THE CENTURY FOUNDATION
Issue Brief

10 Myths about Social Security

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Myth #1: Social Security is in crisis and facing bankruptcy.

Even if Congress were to leave Social Security untouched, the **program would be able to pay** currently guaranteed benefits in full until 2042, according to the program's trustees. Thereafter, about 70 percent of promised benefits could be financed. **The nonpartisan Congressional Budget Office is even more optimistic**: it projects that, without changes, Social Security will be able to meet its obligations in full until 2053, after which about 80 percent of benefits still could be paid for. Even under those worst-case scenarios, decades from now the system would be far from "bankrupt," "flat-out bust," or "broke," which imply that no resources would be available to pay any benefits. At that time, workers and their employers still will be contributing payroll taxes to finance benefits for retirees.

So Social Security is facing a long-term financing problem, but it is far from a "crisis" by any definition of that word. And the problem is much less immediate and threatening now than in the recent past, even though no changes have been made to the program. **In 1997**, Social Security's trustees had projected that the program's trust funds would last only another thirty-two years and would be depleted in 2029. Those forecasts have improved steadily-largely because of stronger than expected economic growth-so that the trust funds now are expected to remain sufficient for thirty-seven more years.

Like a doctor who recommends "watchful waiting" while a patient becomes healthier, Congress should think twice before performing radical surgery on an enormously successful program that appears to be getting better with age.

Myth #2: Social Security is unsustainable.

Over the course of the next seventy-five years, the gap between promised Social Security benefits and resources available to pay those benefits—the shortfall projected to arise beginning in 2042—is predicted to be about 0.7 percent of gross domestic product (GDP), or $3.7 trillion, according to Social Security's trustees. Without question, that's nothing to sneeze at. But by way of perspective, the tax cuts enacted in 2001 and 2003, if made permanent, would cost nearly three times as much: $11.6 trillion, or 2.0 percent of GDP, **according to the Center on Budget and Policy Priorities**. Furthermore, the new prescription drug benefit enacted last year will cost more than twice as much as eliminating the Social Security shortfall.

So saying that Social Security isn't "sustainable" or "affordable" is simply wrong. The program's entire seventy-five-year shortfall could be paid for simply by rescinding just a third of the planned tax cuts, which primarily benefit the highest earners—people who would still be paying substantially

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less to the government than they did in the prosperous 1990s. A myriad other trade-offs are possible as well. But the long-term challenge confronting Social Security is by no means insurmountable.

Myth #3: Social Security's trust funds are filled with worthless IOUs.

When investors become worried about the economy and the stock market, they "flee to safety" by selling their other securities in exchange for U.S. Treasury bonds and bills. Backed by the full faith and credit of the United States government, U.S. Treasury securities are considered to be the safest, most reliable investment worldwide. Because the federal government is legally obligated to pay back interest and principal on those securities, it would take an almost unimaginable calamity for a default to occur. **Social Security's trust funds**, which now amount to $1.5 trillion and are expected to grow to $5.3 trillion by 2018, hold nothing but U.S. Treasury securities.

Alan Greenspan, now the Federal Reserve chairman, led **a bipartisan commission** in 1983 that recommended changes to Social Security explicitly to produce the large trust funds that the system will draw on to pay for the baby boom generation's retirement from roughly 2008 to 2030. Those reforms, signed into law by President Ronald Reagan, were widely hailed at the time by both parties as a model of effective government. If anything, those reforms have turned out to be even more successful than originally imagined, as the improved forecasts in recent years for the program demonstrate. The central reason for that success was the Greenspan Commission's idea of building up trust funds invested in safe U.S. Treasury securities.

Myth #4: The real date to worry about is 2018.

President Bush and others have argued that Social Security's problem begins not in 2042, when the trust funds would be depleted, but 2018, when Social Security's trustees project that payroll taxes will no longer exceed that year's benefit obligations. But the whole reason why President Reagan and Alan Greenspan created the trust funds was to guarantee that benefits could continue to be paid in full when payroll taxes did not fully cover the system's expenses. Remember that the trust funds will amount to about $5.3 trillion at that time. Just the interest on the trust fund's Treasury securities will be more than sufficient to finance payments fully for another ten years. Indeed, the trust funds still will grow another 25 percent from 2018 to 2028, reaching about $6.6 trillion because of the interest earned on those securities.

From the standpoint of the federal budget, after 2018, some general revenues will be needed to pay for the difference between each year's payroll taxes and guaranteed benefits as part of the interest owed on the trust fund's Treasury securities. But in each of those years, the expected cost will be relatively modest. **The Center on Budget and Policy Priorities calculates** that in 2025, for example, the difference between Social Security's benefit costs and its non-interest revenues will be less than 10 percent of the projected federal deficit. By comparison, the Bush administration's tax cuts, if made permanent, and the new prescription drug benefit for Medicare will cost five times as much in that year.

Myth #5: Social Security is a bad deal.

The vast majority of today's retired Americans will receive Social Security benefits that far exceed what they contributed in taxes during their working years. While that so-called "rate-of-return" is projected to decline somewhat for future retirees, the program still offers a far better deal than any other private alternative could conceivably provide. Here's why:

Focusing on retirement benefits alone, most workers with moderate and low incomes will receive an annual rate of return slightly in excess of the 2 percent that government bonds typically provide above inflation. **For example**, a couple with one worker who earned an average income and retires in 2029 would receive an average real rate of return of 3.97 percent. Those with high earnings would receive a lower, but still positive rate of return. Unlike Individual Retirement Accounts and 401(k)s, Social Security's retirement benefits are not subject to investment market fluctuations and provide benefits that increase with inflation. So the program's baseline retirement benefits in their own right constitute a good deal.

Retirement benefits are not all that Social Security offers. In addition, it provides insurance to workers and their families in the event of disability or death. More than a third of Social Security beneficiaries are survivors of deceased workers, spouses and children of retired or disabled workers, or disabled. **For an average wage earner** with a spouse and two children, in 2000 the disability coverage provided by Social Security was equivalent to a $353,000 disability policy in the private sector; Social Security's survivorship insurance was equivalent to a $403,000 life insurance policy. Moreover, Social Security's insurance payments are adjusted annually to protect against erosion caused by inflation; private insurance rarely, if ever, protects against inflation. Rate-of-return calculations do not take into account the significant value of that insurance protection.

From the standpoint of taxpayers, Social Security is enormously efficient. Its administrative costs are less than 1 percent of benefits. In contrast, the fees in privately managed investment accounts are likely to reduce the ultimate retirement value of the accounts by 20 percent, **according to a study** by University of Chicago economist Austan Goolsbee.

Myth #6: Social Security is overly generous.

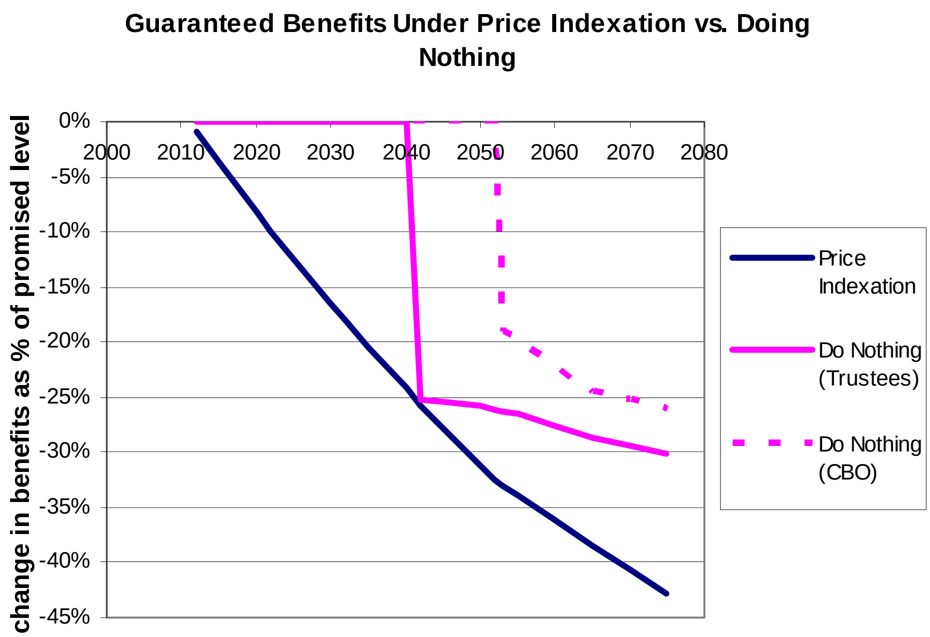
While Social Security continues to be a terrific deal from the perspective of what taxpayers receive relative to their lifetime contributions, it is by no means extravagantly generous. The average monthly payment is $895, or $10,740 a year. By comparison, the poverty level in 2003 was $8,980. The Social Security benefits of an average-wage worker with a spouse who retires at age sixty-five in 2004 were about 63 percent of his or her average earnings. For low-wage workers, it replaces 85 percent of past earnings; for high-wage workers, the replacement level is 45 percent.

Without Social Security, about 40 percent of the nation's elderly would be in poverty, rather than just 10 percent. Before 1960, the poverty rate among the elderly was over 35 percent. The dramatic decline since then is largely attributable to Social Security. In 2003, 34 percent of the elderly relied on Social Security for at least 90 percent of their total income. For 65 percent of the elderly, Social Security constitutes more than half their income. So while the program's guaranteed benefits are far from excessive, they are essential to enabling the nation's retirees, and assuring today's workers, that they will be able to live out their golden years in decency.

Myth #7: "Privatization" will strengthen Social Security.

Although President Bush has not yet put forward a specific proposal, the **President's Commission to Strengthen Social Security** in 2001 laid out three alternative approaches for diverting payroll taxes into individual retirement accounts. The second of those proposals is widely considered to be close to the model that the president will endorse. Its two main features are (1) a cut in promised benefits by switching from a wage-indexing to a price-indexing formula, thereby reducing the wage-replacement rate each year for new retirees; and (2) the creation of personal retirement accounts using up to four percentage points of each worker's taxable payroll income. Here is why the proposal would weaken, rather than strengthen Social Security. (see the issue brief **Twelve Reasons Why Privatizing Social Security is a Bad Idea** for an extended discussion)

• It would dramatically reduce guaranteed benefits-far beyond the amount needed to close the program's long-term financing gap. The graph below shows the extent to which promised benefits would be reduced relative to the current "worst-case scenarios" projected by Social Security's trustees and the Congressional Budget Office. The benefit reductions under the commission's plan would begin to kick in relatively gradually, but would reduce payments steadily so that today's young workers would be far worse off than if no changes were implemented.



Source: "Do Nothing" from [***Social Security Trustees 2004 report***] *Table IV.B1 and from CBO* [***"Long Term Analysis of Plan 2 of the President's Commission to Strengthen Social Security,"***] *Table 1B; "Price Indexation" from SS Chief Actuary,* ***as reported in the*** **Washington Post**. *(Some intermediate numbers interpolated.)*

If retirees have private accounts, these also would contribute to their income. But the contribution of private accounts can be ignored. That is because while "price indexation" would apply to all Social Security recipients, whether or not they opted for private accounts, those who chose to invest would face additional, even greater reductions in guaranteed benefits. Moreover, according to the Congressional Budget Office, the risk-corrected value of private accounts barely would exceed the guaranteed benefits they replace. Private accounts have essentially no effect on the situation.

• Diverting payroll taxes into private accounts would cause a much more immediate and severe "crisis" to arise. Under the commission's plan, Social Security would have to rely on interest from the trust funds to pay benefits starting next year, rather than in 2018. The trust funds would be exhausted well before 2020 if everyone elected to contribute the maximum 4 percent of their income to the accounts-more than thirty years earlier than would otherwise be the case.

• To finance the accounts while continuing to pay benefits to current retirees will require huge new federal borrowing - again, far beyond what would be needed to cover the Social Security's long-term shortfall. The **2004 Economic Report of the President** included an analysis of the fiscal impact over time of the most commonly discussed privatization proposal by the president's commission. It found that the federal budget deficit would be more than 1 percent of GDP higher every year for roughly two decades, with the highest increase being 1.6 percent of GDP in 2022. The national debt levels would be increased by an amount equal to 23.6 percent of GDP in 2036. That means that, thirty-two years from now, the debt burden for every man, woman, and child would be $32,000 higher because of privatization.

• Social Security's disability and survivor's insurance would be decimated under privatization. In the principal proposal put forward by the president's commission, the reduction in disability benefits was severe, with cuts ranging from 19 percent to 47.5 percent after the year 2030. The commission itself somewhat disavowed this aspect of its proposals, suggesting that a subsequent commission or other body that specializes in disability policy might revise how its plans apply to the disabled. **Economists Peter A. Diamond (MIT) and Peter R. Orszag (The Brookings Institution) have noted** that the personal accounts would do little to offset these benefit reductions for the disabled. One reason is that their individual accounts often would be meager, since those who become disabled before retirement age may have relatively few years of work during which they could make contributions to their accounts. Second, under the commission proposals, disabled beneficiaries (like all other beneficiaries) would not be allowed access to their individual accounts until they reached retirement age.

Myth #8: Today's young workers will benefit the most under privatization.

Social Security privatization is often sold to young adults as a much better deal for them than the current system. But **younger generations will be the ones** who bear the bulk of the costs of transforming the program. That is attributable to the additional new debt burden they will face as well as the long-term impact of no longer keeping guaranteed benefit levels connected to improvements in living standards. According to the Congressional Budget Office, "to raise the rate of return for future generations by moving to a funded system, some generations must receive rates of return even lower than they would have gotten under the pay-as-you-go system." A **July 2004 Congressional Budget Office analysis** of the commission proposal found that nearly all age groups at all income levels born from the 1940s through the first decade of the twenty-first century on average do worse under the proposed system of private accounts. Only individuals with the lowest incomes from the 1950s and the 1990s do slightly better, on average.

Myth #9: Privatization will enable retirees to leave the assets in their accounts to their heirs.

Although this claim continues to be made widely, **most workers would not be able to bequeath their Social Security investment accounts upon their death**. The proposals put forward by the president's commission would allow retirees to collect some or all of their lump sums, provided that both spouses agree and that the withdrawals are of sufficient size to keep the worker and spouse out of poverty. (Turning over the entire "nest egg" to retirees would run the risk that individuals would squander it, either leaving them impoverished or the government on the hook for providing subsistence benefits.) The commission did not provide details about how the government would determine whether retirees would be at risk of poverty, but given that nearly half of today's retirees would be in poverty without Social Security, it's safe to say that a large portion of future workers would not be allowed to access their accounts in the form of a lump sum. To a large extent, it would be only the wealthiest elderly—those who already have sufficient assets to pass along to their heirs—who would gain access to their investment accounts.

Most other retirees would be required to convert their lump sums into financial vehicles called annuities, which would provide each retiree monthly payments that would continue until the retiree and his or her spouse died. The value of the annuities' monthly payments is based on the life expectancy of each beneficiary upon retirement. If annuity payments were to continue to children and other heirs after the death of the beneficiary, the investment companies providing the annuities would go out of business. Annuities also are rarely indexed for inflation, as today's Social Security benefits are, for the same reason: private companies would not be able to earn a reliable profit.

Myth #10: Reforms that retain Social Security's existing protections will not work.

Social Security's projected shortfall beginning after the year 2042 could be surmounted by choosing from a menu of modest benefit cuts and revenue increases, without increasing federal deficits. Among the alternatives that would help strengthen the system: including all state and local workers in the program (most of whom are now exempted) to increase revenues; including earlier, lower-salary years of workers in calculating their retirement benefits; changing the benefit formula so that workers with high income have a smaller share of their pre-retirement earnings replaced by Social Security; raising the cap on earnings subject to the payroll tax; modestly reducing early retirement benefits; and so on. Any combination of such changes would strengthen the system's long-term finances while preserving the features that have made it so successful.

Notes

MYTH #1: "Social Security would be able to meet. . . ." The 2004 Annual Report of the Board of Trustees of the Federal Old Age and Survivors Insurance and Disability Insurance Trust Funds, Social Security Administration, March 23, 2004, p. 2, available online at **http://www.ssa.gov/OACT/TR/TR04/tr04.pdf**.

"The non-partisan Congressional Budget Office. . . . " The Outlook for Social Security, Congressional Budget Office, June 2004, p. 8, available online at **http://www.cbo.gov/ftpdocs/55xx/doc5530/06-14-SocialSecurity.pdf**.

"In 1997. . . . " See summary table of past trustees' forecasts in Robert Greenstein, "What the Trustees' Report Indicates about the Financial Status of Social Security" Center on Budget and Policy Priorities, March 31, 2004, available online at **http://www.cbpp.org/3-23-04socsec.htm**.

MYTH #2: See Richard Kogan and Robert Greenstein, "President Portrays Social Security Shortfall as Enormous, But His Tax Cuts and Drug Benefit Will Cost Five Times as Much," Center on Budget and Policy Priorities, Jan. 10, 2005, available online at **http://www.cbpp.org/1-4-05socsec.htm**.

MYTH #3: "Social Security's trust funds. . . . " The 2004 Annual Report, p. 181, available online at **http://www.ssa.gov/OACT/TR/TR04/tr04.pdf**.

MYTH #4: See Jason Furman, "Does Social Security Face a Crisis in 2018?" Center on Budget and Policy Priorities, January 11, 2005, available online at **http://www.cbpp.org/1-11-05socsec.htm**.

MYTH #5: "For example, a couple with one worker. . . . " Orlo R. Nichols, Michael D. Clingman, and Milton P. Glanz, "Internal Real Rates of Return under the OASDI Program for Hypothetical Workers," Office of the Chief Actuary, Social Security Administration, Actuarial Note Number 144, June 2001, Table 3, data for hypothetical workers with a steady earnings pattern, available online at **http://www.ssa.gov/OACT/NOTES/note144.html**.

"For an average wage earner with a spouse. . . . " Statement of Senator Max Baucus, Senate Finance Committee Hearing on the Final Report of the President's Commission to Strengthen Social Security, 107th Cong, 2nd Sess., October 3, 2002.available online at **http://finance.senate.gov/press/pr100302.pdf**.

"In contrast, the fees in privately managed. . . . " Austan Goolsbee, "The Fees of Private Accounts and the Impact of Social Security Privatization on Investment Managers," working paper, University of Chicago Graduate School of Business, September 2004, available online at **http://gsbwww.uchicago.edu/fac/austan.goolsbee/research/ssecfees.pdf**.

MYTH #6: See Social Security Reform: The Basics, The Century Foundation, 2005 (forthcoming)

MYTH #7: See Greg Anrig and Bernard Wasow, "Twelve Reasons Why Privatizing Social Security Is a Bad Idea," The Century Foundation, December 2004, available online at **http://www.tcf.org/Publications/RetirementSecurity/12badideas.pdf**.

MYTH #8: See Richard C. Leone and Libby Perl, "We're All in This Together," American Prospect, February 10, 2005, pp. A20-21., available online at **http://www.socsec.org/commentary.asp?opedid=846**.

MYTH #9: See Greg Anrig and Bernard Wasow, "What Would Really Happen Under Privatization? Part III: IRAs and 401(k)s That You Can't Control or Leave to Your Heirs," The Century Foundation, December 10, 2001, available online at **http://www.socsec.org/publications.asp?pubid=326**.