/data/nvsr/nvsr59/nvsr59_09.pdf).
3. OASDI BOARD OF TRUSTEES, The 2011 Annual Report of the Board of Trustees (May 13, 2011) (online at http://www.ssa.gov/oact/tr/2011/tr2011.pdf).
4. Fleming v. Nester, 363 U.S. 603 (1960).
5. Orlo Nichols et. al, Internal Real Rates of Return Under the OASDI Program for Hypothetical Workers, SOCIAL SECURiTY ADMINISTRATION, Actuarial Note No. 2008.5 (April 2009) (online at http://www.ssa.gov/oact/NOTES/ran5/an2008-5.pdf).
6. Jeff Sommer, Head for the Hills? No Way He Says, NEW YORK TIMES (July 17, 2010) (online at http://www.nytimes.com/2010/07/18/business/18stra.html?_r=1&src=busln).

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