Myths: The Political Tool of Choice ©

By
William Larsen
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The 2004 campaign season has begun and it is sure to get more heated with politicians using social security as their favorite political tool of choice. Politicians have created so many myths surrounding Social Security that many do not know truth from fiction. Social Security is misunderstood and this is the way politician's like it. It is time these myths were revealed for what they are so that politicians are asked the tough questions and held accountable for their actions.

The following deals only with the Social Security Old Age Benefit program and not the Social Security Disability program.

"The present value of Social Security's currently accrued obligations exceeds $12 Trillion. This means that if Social Security were a funded pension plan, it would need to hold over $12 Trillion worth of assets to pay currently accrued benefit commitments. This assumes the assets would be invested at the long-term government bond rate."[1]

Myth 1

<u>Social Security would be fine had the government not spent the surplus</u>

Since 1937, Social Security has collected $6.97 Trillion in taxes and paid out $6.47 Trillion in benefits for a surplus of $627 Billion over 66 years. The trust fund has earned $590 Billion in interest and taxing social security benefits has raised $121 Billion. The trust fund as of the end of December 2002 totals $1.217 Trillion or $8,113 per worker. The trust fund needs $13 Trillion or $86,667 per worker by December 2003 to be able to pay full promised benefits to all. Government borrowing from the trust fund is therefore not the problem.

Myth 2

<u>Reagan spent the Social Security Surplus on Defense</u>

Between 1971 and 1984, Social Security's Old Age Benefit program paid-out more each year than it collected in tax revenues. There were no surplus tax revenues during these years for the Treasury to borrow. In addition any surpluses prior to 1971 were already loaned to the US Treasury and this money spent on such things as Medicare, Medicaid, Education, defense and other government expenses. President Reagan took office in 1981. Social Security's total tax surplus during Reagan's second term amounted to $62.6 Billion.[2]

Myth 3

<u>Social Security is not an Investment, but insurance</u>

Individuals seek value for their money. No one likes paying more for an item such as gas, food or travel than they have too. The value one receives from Social Security depends on when you were born. If you were born prior to 1930, you got great value. If you were born after 1930 your value decreases on an increasing basis.

Insurance normally is a signed agreement for a defined coverage in return for a defined payment; Social Security has no such signed agreement as well as no defined payment and coverage. Social security is not guaranteed.

The Cost of Money is generally the highest rate of interest you are paying. Applying the Social Security tax to reduce the number of loan payments would be an excellent way to create wealth.

The average worker applying the Social Security tax each month to a mortgage reduces a 30-year mortgage to less than 14-1/2 years. Now make the very same payment of principal, interest and Social Security tax into 5% US Savings bonds for the remaining payments of the original term. At the end of 30 years the worker would have a home plus $370,646. This $370,646 is the value attributed to the Social Security tax being used to pay off the mortgage early.

The Social Security Administration has stated they can pay but 73% of benefits. This means the effective interest rate paid on our Social Security taxes is close to zero if not negative. Assuming a 1% return the value at the end of 30 years for the Social Security benefit is $177,807. The mortgage application method improved the net-worth of the worker by $192,839.

Myth 4
Increased Economic Growth will save Social Security
The initial Social Security benefit is based on average lifetime-indexed wages. Wage growth is used to adjust past wages of future retires; similar to inflation being used to adjust social security benefits for current retires. When rate of economic growth, and its resulting increase in wages, exceeds the rate of return on the social security trust fund, then social security is actually disadvantaged due to economic growth.

For example if wages were to rise 5% this year, the initial social security benefit for future retires would also be 5% greater. If the trust fund investment returns did not match or exceed the 5% rate of growth then the trust fund would be falling behind on its ability to meet the pay out commitment.

In simple terms economic growth will not save Social Security and in technical terms, increased economic growth makes funding social security worse. [3]

Myth 5
Productivity growth is what is needed to save Social Security
Social Security revenues are based on wages earned by the worker. Productivity can contribute to real wage growth (see myth 4) and/or the displacement of workers. Both of these conditions reduce social security revenues. Productivity growth will not help at all.

Myth 6

High deficits in the future make it difficult to pay social security benefits

Social Security by law cannot borrow money. It has statutory authority to spend only those funds received from the dedicated social security tax on wages, tax on benefits and funds in the trust fund. Federal Law prohibits transferring general revenues to any trust fund.[4]

By law the trust fund cannot be drawn down to zero. The trustees must submit a report promptly to congress detailing benefit cuts or tax increases when in any given year the trust fund is projected to fall below 20% of that given years expenses. Social Security's ability to pay future promised benefits is dependent solely on the ability to raise social security taxes.[5]

For over twenty years the Social Security Trustees have projected and reported the trust fund to be exhausted anywhere between 2019 and 2042 which is decades before its original projection of 2060. Where is their report detailing benefit cuts and/or tax increases to rectify the inadequacy?

Myth 7

Increasing the payroll tax by 1.9% can save social security

It is true, raising the payroll tax from 10.6% to 12.5% could eliminate the shortfall between revenues and expenses over the next 75 years. However, in year 2079 Social Security would face the age-old problem it now faces in 2041. How will it pay promised benefits? The tax rate needed then would be 19% and the trust fund will have been exhausted. This just puts off the inevitable.

"...the 75-year time horizon is arbitrary since it ignores what happens to system finances in years outside the valuation period. For example, we could eliminate the actuarial deficit by immediately raising the payroll tax by 1.86 percent of payroll. However, as we move one year into the future, the valuation window is shifted by one year, and we will find ourselves in an actuarial deficit once more. This deficit would continue to worsen as we put our near term surplus years behind us and add large deficit years into the valuation window. This is sometimes called the "cliff effect" because the measure can hide the fact that in year 76, system finances immediately "fall off the cliff" into large and ongoing deficits." [6]

Myth 8

Applying the social security tax to 100% of wages will solve the problem

Currently 80% of all wages are subjected to the Social Security tax. Subjecting the remaining 20% of wages will increase revenues by $90 Billion. At the same time it would increase the social security benefits of those subjected to a higher base, negating 15% of this revenue increase. Currently the unfunded liability of Social Security is $11.5 Trillion based on the effective long-term bond. This means in 2003 the trust fund should have earned an additional $747 Billion in interest. The additional $90 Billion solves just 12% of the problem short term.

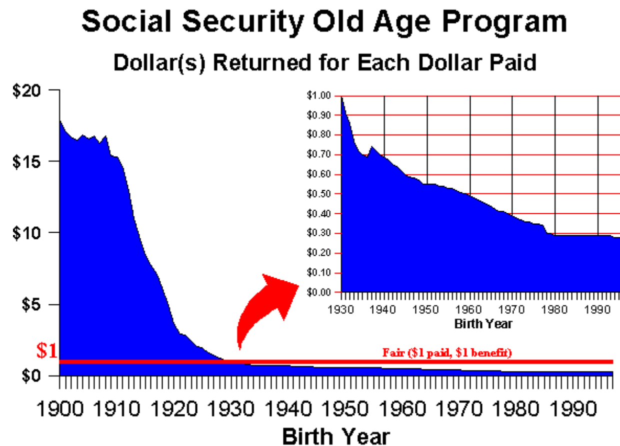
Myth 9

Current retirees have earned and paid for their benefits

The initial tax rate for the first 13 years of the program was 2%. For a pay-as-go program the minimum tax rate should have been 8.2% rising to over 18% by 2050. Collectively those born prior to 1938 paid $2.51 Trillion in Social Security Old Age taxes. They have received $6.47 Trillion in benefits. Over the next eighteen years this group currently retired will be paid an additional $4.5 Trillion in benefits. For every $1 dollar in taxes paid, they received $4 in benefits. They did not pay enough to fund their collective benefits. This is the root cause behind Social Security's problem. A person born in 1985 is projected to receive 29 cents back for every dollar paid to Social Security including credited interest.

"Today's beneficiaries are not living off financial assets accumulated in the past. Today's workers are not accumulating financial assets for the future. Workers invest their payroll taxes not in financial assets but in the willingness of future politicians to tax future workers to pay future benefits." [7]

The accompanying chart shows how a single worker fares. A dual status or non-working spousal benefit would shift the break-even date from 1930 to sometime after 1940.



Myth 10

Increasing the retirement age will help

Increasing the retirement age from 67 to 68 would reduce costs about 6.2%. It would require increasing the retirement age past 73 to solve the problem. This would eliminate 30% of those who lived to age 67, but died prior to reaching 73. This group would have at least received a few months of benefits, but now receive none. This makes Social Security a lottery, if you live long enough, you might collect.

Myth 11

Immigration will save social security

For immigration to influence Social Security, it would have to be large and continual. It is projected there will be 77 million retirees by 2050. To maintain the 10.6% social

security tax, it would require 3.3 workers for every retiree or 231 million workers. This is about 60 million additional workers beyond that forecasted. If for every immigrant worker there were 1 dependent, then we would see a population growth of 120 million between now and 2050. On top of this, the population would have to grow by an additional 396 million between 2050 and 2090 in order to pay benefits to these new immigrants. Immigration just delays the inevitable.

Myth 12
A new baby boom will save social security

A woman's ability to bear a child for the most part is between ages 20 and 40. The critical number of workers required to support one retiree is 3.3 with a 10.6% social security tax. Zero population growth is when one woman has 2.09 babies during their lifetime. This replaces the male and female partners in life and to make up for infant mortality. It would require a growth rate of 2.57% compounded yearly or each woman to bear 3.7 children during her life to produce the number of workers to support 1 retiree. Anything less just delays the inevitable.

Historically a boom begets a boom while a bust begets a bust. The number of births per woman has been dropping consistently for 200 years.

Myth 13
Social Security is running a surplus
There are two types of surpluses: Cash flow and accrual. On a cash flow basis, Social Security is running a surplus. However, based on accrual it has never once run a surplus. Under cash flow accounting, Social Security does not add in the present value cost of future promised benefits earned in that year. This would be similar to an individual buying items on a credit card, but not counting them as an expense until you make a payment to the credit card issuer. This is the reason why Social Security has $11.5 Trillion in unfounded liabilities. Private pension plans are not allowed to use cash flow basis accounting, but by law must use accrual accounting.

Myth 14
Social Security earns a lousy return.
Social Security is invested in US treasury notes. These notes earn a rate based on the average rate paid at the time these notes are auctioned to the public. In 2002 the trust fund earned an effective rate of 6.4%, with an average yearly return of 8.91% since 1980. [8] It is not that the trust fund earns a lousy rate of return, but rather the trust fund balance is too small relative to the taxes paid. Based on the US Treasury rate, the required tax rate to duplicate Social Security’s benefit, based on accrual accounting, would be 5.1%. The payroll tax is 10.6% or twice what it needs to be, based on the current targeted Social Security benefit of 42% of average lifetime indexed wages. Social Security's rate of return is not the problem.

Myth 15
Increased life expectancy is the culprit behind social security's problem

"Life expectancy at birth in 1930 was indeed only 58 for men and 62 for women. But life expectancy at birth in the early decades of the 20th century was low due to high infant mortality, and someone who died as a child would never have worked and paid into Social Security. A more appropriate measure is probably life expectancy after attainment of adulthood.

Since average life expectancy at birth is now about 76, this is interpreted as implying that people collect benefits for 14 to 18 years longer than they used to. However, as Table 1 indicates, the average life expectancy at age 65 (i.e., the number of years a person could be expected to receive unreduced Social Security retirement benefits) has only increased a modest 5 years (on average) since 1940. So, for example, men attaining 65 in 1990 can expect to live for 15.3 years compared to 12.7 years for men attaining 65 back in 1940. So the actual increase in time that males can anticipate receiving Social Security is closer to 3 years than to 14." [9]

Table 1: Life Expectancy for Social Security				
Year Cohort Turned 65	Percentage of Population Surviving from Age 21 to Age 65		Average Remaining Life Expectancy for Those Surviving to	
	Male	Female	Male	Female
1940	53.9	60.6	12.7	14.7
1950	56.2	65.5	13.1	16.2
1960	60.1	71.3	13.2	17.4
1970	63.7	76.9	13.8	18.6
1980	67.8	80.9	14.6	19.1
1990	72.3	83.6	15.3	19.6

Myth 16

<u>Social Security was designed so few would live long enough to collect</u>

"It should be noted that there were already 7.8 million Americans age 65 or older in 1935 (cf. Table 2), so there was a large and growing population of people who could receive Social Security. Indeed, the actuarial estimates used by the Committee on Economic Security (CES) in designing the Social Security program projected that there would be 8.3 million Americans age 65 or older by 1940 (when monthly benefits started). So Social Security was not designed in such a way that few people would collect the benefits" [10]

Social Security reports covered workers to beneficiaries. However, the design criteria relied upon should have been workers to Americans age 65 and older. In this case, the covered workers to those age 65 or older in 1940 would have been 3.9, a far cry from 159.4 reported by Social Security. Social Security was not designed so few would collect, but was designed to fail.

Table 2: Americans Age 65 or Older 1880-1990							
Year	Number of American Age 65 or Older	OASI Beneficiaries [11]	% Beneficiaries to age 65 or older	Covered Workers [12]	Covered Worker to 65 & over Ratio	Covered Worker to Beneficiary Ratio	OASI Tax Rate [13]
1880	1.7 million	0					
1890	2.4 million	0					
1900	3.0 million	0					
1910	3.9 million	0					
1920	4.9 million	0					
1930	6.7 million	0					
1940	9.0 million	0.2 million	2%	35.4 million	3.9	159.4	2.00%
1950	12.7 million	2.9 million	23%	48.3 million	3.8	16.5	3.00%
1960	17.2 million	13.7 million	80%	72.5 million	4.2	5.3	5.50%
1970	20.9 million	22.6 million	108%	93.1 million	4.5	4.1	7.30%
1980	26.1 million	30.4 million	116%	113.6 million	4.4	3.7	9.40%
1990	31.9 million	35.3 million	111%	133.7 million	4.2	3.8	11.02%
2000	34.9 million	38.6 million	111%	152.9 million	4.4	4.0	10.60%

[11]
[12]
[13]

Myth 17
Social Security Benefits are guaranteed
"There has been a temptation throughout the program's history for some people to suppose that their FICA payroll taxes entitle them to a benefit in a legal, contractual sense. That is to say, if a person makes FICA contributions over a number of years, Congress cannot, according to this reasoning, change the rules in such a way that deprives a contributor of a promised future benefit. Under this reasoning, benefits under Social Security could probably only be increased, never decreased, if the Act could be amended at all. Congress clearly had no such limitation in mind when crafting the law. Section 1104 of the 1935 Act, entitled "RESERVATION OF POWER," specifically said: "The right to alter, amend, or repeal any provision of this Act is hereby reserved to the Congress." Even so, some have thought that this reservation was in some way unconstitutional. This is the issue finally settled by Flemming v. Nestor." [14]

"Workers and beneficiaries have no legal ownership over their Social Security benefits. Instead, what they have is a political promise that can be changed at any time, by any amount, for any reason. In any retirement system a lack of legal ownership is a source of insecurity. In one that is under-financed in the long run by 25 percent, it is a serious problem."[15]

Myth 18
The "pay-as-you-go" design worked till ratio or workers to retirees dropped
In 1945 there were 41.9 workers for every beneficiary.[16] However, in 1945 there were 10.7 million age 65 or older, but only 10% of these were eligible for Social Security. Had Social Security been started 40 years earlier, the ratio would have been closer to 4 to 1 instead of 42 to 1 (See Myth 16). Pay-as-you-go has only worked to date due to a 430% increase in the tax, a 2,800% increase in the base[17], retirement age increased by 2 years to 67 and 50% more of the adult population working. The truth is the birth rate per woman has been dropping for the past 200 years, which results in an ever-decreasing

worker to retiree ratio. This was very evident in 1937 when Social Security was passed. This means the pay-as-you-go design was/is nothing more than a con.

Myth 19
<u>The Baby Boomers will bankrupt Social Security!</u>
To date not one baby boomer has collected social security old age benefits, yet they have paid the highest social security taxes their working lives of any generation. Without the baby boom generation, the worker to retiree ratio today would be insufficient to pay promised benefits to current retirees. This would require either a large tax increase or a substantial benefit cut now. The pay-go design is what is failing social security.

Myth 20
<u>Private Accounts will Save Social Security</u>
In general private accounts allow a worker to divert some percentage of their Social Security taxes to a private account. In exchange, the individual's Social Security benefit would be reduced by the value of the equivalent annuity of the diverted tax dollars plus interest at the Treasury rate. This is referred to as the "Offset" condition

The Social Security benefit formula would also change. Currently previous year's wages are indexed by the change in the US Average Wage Growth, but now would be indexed by inflation. In addition the number of work years averaged would increase from 35 to 40. This would reduce current promised benefits by up to 30%.

All private accounts do is repackage the problem. It reduces the problem by legislating nearly a 40% benefit cut on those who retire in the future. They all fall far short of yielding the promised Social Security benefit under current law. 44% of your benefit comes from an 8.6% Social Security tax while 56% of your benefit comes from your diverted 2%. Theoretically diverting four percentage points could reduce your social security benefit to zero.

One must pay particular attention to the terms "**payable benefits**" **and "promised/scheduled benefits**." Payable benefits are generally equal to 60% to 70% of promised benefits. It is important to note what reference base is being used when evaluating private accounts. The only way payable benefits can equal promised benefits is for the combined assets of the trust fund and private accounts to total $13 Trillion by years end. The moral is "You cannot get something from nothing."

Myth 21
<u>Large deficits will make it difficult to pay back the money borrowed from social security</u>
The $1.217 Trillion in special US Treasury Notes held by Social Security are counted as part of the overall National Debt of more than $6 Trillion. When Social Security asks for its money to pay benefits, the US Treasury will simply borrow money some time before on the open market and exchange these special US Treasury Notes. The National Debt will not change one penny, only ownership of the debt. This is exactly what has happened in years past primarily between 1971 and 1983.

Myth 22
If our Senators and Representatives in Congress paid into Social Security the problem would be fixed

If you have read and understood the previous 21 myths, then you will understand that politicians are not interested in solving this problem. The problem they have created by creating and spreading half-truths and lies would be political suicide. Which one will ever confess to perpetuating a Con on the American people?

Myth 23
My retirement plan does not rely on Social Security and I will be fine
Today there are 155 million workers paying 10.6% of their wages to Social Security. The baby boom generation has paid nearly $3 trillion in Social Security taxes. This has cost them nearly $8 Trillion if not more in wealth creation. Future retirees will not have the equivalent assets as past retirees when they begin retirement. This means more retirees needing assistance with fewer workers to support them.

In the future Social Security will have to raise taxes by 85% or cut benefits by 40%. This is the simple reality of the problem. There has been talk of a national sales tax. Today we have a luxury tax on cars and boats. Who is to say that other categories will not be considered a luxury after 2035? A national sales tax on first run movie tickets, restaurants, hotels, amusement parks, airline tickets, furniture, etc could become a reality.

These types of taxes will take what you have earned and saved, and distribute them to others who failed to save for their retirement. You may have assets, but they will not buy as much as you might be counting on. To avoid this all must save and prepare for their own retirement.

It has now been 20 years since the big fix of 1983 to save Social Security. The "Big Fix" was supposed to fund the baby boomers Social Security Benefits, but not those who would come afterwards. What has congress been doing for these past 20 years to resolve this 66-year-old problem?

For William Larsen's plan for Social Security go to
www.justsayno.50megs.com/bill_larsen_platform.html

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[1] President's Commission to Strengthen Social Security, Interim Report August, 2001, page 10, http://www.csss.gov/reports/Report-Interim.pdf

[2] Social Security Administration's Web Site
http://www.ssa.gov/OACT/STATS/t4a1Income.html
http://www.ssa.gov/OACT/STATS/t4a1Outgo.html

[3] President's Commission to Strengthen Social Security, Interim Report August, 2001, Page 16, http://www.csss.gov/reports/Report-Interim.pdf

[4] United States Code Title 42, Chapter7, Subchapter VII, Sec. 911 (a), http://www4.law.cornell.edu/uscode/42/911.html

[5] United States Code Title 42, Chapter7, Subchapter VII, Sec. 910 (a), http://www4.law.cornell.edu/uscode/42/910.html

[6] Strengthening Social Security and Creating Personal Wealth For All Americans, Final Report December 21, 2001, Page 70, http://www.csss.gov/reports/Final_report.pdf
[7] President's Commission to Strengthen Social Security, Interim Report August, 2001, page 10, http://www.csss.gov/reports/Report-Interim.pdf
[8] Social Security Administration's Web Site, http://www.ssa.gov/OACT/ProgData/effectiveRates.html
[9] Social Security Administration's Web Site, http://www.ssa.gov/history/lifeexpect.html
[10] Social Security Administration's Web Site, http://www.ssa.gov/history/lifeexpect.html
[11] Beneficiaries are defined as those with monthly benefits in current-payment status as of December 1940. This is a slightly different basis than that used in the rest of this table. Therefore the ratio for 1940 is only approximately comparable to the data for the subsequent years. http://www.ssa.gov/OACT/TR/TR01/lr4B2-h.html
[12] Covered Workers is defined as those who are paid at some time during the year for employment on which Social Security taxes are due.
[13] Social Security Administration's Web Site, http://www.ssa.gov/OACT/ProgData/oasdiRates.html
[14] Social Security Administration's Web Site, http://www.ssa.gov/history/nestor.html
[15] President's Commission to Strengthen Social Security, Interim Report August, 2001, Page 3, http://www.csss.gov/reports/Report-Interim.pdf
[16] Social Security Administration's Web Site, http://www.ssa.gov/history/ratios.html
[17] Social Security Administration's Web Site, http://www.ssa.gov/OACT/COLA/cbb.html