

Trust Fund Critics Detract From Real Social Security Debate
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By Katie Baird

The current debate about Social Security focuses on whether the system is in need of dramatic change--such as through the establishment of private accounts--or is basically sound and needs only some combination of tax increases and benefit reductions. Unfortunately, much of the rhetoric around the failures of the existing system is designed to alarm rather than inform, and detracts from the main issues that we should be discussing. This tactic is most evident in those who claim that the Social Security trust fund is in fact fictitious.

As most now know, the trust fund is Social Security's "rainy day" account that has been accumulating "funds" since around 1983 when Social Security tax revenue started exceeding its payments. The purpose of this trust fund is to help pay for pension and disability payments when tax revenues are expected to fall below anticipated payouts – currently anticipated to occur in 2018.

By law, any "surplus" in Social Security has to be invested in US government bonds. This provision in the law exists for two reasons. First, investing tax revenue in the private sector raises the specter of socialism, and as such has always been an unpopular option. Second, federal debt is the safest way to invest future pensioners' dollars.

As a result, Social Security's surpluses now take the form of a trust fund consisting of almost \$2 trillion in U.S. federal bonds. Misinformed and biased critics of Social Security make the alarming but unfounded claim that the trust fund is nonexistent

The main claim is that trust fund assets – U.S. government bonds – are not real assets but simply government IOUs. There is nothing to "draw" from in 2018, and thus the future crisis will hit in 2018, not in 2042 when the trust fund, if one had existed, would be depleted.

Many Americans (not to mention foreigners) own U.S. government bonds, and would be surprised to learn that they are not a "real" asset. Government debt fails to be an asset when the government in question fails to pay it, which in the United States *might* happen if the current system of government were overturned, or if it were impossible for the government to raise the money needed. Both of these are highly unlikely events, at least in the medium term.

Perhaps, you say, it is different when the government "owes the debt to itself"? Perhaps then it is less likely to make good on its debt? But the U.S. government has always met its interest obligations to Social Security. Moreover, it has readily repaid its debt in the past when Social Security's tax revenue was insufficient to meet pension and disability payouts--which happened every year between 1976 and 1982. The political and

economic fallout from not making good on its debt is enough to assure that the federal government will pay up. And so, yes, the trust fund does consist of assets, if by assets you mean something that Social Security can draw on to meet its legal obligations.

When pushed, critics of the trust fund will make a further claim: that these assets are, in the words of the Cato Institute's Michael Tanner, simply "claims against future taxes"--for the federal government to pay off its debt to Social Security, goes the reasoning, it must raise taxes. That is because the federal government spent everything that Social Security loaned it, and thus the government has nothing but the hard-earned money of citizens to fall back on to repay its debt to Social Security.

In one sense, this is of course true. By definition, federal debt (in the form of U.S. government bonds) is issued when the government spends more than it takes in. The trust fund's investments in these bonds – or anyone else's investments for that matter--help the government finance its expenses. And all debt eventually must be paid by future taxes.

The federal debt is now around \$8 trillion—meaning that over the years, the federal government has accumulated \$8 trillion more in expenses than it has raised in revenue. Had it not been for the Social Security reserves, which has provided almost \$2 trillion of this \$8 trillion, the government would have had to have borrowed from the public instead. And yes, the federal government has "spent" all 8 trillion of these dollars. However, when the government in 2018 starts paying back Social Security, it can do this without raising taxes, or without cutting back on services: it can raise the funds to retire Social Security's bonds by simply issuing new bonds to the public. Its debt would remain the same.

So the charge that the federal government "spent" the money has meaning only if the federal government spent more than it *would* have had Social Security's surpluses not been an option. As Roger Lowenstein puts it in a recent *New York Times* article, "Just as lending money to a child outside a candy store may impose an impossible temptation, so the government may feel tempted [to spend] while it holds onto Social Security's purse."

Has the federal government been tempted into spending more because of Social Security's surpluses? During the last fifteen years, the trust fund has been accumulating annual surpluses of around \$50 billion to \$150 billion. Yet during this period (with the exception of the last few years of course) federal deficits as a share of gross domestic product have been declining. This is not what one would expect if legislators had been engaged in a spending spree spurred by Social Security's surplus.

The trust fund is not a hoax. Those who insist on claiming it is are either misinformed or disingenuous. More importantly, they detract from three questions we should be addressing.

First, should public pensions be redistributive? As is, Social Security redistributes income from the wealthiest of the elderly to the poorest, and in consequence is successful

in keeping the elderly out of deep poverty. If this is an important characteristic of our pension program, this should be a central issue that proponents of privatization address.

Second, how much of the risk to individuals of disability, early death, market fluctuation, unemployment, uneven earnings, and (heaven forbid!) longevity should be born by individuals versus being shared more broadly by all Americans? Under Social Security, individuals bear little of this risk – in fact, Social Security provides *insurance* against such risks, being by design an insurance not an investment program. Is it desirable to protect individuals from these risks, or is it preferable to have individuals bear more of these risks themselves?

Finally, how can we structure our public pension system so as to promote private savings?

These three questions about the structure and purpose of a public pension system are what we should be discussing, not the mythical properties of the trust fund.