

14. Social Security

TODAY'S Social Security faces two serious problems that only get worse with time. *First*, the program has promised workers more in benefits than it can afford to pay. In about 11 years, Social Security will begin to spend more to pay benefits than it takes in from payroll taxes. These annual deficits will rapidly exceed \$100 billion a year and will continue to grow to well over \$300 billion. *Second*, the current system gives younger and lower-income workers a very poor return on the taxes that they pay. The only way to avoid the coming financial problems without making Social Security an even worse deal for younger and lower-income workers is to establish a system of personal retirement accounts. These accounts would give all workers the flexibility both to improve their retirement income above what Social Security will be able to pay and to leave a nest egg to future generations.

by David C. John

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Recommendations

1. Create Social Security personal retirement accounts that workers would own and could use to build nest eggs for retirement. The next Congress should move quickly to establish “Social Security Part B,” composed of personal retirement accounts that would be funded with a portion of the taxes that workers now pay. “Social Security Part A” would be the program’s traditional benefits. Workers would have the choice of either placing part of their Social Security taxes into the new personal retirement accounts (Part B), with their benefits being a combination of Parts A & B, or remaining exclusively in the existing Social Security system (Part A) and accepting whatever benefits are available at the time that they retire.

Personal retirement accounts would be invested in lifespan accounts, which are a mixed portfolio of low-risk assets such as stock index funds and super-safe government bonds. The accounts automatically choose the best mix of investments that a worker of that age should have for maximum income and investment safety. This type of investment would allow workers to earn higher rates of return without requiring them to choose specific stocks or to guess which sectors of the economy are going to do best.

2. Focus Social Security benefits on those who most need them. An essential step in reforming Social Security will be to create a system of real benefits on which workers and retirees can depend rather than promised benefits that cannot be paid. Congress should slow the growth of traditional benefits for middle- and upper-income Americans, who are much less dependent on Social Security for their retirement income, so that the benefits of lower-income Americans can be protected and improved.

3. Improve the information that workers receive about Social Security. Congress should make the Social Security statement that the Social Security Administration sends to every taxpayer over the age of 25 more accurate and informative. The statement should include additional accurate information about Social Security's financial crisis and the real nature of Social Security's trust funds—information without which American workers cannot plan adequately for retirement.

4. Protect the benefits of existing retirees and workers who are close to retirement. Any comprehensive reform plan establishing personal retirement accounts should include a guarantee in law that seniors will receive every cent that they have been promised, including an annual cost-of-living increase.

Facts and Figures

■ Data from The Heritage Foundation's Social Security Calculator reflect that the current Social Security system is a very poor investment for many workers. A 25-year-old man is predicted to receive a -0.82 percent rate of return on his Social Security taxes.

■ The same data reflect that low-income workers have extremely poor rates of return, and many low-income men will receive less in benefits than they paid in Social Security payroll taxes. A 25-year-old man living in Harlem would have a -4.46 percent rate of return on his Social Security taxes.

■ Social Security is the only retirement plan that many Americans now have. The Employee Benefit Research Institute reports that of the roughly 153 million workers in the U.S. in 2004, 71 million worked where the employer did not offer a pension plan, and 17 million more were offered a pension plan but did not choose to participate.

■ In about 2017, Social Security will begin to spend more for benefits than it takes in from its taxes. For the program to pay full promised benefits between then and 2080, each family in America would have to

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pay over \$100,000 in additional taxes. In total, Social Security will need about an additional \$27 trillion (in constant 2004 dollars without inflation) over and above what it is scheduled to receive in payroll taxes.

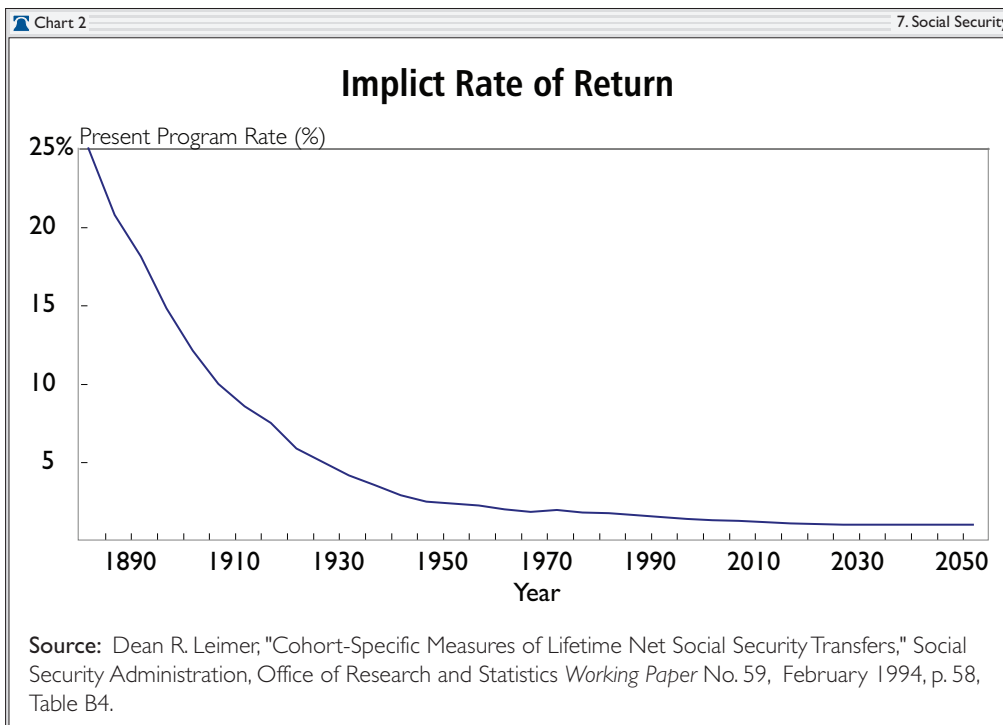
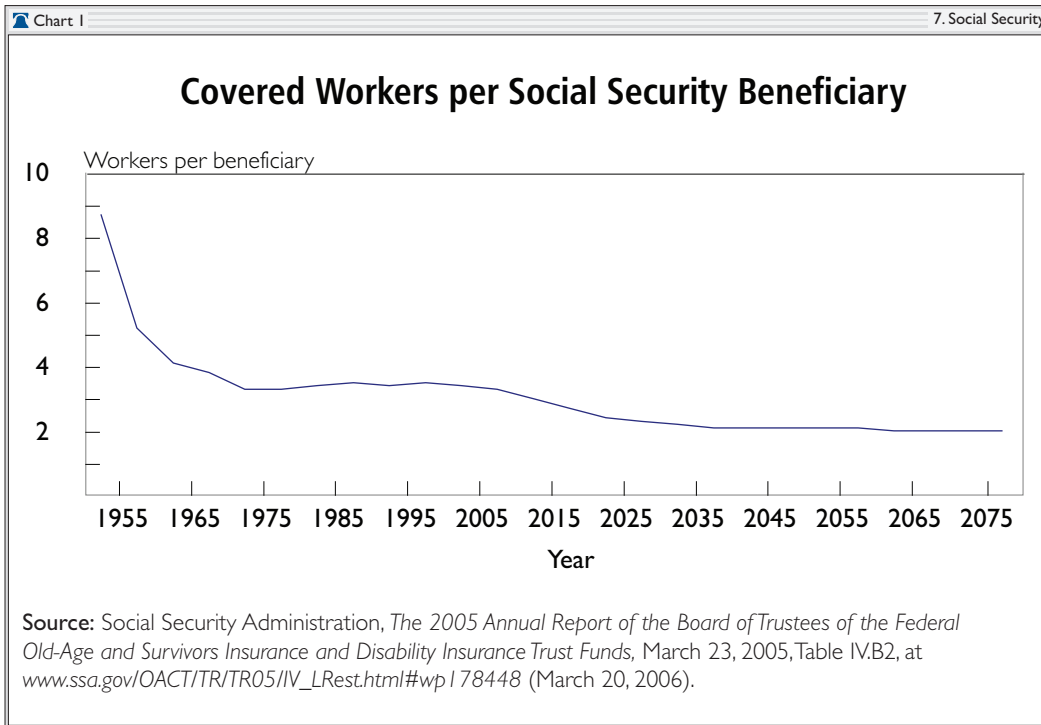
■ The Social Security trust fund does not contain either cash or saleable assets. All of the extra money that Social Security collects in taxes over what it needs to pay benefits each year is spent on other government programs. In return, the trust fund gets only special-issue government bonds that are really nothing more than IOUs between one part of the government and another.

■ After 2041, the special-issue IOUs in the trust fund will run out. The law allows Social Security to pay out benefits equal to the amount of payroll taxes that it collects each year. After 2041, the Social Security Administration says that it will either have to cut benefits by about 35 percent or raise taxes by about 50 percent.

■ Today's Social Security benefits are not safe or guaranteed. After 2041, Social Security will have to cut benefits unless Congress approves massive tax increases. Anyone born after 1974 will not get the benefits they are promised unless their children and grandchildren pay much higher taxes.

■ Social Security personal retirement accounts would give workers much more flexibility to provide for their retirements and build a nest egg for the future. A Heritage Foundation study shows that workers would be able to leave a legacy for future generations that could grow into a significant nest egg that could be used, for example, to pay for college educations, finance a small business, or improve retirement benefits.

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This paper can be read online at issues2006.org/socialsecurity.

Additional Reading

David C. John and Stuart Butler, “Bush’s Progressive Indexation Plan: A Key Step to Preserve Social Security,” Heritage Foundation *WebMemo* No. 733, May 2, 2005, at www.heritage.org/Research/SocialSecurity/wm733.cfm.

David C. John, “A Guide to the 2005 Social Security Trustees’ Report,” Heritage Foundation *WebMemo* No. 702, March 24, 2005, at www.heritage.org/Research/SocialSecurity/wm702.cfm.

David C. John, “How Today’s Social Security Works,” Heritage Foundation *Backgrounder* No. 1827, March 2, 2005, at www.heritage.org/Research/SocialSecurity/bg1827.cfm.

David C. John, “How to Fix Social Security,” Heritage Foundation *Backgrounder* No. 1811, November 17, 2004, at www.heritage.org/Research/SocialSecurity/bg1811.cfm.

William W. Beach, Alfredo Goyburu, Ralph A. Rector, Ph.D., David C. John, Kirk A. Johnson, Ph.D., and Thomas Bingel, “Peace of Mind in Retirement: Making Future Generations Better Off by Fixing Social Security,” Heritage Foundation *Center for Data Analysis Report* No. 04–06, September 10, 2004, at www.heritage.org/Research/SocialSecurity/CDA04-06.cfm.