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Misleading the Public: How the Social Security Trust Fund Really Works

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As political leaders debate how best to fix Social Security, many policymakers are focusing on the wrong issue. Their sole concern seems to be the date when the Social Security retirement and survivors trust fund will run out of its paper assets. This mistaken emphasis misses the fundamental point about Social Security's problems: There is no cash in the Social Security trust fund, and there never has been any.

- The Social Security trust fund is merely an accounting device filled with IOUs that future taxpayers must repay.
- The most important date for Social Security is 2018, when the taxpayers must begin repaying the IOUs, not 2042, when the trust fund will be exhausted.

The Social Security trust fund is merely an accounting device filled with IOUs that future taxpayers must repay. Far too soon, payroll taxes will be insufficient to pay all of the promised benefits. Unless Congress promptly takes action, taxpayers will have to pump hundreds of billions of additional tax dollars into Social Security to pay the promised benefits.

How the Trust Fund Operates. Workers pay their Social Security taxes through their employers. Each employer periodically sends a lump sum payment to the U.S. Treasury that includes all of the income taxes and Social Security and Medicare payroll taxes paid by both the employer and its employees.

The Treasury both receives the payroll taxes (and income taxes that higher-income retirees pay on their Social Security benefits) and pays monthly benefits on behalf of the Social Security Administration (SSA). The money stays in the Treasury's hands until it is either paid out as Social Security benefits or otherwise spent by the government. In fact, no money ever goes into the trust fund. Instead, the trust fund balance is the result of two accounting entries by the Treasury.

First, the Treasury estimates how much of the aggregate tax receipts are Social Security taxes and "credits" the Social Security trust fund with that amount. Then the Treasury "subtracts" the total amount paid in monthly Social Security benefits from the trust fund balance. No money actually changes hands; these are strictly accounting entries.

Any "money" remaining in the trust fund is converted into special-issue Treasury bonds, which are really nothing more than IOUs. In addition, the Treasury pays interest on the trust fund's balance by crediting the trust fund with additional IOUs. These are also strictly accounting entries, and again no money changes hands. After credit-

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ing the trust fund with the proper amount in IOUs, the government spends the extra Social Security tax collections just like any other tax revenue—to finance anything from aircraft carriers to education research.

At the end of 2002, the Social Security trust fund had a balance of $1.22 trillion. During 2003, the Treasury received $544 billion in Social Security taxes and paid out $406 billion in Social Security benefits. Therefore, the trust fund received $138 billion in these special-issue Treasury bonds, resulting in a trust fund balance of $1.36 trillion at the end of 2003.

Why the Social Security Trust Fund Differs from Real Trust Funds. Private-sector trust funds invest in real assets ranging from stocks and bonds to mortgages and other financial instruments. However, the Social Security trust funds are only "invested" in a special type of Treasury bond that can only be issued to and redeemed by the Social Security Administration. As the Congressional Research Service noted in a report on May 5, 1998:

> 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.

According to the Office of Management and Budget under the Clinton Administration in 1999:

> 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. [Emphasis added.]

In short, the Social Security trust fund is really only an accounting mechanism. The trust fund shows how much the government has borrowed from Social Security, but it does not provide any way to finance future benefits. The money to repay the IOUs will have to come from taxes that are being used today to pay for other government programs. For that reason, the most important date for Social Security is 2018, when taxpayers must begin to repay the IOUs, not 2042, when the trust fund is exhausted.

Conclusion. Social Security's financial crisis will begin far sooner than many politicians claim. In less than three years, the first baby boomer will reach retirement age. Once that happens, Social Security (and Medicare) will be on a slippery slope toward insolvency. While Social Security can continue to use its tax receipts to pay full retirement benefits until 2018, Congress cannot wait that long to act. Misleading the public into believing that Social Security is secure until 2042 or beyond will only make the impending crisis more difficult to avoid.

Furthermore, huge impending deficits are only one of the problems facing Social Security. The sad reality is that millions of workers receive a dismal rate of return on their Social Security retirement taxes. Making matters worse, the current program does not enable workers to build up investments and cash savings to supplement their monthly Social Security checks.

The debate about Social Security's future should be about how to improve each American's personal retirement security and how to enable each American to build a nest egg for the future. Otherwise, Americans will lose a real opportunity to improve the lives of future retirees. The best way to fix Social Security is to provide younger workers with the opportunity to invest part of their Social Security taxes in personal retirement accounts.

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