

10 Myths about Social Security

by Michael Tanner

The debate over Social Security reform is heating up. As it does, we can expect the air to be filled with competing claims and counterclaims. Organizations from the AFL-CIO to the National Organization for Women have announced plans to mount a campaign against proposals to transform the 63-year-old retirement program to a system of individually owned, privately invested accounts. Therefore, it seems like a good idea to dispel some of the myths that you may be hearing over the next few months.

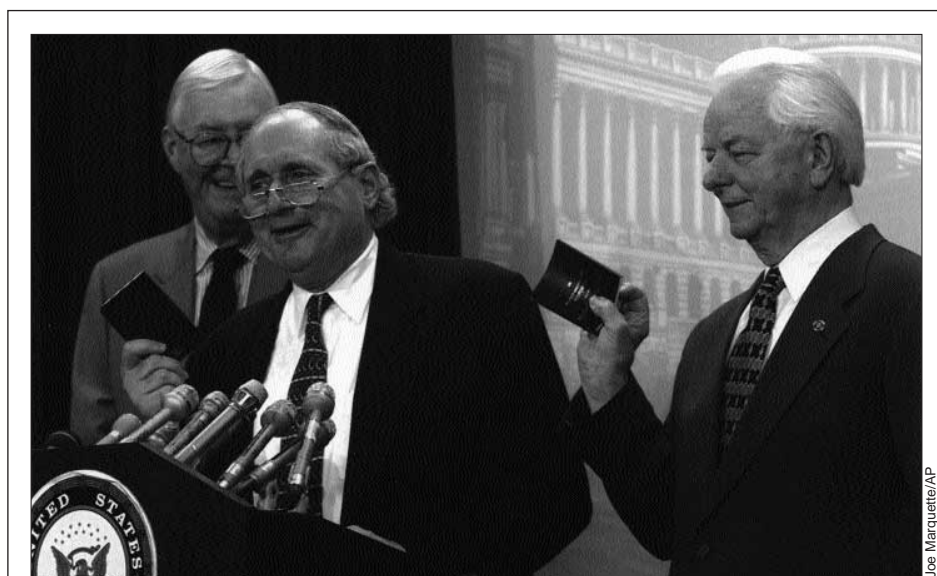
Myth 1: There's No Need to Rush; Social Security Is Safe for the Next 35 Years

That rush of hot air you heard a couple of months ago was the collective sigh of relief when the Social Security trustees reported that the system's technical insolvency date had been extended to 2032. But that date does not provide the full story of Social Security's looming crisis. The important date is 2012. Social Security taxes currently bring in more revenue than the system pays out in benefits. The surplus theoretically accumulates in the Social Security Trust Fund. However, in 2013, just 15 years from now, the situation will reverse. Social Security will begin paying out more in benefits than it collects in revenues. To continue to meet its obligations, it will have to begin drawing on the surplus in the trust fund. Which brings us to

Myth 2: The Trust Fund Is Real

The trust fund is really little more than a polite fiction. For years the federal government has used the trust fund to disguise the

Michael Tanner is director of the Cato Institute's Social Security Privatization Project and coauthor with Peter Ferrara of A New Deal for Social Security and Common Cents, Common Dreams: A Layman's Guide to Social Security Privatization.



At a Capitol Hill press conference celebrating the Supreme Court's rejection of the line-item veto law, Sens. Carl Levin (D-Mich.) and Robert Byrd (D-W.Va.) read from their Cato-supplied pocket Constitutions. Sen. Daniel Patrick Moynihan (D-N.Y.) looks on. Copies of the booklet containing the Constitution, the Declaration of Independence, and an introduction by Roger Pilon are available in any quantity for \$1.00.

Joe Marquette/AP

actual size of the federal budget deficit, borrowing money from the trust fund to pay current operating expenses and replacing the money with government bonds—essentially IOUs. Half the trust fund consists of those bonds. The other half is simply an accounting entry attributing interest to the bonds.

The Social Security Administration insists that there is no need to worry. Those bonds are backed by the full faith and credit of the U.S. government. But that is irrelevant. Pretend for a moment that there were no trust fund. What would happen in 2013? The government would have to raise taxes to continue paying promised benefits. Now, consider what will happen with the trust fund. The government will have to raise taxes to make good on the bonds to continue paying promised benefits.

Either way, young workers can expect to get hit with a big tax increase.

Continued on page 10

In This Issue



Armeny on the IMF, p. 6

Boaz: Are we anti-government?	2
Two new books on Social Security	3
Deregulating Japan: four views	7
New Cato studies	12
Spanish-language Web site	15
The B. Kenneth Simon Chair in Constitutional Studies	15

“Privitizing Social Security will make every worker an investor.”

MYTHS *Continued from page 1*

Myth 3: Your Social Security Taxes Are Being Saved for Your Retirement

Social Security is a pay-as-you-go program. The money that you pay in taxes today is not saved or invested for you in any way; it is immediately paid out in benefits to today's retirees. You have to hope that when you retire there is another generation of workers to pay the taxes that will fund your benefits. Unfortunately, because we are living longer and having fewer children, there are going to be fewer and fewer workers to pay taxes and more and more retirees collecting benefits. In 1950 there were 16 workers paying taxes for every person collecting benefits. Today there are just 3.3; by 2025 there will be only 2.

Myth 4: Social Security Is a Good Deal for Today's Workers

Even if there were no reduction in benefits or increase in taxes—an impossibility given Social Security's looming financing shortfalls—Social Security is an extremely bad investment for most young workers. In fact, according to a study by the nonpartisan Tax Foundation, most young workers will actually receive a negative return on their Social Security taxes—they will get less in benefits than they paid in taxes. Some studies indicate that a 30-year-old two-earner couple with average income will lose as much as \$173,500.

That actual loss does not even consider the opportunity cost, what workers might have earned if they had been able to invest their taxes in real assets that yield a positive return. In fact, a study by financial analyst William Shipman demonstrates that, if a 25-year-old worker were able to privately invest the money he or she currently pays in Social Security taxes, the worker would receive retirement benefits three to six times higher than under Social Security.

That is one more reason why Social Security reform can't be put off. Social Security is not just a bad deal when the program becomes insolvent in 2013. It is a bad deal today. Working Americans are losing money every day that they are forced to continue putting their money into a system that will cost them a substantial portion of their potential retirement income.

Myth 5: Well, at Least Social Security Helps the Poor

The low-income elderly are much more likely than their wealthy counterparts to be dependent on Social Security benefits for most or all of their retirement income. In fact, the poorest 20 percent of the elderly receive more than 81 percent of their retirement income from Social Security. Clearly, raising the rate of return through privatization will help people with no income except Social Security.

In contrast, increasing payroll taxes to keep Social Security solvent would badly hurt the poor. The payroll tax is one of the most regressive of all taxes, a tax on wages. Seventy-one percent of Americans already pay more in payroll taxes than in federal income taxes. They can hardly afford the 50 percent increase in payroll taxes required to keep Social Security afloat.

In addition, the progressivity of Social Security is undermined by differences in life expectancy. Because the wealthy generally live longer than the poor, they receive more total Social Security payments over the course of their lifetimes.

A February 1996 study by the RAND Corporation concluded that, because of differences in life expectancy, Social Security actually transferred wealth from the poor to the rich. The RAND study also concluded that the current benefit structure disadvantages African-Americans, who have lower life expectancies and marriage rates. According to the study, whites consistently earn higher rates of return than blacks. In fact, on a lifetime basis, the income transfer from blacks to whites is as much as \$10,000 per person.

In a privatized system, an individual's benefits would not be dependent on life expectancy. Individuals would have a property right in their savings. Any benefits remaining at their deaths would become part of their estates, inherited by their heirs.

Privatizing Social Security would help the poor in another way, too. Today, after paying for the necessities of life and being forced to contribute 12.4 percent of their income to Social Security, few poor people have the opportunity to invest. But privatizing Social Security will make every worker an investor. The old distinction between capital and labor will come crashing down as every truck driver, waitress, and lathe oper-

ator becomes a capitalist, a stockholder. Sam Beard, a former aide to Sen. Robert Kennedy, calls this process the “democratization of capital” and points out that privatizing Social Security will give every American a real stake in our economic future. Beard also notes that the benefits are psychological as well as tangible. “Personal participation will make savings and economic education part of everyone's day-to-day experience. . . . The benefits of this knowledge for individuals and families will include increased economic capability, a confident sense of the future, and more power to make fundamental choices that effect their lives.”

José Piñera, architect of Chile's successful privatization of its government-run pension system, explains that those types of changes took place in his country:

The new pension system gives Chileans a personal stake in the economy. A typical Chilean worker is not indifferent to the stock market or interest rates. When workers feel that they own a part of the country, not through party bosses or a Politburo, they are much more attached to the free market and a free society.

The same worker empowerment is possible through privatization of Social Security in this country.

Myth 6: There Is a Legal Right to Social Security Benefits

The fact that you paid Social Security taxes all those years doesn't mean that you have any right to Social Security benefits. The Supreme Court has ruled, in the case of *Nestor v. Fleming* (1960), that individuals have no right to Social Security benefits based on the taxes they've paid. Congress and the president can change or reduce Social Security benefits any time they choose. For example, Congress is currently debating whether to adjust the way the consumer price index (CPI) is calculated. If Congress were to adopt the proposal of the Boskin commission to reduce the CPI by 1.1 percent, the average Social Security recipient would lose \$5,000 in lifetime benefits. Other suggested changes to Social Security, such as raising the retirement age or means testing, would also reduce benefits. And we should not forget that many

“The political risk of staying in Social Security far exceeds the market risk of private investment.”

Social Security benefits are simply taxed away today, a case of the government giving with one hand and taking away with the other. Increasing payroll taxes—as has already been done 38 times since the system’s inception—produces similar results.

Myth 7: Social Security Can Be Fixed with a Few Minor Reforms

Defenders of the current Social Security system suggest that it can be fixed with only minor tinkering—tax increases or benefit cuts. But Social Security’s unfunded liabilities are truly staggering—more than \$9.5 trillion according to Alan Greenspan. Paying all the promised benefits, under the government’s relatively benign intermediate assumptions, would require nearly a 50 percent increase in Social Security taxes, from 12.4 percent to 18.3 percent. That would be by far the largest tax hike in U.S. history.

Myth 8: The Market Is Risky; Social Security Is Safe

“Privatizing Social Security is too risky,” warn critics of reforming the retirement program. “You just can’t trust the stock market.” But that seriously misstates both the risks of privatization and those of remaining with the current Social Security system.

Are stocks really risky? In any given year, stocks can go up, but they can also go down. For the last several years the stock market has been riding a wave of expansion. Undoubtedly, there will eventually come a correction. But the year-to-year fluctuations of the market are actually irrelevant. What really counts is the long-term trend of the market over a person’s entire working lifetime, in most cases 45 years. Given that long-term perspective, there is no time at which the average investor would have lost money by investing in the U.S. stock market. In fact, taking just 20 years of stock market returns, the worst period in U.S. history, including even the 1929 crash and the Great Depression, produced a positive real return of more than 3 percent. The average 20-year real rate of return has been 10.5 percent.

By comparison, relying on the current Social Security system is extremely risky. Because Social Security is at its core a political system, future benefits are dependent on political decisions. A young worker entering

the Social Security system is gambling on what a Congress and president 45 years from now will decide to do. Given the system’s \$9.5 trillion unfunded liability, and the inevitable tax hikes and benefit cuts to come, the political risk of staying in Social Security far exceeds the market risk of private investment.

Myth 9: The Transition to a Privatized System Would Be Too Expensive

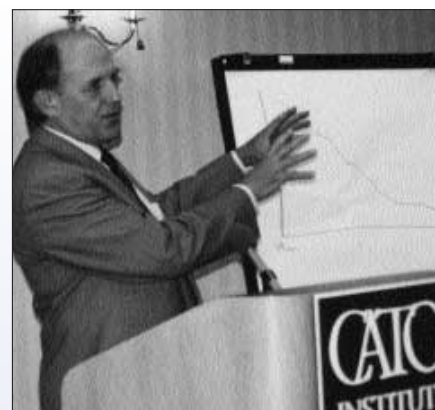
The most difficult issue associated with any proposed privatization of Social Security is the transition. Put quite simply, regardless of what system we choose for the future, we have a moral obligation to continue benefits to today’s recipients. But if current workers divert their payroll taxes to a private system, those taxes will no longer be available to pay benefits. The government will have to find a new source of funds. But that cost must be looked at in light of Social Security’s current unfunded liabilities. Privatizing Social Security will actually reduce the total debt we owe.

Of course, there will be a temporary cash flow problem while we make the transition. We will have to find the revenues to pay benefits to current retirees. While any financing mechanism will be political—involving some combination of debt, transfers from general revenues, asset sales, and the like—the expected budget surplus offers a good place to start. If both parties are willing to forgo new spending programs and junk tax cuts, we can begin the transition to a new, improved Social Security system.

Myth 10: Social Security Is Politically Untouchable

Former house speaker Tip O’Neill reputedly described Social Security as the “third rail” of American politics—touch it and your political career dies. However, that no longer appears to be true. Polls now show that substantial majorities of the American people support privatization. Indeed, a 1996 poll conducted for the Cato Institute found that two-thirds of voters preferred the opportunity to privately invest their Social Security taxes.

As on so many other issues, the public is out ahead of the politicians. What is needed now are politicians with the courage to demand real Social Security reform. ■



Cato University guest lecturer Charles Murray, author of *What It Means to Be a Libertarian*, challenges the audience to find the point on a trendline at which government intervention occurred; in most cases, he said, government programs accomplish nothing measurable.



About 40 people gathered at the first Cato University seminar, held in Princeton, N.J., over Memorial Day weekend. Philosopher David Kelley (above), author of the forthcoming Cato book *A Life of One's Own: Individual Rights and the Welfare State*, lectured on individualism, natural rights, and welfare rights. Also on the faculty was legal scholar Randy Barnett, author of *The Structure of Liberty*. Barnett and Kelley will lecture again in San Francisco over Columbus Day weekend.