Social Security Isn't Going Away — But It Is Going to Get Worse

By Michael D. Tanner

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Seventy-five years ago, Ida Mae Fuller of Ludlow, Vermont received the first American Social Security check. Ida, who lived to be 100, ultimately collected $22,888 in benefits. Because she had paid only $24.75 in Social Security taxes, the national retirement program turned out to be a very good deal for her.

Unfortunately, it's not such a good deal for today's young workers. Thirty year olds now will be lucky to receive a 1.5 percent return on what they pay into the system, far below what they could earn from investing that money privately. In fact, many will die before they get back what they paid in, let alone collect any extra return.

That's because Social Security operates very much like a pyramid scheme. When you pay your Social Security taxes, none of that money is saved for your retirement or invested. Instead, every cent you pay in is used to provide the benefits to those who are already collecting. When you finally retire, your benefits will come from the taxes paid by the next generation of workers — your children and grandchildren.

Like any pyramid scheme, Social Security was able to deliver a windfall to early recipients like Ida Mae, who received their benefits when there were lots of workers and only a few retirees. Today, however, Americans are living longer and not having as many babies, meaning there are more retirees and fewer workers to support them. In 1950, there were 16.5 workers supporting every retiree. Today, there are 2.8. And by the time today's young workers retire, there will be just over two.

Does that mean Social Security won't be there when they're ready to collect? No. As long as there are people paying into the program, retirees will be able to take benefits out. Unlike a pyramid scheme, Social Security cannot go broke as long as the government can make future generations pay taxes.

But if fewer young workers are there to support each retiree, one of two things will have to happen: Either those young workers will have to pay more (tax increases) or retirees will have to get less (benefit cuts).

To pay all the benefits promised in the future, Social Security would have to increase the payroll tax by as much as half, or slash benefits by 23 percent.

The government has already raised Social Security taxes more than 40 times since the program began. Initially, the maximum tax anyone had to pay was $60, or 2 percent of the first $3,000 in wages paid by both the employer and employee. Today, people pay 12.4 percent of their first $118,500 in wages. Even after inflation, that's a roughly 1,490 percent increase.

To pay all the benefits promised in the future, Social Security would have to increase the payroll tax by as much as half, or find that revenue elsewhere. The government can always cut benefits, but without a tax increase those benefits would have to eventually be slashed by 23 percent. That would be very hard for seniors who depend on the program to get by.

Until recently Social Security ran a surplus, taking in more in taxes than it paid out in benefits. That extra money was used to purchase government bonds, which became so-called Trust Funds to pay future benefits. Of course, once a bond was purchased, the money used to buy it became general revenue and was spent by the government. So the Trust Funds are simply an accounting measure of how much money the Social Security system is owed by the federal government. The bonds are basically IOUs.

That's not to say that the government won't make good on that debt. It always has and likely always will. But the money needed to redeem the $2.8 trillion in bonds currently in the Trust Funds comes from the government's general revenue — that is, the taxes being paid by today's workers. There's no free lunch.

The Trust Funds will be empty by 2033. That's the point at which Social Security will either have to make that 23 percent cut to benefits, or raise taxes by about half.

There is only one other answer to Social Security's growing crisis: Let young workers who wish to get out of this pyramid scheme to do so, and save a portion of their taxes for their own retirement through personal accounts. Allow that money to be invested in assets that earn a return, such as stocks, bonds, annuities, and so forth. The average annual return on US capital investment over the last century has been roughly 7.28 percent after adjusting for inflation, far better than what young people can expect from Social Security.

The program will have to change in the future. But as we debate Social Security, it is vital that young people be involved. They have the most at stake.

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