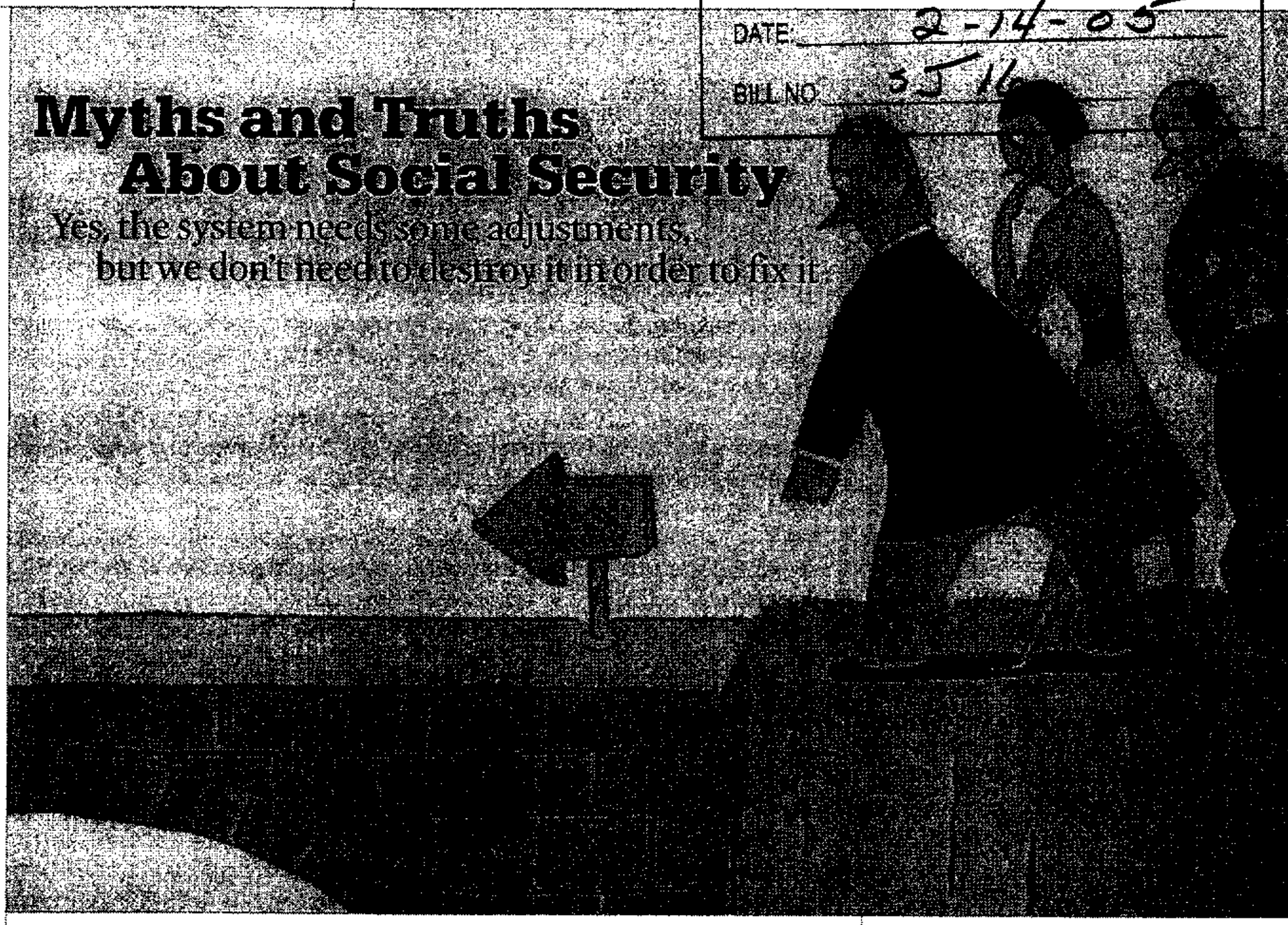
SENATE PUBLIC HEALTH, WELFARE & SAFETY
EXHIBIT NO. 11
DATE 2-14-05
BILL NO. SJ 16

NeedtoKnow By Karen Westerberg Reyes

Myths and Truths About Social Security

Yes, the system needs some adjustments, but we don't need to destroy it in order to fix it



SOCIAL SECURITY IS THE ULTIMATE support system, a monetary cushion for grandmothers and granddads, but also a lifeline for widows, widowers, divorcées, orphans, and people with disabilities. For the average American over 65, Social Security makes up nearly 40 percent of their income. For about 20 percent, it is their only income. The system has worked well for some 70 years now with few adjustments. These days, it's on everyone's radar. That's because President Bush has put Social Security reform at the top of his second-term to-do list. He and many others argue that big changes are necessary if Social Security is to survive, much less thrive. But there are those, AARP included, who believe a radical overhaul could spell disaster—the end of Social Security as we now know it.

Is the current Social Security system really at death's door, or are the rumors of its demise greatly exaggerated? Following are some common misconceptions.

Myth: Social Security is broke.
Those who argue that Social Security needs a dramatic reorganization begin with this premise: the system is failing; Social Security isn't sustainable in its present form. From there, the argument goes that what's best for the country is some form of privatization. With privatization, a portion of the Social Security taxes now paid would be diverted into an account that each taxpayer would control themselves. (Under the current system, all surplus Social Security revenue is invested in special U.S. Treasury bonds.)

So, is Social Security about to go bust? Not by a long shot. In fact, Social Security is in better shape today than at any other time since it was enacted in 1935. That's because of some judicious adjustments suggested in 1983 by a commission set up by Ronald Reagan and headed up by Alan Greenspan. Since then, trust fund reserves have gone from nearly zero to $1.6 trillion.

Social Security trustees acknowledge that by 2028 the system will need to start redeeming the bonds in its reserve, but they calculate that the fund will be able to meet 100 percent of its obligations until 2042. By that date, the principal will be exhausted, but the system will still bring in enough revenue from taxes to pay nearly 75 percent of benefit amounts. (An even rosier Congressional Budget Office report says the system will be able to pay full benefits until 2052, and 80 percent after that.)

Myth: The fund starts getting into trouble in 2018.
Not true. The year 2018 is when Social Security benefit payments are expected to exceed payroll tax revenues. That's not exactly cataclysmic. Reason: from 2018 through 2027, incoming tax revenue combined with interest earnings

MARC ROSENTHAL

from trust reserves will still be enough to maintain a positive trust fund balance and pay benefits. Beginning in 2028, as mentioned, the trust fund principal will have to be tapped, and that'll get us through 2042—even if we do nothing.

Clearly a tune-up is needed to extend Social Security's life beyond that horizon. "But dismantling the whole system would be like buying a new car because the one you have has a flat tire," says Peter R. Orszag, a senior fellow of economic studies at the Brookings Institution in Washington, D.C.

Myth: The Social Security reserves are only on paper.

Well, yes, but that paper is U.S. Treasury bonds, which have been earning a combined interest rate of about 6 percent a year. For more than 200 years, in good times and bad, during wars and depressions, American bonds have always paid off. They're one of the safest investments in the world. In 2003, some $80 billion, about 13 percent of Social Security's total income, came from the interest from these bonds.

Myth: The 77 million Baby Boomers marching toward retirement are going to break the system.

Advocates for radical reform point out that once the boomers retire they will start taking more money out of the system than younger workers are putting in. The oft-cited statistic is that by 2040 there will be just two workers for each retiree. (Today there are just over three workers for each retiree.) But that fact, while accurate, fails to acknowledge that workers today are more productive, earn higher wages, and plan to stay in the workforce longer—all factors that will help fill the future gap. In fact, in the near term, this population juggernaut, being at the peak of its earning years, is currently helping to amass a huge surplus in the fund.

Once boomers start retiring, sure, that's going to put a strain on the system. "But it isn't going to be Armageddon," says Kenneth S. Apfel, former commissioner of the Social Security Administration and current member of the faculty at the LBJ School of Public Affairs at the University of Texas at Austin.

We can strengthen Social Security by making small adjustments, just as we've done in the past. These include raising the cap on wages subject to Social Security (currently you're taxed on income up to $90,000) and investing part of the Social Security surplus in other vehicles that pay higher interest than Treasury bonds do.

Myth: A system of private accounts would save Social Security.

The buzz phrase being bandied about by those who favor privatization is "an ownership society." They favor taking a portion of Social Security taxes and diverting it to individuals to invest. They say such a system would give workers ownership of their money. It would allow taxpayers to put their own dollars into stocks, bonds, and other investments that would pay them a higher return.

Those who oppose privatization, including AARP, argue that setting up private accounts would effectively scuttle Social Security. "Siphoning money from Social Security will not strengthen it," says David Certner, AARP's director of federal affairs. "It will just make the problem much worse."

First, the transition costs alone would be crushing—as high as $2–$3 trillion, according to AARP's own economic analysis. "The amount of additional national debt that would generate could eat into any returns people might actually get from a private account system," says Barbara Kennelly, president and CEO of the National Committee to Preserve Social Security and Medicare, a 3.2-million-member organization located in Washington, D.C.

Second, diverting a portion of Social Security money to private accounts means that there would be fewer dollars available to pay Social Security benefits. That would leave the whole system with less of a reserve, as well as less cash on hand to pay beneficiaries. This situation would lead to hard choices: cutting benefits, raising taxes, or doing none of the above and watching the trust fund run out of cash sooner.

According to a letter entitled "The Consequences of Social Security Privatization" signed by Congressmen Charles B. Rangel (D-NY) and the late Robert T. Matsui *(continued on page 87)*

Diverting part of Social Security contributions to private accounts would "blow a hole" in the entire system.

Social Security

(continued from page 31)

(D-CA), diverting a portion of workers' current Social Security contributions to private accounts "blows a hole in the Trust Funds...and directly threatens our ability to pay current retirees." They predict that under privatization the trust fund reserves will be wiped out by 2021, a full 20 years sooner than if the system had been left alone.

Myth: Private accounts will give individuals more control.

People already have control over their money when they invest in private pensions, IRAs, and 401(k) plans. When combined with the solid foundation that Social Security provides, these are excellent vehicles for retirement savings. "What we should be doing is making these work better," says Orszag.

Myth: Individuals will get higher returns with private accounts.

Surely you can do better with your investments than a big bureaucratic government agency can, say those who favor private accounts. Well, the truth is, some people may do better. But who's going to pay for the care and feeding of all those who do worse?

"Under privatization, current workers will have to pay three times," says Certner. "Once to ensure the benefits for those currently at or near retirement, once for themselves, and once more for those whose investments didn't pan out." In the current Social Security system, the risk is near zero. You know it will be there regardless of what the market does. That's because United States Treasury bonds don't crash when the stock market does.

So what can be done? Yes, the Social Security system needs some work, but there's nothing so seriously wrong with it that some due diligence and nonpartisan intervention and planning can't repair. "There's no need to take the risky step of privatization," says Kennelly. ■

Karen Westerberg Reyes, planning editor, is the magazine's Social Security specialist.