Debunking the Social Security Bankruptcy Myth

WHAT YOU NEED TO KNOW ABOUT HOW SOCIAL SECURITY IS MANAGED BY THE GOVERNMENT

By:

Jill L. Ward
CFP®, CTFA
Partner
Wealth Advisor
jward@tcwealthpartners.com
630-545-4841

For some, Social Security is their only source of retirement income. Amid the growing belief that Social Security will no longer be available when they retire, many people feel they should grab it while they can. Even though this means they could be missing out on thousands of dollars in benefits over their lifetimes, they take it as soon as they are eligible.

This reliance on Social Security – combined with fear generated by lingering conspiracy theories – often causes retirees to make poor choices when it comes to claiming benefits.

In recent years, Social Security planning and education have become an integral part of overall financial planning. It's important to take a close look at how Social Security fits into your overall retirement plan, recognizing that the optimal claiming strategy is dependent upon each individual's unique circumstances.

One belief that needs to be dismantled is that Social Security will not be around when it is most needed.

Every so often we like to share articles from authors outside of our firm when we think they are of particular interest. Elaine Floyd, an authority on Social Security rules and strategies, recently wrote about the Social Security trust fund, specifically dispelling beliefs that it has been taken over and spent by the government and is now bankrupt.

Here are a few excerpts from the interview, used with permission by Horsesmouth.

"What Has the Government Done with the Social Security Trust Fund?"

By Elaine Floyd

Some form of this Social Security conspiracy theory has been going around for years: That the trust fund is just a bunch of I.O.U.s. That the government has spent all the money. That there is no trust fund. That Social Security is bankrupt.

Government malfeasance of our Social Security system is one of the most popular and tenacious of all conspiracy theories. It probably started shortly after the trust fund was established in 1939.

Between those who objected to the underlying concept of the government taxing the people and using that money to pay benefits to retirees (it will "destroy initiative, discourage thrift, stifle individual responsibility"), to those who simply don't trust the government, confusion has always swirled around the Social Security system and how it is financed.

Meanwhile, the Social Security system keeps cranking out benefits. In 2020 over one trillion dollars in Social Security benefits will be paid to some 65 million retired and disabled workers, their dependents and survivors.

What follows is an explanation of how Social Security is financed and, perhaps more important, how people came to be confused about the existence of the trust fund and what has happened to the money inside.

DID THE GOVERNMENT SPEND THE TRUST FUND?

Social Security is a pay-as-you-go system. The benefits paid out to current retirees come from the payroll taxes collected from current workers. Because the income and outgo don't always match, a trust fund was established in 1939 to hold the excess payroll taxes until they are needed to be paid out in benefits. For the last three decades, as baby boomers have moved through their peak earning years, the trust fund has been growing and now holds about $2.9 trillion.

This $2.9 trillion is not sitting in a bank account somewhere in cash. Rather, as required by law, it is invested in U.S. Treasury securities. These securities are backed by the full faith and credit of the U.S. government and are considered one of the safest investments in the world. As an investor in U.S. Treasury securities the Social Security trust fund joins the many pension funds, mutual funds, sovereign governments, and individual investors around the world who consider U.S. Treasury securities one of the safest places to park their money. The securities owned by the Social Security trust fund are even safer because they are payable on demand at par. There is no interest-rate risk. That is, unlike most fixed-income instruments, the securities in the trust fund hold their value and will be redeemed at full value regardless of interest rate movements.

Now let's look at this from the perspective of the issuer of these securities: The U.S. government. All debt securities have two parties: a borrower and a lender. When an entity wants to borrow money, it gives the entity lending the money some kind of evidence promising to repay the loan, with interest, by a certain date. When the U.S. government borrows money, it uses the proceeds to spend on the various government programs and, as evidence of the loan, issues Treasury securities which can be taken as a promise to pay. Whoever holds these securities can be assured that the government will honor its promise and will pay back the funds.

So in looking at the securities owned by the Social Security trust fund, the U.S. government is the borrower and the Social Security trust fund is the lender. When the trust fund needs money to pay benefits—that is, if in any given month the payroll taxes collected are insufficient to pay scheduled benefits that month—it essentially "calls the loan" by redeeming the necessary amount of Treasury securities. The government then finds the money elsewhere—perhaps from tax revenues or additional borrowing—to repay those securities.

So, all the money is carefully accounted for. You could say the government "spent" the trust fund, but the more accurate word is "borrowed." The government was actually required to borrow the funds in order to issue Treasury securities to the trust fund. The money will be paid back. There is no question about that.

IS THERE REALLY A TRUST FUND?

Meanwhile, the United States government has been reporting on overall spending through the Congressional budget process since 1921. Because the Social Security system had its own system of financing it was considered "off-budget"—that is, the benefit payments and the payroll taxes that funded them were not included in the federal budget process.

This changed in 1968 when President Lyndon Johnson began including Social Security and several other trust funds in a unified budget. This made Social Security "on-budget" and was done to bring consistency to the federal budget reporting and make it less confusing. As an illustration of the problem, the projected fiscal 1968 budget was in deficit by $2.1 billion, $4.3 billion, or $8.1 billion, depending upon which measure one chose to use. It was felt that a single, unified, measure of the federal budget offered a better picture of the government's fiscal position.

Under the unified budget perspective there is no Social Security trust fund. Rather, payroll taxes are deposited into the general Treasury, and Social Security benefits are a budget item, like Medicare, defense, and other federal expenditures that are paid out of general revenues. However, unlike defense and other expenditures, Social Security and Medicare are mandatory expenses. They are not subject to the annual budget process. These payments are authorized by law, and to change them Congress would have to change the authorizing laws. The $1 trillion paid out in Social Security benefits in 2019 represented about 23% of the government's $4.4 trillion budget.

In 1990 Social Security was once again taken "off-budget," so the trust fund perspective is now the main way of viewing Social Security financing. This is appropriate because the Antideficiency Act prohibits government spending in excess of available funds. By law, the government can't pay benefits that exceed Social Security's dedicated revenues (the three sources being the payroll tax, income taxes on benefits, and interest on the securities in the trust fund) and assets (the securities owned by the trust fund). In their 2020 report, the Social Security trustees estimated that the combined OASDI trust funds would exhaust in 2035, after which payroll taxes would cover just 80% of scheduled benefits. In September, the Congressional Budget Office moved the trust fund exhaust date up to 2030 to take into account the economic impact of COVID-19.

But when planning federal spending each year, Congress still uses the unified budget perspective. It counts Social Security's dedicated payroll taxes among the government's revenue sources along with individual and corporate income taxes. And it counts the roughly $1 trillion paid out each year in Social Security benefits as a mandatory expense.

This is why there is so much confusion over Social Security financing. Is there a trust fund? Yes and no. It depends on whether you are using the trust fund perspective or the unified budget perspective. Did the government spend the money in the trust fund? Well, it borrowed the money and spent the loan proceeds; but it will pay it back when needed. But it's not as bad as it sounds. There is no conspiracy here. It's just two ways of looking at how Social Security benefits are funded and paid.

WHAT CLIENTS REALLY WANT TO KNOW IS THIS: WILL THEY RECEIVE ALL THE BENEFITS THEY ARE ENTITLED TO?

If clients' worst fears play out and they end up not receiving the Social Security benefits they expect, it will not be because the government absconded with the money. It will be because Congress changed the authorizing laws that allow benefits to be paid. Congress can do that. But will they? Not without an uprising on their hands. Millions of people depend on Social Security as an important source of income in retirement. The steady stream of income not only provides security to individual households but also serves as a source of continued demand to stabilize the economy. Any efforts to reform the system will likely be phased in over a long period of time, as was done by the 1983 amendments and proposed by the Social Security 2100 Act.