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The Myth of 40 Percent Benefit Reductions Under Social Security Reform

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Social Security personal retirement accounts (PRAs) are the only way to ensure that younger workers can receive benefits in retirement that match the level they have been promised without levying a huge tax increase on working Americans. Yet opponents claim that diverting as little as 2 percent of an individual's 10.6 percent payroll tax into a PRA would lead to a 40 percent reduction in that worker's Social Security benefits. This is simply wrong.

PRAs can and should become an integral part of the Social Security system. Under this reform, the existing program would remain *Social Security Part A*, but a *Part B* would be added for PRAs. Both parts would be funded by the same payroll taxes that a worker pays today, not by new taxes. Most of the payroll taxes would go into Part A, and the rest would go to fund a PRA. Whereas today's benefits are completely paid through Part A, future retirees' retirement benefits would be paid through a combination of Part A and Part B. This system could comfortably provide at least the same monthly Social Security retirement benefits that workers are currently promised, or more. Congress could easily mandate that the sum of a worker's *Part A* and *Part B* benefits equal or exceed what is promised under current law. The threat of benefit reductions is based on myth, not reality.

False Charges and Faulty Math. For some time, opponents of PRAs have claimed that these accounts would lead to sharply lower Social Security benefits. An article in the June 25 issue of *Newsweek* by columnist Alan Sloan, for example, claims that if Congress wants to establish PRAs, "you need to cut future benefits about 40 percent from the current formula."

How do opponents of PRAs come up with this number? By combining Social Security's current-law deficit with the amount of taxes likely to be diverted into PRAs. They start by using the Social Security Administration's estimate that in 2035, the program will take in 27 percent less in payroll taxes than it will pay out in retirement and survivors' benefits. Since they claim that funding PRAs by diverting an amount equal to 2 percent of income would reduce the amount available for benefits by another 13 percent, they then add these two estimates to reach a projection of a 40 percent shortfall.

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They seem to assume that the money that goes into the PRAs would disappear, and that none of it would actually be available to pay Social Security benefits in the future. It is less than intellectually honest to subtract money that would go into PRAs from Social Security's would be financed by the PRAs in the future.

The Real Threat. Doing nothing is the real threat to younger workers' Social Security benefits. Without reforming the current system, younger workers will have to pay additional taxes totaling about $5 trillion (in current 2001 dollars, unadjusted for inflation) in order to retire the bonds in the Social Security trust fund. Sadly, unless Social Security is made more secure, they will have nothing to show for this massive investment. After taxpayers have spent trillions of dollars in additional taxes between 2016 and 2038 to repay the bonds, the Social Security trust fund will be exhausted. By law, Social Security cannot pay out more in benefits than it takes in through taxes. In 2039, Social Security will be required immediately to cut benefits by about 30 percent.

This is not an abstract problem. Today's workers who are 28 years of age or younger face the reality that Social Security will not be able to pay them their full promised benefits. For example, a single, low-income, African–American male is currently promised full monthly retirement benefits of $1,027 (in 2001 dollars) once he reaches the age of 66. He can retire with full benefits in 2039, but Social Security will have only enough tax revenue on hand that year to pay him $750 a month. The shortfall of $277 a month in promised benefits basically would be lost.

A retirement benefit of $1,027 is scarcely a princely sum, but it is far better than a retirement check of only $750 a month. Today, 40 million Americans—mainly those with lower incomes—retire depending on Social Security alone for their income. It is wrong to condemn these workers to a future with *lower* benefits because today's leaders refuse to face reality.

A Better Future. If this same 28-year-old, single, lower-income African–American male were allowed to establish a PRA today, he could avoid this benefit reduction. If his PRA were funded with an amount of income equal to 3 percent of his first $10,000 in annual income and 2 percent of the amount over that, he could convert it into an annuity paying monthly benefits of $411—equal to 40 percent of his promised monthly benefit.

Thus, PRAs can fund a significant portion of a worker's promised benefits. Rather than disappear, as some critics assume in their calculations, this worker's PRA would be able to fund an amount equal to 40 percent of his monthly Social Security retirement payment. This is true because, while his rate of return on taxes going into today's Part A system is an embarrassing –4.3 percent annually, he would earn a rate of return on his Part B PRA of +5 percent. Just having a PRA means that this worker goes from losing money to making money.

Conclusion. Through 2038, American taxpayers are going to spend $5 trillion in additional tax dollars in order to pay for Social Security benefits that are already promised and earned. After spending that huge amount, what will they have to show for it?

Once the Social Security trust fund is gone, workers could face a bleak future in which the program can pay for only 70 percent of what it has promised. Or their representatives in Washington could spend that $5 trillion to establish a system of PRAs that could pay for much—if not all—of the difference. It is time to stop clouding the issue of Social Security reform with false claims and faulty math.

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