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THE SOCIAL SECURITY TRUST FUND FRAUD

DANIEL J. MITCHELL

Defenders of the current Social Security system claim that huge future deficits in the program are not a cause for concern because money in the Social Security Trust Fund can be used to finance all promised benefits until 2032. Moreover, because President Clinton has proposed that a significant share of projected budget surpluses be diverted to the Trust Fund, supporters argue that this move would allow benefits to be fully financed through 2049.

The implication is that Social Security can continue for another 50 years without a tax increase. Therefore, argue supporters of the status quo, there is no need for fundamental reform, such as privatization.

Yet these assertions are based on a gross misrepresentation. The Social Security Trust Fund is a deception. It contains no genuine assets, only government bonds—IOUs that have no value beyond a promise to impose higher taxes on future workers. Even the Clinton Administration admits that the Trust Fund is fraudulent, stating in its proposed budget for fiscal year 2000 that:

> These [Trust Fund] balances are available to finance future benefit payments and other trust fund expenditures—but *only in a bookkeeping sense*. These funds are not set up to be pension funds, like the funds of private pension plans. *They do not consist of real economic assets* that can be drawn down in the future to fund benefits. Instead, *they are claims on the Treasury*, that, when redeemed, *will have to be financed by raising taxes*, borrowing from the public, or reducing benefits or other expenditures. The existence of large trust fund balances, therefore, does not, by itself, make it easier for the government to pay benefits. [Emphasis added.]

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Other government agencies and officials acknowledge that the bonds held by the Social Security Trust Fund are meaningless. The Congressional Research Service (CRS) notes that "Simply put, the trust funds do not reflect an independent store of money for the program or the government...."

What, then, is the purpose of the Trust Fund? According to the Congressional Budget Office, "Trust Funds have no particular economic significance; they function primarily as accounting mechanisms to track receipts and spending for programs that have specific taxes or other revenues earmarked for their use."

The bonds have no independent value because, as the CRS notes, "When the government issues a bond to one of its own accounts, it hasn't purchased anything or established a claim against another entity or person. It is simply creating a form of IOU from one of its accounts to another."

The Comptroller General of the United States recently testified to this effect: "[An] increase in assets to the SSTF [Social Security Trust Fund] is an equal increase in claims on the Treasury. One government fund is lending to another. These net out on the government's books."

An actuary from the Social Security Administration admitted that the Trust Fund is a fiction, writing in 1990 that "in the more relevant area of actually obtaining cash to pay promised benefits in the future, the trust funds accomplish nothing…."

In reality, the Trust Fund's holdings simply measure that one part of the government—the Treasury—owes money to another part of the government—the Social Security Trust Fund. Indeed, the best possible interpretation of the Trust Fund is that the IOUs are a measure of how much in taxes will have to be raised in the future.

A group of government actuaries acknowledged this fact, writing that "we are not accumulating a true trust fund and are instead merely accumulating a right to future government revenues."

As the U.S. General Accounting Office (GAO) explains, "While the Trust Funds' Treasury Securities [bonds] are assets of the Social Security program, they are also liabilities for the rest of the federal government that, when redeemed, will have to be financed by raising taxes, borrowing from the public, or reducing other federal expenditures."

It should also be obvious that the interest "paid" to the Trust Fund is equally meaningless. It is true that the bonds in the Trust Fund receive interest, but that interest income takes the form of additional IOUs. In other words, the original IOUs result in more IOUs. The CRS refers to the supposed interest payments as "paper income."

The GAO concurs:

> The interest credited to the trust fund…is an internal transaction of the government. One part of the government (the Treasury) credits the interest to another part (the trust fund), so the two transactions offset one another and have no budgetary effect.

The President's plan is a disappointing diversion, an accounting gimmick instead of real reform. As the Comptroller General recently testified, "Without the President's proposal, payroll tax receipts will fall short of benefit payments in 2013; *with* the President's proposal, payroll tax receipts also fall short of benefit payments in 2013."

Privatization is the only way to solve Social Security's financial woes while also increasing retirement income for today's workers. The concept of individual accounts has bipartisan support in Congress. Moreover, about two dozen nations around the world have shown that private retirement systems are feasible. As evidence mounts that the White House plan is phony, baby boomers can only hope that the Administration will abandon gimmicks and embrace real reform.

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Thanks largely to the upcoming retirement of the baby boom generation, Social Security benefit payments soon will exceed payroll tax revenues. Beginning in about a dozen years, these annual cash-flow deficits will begin to climb rapidly, soaring to $100 billion in 2015 and $500 billion in 2025. Defenders of the current system claim that these huge shortfalls are not a cause for concern because money in the Social Security Trust Fund can be used to finance all promised benefits until 2032.

President Bill Clinton, moreover, has proposed that a significant share of projected budget surpluses be diverted to the Trust Fund. Supporters argue that this move would allow benefits to be fully financed through 2049.[1] The implication, of course, is that Social Security can continue for another 50 years without a tax increase. Therefore, argue supporters of the status quo, there is no need for fundamental reform, such as privatization.

Yet these assertions are based on a gross misrepresentation. The Social Security Trust Fund is a deception. It contains no genuine assets, only government bonds—IOUs that have no value beyond a promise to impose higher taxes on future workers. Even the Clinton Administration admits that the Trust Fund is fraudulent, stating in its proposed budget for fiscal year 2000 that:

> These [Trust Fund] balances are available to finance future benefit payments and other trust fund expenditures—but *only in a bookkeeping sense*. These funds are not set up to be pension funds, like the funds of private pension plans. *They do not consist of real economic assets* that can be drawn down in the future to fund benefits. Instead, *they are claims on the Treasury*, that, when redeemed, *will have to be financed by raising taxes*, borrowing from

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1. The Administration also has proposed to let politicians invest a portion of the Trust Fund, a step officials claim will add another six years to the life of the Trust Fund and delay bankruptcy until 2055.

the public, or reducing benefits or other expenditures. The existence of large trust fund balances, therefore, does not, by itself, make it easier for the government to pay benefits.[2]

Yet even though the Administration admits that the Trust Fund is phony, it wants Americans to believe that adding more IOUs to the Fund will solve Social Security's problems. The system's problems are enormous. If Social Security were a private pension company, it would be forced to declare bankruptcy. Promised benefits exceed projected revenues over the next 75 years by an astounding $20 trillion—and that is after adjusting for inflation. The program also is a bad deal for workers. Promised retirement benefits are meager compared with the record level of payroll taxes that workers put into the system.

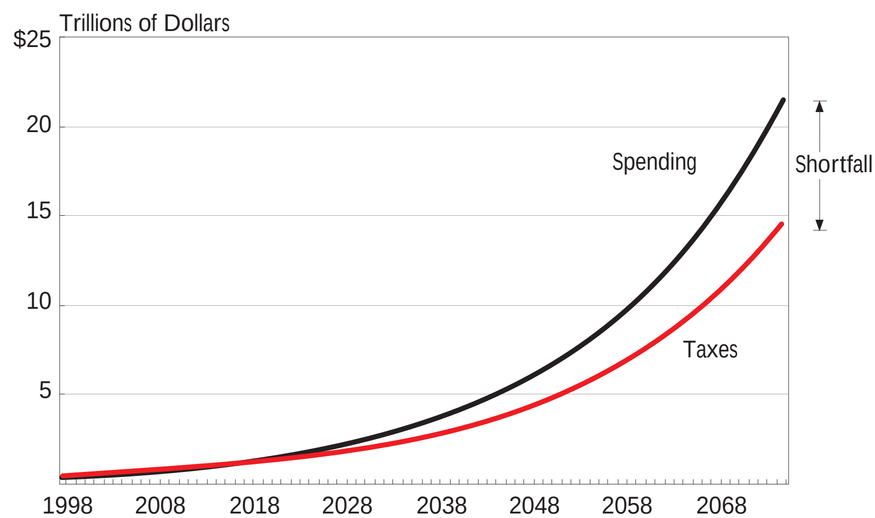
This is why the Administration's plan is so misguided. Social Security cannot be salvaged with budget gimmicks. If lawmakers want to ensure a safe and comfortable retirement income for today's workers, they should privatize the program. Allowing workers to divert a portion of their payroll taxes into personal retirement accounts would permit those workers to boost their old-age security while simultaneously reducing the government's long-term budget liabilities.

THE KEY QUESTION: DOES THE MONEY RUN OUT IN 2013 OR 2032?

Social Security receives the bulk of its revenue from the 12.4 percent payroll tax imposed on workers (see appendix). Income taxes imposed on the Social Security income of retirees also are counted as revenue for the program. Most of that money is paid out in benefits immediately.[3] Since the mid-1980s, however, revenues have exceeded outlays, and these annual cash surpluses are expected to continue until 2013.[4] After 2013, annual deficits will grow rapidly, reflecting the retirement of the baby boom generation.

Chart 1 B1256

Social Security's Dismal Long-Term Outlook



Source: *1997 Trustees' Report*, Social Security Administration.

2. Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2000,* Analytical Perspectives (Washington, D.C.: U.S. Government Printing Office, 1999), p. 337; emphasis added.
3. Monthly retirement checks represent the lion's share of program outlays, but Social Security also makes payments to the non-elderly. Survivors of deceased workers and disabled workers are two major examples.
4. The 2013 date assumes that the payroll taxes of federal government employees represent real resource flows. If these taxes were not counted—because the federal government does not actually pay the money but instead makes a bookkeeping entry—surpluses would end in 2009. For the purpose of this analysis, however, it is assumed that these monies are real.

Surplus Social Security revenues are collected by the Treasury and spent on other government programs.[5] In exchange, the Treasury issues an IOU to the Social Security Trust Fund. In theory, this IOU will earn interest until it is cashed in to help pay retirement benefits for the baby boom generation. These IOUs, combined with the taxes that are paid into the system every year, supposedly mean that the Trust Fund will be able to fully finance benefits through 2032.

But the IOUs are not real assets. Social Security will run short of money in 2013, if not before, and proposals to add more IOUs to the Trust Fund are nothing but hollow budget gimmicks.

Why the Trust Fund's IOUs Are Not Real Assets

The bonds held by the Social Security Trust Fund are meaningless. The Congressional Research Service (CRS) notes that "Simply put, the trust funds do not reflect an independent store of money for the program or the government...."[6] What, then, is the purpose of the Trust Fund? According to the Congressional Budget Office, "Trust Funds have no particular economic significance; they function primarily as accounting mechanisms to track receipts and spending for programs that have specific taxes or other revenues earmarked for their use."[7]

The bonds have no independent value because, as the CRS notes, "When the government issues a bond to one of its own accounts, it hasn't purchased anything or established a claim against another entity or person. It is simply creating a form of IOU from one of its accounts to another."[8] And just as an individual or a business cannot write an IOU to itself and count that as an asset (because the IOU is simultaneously a liability), neither can the government.

The Comptroller General of the United States recently testified to this effect: "[An] increase in assets to the SSTF [Social Security Trust Fund] is an equal increase in claims on the Treasury. One government fund is lending to another. These net out on the government's books."[9] An actuary from the Social Security Administration admitted that the Trust Fund is a fiction, writing in 1990 that "in the more relevant area of actually obtaining cash to pay promised benefits in the future, the trust funds accomplish nothing…."[10]

In reality, the Trust Fund's holdings simply measure that one part of the government—the Treasury—owes money to another part of the government—the Social Security Trust Fund. Indeed, the best possible interpretation of the Trust Fund is that the IOUs are a measure of how much taxes will have to be raised in the future. A group of government actuaries acknowledged this fact, writing that "we are not accumulating a true trust fund and are instead merely accumulating a right to future government revenues."[11]

5. Technically, all Social Security revenues are collected by Treasury. No money passes through the Social Security Administration or the Trust Fund. Instead, the Treasury Department merely credits and debits Social Security accounts.
6. David Koitz, "Social Security and the Federal Budget: What Does Social Security's Being Off-Budget Mean?" Congressional Research Service, May 5, 1998.
7. Congressional Budget Office, *The Economic and Budget Outlook, Fiscal Years 2000-2009*, January 1999, available on the Internet at *http://www.cbo.gov/showdoc.cfm?index=1059&sequence=3*.
8. Koitz, "Social Security and the Federal Budget."
9. David M. Walker, Comptroller General of the United States, "Social Security: What the President's Proposal Does and Does Not Do," testimony before the Committee on Finance, U.S. Senate, February 9, 1999.
10. Steven F. McKay, "Using Interest in the OASDI Summary Measure—An Opposing View," unpublished memorandum, February 6, 1990.
11. Richard S. Foster, Toni S. Hustead, and Steven F. McKay, "Measures of Actuarial Status of the OASDI System," memorandum for American Academy of Actuaries, March 30, 1988.

The preposterous nature of this arrangement is exposed when the time comes for the Trust Fund to redeem these IOUs. As the U.S. General Accounting Office (GAO) explains, "While the Trust Funds' Treasury Securities [bonds] are assets of the Social Security program, they are also liabilities for the rest of the federal government that, when redeemed, will have to be financed by raising taxes, borrowing from the public, or reducing other federal expenditures."[12]

The government actuaries mentioned above came to the same conclusion. They asked: "Where would the cash required to pay the principal and interest on the bonds come from?" Their answer: "The Treasury would have to (1) increase its borrowing from the private sector and from other countries to raise the cash necessary to fund the deficiency in the OASDI program, or (2) raise taxes."[13]

Mythical Interest Income

It should also be obvious that the interest "paid" to the Trust Fund is equally meaningless. It is true that the bonds in the Trust Fund receive interest, but that interest income takes the form of additional IOUs. In other words, the original IOUs result in more IOUs. The CRS refers to the supposed interest payments as "paper income."[14]

The GAO concurs: "The interest credited to the trust fund…is an internal transaction of the government. One part of the government (the Treasury) credits the interest to another part (the trust fund), so the two transactions offset one another and have no budgetary effect."[15]

Finally, recall the question that prompted this discussion: Do Social Security's deficits begin in 2013 or 2032? The Comptroller General answered that question recently, testifying that "Without the President's proposal, payroll tax receipts will fall

A FAMILY BUDGET USING SOCIAL SECURITY TRUST FUND ACCOUNTING

What if a family used the same financial practices as Social Security? Imagine that this family has a child and they want to save for the child's college education. Every year, they save $1,000, and this money is deposited in the bank. At the end of every year, however, the parents withdraw the money and go on a trip to the Bahamas. In exchange, they leave a piece of paper on their child's dresser that states, "We owe you $1,000."

At first glance, this seems like the best of all worlds: The parents get their vacation and the child has a growing pile of assets (indeed, the parents can even agree that the IOUs will grow over time to reflect supposed interest earnings).

But this house of cards will come tumbling down when the parents try to pay their 18-year-old child's college tuition with IOUs. The scrap of paper may have seemed like an asset to the child, but it was a liability to the parents. As a result, the only way to enroll their child in classes is for the family to earn more money, cut back on other expenditures, or borrow money.

None of these options, however, is made any easier by having a pile of IOUs on the dresser. Likewise, paying future Social Security benefits will require lawmakers to come up with money, regardless of how many IOUs are in a phony Trust Fund.

12. U.S. General Accounting Office, *Social Security: Different Approaches for Addressing Program Solvency*, GAO/HEHS–98–33, July 22, 1998.
13. Foster *et al*., "Measures of Actuarial Status of the OASDI System."
14. David Koitz, Gene Falk, and Philip Winters, "Trust Funds and the Federal Deficit," Congressional Research Service, February 26, 1990.
15. U.S. General Accounting Office, *Social Security Financing: Implications of Government Stock Investing for the Trust Fund, the Federal Budget, and the Economy*, GAO/AIMD/HEHS–98–74, April 1998.

short of benefit payments in 2013; *with* the President's proposal, payroll tax receipts also fall short of benefit payments in 2013."[16]

CLINTON'S FRAUDULENT GIMMICK

Since the Trust Fund is demonstrably meaningless, it should come as no surprise that a range of analysts have condemned the President's plan. Writing in *The New Republic*, syndicated columnist Matthew Miller stated that the Administration's plan is nothing more than "a phantom bookkeeping transfer each year from the rest of the budget to the trust fund."[17]

A particularly odd feature of the White House proposal is that the President is creating $2 of IOUs for every $1 of Social Security surplus that is spent on other government programs. The first IOU is created when extra Social Security revenues are "lent" to the Treasury. Then, when this extra money is used by the Treasury to reduce the national debt, the Trust Fund would get another set of bonds. As stated in *The Washington Post*, "the net effect would be that the program would get a second set of IOUs...."[18]

Other analysts have been equally critical. Reviewing the White House claim that its plan will delay the program's bankruptcy, the Associated Press reported, "The blunt answer is that it does so only on paper. The trust fund will now hold more Treasury bonds—the second set of IOUs. But they will be worth the same as the first set—nothing."[19] The Comptroller General agreed, testifying that "although the trust funds will appear to have more resources as a result of the proposal, in reality nothing about the program has changed."[20]

Ironically, this use of accounting gimmicks overshadows the fact that the Administration actually is advocating a policy—paying down the national debt—that has some merit. The President even acknowledged that this was the real policy, remarking that "we will, in effect, be buying back the national debt."[21] But as Matthew Miller has pointed out, "Clinton could have called for using the surpluses to pay down debt without the phony hike in the trust funds."[22]

CONCLUSION

According to the GAO, the proposal put forth by the Administration "does not represent a Social Security reform plan."[23] Privatization is the only way to solve Social Security's financial woes while also increasing retirement income for today's workers.

The concept of individual accounts has bipartisan support in Congress. Moreover, about two dozen nations around the world have shown that private retirement systems are feasible. As evidence mounts that White House plan is phony, baby boomers can only hope that the Administration will abandon gimmicks and embrace real reform.

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16. Walker, "Social Security: What the President's Proposal Does and Does Not Do."
17. Matthew Miller, "Slick: Saving Social Security with a Pencil," *The New Republic*, February 15, 1999.
18. George Hager and Amy Goldstein, "Criticism Mounts on Clinton's Rescue Plan for Social Security," *The Washington Post*, January 28, 1999.
19. Martin Crutsinger, "Answers About Social Security Plan," Associated Press, February 7, 1999.
20. Walker, "Social Security: What the President's Proposal Does and Does Not Do."
21. "Remarks by the President During Social Security Roundtable," The White House, Office of the Press Secretary, January 27, 1999.
22. Miller, "Slick: Saving Social Security with a Pencil."
23. Walker, "Social Security: What the President's Proposal Does and Does Not Do."

APPENDIX: SOCIAL SECURITY'S RISING TAX BURDEN

Payroll taxes have been one of the fastest-growing burdens on families over the past three decades. As the following charts illustrate, the rate has climbed steadily.

The payroll tax, however, is only part of the burden. As recently as 1971, Social Security taxes were applied only to the first $7,800 of income; today, they are applied to the first $72,600 in wages. By taxing more of a worker's income and at a higher rate, the payroll tax has become a bigger burden than the income tax for about 75 percent of U.S. workers.[24]

Because of this crippling burden, the consequences of trying to finance Social Security's deficit with higher taxes would be catastrophic. Just bringing the system into balance would require an increase of about 6 percentage points in payroll tax rates.[25]

Moreover, this estimate is based on a set of economic assumptions that may not be warranted. Based on the Social Security Administration's less optimistic assumptions, payroll tax rates would have to rise to 28 percent for promised benefits to be paid.[26]Although such tax increases might be sufficient to pay promised future benefits, the economy would suffer severe consequences. Total job losses could reach as high as 3.5 million even under the more favorable assumptions,[27]and fewer jobs would mean lower Social Security payroll tax collections, causing the actual tax burden to climb even higher.

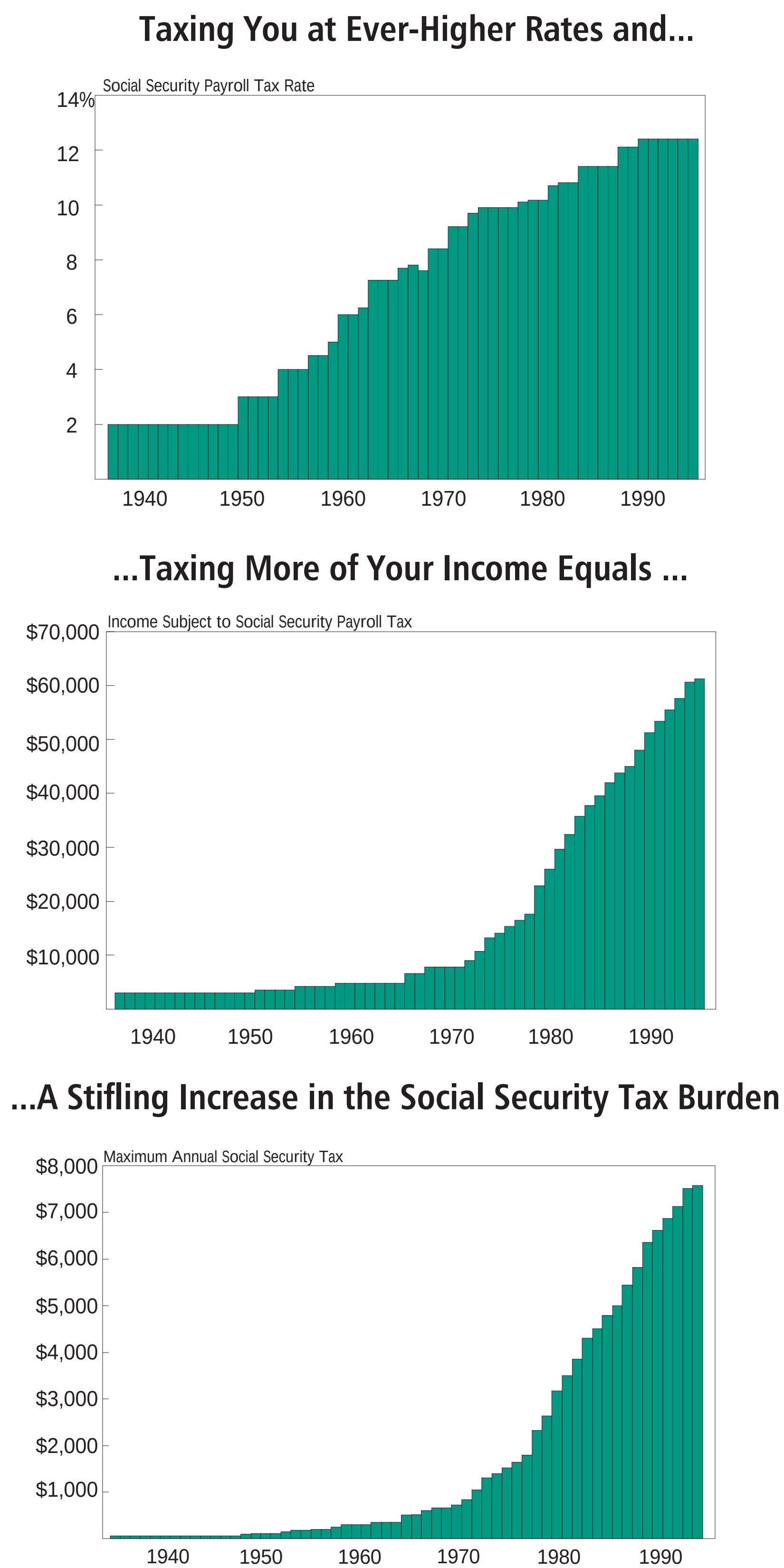
24. William G. Shipman, "Retiring with Dignity: Social Security vs. Private Markets," Cato Institute *SSP* No. 2, August 14, 1995.

25. Martin Feldstein, "The Missing Piece in Policy Analysis: Social Security Reform," *American Economic Review*, Vol. 86, No. 2 (May 1996).

26. Karl Borden, "Dismantling the Pyramid: The Why and How of Social Security Privatization," Cato Institute *SSP* No. 1, August 14, 1995.

27. Stephen J. Entin, "Private Savings vs. Social Security: Many Happier Returns," Institute for Research on the Economics of Taxation *Congressional Advisory* No. 55, September 4, 1996.

Chart 3 B1256



Source: Social Security Administration Board of Trustees Report, 1996.