Social Security Is in Good Shape?

BY MICHAEL D. TANNER

Denial, as the saying goes, is not just a river in Egypt.

Gene Lyons, a columnist with the *Arkansas Democrat-Gazette*, is one of numerous opponents of Social Security reform to allege that Social Security is not facing a crisis ("Social Security Alarm Just Another Flimflam," December 15). The program is just fine, able to pay promised benefits far into the future, needing only minor changes after that.

Unfortunately, this sort of political whistling past the graveyard has to confront economic and demographic reality.

First, contrary to Lyons's assertion, the current Social Security system is a "pay-as-you-go" scheme. It is not a savings or investment system, but a simple transfer from workers to retirees. The payroll taxes from each generation of workers are not saved or invested for that generation's retirement, but are used to pay benefits for those already retired. The current generation of workers must then hope that when their retirement comes, the next generation of workers will pay the taxes to support their benefits, and so on.

Obviously, a pay-as-you-go system is sensitive to the number of people paying in versus the number of people collecting benefits. In other words, the ratio of workers to retirees is crucial to the financing of the current system.

The current worker-to-retiree demographics in the United States spell trouble for Social Security and its ability to keep up with its promised benefits. People are having smaller families, resulting in fewer new workers paying taxes into Social Security. And seniors are living longer and collecting benefits for many more years. Add to this the fact that the Baby Boom generation is about to retire and you end up with far, far fewer workers per retiree than when Social Security started.

In 1950, there were 16 workers paying taxes into the system for every retiree who was taking benefits out of it. Today, there are a little more than three. By the time the baby boomers retire, there will be just two workers who will have to pay all the taxes to support every retiree.

Fewer workers for more retirees mean each worker bears an increasing financial burden to pay the benefits that Social Security has promised. The original Social Security tax was just 2 percent on the first $3,000 that a worker earned, a maximum tax of $60 per year. By 1960, payroll taxes had risen to 6 percent. Today's workers pay a payroll tax of 12.4 percent. But it is going to get much worse. To continue funding retiree benefits, the payroll tax will have to be raised to more than 18 percent. That's nearly a 50 percent increase!

Let's look at that financial burden another way. The Social Security payroll tax is already 12.4 percent of wages, or one-eighth of a worker's total annual income. It is the biggest tax the average household must pay. Roughly 80 percent of American families pay more in Social Security taxes than they do in federal income taxes. Despite that already huge tax burden, the payroll tax will have to be increased by nearly half to continue paying benefits. That's a terrible thing to impose on our children and grandchildren.

Lyons and others prefer to gloss over these facts by citing the Social Security Trust Fund. In reality, how-

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ever, the Trust Fund is simply an accounting measure, a promise against future taxes, in essence an IOU. As Douglas Holtz-Eakin, director of the Congressional Budget Office, puts it, the Trust Fund "has no real economic resources . . . . The key moments for Social Security are in 2018. Cash-flow benefits will equal cash-flow payroll taxes, and then after that, the Social Security Administration will have to come back to the rest of the budget for additional resources to pay promised benefits."

Or perhaps, Mr. Lyons would prefer the word of another Arkansan, former President Bill Clinton. In his FY2000 budget, Clinton said of the Social Security Trust Fund:

> These Trust Fund balances are available to finance future benefit payments . . . but only in a bookkeeping sense. . . . 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 Trust Fund balances, therefore, does not by itself have any impact on the government's ability to pay benefits.

Lyons suggests that a private insurance company in Social Security's position would be considered "flush." More likely, the company's directors would be hauled off to jail to spend time with Bernard Ebbers. Indeed, it is illegal for private companies to operate the way Social Security does.

Lyons is also one of the people who say that even after Social Security's IOUs are all spent, the system will still be able to pay 75 percent of its promised benefits. He then argues that is not the stuff of crisis. Well, Lyons's reassurances must offer cold comfort to those 30-year-old workers who will be retiring just about the time that Social Security must cut its benefits by 25 percent. Given that half of seniors rely on Social Security for at least half their retirement income, and low-income seniors receive nearly 80 percent of their retirement income from Social Security, the millions of elderly thrown into poverty by those cuts are liable to disagree with Lyons on whether it is a crisis.

Dismal Rate of Return

It is also worth asking how Lyons and other opponents of individual accounts would deal with Social Security's other problems. For example, payroll taxes are already so high that most young workers will receive a dismal rate of return on their money, far less than they could earn in private markets. Does Lyons think that this poor and declining rate of return is a problem? If so, how would he fix it? The current Social Security system also has a variety of inequities that penalize working women and minorities. How would he address those issues? Do Lyons and his fellow individual-account critics have a plan to help low-income workers save and invest more, accumulate real wealth, and pass it on to their heirs?

Finally, while defenders of the current Social Security system often speak of it as a "guaranteed benefit," no such guarantee exists. The Supreme Court has ruled twice, in *Flemming v. Nestor* and *Helvering v. Davis*, that there is no legal, contractual, or property right to Social Security benefits. Retirees are left at the mercy of politicians to determine how much they will receive in retirement benefits. Congress is free to change or reduce those benefits at any time. The critics are quick to point to the risks of market investment. But what would they do to protect against the political risks of a system where you don't own your money or have a right to your benefits?

Ultimately, the only way to fix Social Security's many problems—both fiscal and otherwise—is to change the system from a pay-as-you-go model to one based on savings and investment.

Those who disagree have an obligation to tell the rest of us how they would deal with the grim demographic reality.