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Michael Tanner: Social Security deficits soon will be permanent

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When last we heard from Senate Majority Leader Harry Reid, he was proclaiming that there was no need to reform Social Security because the program "is on solid ground for decades to come."

Well, apparently that's true – if by "decades" Reid, D-Nev., meant "five years."

Social Security's trustees this month finally released their long-delayed report on the system's finances. According to the trustees, who include President Barack Obama's secretaries of Labor and Treasury, Social Security is actually running a cash-flow deficit today, spending more money on benefits than it takes in through taxes. Most of that deficit has been caused by the recent economic downturn and, hopefully, will be only temporary.

But regardless of how the economy performs in the next few years, the trustees warn that by 2015, just five years from now, Social Security will again start to run deficits – and this time they will be permanent. That's a year sooner than predicted in last year's report.

While, in theory, the Social Security Trust Fund will be able to pay benefits until 2037, the same as in last year's report, that figure is misleading because the trust fund contains no actual assets. The government bonds it holds are simply a form of IOU, a measure of how much money the government owes the system, $2.6 trillion, according to the report.

Of course, no one is saying that the government will default on its obligations, but one might ask where the government will get the money to pay back that $2.6 trillion. It's not as though the government has it laying around. To say that Social Security is fine because the Treasury will find a way to pay its debts is like saying you have plenty of money for your mortgage – as long as you don't eat.

Even if Congress can find a way to redeem the bonds, the trust fund surplus will be completely exhausted by 2037. At that point, Social Security will have to rely solely on revenue from the payroll tax – and that won't be sufficient to pay all promised benefits. Overall, the amount the system has promised beyond what it can actually pay now totals $18.7 trillion.

Not surprisingly, Reid and others have suggested that all of this could be fixed with a simple tax increase. They have suggested, for instance, taking the cap off the amount of income subject to the Social Security payroll tax. This would be the largest tax increase in U.S. history, and would give this country a higher marginal tax rate than, say, Sweden. And it wouldn't come close to fixing Social security's financial shortfall.

In fact, even if you took the cap off completely, without giving anyone additional benefits in exchange for the higher taxes, you would extend the date at which Social Security begins to run a deficit by seven years – to 2022. That's not much gain for all that pain.

To actually "save" Social Security would require a 50 percent hike in the payroll tax, from 12.4 percent to at least 18 percent, or the equivalent in other taxes. That's a big tax hike.

And all this says nothing about Social Security's other problems. Social Security taxes are already so high, relative to benefits, that Social Security has simply become a bad deal for younger workers, providing a low, below-market rate of return. Many young workers will end up paying more in taxes than they receive in benefits. They will actually lose money under the program.

And, most importantly, under the current system, workers do not actually own their Social Security benefits. They are left totally dependent on the goodwill of the 535 politicians in Congress to determine what they'll receive in retirement. Benefits are not inheritable, and the program is a barrier to wealth accumulation.

Politicians like Reid can no longer be allowed to duck this vital issue. The trustees' report makes it clear that Social Security is not "on solid ground." Social Security must be reformed, sooner rather than later.