The Social Security Trust Fund Revisited

A central goal of the 1983 Greenspan Commission on Social Security reform was to pre-fund scheduled benefits for future retirees (especially the baby boom generation) while adjusting for the rising life expectancy of beneficiaries. In other words the intent was to set up a reserve (or trust fund) for anticipated payouts just as every ordinary pension fund is required to do. To that end, payroll taxes were increased so that each year Social Security revenues would exceed outlays and the surplus cash could be set aside to fund future benefits.

Meanwhile Congress stipulated that Social Security's annual surplus could only be held in cash or U.S. Treasury bonds. Thus one sensible option would have been for the Trust Fund to buy publicly traded U.S. Treasury bonds and to fund future retiree benefits by raising cash from these securities as the need arose. In addition to investing in corporate bonds and common stocks, this is what ordinary pension funds (both public and private) normally do.

But Congress came up with a different plan. Since the federal budget was running perennial deficits why not use the Social Security surplus to fund them? In other words just treat the annual surplus as if it were general tax revenue and use it to pay for everything from Congressional pork to space exploration. And that, alas, is what has been happening for the past 27 years. Indeed, this slight of hand has been perfected to such a degree that the federal budget deficit reported to the public is routinely reduced by the amount of the payroll tax surplus that Congress has seized to pay for it

For accounting purposes, this transfer of cash from the Trust Fund to the Federal budget is handled as a loan with the Trust Fund receiving "special issue Treasury bonds" in exchange. Meanwhile, the annual payroll tax surpluses are rapidly dwindling and will be a thing of the past in only five years. At that point, Social Security payroll taxes will be unable to fully cover retiree benefits and the government will have to tap into Trust Fund assets. Since the Treasury Department lacks the cash for redeeming these securities, income taxes will have to be raised or the shortfall (effectively a deficit) will have to be financed by selling bonds to China, Japan, the DuPont pension fund, etc. In other words, because of these maneuvers, taxpayers are going to have to pay twice to fund Social Security benefits for countless retirees.

Meanwhile, it is worth noting that Social Security's benefits are indexed to real growth in the economy and in constant dollars will steadily rise by more than 62% through 2050 and by 140% in 2085. Thus, future benefits will provide substantially more purchasing power than today's beneficiaries receive even if payroll taxes are projected to cover only 75% of scheduled benefits beyond 2037 when the Trust Fund's "special issue" assets will have been exhausted. To maintain the same level of purchasing power for retirees relative to the overall economy, however, will require a significant boost in Social Security's revenue stream.

To lay concerns about the Social Security Trust Fund's viability to rest, consider the following "Q and A" posted online by the Social Security Administration:

> **Q**. Why do some people describe the "special issue" securities held by the trust funds as worthless IOUs? What is SSA's reaction to this criticism?
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> **A.** Money flowing into the trust funds is invested in U. S. Government securities. Because the government spends this borrowed cash, some people see the current increase in the trust fund assets as an accumulation of securities that the government will be unable to make good on in the future. Far from being "worthless IOUs," the investments held by the trust funds are backed by the full faith and credit of the U. S. Government. The government has always repaid Social Security, with interest. The special-issue securities are, therefore, just as safe as U.S. Savings Bonds or other financial instruments of the Federal government.

Clearly the above answer misses the point about why some observers claim the Trust Fund's special issue Treasury bonds are akin to worthless IOU's. Indeed, no serious observer expects the government will fail to meet the Trust Fund's obligation to pay retiree benefits through 2037. *Rather, the core issue is where will the money come from*?

For example, consider the following statement that appeared in the 2009 Social Security Trustees Report: "Neither the redemption of trust fund bonds, nor interest paid on those bonds, provides any new net income to the Treasury, which must finance redemptions and interest payments through some combination of increased taxation, reductions in other government spending, or additional borrowing from the public." Thus, unlike every other pension fund that invests in "third party" securities that can be sold in the capital market to pay retirees, Social Security has no such assets. The Trust Fund's securities consist of IOU's payable by one Federal entity to another Federal entity. And the only resource for such purposes is government's power to tax the public or issue interest bearing debt on its behalf.

As indicated above, deficit spending is the root cause of most of these problems. Thus, confronted with a deficit, Congress refused to cut expenditures or raise taxes. Instead it took possession of "excess" payroll taxes, (intended to pre-fund retiree benefits) and spent them on current operations. By temporarily borrowing billions of dollars from Social Security, Congress has managed to delay the day of reckoning for its spendthrift ways and transferred the task of finding (or funding) a solution to future generations.

In conclusion, as a pay as you go system Social Security entails a massive exercise in cost shifting. Thus, current taxpayers expect future taxpayers to pay their retirement benefits just as they have done for their own parents. In addition, for more than 25 years workers have paid excess payroll taxes (a.k.a. the Trust Fund) so they would pose less of a burden on their children. But by seizing the payroll tax surplus to cover budget deficits, Congress has overturned this compact and temporarily avoided the embarrassment of raising taxes or issuing more interest bearing debt to foreign nations.

Conveniently, this also has the effect of making the federal deficit look smaller by the amount of the surplus and spares Congress from additional pressure to cut spending.

As Abraham Lincoln wryly observed: You can fool some of the people all of the time, and all of the people some of the time, but you can not fool all of the people all of the time.

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