American Thinker

Return to the Article

March 10, 2011

The Politics of Social Security Reform

By Randy Fardal

Democrat politicians are waging yet another media campaign to block Social Security reform. Late last month Senator Durbin claimed, "Social Security does not add one penny to the deficit." Two days later, a White House aide assured voters that Social Security reform is "not one you care about" and President Obama's budget director opposed reform in a USA Today op-ed. The Hill then quoted half a dozen more Democrats singing from the same anti-reform songbook.

The inspiration for their lyrics dates back to the 1930s, when Coots and Gillespie wrote, *You better watch out, You better not cry, You better not pout, I'm telling you why: Santa Claus is coming to town.*

Why do Democrats scold workers like PTA mothers in December? Probably because the politicians worry that they will stop believing in Santa Claus government and become enthusiastic about Social Security privatization. At least some Americans must have noticed that the stock market rose by about 80 percent over the past two years and the Social Security trust fund gained only eight percent.

For decades, leftist politicians and their big media chorus girls have intimidated reform-minded lawmakers by claiming that modifying the Social Security entitlement scheme is politically equivalent to touching the deadly third rail in a subway station. However, the real reason the left wants to keep reformers away from the third rail is because that's where the power is distributed. In politics, money is power and the Social Security trust fund currently has assets of 2.6 trillion dollars.

Despite that large endowment, trust fund investments still earn too little to cover dividend distributions and administrative costs, so the Social Security Administration must rely on a constant stream of payroll tax receipts. The SSA invests in debt from the US Treasury, an organization that has never defaulted on its payments. How then could the SSA possibly be running out of money?

The answer, of course, is that Social Security is not just a retirement plan. It is a schizophrenic combination of financial enterprises and fund raising:

- A tax-deferred intermediate bond fund that invests only in US Treasury debt
- A term life insurance pool
- A disability insurance pool (since 1956)
- A Ponzi scheme that shifts wealth from private individuals to government
- A federal flat tax, currently on income up to $106,800

A Treasury bond fund is a poor investment for younger workers. Yields on intermediate-term Treasury bonds barely beat inflation: In real dollars, they typically return only two or three percent. Still, if the money were held in individual private accounts, it might be a good investment for retirees or those nearing retirement, as it would be a safe place to park cash for covering monthly retirement expenses.

However, the investments aren't really held in individual private accounts. And as a bond fund, its net asset value is far below what is needed to sustain its current dividends. The retirement portion of the trust fund had assets of $2.34T at the beginning of 2010 and it paid dividends and administrative costs of $586B during 2010 -- about 25 percent of its assets -- while earning only 3.4 percent on its investments. (SSA annual report, page 38) If it were a Wall Street government bond fund, it would be broke in just a few years, though the SEC probably would shut it down long before that.

As a disability insurance pool, its asset value is far too small to sustain its current claims rate. The DI portion of the trust fund had assets of $204B at the beginning of 2010 and it paid claims and administrative costs of $128B during 2010 -- about 63 percent of its assets. (SSA annual report, page 41) Why is the inefficient, fraud-plagued government in the insurance business? If DI were a Connecticut insurance company, it would be broke within a year or two. In other words, DI primarily is a taxpayer-funded welfare program. That might be fine, but don't call it "insurance".

In contrast, as a government-run Ponzi scheme, Social Security has a brighter future. In 2010, it took in $791B and paid out a total of $715B. Yes, its costs soon will exceed its income, but its assets will cover the shortfall for another 26 years or so. (SSA annual report, page 58)

In 1935, when the Democrats launched it, the Ponzi scheme seemed brilliant. And by playing Santa Claus with the proceeds, it bought them control of Congress for much of the rest of the century. But it also planted the seeds of its own inevitable destruction because economically and politically, it is "State Socialism":

- Participation is involuntary
- Contributions are pooled (no individual investment accounts)
- Individual benefits are linked only loosely to contributions
- It shifts control of private wealth from individuals to big government
- It shifts fiscal responsibility from individuals to big government
- It buys votes by shifting wealth from the politically weak to the politically powerful

In their role as Santa Claus, Democrats plundered the trust fund to advance their political fortunes. Initially, the individual benefits far surpassed the investments. For instance, the first monthly retirement check was issued to Ida May Fuller, who retired in November 1939 after paying a total of $24.75 in Social Security taxes -- $387 in today's currency. She lived to be 100 years old, dying in 1975. During her lifetime she collected a total of $22,888.92 in Social Security benefits -- about $180,000 in today's currency.

That's an extreme example, but on average, the initial financial windfall of Social Security investment returns diminished continuously over the decades. Payroll tax hikes outpaced the rise in retirement distributions, yet Santa's workshop still is running out of money. During the 20th Century, politicians distributed much of that money to buy votes. It's gone. Conversely, today's politicians are scrambling to find ways to avoid looking like the Grinch when they take the promised money away.

Winners and Losers

The chart below predicts how the politicians will play the Grinch, while wearing their Santa masks. The numerous reform options are summarized into three categories: Hike payroll taxes, cut initial benefits, and shift to private individual accounts. As shown, tax hikes give politicians even more money and power. Benefits cuts are politically neutral or slightly positive if they are implemented slowly. Conversely, privatization shifts money and power back to individuals -- where it came from. So naturally, the big-government politicians will continue to demagogue that solution.

Why don't the individuals revolt? --Because the scheme is rigged to favor current retirees, who are politically powerful via AARP and other left-wing activist organizations. Meanwhile, most current taxpayers are too busy working to protest the fact that they're getting shafted, and their children can't vote -- or they are told by their leftist college professors to vote Democrat. Consequently, the big-government politicians are getting away with fiscal child abuse.

Social Security Reform Winners and Losers

Reform Option	Who Benefits			
	Politicians	Retirees	Workers	Children
Hike SS Payroll Tax	++++	+++	- -	- - - -
Cut Initial Benefits	+	++	- -	- - - -
Shift to Private Individual Accounts	- - - - - - - - - - - - - -	0	++++ +++	++++ ++++ +++
		Politically Powerful	*Politically Preoccupied*	*Politically Powerless*

The simplest way to privatize Social Security might be to raise the limit on tax-deferred IRA contributions to about $18K per year and let workers invest their retirement money any way they like. If Congress gave workers the option of doing that or remaining in the Social Security program, virtually everyone would switch to the private, self-directed IRA. After all, they still would have the option of investing their IRA money in an intermediate government bond fund, which is exactly what they have now, so there would be no downside for those that make the switch.

However, overnight privatization won't happen, for at least two reasons: selfish big-government politicians never voluntarily surrender trillions of dollars of vote-buying power; and, without the Ponzi income, the Social Security trust fund would be insolvent in only a few years, so existing retirees could not be paid.

Just Obey Maternal Democrats and Pretend there's a Santa Claus

Given that politicians already spent most of the trust fund's endowment, and that the US population demographics also work against it, Social Security can't be saved without harming retirees, workers, or future workers. In fact, Congressman Ryan's "roadmap" for Social Security -- probably the most viable reform plan out there -- harms all three groups. What's worse, any plan that saves Social Security will leave the retirement money in the hands of "the crooks and buffoons in Washington", as Dan Mitchell, of the Cato Institute, describes them.

The best way to privatize Social Security is to grant Democrats their wish: refuse to privatize it. Ignoring the problem will ensure that the program will self-destruct in the late 2030s, just as the Soviet Union self-destructed two decades ago. Conversely, fixing Social Security now would be like sending massive foreign aid to the Soviet Union in 1985.

All three groups -- retirees, workers, and future workers -- still will be harmed by the trust fund's bankruptcy, but not without ample warning. The SSA's current best guess is that the trust fund will be depleted in about 26 years. Then a taxpayer revolt might demand that: 1) payroll taxes no longer be withheld; 2) tax-deferred IRA deduction limits be incremented by an amount equal to the obsolete payroll tax; and 3) the insolvent Social Security Administration be closed after a century of robbing Peter to pay Paul. Selfish big-government politicians even might cooperate, realizing that they can't loot an empty store.

What about the "social safety net"? Since DI already has devolved into a welfare program, it might as well be moved to the HHS general budget. On the other hand, Social Security retirement payments rarely mean the difference between living and dying. And if they do, chances are those recipients also participate in some of the other 70 (yes, 70!) federal poverty programs that already exist.

Furthermore, Americans are the most generous charitable contributors in the world, voluntarily donating billions of hours and hundreds of billions of dollars annually to private charities that are far more efficient than the federal government. So there's plenty of historical evidence that volunteers would be eager to pitch in too, should the need arise.

And even though the big-government politicians try to hide it, there also is plenty of evidence that workers have suspected for some time that Social Security is going broke. At the end of 2009, Americans had set aside $4.2T in private IRAs and $4.1T in private defined-contribution plans such as a 401(k), a combined value of $8.3T.

During 2010, the stock market and its dividends returned 15 percent while intermediate bond funds returned about eight percent, so IRA and the defined-contribution funds probably earned an average of about 10 percent. That brought their combined value to about $9.1T, well over three times the asset value of the Social Security trust fund. More evidence that Americans can get along just fine without a Santa Claus government.

Before Social Security, retirees also used to rely more on their children for financial assistance. In that regard, Social Security is partly responsible for the falling birth rate in America -- which ironically is threatening the program itself. And in a roundabout way, Social Security also might be harming education. Here's why: If parents think they might some day have to rely on their children for support, they have greater incentive to make sure the kids are well educated and inspired to get good jobs. Today's teachers -- especially in the inner city -- complain that many parents show little interest in motivating their children to learn. Could that partly be Social Security's fault?

Medicare and Medicaid are far bigger fiscal problems, so politicians should tackle those entitlement programs first. And those programs sometimes really do determine the outcome of life-and-death situations. Such a debate also has the benefit of shining a bright spotlight on ObamaCare, which fundamentally is just a nationwide expansion of Medicare and Medicaid -- programs that already are poorly run, fraught with corruption, nearly insolvent, and are driving physicians out of the healthcare profession.