

# Executive Summary Backgrounder

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## The Top 10 Myths About Social Security Reform

*David C. John*

Arguments against Social Security personal retirement accounts (PRAs) rest on a great deal of incorrect and misleading information. These myths have spread and taken on a life of their own, despite the absence of any factual foundation.

These myths appear valid because they either sound logical or contain phrases that mean one thing in the context of Social Security but something quite different outside of it. Many have spread because workers lack sufficient information both about the way Social Security actually operates and the proposal to use PRAs to reform the system. Other myths have been purposefully initiated to promote a political agenda rather than to advance debate in pursuit of workable reform.

Looking at the actual facts behind the common misconceptions about Social Security and PRAs shows that these myths are either incorrect or irrelevant to the debate about Social Security's future and ensuring retirement security for future generations.

America's workers deserve a more informative, less partisan debate about Social Security reform. Although the current system may be able to pay for all the benefits that it has promised today's older workers (and those who have already retired), it cannot do so for younger workers.

There are only three ways to avoid the impending Social Security crisis: (1) raise taxes and borrow massive amounts of money, or make massive

cuts in other federal programs; (2) reduce benefits promised to younger workers; or (3) make payroll taxes work harder and bring greater returns by allowing workers to invest all (or a part of) the tax through PRAs. While the first two options would make Social Security returns even lower than they are today, PRAs would not only address the impending insolvency of the system, but also improve retirement incomes and help to close the gap between what the current system has promised and what it will be able to pay. It would also allow workers of all income levels to build a nest egg for the future. Simply put, PRAs can give workers a much more secure retirement income than can the current Social Security system.

The debate regarding Social Security reform is not an academic exercise, nor should it be used as a political ploy. The outcome of this debate will determine whether or not younger workers and their children will be able to receive retirement benefits that are comparable to those enjoyed by their parents.

The various myths and scare tactics that have emerged in the course of this debate do not alter

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the unpleasant realities that will confront American workers if nothing is done. Every day that Congress and the President delay taking action makes it more likely that our children and grandchildren will face the cost of crippling deficits. It is time to put aside the myths that have been stum-

bling blocks in a quest for authentic, effective, and critically needed Social Security reform

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# Background

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Arguments against Social Security personal retirement accounts (PRAs) rest on a great deal of incorrect and misleading information. These myths have spread and taken on a life of their own, despite the absence of any factual foundation.

These myths appear valid because they either sound logical or contain phrases that mean one thing in the context of Social Security but something quite different outside of it. Many have spread because workers lack sufficient information both about the way Social Security actually operates and the proposal to use PRAs to reform the system. Other myths have been purposefully initiated to promote a political agenda rather than to advance debate in pursuit of workable reform.

Looking at the actual facts behind the common misconceptions about Social Security and PRAs shows that these myths are either incorrect or irrelevant to the debate about Social Security's future and ensuring retirement security for future generations.

**Myth #1: We cannot afford to reform Social Security. Establishing a PRA system would cost between \$1 trillion and \$2 trillion—far more than just continuing the current system.**

This myth argues that the “transition costs” for establishing a PRA system would be huge and that the money that would go into those accounts would be unavailable to pay benefits to current retirees. PRA opponents say that the surpluses in the current system are used to build the Old-Age and Survivors Insurance (OASI) trust fund<sup>1</sup> and that, if this money

### Talking Points

- Many of the arguments against Social Security personal retirement accounts (PRAs) rest on a great deal of incorrect and misleading information. These myths have spread and taken on a life of their own, despite the absence of any factual foundation.
- Looking at the actual facts behind the common misconceptions about Social Security and PRAs shows that these myths are either incorrect or irrelevant to the debate about Social Security's future.
- The various myths and scare tactics do not alter the unpleasant realities that will confront American workers if nothing is done. Every day that Congress and the President delay taking action makes it more likely that our children and grandchildren will face the cost of crippling deficits.

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were instead placed in PRAs, the trust fund would run out of money sooner.

**Fact: In the long run, establishing PRAs would cost about \$20 trillion less than funding the current Social Security system.**

Ignoring the costs of the current system is disingenuous. Under any circumstances, keeping Social Security solvent will require a great deal more money than it is currently receiving. This additional money is necessary to reduce the difference between what Social Security will owe and what it will be able to pay.

Although the exact amount that will be needed to establish a PRA system in the first 10 years will depend upon the specific plan that is adopted, the Social Security Administration estimates that the amount needed will be closer to \$500 billion than the \$1 trillion or \$2 trillion figures that are often cited. If Congress retains the current system, Social Security will need almost \$27 trillion (in inflation-adjusted 2004 dollars) in additional funding over the next 75 years. If Congress acts quickly to establish PRAs, these costs could be as low as \$7 trillion to \$8 trillion—about one-third of the cost of doing nothing. A PRA system could save our children and grandchildren up to \$20 trillion. This is literally a case where spending billions will save trillions.

The Social Security system will require additional money under any circumstances. The only questions are when additional funds will be needed and in what amounts. Starting in 2018, Social Security will begin to spend more each year than it receives. From then on, it will need billions of dollars of general revenue money to pay promised benefits. There is a “trust fund,” but it contains only what are essentially IOUs that must be repaid out of general revenues.

Practically speaking, the funds for moving to a PRA system would come from the same source as the money that would be necessary to repay the Social Security trust fund. The two main sources of such funds would be general (non-Social Security) revenues and loans in the form of government

bonds. The only issues that must be determined are the time at which payments should start and whether the trillions of dollars involved will be used to reform the system or simply delay its insolvency.

Paying for the current system or a reform plan will require Congress to balance Social Security's needs against those of the rest of the economy. In general, as more additional dollars are needed for the current system or a reform plan, less money will be available for other government programs and the private sector.

As this persistent burden on the general federal budget increases, Congress will find it increasingly difficult to get the money for Social Security, making it increasingly unlikely that promised benefits will be paid on schedule.

**Myth #2: The Social Security trust fund contains assets that make Social Security secure for the next 40 years.**

This myth argues that the system has enough assets to pay full benefits through at least 2042. This estimate is based on combining Social Security's projected receipts from its payroll tax and other revenue sources with the amount of the bonds that will be in the trust fund.

**Fact: The Social Security “trust fund” is essentially a bookkeeping system through which the government lends money to itself.**

There is no pool of actual assets that is being reserved to pay the benefits of future retirees. The Social Security trust fund contains nothing more than IOUs (in the form of special issue U.S. Treasury bonds), which the federal government can repay only through higher taxes, massive borrowing, or massive cuts in other federal programs. While many workers thought that the system's annual surpluses were being used to build up a reserve for baby boomers, the federal government has been spending this money to fund other government programs and to reduce the government debt.

According to the Social Security Administration, in less than 5 years the size of the Social Security

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1. There are three Social Security trust funds. Unless specifically indicated otherwise, “trust fund” as used in this paper refers to the OASI trust fund, and “trust funds” refers to all three Social Security trust funds.

surplus will begin to drop, and in less than 15 years, Social Security will begin to run a deficit requiring it to begin cashing the IOUs. Hence, the government will need to find additional money just to repay the bonds as Social Security cashes them. Between 2018 and 2042, the government will have to make up for a total funding deficit of over \$5 trillion.

In the private sector, trust funds are invested in real assets ranging from stocks and bonds to mortgages and other financial instruments. Assets are used only for specifically designated purposes, and the fund managers are held accountable if the money is mismanaged. Funds are managed in order to maximize earnings within a predetermined risk level. Investments are chosen that will provide cash at set intervals, allowing the private trust fund to pay its obligations.

The Social Security trust funds are very different. As a report from the federal Office of Management and Budget (OMB) during the Clinton Administration noted:

The Federal budget meaning of the term “trust” differs significantly from the private sector usage.... [T]he Federal Government owns the assets and earnings of most Federal trust funds, and it can unilaterally raise or lower future trust fund collections and payments or change the purpose for which the collections are used.<sup>2</sup>

Furthermore, Social Security trust funds are “invested” exclusively in a special type of Treasury bond that can only be issued to and redeemed by the Social Security Administration. According to a Congressional Research Service report,

[W]hen 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.<sup>3</sup>

According to OMB, this situation allows funds to appear on the books while in reality they are unavailable:

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.<sup>4</sup>

In short, the Social Security trust funds are only an accounting mechanism. They show how much the government has borrowed from Social Security, but do not provide any way to finance future benefits.

Thus, while Social Security has enough paper assets to finance benefits until 2042, the reality is quite different. Social Security will have enough cash to pay benefits only until 2018. After that, the program will have to rely on ever-growing amounts of additional tax dollars to pay promised benefits.

**Myth #3: The Social Security system can be fixed by implementing modest changes, including raising the retirement age, making the wealthy pay Social Security taxes on all of their income, or creating faster economic growth.**

Those who spread this myth say that the program’s average annual cash flow deficit (after

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. 335, at [www.whitehouse.gov/omb/budget/fy2005/pdf/spec.pdf](http://www.whitehouse.gov/omb/budget/fy2005/pdf/spec.pdf) (September 23, 2004).

3. David Koitz, “Social Security Taxes: Where Do Surplus Taxes Go and How Are They Used?” Congressional Research Service, March 31, 1999, p. 3, at [www.concordcoalition.org/entitlements/crs042998.html](http://www.concordcoalition.org/entitlements/crs042998.html) (September 28, 2004).

4. Office of Management and Budget, *Analytical Perspectives*, p. 337.

repaying the trust fund) is 1.89 percent of taxable income—a relatively small gap that could be closed through modest changes in the current system.

**Fact: According to the Social Security Administration, the current system will require a total of \$27 trillion (in constant 2004 dollars) more revenue than it will receive in taxes over the next 75 years.<sup>5</sup>**

It will require much more than modest changes to raise that amount of money. While modest changes may produce enough savings to reduce the deficit for a time, they cannot close it completely. On the other hand, any proposal that does raise a total of \$27 trillion through a combination of tax hikes and benefit cuts can scarcely be called a “modest change.”

For example, one proposed “modest” step would be to raise Social Security taxes by an additional 2 percent of a worker’s income. This number was derived by calculating the mathematical average of the additional funds that the Social Security system will need over the next 75 years. However, raising Social Security taxes by 2 percent of income only delays the deficits for about six years—it does not end them. The problem is that this approach does not allow for the fact that Social Security will not need the same amount each year. In the short run, the program will collect more money than it needs, but once annual deficits start in 2018, they will grow ever larger. Increasing Social Security’s revenues by the same amount each year would initially provide much more money than it can use, and then, not nearly enough. By 2050, the program would be running an annual deficit of \$280 billion, which would rise to \$640 billion per year by 2075.

Another suggested reform is to make higher-income workers pay Social Security taxes on their entire income (rather than on just the first \$87,900 they earn). However, this relatively substantial increase on targeted workers’ tax burden

would only delay Social Security’s annual deficits by approximately six years. More money would initially come into Social Security’s coffers, but the program would ultimately pay greater benefits to retirees who had higher incomes. Although the government could collect higher taxes from certain citizens without offering higher benefits, such a move would be the first step in transforming Social Security into a welfare program.

Moreover, such a tax increase would seriously harm the nation’s economy. While those who support this tax increase may envision it as a tax on the rich, it would also affect millions of middle-income families. Combined with federal and state income taxes, it would raise their overall taxes to 50 percent—or even 60 percent—of income, discouraging people from working, saving, and investing. To make matters worse, such an increase in taxation would affect entrepreneurs and business owners, resulting in job losses as businesses downsized to make up for the greater tax burden.

Calculations by the Social Security Administration likewise show that faster economic growth would not be enough to fix the deficit problem. Even with a growth rate that far exceeds historic levels, the system would still begin to experience massive deficits within a few years. Higher economic growth—and the resulting higher wages—would allow the program to receive more money in the short run, but it is also correlated with greater benefits for retirees.

**Myth #3a: If Congress would stop spending the Social Security surplus and repay the money that it has already spent, Social Security would not need to be fixed.**

This corollary to Myth #3 recognizes that the federal government takes excess Social Security taxes and spends them to meet its bills. In return, the Social Security trust funds get only special issue Treasury bonds (i.e., IOUs) that will be repaid later. Those who believe this corollary say

5. Social Security Administration, *2004 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds* (Washington, D.C.: U.S. Government Printing Office, 2004), at [www.ssa.gov/OACT/TR/TR04](http://www.ssa.gov/OACT/TR/TR04) (September 23, 2004).

that if Social Security's excess taxes were really invested, the program would have enough money to pay full benefits well past 2042.

**Fact: Even if it were possible for the federal government to invest the Social Security trust funds, repaying the borrowed money would only delay—not solve—Social Security's financial problems.**

Repaying the trust fund could delay Social Security's cash crunch, but it would not eliminate it. According to the Social Security Administration's own estimates, even with real money in the trust fund, the program will begin to run deficits in 2042 and will continue to run deficits as far into the future as the agency's forecasting tools can predict.

Social Security's calculations assume that the trust fund receives the same interest as other federal bonds. Even though the trust fund consists of only promises to repay the money, those bonds are still credited with the same interest rate that other bonds of the same maturity length issued on the same day would receive. The interest is "paid" by issuing the trust fund still more bonds.

If the government could invest Social Security money in stocks, the deficits predicted for 2042 could be further delayed. However, allowing the government to invest the Social Security trust funds could create serious conflicts of interest. For instance, if such investing had been allowed in the past, the U.S. government could have been the largest stockholder in Microsoft at the same time that it was suing the company for antitrust violations. It could also have been the largest stockholder in both WorldCom and Enron at the time of those firms' demise.

**Myth #4: Introducing Social Security personal retirement accounts would result in reduced benefits for existing retirees and those close to retirement.**

Opponents of PRAs say that if a portion of the Social Security payroll taxes is diverted to personal retirement accounts, there will not be enough money left to pay the full benefits promised to existing retirees and those close to retirement.

They further claim that as Social Security's obligations increase in the future with the retirement of millions of baby boomers, benefits would need be cut even more.

**Fact: For now, Social Security is collecting more than enough money both to pay full benefits to current retirees and those about to retire and to fund PRAs. When extra money is needed for these accounts, it can be found through the same method that is used today to finance Social Security.**

Establishing PRAs would not require benefit reductions for either current retirees or those close to retirement. This argument against PRAs assumes that Social Security is a closed system with money coming only from Social Security taxes. This is not true today and will not be the case in the future.

The OASI trust fund pays retirement and survivors' benefits. In 2003, the OASI trust fund had a total income of \$543.8 billion: \$456.1 billion (83.9 percent) from payroll taxes; \$12.5 billion (2.3 percent) from income taxes paid by higher-income retirees on their Social Security benefits; and \$75.2 billion (13.8 percent) from interest paid on the trust fund. Both the income tax and the interest payments that the OASI trust fund received in 2003 came from general (non-Social Security) tax revenues, such as federal personal and corporate income taxes and federal excise taxes. In short, today's Social Security is *not* a closed system that relies exclusively on its payroll tax for money and there is no reason to assume that establishing a system with personal accounts should be financed exclusively through payroll taxes.

During 2003, the trust fund paid out \$399.8 billion in benefits (73.5 percent of the taxes it collected) and \$2.6 billion for administrative expenses (0.5 percent of all the taxes it collected). The remaining \$137.8 billion (25.3 percent of tax income) was retained as special issue Treasury bonds in the trust fund. Today's Social Security receives more money than it pays out in benefits. That money could be used to pay for some of the cost of establishing PRAs.

The sad fact is that regardless of whether or not PRAs are established, Social Security will require hundreds of billions of dollars of additional money. The only questions are when Social Security will require additional general revenues and in what amounts. Under the current system without PRAs, Social Security will begin to require large amounts of additional general revenues in 2018, when the system begins to pay out more in benefits than it takes in each year in taxes.

According to the Social Security Administration, the current program will need \$15 billion (in 2004 dollars) in general revenue money in 2018. That amount will grow to \$101 billion by 2022, \$203 billion by 2027, and will continue to grow each year until the last paper bond in the trust fund is cashed in 2042. In total, the federal government will need over \$5 trillion between 2018 and 2042 just to repay the trust fund.

After the trust fund assets run out, current law does not allow Social Security to pay any more in benefits than it takes in annually in taxes. If the law is changed to allow payment of full benefits, Congress would have to come up with an additional \$20 trillion to \$21 trillion between 2042 and 2070 for a total of almost \$27 trillion<sup>6</sup> more in general revenue to make up for the shortfall.<sup>7</sup>

If PRAs are established, it is true that the money that goes into them will not be available for benefit payments. Initially, these accounts can be funded from the excess revenues that Social Security collects each year. After that, the additional money needed to pay Social Security benefits would come from general revenues just as it will if Social Security is not fixed.

A key fact to remember is that while doing nothing will require \$27 trillion in additional general revenue money, a reformed Social Security system using PRAs will cost only \$7 trillion to \$8 trillion. One reason for the lower cost of PRAs is that payroll taxes diverted to PRAs will not be lost.

The money will be available to help pay for younger workers' retirement benefits.

**Myth #5: Repealing the Bush tax cuts would save Social Security.**

Opponents of PRAs also charge that the Social Security surplus has gone to wealthy Americans as a result of the Bush tax cuts. They further claim that repealing some of these tax cuts would make Social Security financially healthy for many years.

**Fact: The Bush tax cuts do not directly affect Social Security's finances. They did not reduce Social Security's cash flow, and repealing all or part of the tax cuts will not improve Social Security's financial outlook.**

There are three reasons why neither the Bush tax cuts nor their repeal will affect Social Security:

First, while the Bush tax cuts made major changes to the income tax system, they made no changes to the Social Security payroll tax system, which provides most of Social Security's revenue. Social Security payroll tax collections were the same in 2003 as they would have been if the tax cuts had never passed. The tax cuts' only effect on Social Security's tax revenues was to increase collections from people who filled the new jobs created by the tax cuts.

Second, passage of the Bush tax cuts did not affect the Social Security surplus in any way. As noted above, there is no actual money in the Social Security trust funds, only special-issue government bonds. This has been the case since the trust funds were first created. The Treasury collects all payroll taxes on behalf of Social Security and pays all of its benefits. Any surplus left over after paying the Social Security benefits remains with the Treasury, while the trust funds get bonds, which are essentially IOUs. The government then spends the money on whatever it needs to buy, from aircraft carriers to health care services. This has been true under every President since President Franklin D.

6. The numbers do not add up due to rounding. Recent scoring from SSA shows that Congress will need to provide about \$5.7 trillion to repay the trust fund and about \$21.4 trillion between 2042 (the time the trust fund runs out) and 2078.

7. Social Security Administration, *2004 Annual Report*.



Roosevelt and remains true under President George W. Bush.

Third, even if the tax cuts were repealed and every dollar of additional revenue was given to Social Security, under current law the system would be no better off. Because Social Security has no legal way to stockpile or invest extra money, the extra cash would remain with the Treasury, and Social Security would simply receive more special issue Treasury bonds. While this would inflate the size of the trust fund, those bonds would still need to be repaid, just like the existing ones, using federal tax dollars. Social Security would still need \$56 billion in additional tax money in 2020, \$163 in 2025, and so forth—just as it will with the tax cuts in place. That additional money would still come out of pockets of future taxpayers, just as it must under current law.

**Myth #6: Personal retirement accounts would incur high administrative costs that would eliminate any potential benefits, and the only people who would gain would be the wealthy and Wall Street.**

Some critics of PRAs argue that workers would incur high administrative fees if private funds managers administer the PRA assets. They claim that these fees would be so high that they would consume a major portion of the money in PRAs.

**Fact: Developing a simple personal retirement account system with very low administrative costs would be simple.**

State Street Trust, one of the largest managers of retirement savings, has estimated that administering a personal retirement account would cost from \$3.55 to \$6.91 per person annually, based on proprietary data that the bank accumulated from its experience in managing a host of pension plans.<sup>8</sup> In terms of the percentage of assets under management, the annual fee would be only 0.19 percent to 0.35 percent. This fee assumes an annual contribution per worker equal to 2 percent of his or her gross earnings. The cost would drop significantly if

that contribution increased to an amount equal to 4 percent of earnings or higher. State Street Trust's findings were reviewed and accepted by the Government Accountability Office<sup>9</sup> as accurate.

This low level of administrative fees would certainly not reduce the benefits of a PRA. In addition, history shows that administrative costs are highest when a system is first implemented and start-up costs must be covered. As time passes, administrative costs decline significantly. This has been true for 401(k) accounts, the Thrift Savings Plan (TSP) for federal employees, and even Social Security. For example, the administrative costs of 401(k) plans have decreased over time, despite the plans offering an increasing number of investment options and a higher level of personal service. Although the costs of specific plans vary according to each plan's complexity, size, and the types of investments, many large companies have been able to keep their administrative costs as low as 0.3 percent by offering only a limited number of broad-based funds.

The federal Thrift Savings Plan, a privately managed retirement plan open only to federal employees, has experienced a dramatic 76 percent reduction in administrative costs since the system started in 1988. Today, participants pay annual administrative fees that are below 0.1 percent of assets under management. TSP's extremely low administrative costs are significant, given that many experts expect that a PRA system would closely resemble the structure and investment choices found under TSP.

The Social Security system experienced similar reductions in administrative costs during its formative years. In 1940, when the system first began to pay benefits, its administrative costs equaled 74 percent of all Old-Age and Survivors Insurance benefits paid. In 1945, this figure had declined to 9.8 percent. Today, administrative costs make up only 0.5 percent of payments from the OASI trust fund. Even though this is not a perfect comparison with the other two examples,

8. State Street Corporation, "Administrative Challenges Confronting Social Security Reform," Boston, March 22, 1999.

9. Effective July 7, 2004, the General Accounting Office's legal name became the Government Accountability Office.

given that Social Security's structure has changed over the years, it does suggest that fees could be very low.

**Myth #7: Unlike stock market investments, today's Social Security is guaranteed and risk-free.**

This myth rests on the belief that there is no investment risk under today's Social Security system because an individual's benefits are paid entirely out of taxes. Those who support this myth point out that Social Security is an entitlement that does not require congressional appropriations and that benefits are automatically paid out to anyone who meets the legal qualifications.

**Fact: The current Social Security system is not risk-free: Future generations may be unwilling to pay the sharply rising costs of the current Social Security system.**

While there is no immediate investment risk associated with Social Security, its future survival will depend on the willingness of future taxpayers to spend the massive additional sums needed to pay the promised benefits. If Congress does not reform the system, annual cash flow deficits are predicted to begin in 2018, with the deficits quickly ballooning to alarming proportions. After adjusting for inflation, annual deficits will exceed \$100 billion by 2022, \$200 billion by 2027, and \$300 billion by 2034.

These annual deficits will necessitate pumping massive additional sums of tax money into Social Security. Paying full promised benefits will require some combination of much higher taxes, borrowing large amounts of money, or sharp reductions in other federal programs. Future generations could face a choice between paying grandma her full Social Security benefits and cutting her grandchildren's health and education programs.

Social Security taxes would need to increase by nearly 50 percent during the coming decades to pay future retirees their full promised benefits. If taxes were not raised, Social Security benefits would need to be reduced by as much as 35 percent by 2079. No matter which option Congress chooses, younger workers will end up paying much more for poten-

tially lower benefits. Those younger workers would be much better off with PRAs.

No one doubts that future generations will want to pay retirees the full amount of the retirement benefits that they have been promised. However, if Social Security is not reformed, the question remains whether or not those younger workers will be willing to make the necessary sacrifices to do so. This means that future retirees' Social Security benefits are at risk.

**Myth #8: Recent volatility in the stock market proves how dangerous PRAs would be.**

Opponents point out that the stock market declined by approximately 12 percent during the second quarter of 2002 alone. During the stock market losses from 2000 to 2002, PRAs would have lost much of their value and would be unable to provide adequate Social Security benefits to retirees.

**Fact: PRAs would be invested in more than just stocks. Furthermore, because retirement investing would take place over decades, not just a few years, longer-term gains will more than make up for periods of stock losses.**

Studies that purport to show that either PRAs or the Social Security trust fund would have lost money over the past few years if they had been invested in stock assume that 100 percent of the trust fund would have been invested in stocks, rather than a diversified portfolio that would have balanced stock losses with gains on bonds or other investments. They also focus on only the short-term market trends, ignoring the gains that would result from longer-term investments.

Morningstar, Inc., an independent market data and analysis firm, estimates that the value of mutual funds invested in diversified U.S. stocks declined 12.1 percent during the second quarter of 2002. However, not all types of investments went down. Mutual funds containing lower-risk instruments such as taxable bonds (which are routinely held by those nearing retirement) rose an average of 1.4 percent over that same period, while funds invested in tax-exempt bonds rose 3.2 percent. Thus, in one of the worst quarters for stock investment, PRAs invested in a diversified portfolio would remain strong.

Over the long run, all of these investments did even better. Over a five-year period including the second quarter of 2002, mutual funds invested in stocks earned an average of 3.9 percent per year, while mutual funds invested in taxable bonds and tax-exempt bonds earned an average of 5.0 percent a year.

PRAs should not be invested solely in stocks. They should instead be invested in a diversified portfolio of stock index funds and different types of bond index funds. The default investment for PRAs should be a lifestyle fund that automatically reduces the proportion of stocks as the worker gets older, thus locking in past gains and sharply reducing the chance of major losses in the years approaching retirement.

**Myth #9: Lower-income and minority workers are better off with the current Social Security system. The rate of return is not a primary concern because Social Security is essentially an insurance program.**

People who believe this myth argue that the existing Social Security system pays proportionately higher benefits to lower-income workers than it does to higher-income workers and that minority workers likewise receive proportionately more from Social Security's disability program than non-minority workers. They stress that Social Security was intended to be an insurance program and that, like holders of car insurance, Social Security enrollees should not feel cheated if they do not collect on their investment: It should be enough for them to know that funds will be available if needed.

**Fact: Personal retirement accounts would allow lower-income and minority workers to earn more on their Social Security investments and could create assets that could be passed on to their families.**

Although Social Security is structured to pay higher benefits to workers with lower incomes, virtually all low-income males are more likely to pay more into the system than they will ever receive in benefits, even under the most favorable assumptions. To receive a favorable rate of return on Social Security payments, a worker must live

long enough to receive more in benefits than he or she paid in taxes. Statistics show that lower-income workers have a much shorter average lifespan than upper-income workers. Therefore, although they receive higher benefits relative to their incomes, they receive them for a much shorter length of time.

Making matters worse, the current Social Security system does not allow these workers to create any sort of nest egg that could be left to their families in the event of an early death. Instead, today's system pays low benefits to limited categories of survivors. In contrast, a PRA system would allow workers to create a nest egg that could be left to their families or even to organizations such as churches.

Just about every male currently under the age of 38 will actually lose money under the current Social Security system. For example, the average single male in his mid-20s earning \$13,000 per year would receive approximately 88 cents in retirement benefits for every dollar that he paid in Social Security taxes—a lifetime loss of about \$13,400. If such an individual had been allowed to invest the Social Security retirement taxes that he and his employer paid in a portfolio comprised of 50 percent government bonds and 50 percent stock equity funds, he would have earned \$145,000 on his investment by retirement.

On average, a 21-year-old African-American single mother earning approximately \$20,000 per year (the current average income for African-American females) can expect to receive a rate of return from Social Security of only 1.2 percent. If the amount that she and her employer paid in Social Security taxes had instead been invested in U.S. government bonds, she would have received a return of approximately 3 percent (\$93,000 more than from Social Security) to fund her retirement. If the money she paid in Social Security taxes had been invested in a portfolio composed of 50 percent government bonds and 50 percent stock index funds, she would have earned nearly \$383,000 (before taxes) for retirement (\$192,000 more than from Social Security).

Because of their shorter life expectancies, lower-income Americans are hit especially hard by the inability to include their lifetime Social Security investments in their estates. Except in situations in which a worker leaves behind young children or a spouse who has lower benefits, the payroll taxes of low-income workers will permanently leave their families and their communities at the time of their deaths—and will instead benefit others with longer life spans.

With regard to disability benefits, it is true that African-Americans and other minority groups do receive proportionately greater benefits than non-minority workers. However, Social Security's disability program is a separate program that is financed with its own tax and trust fund. The fact that minority workers do better under Social Security's disability program does not compensate for their poor returns under Social Security's larger retirement program.

Moreover, Social Security should not be considered simply as an insurance program any more than workers would view their 401(k) plans as insurance. Workers should view Social Security as they would any other retirement plan and see it as a way to provide income for retirement. The Social Security system should be measured against other retirement plans to measure its ability to function as a cost-effective source of retirement income.

**Myth #10: Introducing PRAs would reduce Social Security's disability benefits.**

Currently, both Social Security's retirement program and its disability program use the same benefit formula to determine a worker's monthly payment. Establishing PRAs would require changing the benefit formula to reflect the portion of retirement benefits that would be paid from the accounts. Those who oppose PRAs claim that any changes to the current formula would necessarily lower disability benefits. They also say that the PRAs of disabled workers (who tend to be much younger than retirees when they are disabled) would not have enough money in them to make up for lower government-paid benefits.

**Fact: PRAs could easily be designed to avoid changing disability benefits.**

The solution is simple: create two benefit formulas. Opponents are correct that changing current government-paid benefit formula without retaining the existing formula for disability benefits could reduce disability payments. However, Congress could simply change the law to require the Social Security Administration to use the existing formula to calculate disability benefits and a new formula to calculate retirement benefits. That would leave disability benefits unaffected by any change in the formula for retirement benefits.

**Conclusion**

America's workers deserve a more informative, less partisan debate about Social Security reform. While the current system may be able to pay all the benefits that it has promised today's older workers and those who have already retired, it cannot do so for younger workers.

There are only three ways to avoid the impending Social Security crisis: (1) raise taxes and borrow massive amounts of money, or make massive cuts in other federal programs; (2) reduce benefits promised to younger workers; or (3) make payroll taxes work harder and bring greater returns by allowing workers to invest all (or a part) of them through PRAs. While the first two options would make Social Security returns even lower than they are today, PRAs would not only address the impending insolvency of the system, but also improve retirement incomes and help to close the gap between what the current system has promised and what it will be able to pay. It would also allow workers of all income levels to build a nest egg for the future. Simply put, PRAs can give workers a much more secure retirement income than the current Social Security system.

The debate regarding Social Security reform is not an academic exercise, nor should it be used as a political ploy. The outcome of this debate will determine whether or not younger workers and their children will be able to receive retirement benefits that are comparable to those enjoyed by their parents.

The various myths and scare tactics that have emerged in the course of this debate do not alter the unpleasant realities that will confront American workers if nothing is done. Every day that Congress and the President delay taking action makes it more likely that our children and grandchildren will face the cost of crippling deficits. It is

time to put aside the myths that have been stumbling blocks in a quest for authentic, effective, and critically needed Social Security reform.

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