

Social Security: The Long View

Since 1935, AIER has spotted flaws in the program. A quick look at 77 years of commentary.

by AIER Staff

One of the facts of contemporary life is that Social Security is in crisis. Simply put, there's not enough money to pay for all the benefits that have been promised. AIER has been there with a critical eye since the program's inception during the Great Depression. In the pages that follow, we draw from our extensive writings on the subject.

President Franklin Roosevelt specifically argued against Social Security as a welfare system. The plan he described was for social insurance, designed to protect American workers against two specific, identifiable risks—disability and old age. Individuals paid for their own insurance.

Most government programs seldom turn out as originally envisioned. The Social Security program we got is not an insurance program, it is not a retirement plan, and it is not saving. The system has a faulty structure, flawed financing, and a lack of actuarial soundness. AIER readers have known this since 1935.

Social Security is basically a pay-as-you-go system, with most benefits paid by current tax receipts. It needs a growing number of taxpayers to support the payouts to a growing number of beneficiaries. It is a Ponzi scheme.

Since the beginning, beneficiaries typically received substantially more than the value of the taxes they paid. When the Act became effective, each worker was required to pay an annual tax of \$30 and upon retirement at age 65 received an average monthly payment of about \$22. Ida May Fuller, recipient of the first monthly Social Security check, received over \$22,000 in benefits over her lifetime after paying only

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\$22.54 in taxes. To meet private sector financial requirements as a retirement plan, the streams of payments in and out would have to match.

As the AIER archives make abundantly clear, the Social Security Trust Fund isn't a trust. The funds are held in a special class of Treasury bonds that have no market value, and that are not backed by private sector assets. And according to a 1960 Supreme Court decision, individuals have no legal claim to any funds they've "paid in," and no legal claim to any benefits.

By diminishing saving and therefore investment, the government program also slows economic growth and lowers standards of living. Portions of the tax paid by employers largely come out of wages, further lowering living standards and consumer demand.

Early on, AIER also warned that the program was destined to expand. In 1939, coverage was added for workers' families and dependents. In 1950, cost of living adjustments were added. In 1956, insurance for disabled workers was added; their dependents became covered in 1959. Medicare came in 1965. In 1972,

the Consumer Price Index became the official measure of inflation to be used in computing COLAs.

The excerpts on the following pages range from AIER's first commentary in 1935 to sections of our 2007 book, *What You Need to Know About Social Security*. We have also discussed the embattled program in several recent publications and will continue to focus AIER's flagship brand of unbiased, consistent analysis to the subject in the years to come.

—Steven R. Cunningham, PhD
Director of Research and Education

**From the August 1935
Monthly Bulletin:**

AIER cited constitutional problems with taxation to pay for retirement benefits. We also said that Social Security surpluses amount to reductions in private saving without increases in public saving. The surpluses are simply diverted to fund current expenditures of the federal government.

It should be noted that the income and excise taxes are not imposed for the specific purpose of building up the Old Age Reserve Account which is created by the Social Security Act. Apparently, it was felt that constitutional difficulties prevented taxation for the purpose of providing old age benefits. The taxes imposed are termed "excise" and "income" taxes, and are not segregated in any way but are paid into the United States Treasury in the same manner as all other Federal taxes. Annual Congressional appropriations will be necessary to transfer these funds to the Old Age Reserve Account.

In Massachusetts there is a state gasoline tax which was imposed originally to pay for the construction and care of state highways. Despite the fact that this was the only purpose of the tax and that it is well adapted for this purpose, the tax has gradually been diverted to other uses. It should be noted that a fund established for old age pensions is peculiarly subject to abuse of this nature. Under the normal operation of the Old Age Reserve Account, it should grow rapidly during the first 20 to 40 years because a large volume of the contributions will be made by and for young employees who will not become entitled to benefits until after a long period of years. At first, therefore, the income of the fund should exceed expenditures. Undoubtedly, there will be political leaders who will ignore the fact that the excess of income over expenditures is offset by a growing liability in the form of an obligation to pay pensions in the future.

**From the Jan. 23, 1939
Research Reports**

The Social Security System is not set up as a retirement system in the private sense. But given the public's sense of pride and work ethic in the 1930s, it was not possible to promote the idea of a Social Security System as a safety net.

Many people apparently regard the Social Security Act as the embodiment of our generous attitude toward the aged. They perhaps flatter themselves that, when they advocate this grandiose plan, their actions testify to the warmth of their hearts, if not to the soundness of their heads. However, the facts involved prove that they are not entitled even to that much credit.

The truth of the matter is that we (citizens of voting age today) are attempting to provide for our own old age at the expense of our children and grandchildren. We would not dream of assuming one-third of the burden that we are planning to place on the shoulders of those too young to know what we are doing, and others yet unborn.

Because the Social Security System lowers private saving and does not offset it with public saving, it diminishes the funds available to finance private sector business investment. Capital formation is further hampered by tighter credit conditions and higher interest rates caused by the program. This must have an impact on capital formation, hence growth and future standards of living.

In addition to indulging our delusions of grandeur, we are accumulating a vast public debt, thus using the current savings which might otherwise provide the capital equipment for our and the next generation. Without that capital equipment available to business, it will be impossible to maintain the standard of living which we have at present, to say nothing of regaining that which the country enjoyed in 1929.

Given the intrinsic pay-as-you-go nature of the system, each working generation is paying for the generation that worked before them. This inter-generational transfer is imposed on all future generation. With the growing numbers of older Americans, the Social Security crisis of the early 21st Century was put in motion early on.

We are assuming that our children and grandchildren will be peculiarly eager to shoulder burdens which were not of their making. Wouldn't it be wiser to fear that any human beings who would supinely accept the enormous load of debt and Social Security obligations that we propose to give them would be such inferior creatures as to lack the earning capacity required to carry the burden? Perhaps the wisest course to follow would be to review the whole Social Security problem in order to determine whether we dare undertake to provide pensions for all, regardless of their need of help from the rest of us.

**From the Dec. 2, 1940
Weekly Bulletin**

AIER recognized that ultimately the Social Security System would cause inflation. We predicted that the initial inflationary impact would reverse once the system went into deficit. The Institute wrote about how the politics of entitlements made the expansion of benefits inevitable, compounding the funding problems. And we foresaw the ever-escalating payroll tax.

Ordinarily, the probable effects of economic influences extending over a long period of years in the future cannot be estimated accurately, but there is one long-term inflationary factor the effects of which can be foreseen with unusual clarity. We refer to the Social Security Act, especially to that portion of it providing for old-age pensions. This economic factor is of interest, because its short-term effects are precisely opposite to the long-term consequences.

During the latest three-month period for which data are available, August-October 1940, the Government collected Social Security taxes totaling \$172,000,000. Expenditures for various purposes under the provisions of the Act during this period were \$101,000,000, not including the bookkeeping allocation to the so-called "reserve." It is therefore apparent that the present effects of the Social Security Act are mildly deflationary. The excess collected partly finances the Treasury deficit, thereby making it unnecessary for the Treasury to undertake inflationary borrowing.

The original plan called for gradual increases in the pay roll taxes to a maximum of six per cent in 1949. A few years later, the cost of the benefits will exceed income from pay roll taxes and the difference will increase each year to \$3,000,000,000 or more in forty years, even if the pay roll taxes are increased to the point now contemplated.

As soon as Social Security payments exceed the pay roll taxes, the economic effects of the Act will be reversed. Because it will then be increasing the Federal deficits, the Act will have become an important factor tending to increase the degree of inflation. The Act has already been "liberalized," and there is an evident desire on the part of many Congressmen to broaden the coverage of the Act. Furthermore, it will obviously be politically expedient to postpone the increases in the pay roll taxes as long as funds can be borrowed to finance the deficits. The first small increase has already been postponed, and the indefinite postponement of the much greater taxes prescribed for future years is to be expected unless the breed of politicians changes. (This does not imply a mere change of the party in power. The politicians in both parties have refused to face the Social Security "facts of life.")

If, as we expect, the pay roll taxes are not increased as contemplated by the Act, expenditures will exceed

income beginning about 1943. It is also probable that the benefits will be increased and that the coverage of the Act will be broadened. Such "liberalization" of the Act will further augment the inflationary possibilities involved to such an extent that there may be seriously adverse effects within the next ten to twenty years.

One of the ablest economists who has analyzed the Social Security Act ["Actuarial Principles vs. Financial Principles," by George Buchan Robinson, *The Annalist*, October 24, 1940] commented as follows: "Second, the program involves governmental promises so vast that it alone may make a financial wreck of the government if its tangled reasoning and under-financed condition are not soon taken vigorously in hand."

From the May 9, 1966 Research Reports

AIER warned Americans that mandatory payments to the Social Security System are not saving, and we explained what the difference means to all of us.

Many Americans seem to believe that the payments the Social Security system compels them to make constitute savings that will be invested and provide an income for them during their old age. However, the fact is that such payments are transferred as benefits to those now retired. Present contributors have to show for their money only the hope that their retirement income will be provided by future workers similarly forced to contribute increasing portions of their incomes to others. Moreover, many individuals might wish to use that portion of their income for other purposes, such as investing in business enterprises, educating their children, or maintaining a higher standard of living. Instead, the Social Security system denies individuals the right to spend that income as they choose, and it forces them to pay to others

a very large sum throughout their working lives.

If individuals were free to invest their Social Security taxes in a home or in certain types of securities, the added loss of future purchasing power attributable to a depreciating dollar might be at least partly offset by appreciation in market value of such investments.

Many persons believe that what they are compelled to pay by the Social Security system will be returned to them eventually. However, the individual who chooses to continue working after he becomes eligible for old age payments (or who is forced to do so because the purchasing power of such payments has been reduced drastically) will forfeit receipt of part of his payments if he earns more than \$125 per month before age 72; if he earns substantially more, he will forfeit *all* of his payments. Moreover, Social Security tax payments throughout a working lifetime are lost if the wage earner and spouse die before becoming eligible for payments.

Older employees who now or soon will receive old age benefits have paid a much smaller amount than younger workers have and will pay, because the latter must pay the tax for a much longer time and at much higher rates before they become eligible to receive old age payments. Because the contributions of younger persons are and will be used to make payments to the elderly, the latter will receive benefits at the expense of younger employees.

The outcome of Social Security's financing system is more than a simple income transfer. Because current income is diverted from saving and is used to finance current consumption, capital formation is reduced, economic growth is forfeit, and future standards of living are compromised.

Comparing the consequences of voluntary saving and investing with those resulting from the

compulsory payments required by the Social Security system reveals a seriously uneconomic aspect of the latter. An individual who saves a portion of his income during his productive years ordinarily deposits his savings in a bank or purchases stocks or bonds of business enterprises. Because the bank usually lends the deposited funds to businesses, such funds, like those obtained by businesses through the issue of stocks and bonds, are used to purchase plant and equipment for processing additional things. Through the saving-investing process, the saver becomes the owner of machinery in an automobile factory, or of a part of a locomotive, or some other capital equipment.

Such equipment continues to be used long after the saver retires, and the income that he receives from his investments represents his share of the additional things that can be and are processed as a result of his furnishing the additional equipment to businesses. Those still working receive as much of what they process as they would have received without use of the equipment furnished by the saver; therefore, provision of his retirement income involves no burden on younger workers engaged in processing.

Savings taken by Social Security taxes are *not* used to purchase plant and equipment, however. Instead, such savings are immediately turned over to and spent by the 20 million persons currently receiving retirement and other Social Security benefits. Because those savings do not make possible the processing of more things by those still working, Social Security retirement payments necessarily involve a transfer of some of their income to retired persons. Those who work thus are compelled to bear the burden of such payments. ...

... If politicians succeed in bestowing more and more Social Security "benefits" on the American people, at what point will the saving-investment process be impaired,

assuming that such a point has not already been reached?

**From the Jan. 16, 1967
Research Reports**

As AIER warned earlier, political expediency led to expansions in benefits, and the arithmetic demanded increases in payroll taxes.

Readers may recall the Administration's suggestion, early last fall, that Social Security benefits be increased 10 percent in 1967. The leaders of the other party soon countered with the suggestion that an 8-percent increase should be made effective immediately. Now the President has proposed a 15-percent increase for most beneficiaries and much more for some, with a resulting overall increase of 20 percent in benefit payments, more than twice the Republican proposal. This aspect of the game seems to have escalated to the "double or nothing" range rather quickly.

No mention was made of the means of financing the \$4.5 billion increase in benefit payments. With large deficits now firmly established as Government policy even in the most prosperous times, is there any possibility that the increases in Social Security benefits will not prove to be illusory as inflating the money supply continues and the buying power of the dollar depreciates further? One policy seems effectively to counteract the other, except perhaps from the viewpoint of getting votes in the short run.

**From the April 17, 1967
Research Reports**

AIER identifies an essential contradiction within the Social Security System. It is supposed to be self-financing, yet each beneficiary receives in (the present value of) benefits more than (the present value of) taxes he or she paid to the system.

The article quotes a statement to the Committee on Ways and Means

of the House of Representatives made in March by Professor Colin D. Campbell, department of economics, Dartmouth College.

"The reason for the excessive burden on young workers is that there are currently 15 million persons receiving social security old age 'benefits, all of whom contributed less than the discounted values of their benefits during their own income-earning careers. The social security system is independent and self-financing. Some contributors must be paying not only the cost of their own coverage, but also the cost of the pensions of those who have already retired.

"The Social Security Administration's estimates of the cost to the worker of his old-age benefits are less than that shown above. In their cost estimates, they exclude the tax on the employer. Thus, their estimates of the cost to the employee are approximately one-half mine. The problem of tax shifting is a difficult one; nevertheless, to my knowledge, most tax economists believe that payroll taxes on an employer are soon shifted to their employees. This is because the tax increases the employer's labor costs and decreases his demand for labor. This spread over all firms causes the level of money wages to fall (or to rise less than it otherwise would), so that the wage earner, in effect, pays this employer part of the tax as well as that nominally levied on the employee. In my opinion, the tax payment by the employer should be included as part of the cost of the worker's old-age pension."

**From the Aug. 27, 1973
Research Reports**

We highlight the continuing expansion of benefits and rising costs of the system, and warn that the system may undermine private saving and the sense of personal responsibility of Americans.

During the nearly 4 decades since its introduction, the social security

program has been altered markedly. The program now requires the Federal Government to assume much of the responsibility for the welfare of the retiree. Early in 1973, the average monthly benefit payment to retired workers aged 65 and older was about \$164.00. Originally, the program provided only for benefits to be paid during retirement years. However, in 1939 benefits were added for workers' dependents and survivors. Insurance for disabled workers was added in 1956, and benefits for their dependents in 1958. Health insurance for old people (Medicare) was added in 1965. More recent increases in benefits reflect the 1971 recommendations of the Advisory Council on Social Security. Minimum benefits now are provided for those retirees who worked 30 years in a covered position, but whose earnings resulted in benefit payments that were considered to be too small.

The Social Security Act of 1972 provided, for the first time, that increases in social security benefits would be based on increases in the cost of living as reflected in the Consumer Price Index. The first such increase was to have been provided in January 1975. However, subsequent legislation in July 1973 provided for a 5.9-percent increase in benefits to begin next June, based on the rapid increase in the Consumer Price Index between June 1972 and June 1973.

Contributions to social security supposedly are shared by the employer and the employee. Actually, they are derived solely from the employee's income, because the employer's share represents wages that otherwise presumably would be paid to the employee. Also, much or all of the payments made by the employer are offset by higher prices of the goods or services that he offers for sale. ...

...In a separate statement in the 1971 Report of the Advisory Committee on Social Security,

Charles Siegfried, Robert Tyson, and Dwight Wilbur commented that further expansion of the social security program, including automatic cost-of-living increases in benefits and the resultant increases in taxes, "ignores the total tax burden placed on the average taxpayer by social security plus other federal, state, and local taxes. It tends to ignore the long-held premise that the primary responsibility to take care of himself and his family rests with the individual and not with other taxpayers. We believe the recommended expansions constitute further encroachment on the functions presently performed by private retirement plans, individual savings, and other efforts by or on behalf of the individual, and these encroachments will reduce the ability and incentive to save and invest—thus further curtailing individual responsibility."

Later in the same issue, we answered the question, "What would it mean for a program like Social Security to be actuarially sound, as would be required of a private retirement program?" The data provided demonstrates that current tax receipts are, in the main, going out to pay current beneficiaries, and equity in the fund is small compared to past receipts and future claims.

The financial structure of the social security program has changed from what was once considered actuarially sound to something entirely different. In *Social Insurance and Allied Government Programs*, Dr. Robert J. Myers, former chief actuary of the social security program, defined an actuarially sound plan as one "where the employer is well informed as to the future cost potential and arranges for meeting these costs through a trust or insured fund under which, should the plan terminate at any time, the then pensioners would be secure in their pensions and the active employees would find an equity in the fund assets reasonably commensurate with their accrued

pensions for service from the plan's inception to the date of termination of the plan."

Current financing of the social security program is best described as "taxing Peter to pay Paul." Many Americans seem to believe that their payments to the social security system constitute savings that will be invested, and that these savings and earnings from them will be returned to them during their old age. However, the fact is that most such payments are not invested; they are used to pay benefits to those now retired. Present contributors must rely on the hope that their retirement income will be provided by future workers similarly forced to contribute increasing portions of their incomes to others.

During fiscal year 1972, revenues of the old age and survivors insurance trust fund were \$35.7 billion, and benefit payments were \$34.5 billion. The excess of receipts over expenditures was invested in U.S. Government securities and added to the current fund balance. In recent years, this fund has been approximately \$36 billion, about equal to the amount of benefit payments for 1 year. This amount is only a fraction of the several hundred billion dollars that would be required for funding the liability of future benefit payments on an actuarially sound basis.

From the Jan. 3, 1977

Research Reports

As we had the previous year, AIER here discusses the growing demographic problems with Social Security funding—falling birth rates, longer life-spans, and an expansive "baby boom" cohort moving inexorably toward retirement. We also examine the possibility of full actuarial funding of Social Security, as would be required of a private program.

The possibility of full actuarial funding of the program continues to be supported by some. Of course,

this is the only possibility that does not involve a breach of promise, but that it would be accomplished is most improbable. For this to occur, tax rates would have to be increased substantially in the near future and the accumulating reserve would have to be invested in the private sector in order not to retard capital formation and economic growth. ...

...In a decade or two, the magnitude of the underfunding will have increased further and the demographic trends will have made the accumulation of an adequate reserve virtually impossible. A decade or two after that, the payment of promised benefits will become impossible.

From the Nov. 22, 1982

Research Reports

In this lively newsletter, an apocryphal 40-year-old voices his concerns in an open letter to then-Speaker of the House Thomas P. O'Neill, Jr. The letter points out that Social Security is not a savings program. It also says that the imbalance in receipts and pay-outs of the system are unsustainable and inconsistent with actuarial standards.

My father retired early this year at age 65. He and my stepmother now receive about \$1,100 per month from Social Security. He worked nearly continuously since Social Security began, and he nearly always paid the maximum tax.

Over the years, the taxes he paid totaled about \$15,000. He will receive all of this back in "benefits" in the space of about 14 months. Mortality tables indicate that he will live to receive an additional 140 months or so of Social Security retirement benefits. Obviously, the extra 140 months of expected benefits will have to be provided by somebody else.

Looking at the situation from another angle, my father's expected benefits are equivalent to an annuity. You cannot buy an annuity from a private company equivalent to Social Security because none can

promise to increase payments by the cost of living. (If one did, its officers probably would be charged with fraud and possibly incarcerated.) However, if no inflating were to occur (little chance of that) a fixed-dollar annuity would provide a stable amount of purchasing power over the years and probably would be offered at interest rate of 3 to 4 percent. In these circumstances, an annuity paying \$1,100 monthly, with a lesser amount to the survivor, might be available to my 65-year old parents from a private carrier at a cost of about \$150,000—10 times the amount of Social Security taxes my father paid. ...

...When I reach retirement age, there will be far fewer persons of working age in relation to those of retirement age than there are at present. Therefore, for the Social Security fund to pay me even these "modest" benefits, my children and their age-mates would have to be taxed significantly more than I am now taxed to support my father and his age-mates. The thought of loading my children with this burden does not appeal to me. Besides, I expect they would not stand for it in any event.

How the future working generation will express its refusal to pay for the level of benefits this working generation is providing to present retirees is questionable. One possibility is that it simply will choose more leisure rather than more work. And without that generation producing more, there is no way my generation will be able to consume in retirement at the rate of present retirees. It thus seems inescapable that my age-mates and I not only will receive far smaller returns on what we paid in to Social Security, but also in all probability we will have to work longer (i.e., past age 65), receive smaller checks, or both.

The view that Social Security is a savings program is plainly false. There are no investment returns involved (nominal or "real") because the taxes are virtually paid out as

soon as they are received. The level of benefits paid to today's retirees is not determined in any meaningful sense by past earnings and taxes. The level has been legislated by you and your colleagues in Congress, and past earnings only determine, in part, the way in which the booty is divided up among individual retirees. I am heavily taxed now to maintain payments that you chose to award to the generation ahead of me, not to provide for my old age.

From the Jan. 31, 1983

Research Reports

Once again, we reiterate that Social Security is not an insurance program. We outline the features of the system that are consistent and inconsistent with insurance—and explain the consequences.

Since its inception, Social Security has been "sold" to the American people as an insurance plan, but in practice Social Security's operations have never followed sound insurance principles. Congress first promoted and has perpetuated the myth that Social Security is a form of insurance by stressing certain aspects of the program. One is the payment of benefits out of specific funds generated from a specific tax, soothingly labeled "contributions." The second is the payment of benefits according to the "insured's" work history and its effect on his "contributions" to the program rather than according to the recipients "need." These aspects resemble private insurance because a private issuer pays claims out of a fund accumulated from premiums received (and the earnings thereon) and pays benefits according to the contract terms, without regard for what beneficiaries "need." But these two features of Social Security are its only aspects that resemble insurance.

Unlike a private insurance contract, the terms of the Social Security "contract" have often been changed. And although the

benefits paid to recipients have not been “means” tested, Congress has highly “skewed” them in favor of lower-paid workers. Upon retirement, lower-paid workers receive more in relation to past “contributions” than do higher-paid workers, but even higher-paid workers now receive what amounts to a fabulous investment return on what they paid in. Congress has done this by continually increasing the burden on current workers, but now it is obvious that the younger of current workers are unlikely ever to receive a “good deal.” ...

...The recurrent “crisis” in Social Security traces to its being another large (if disguised) income transfer (welfare) program rather than a savings-investment program. One result has been that the Nation has had less and less savings and more and more income transfer. As severe a problem as this is today, it will become acute—indeed, insurmountable—in the next century when the number of retirees per worker would increase markedly under present retirement retirement practices.

This long-term problem for Social Security has not been seriously addressed, any more than Mr. Ponzi’s plan provided a means to pay all of his “investors.” The immediate problem, that this year or next Social Security would run out of money to pay current benefits unless some changes are made, has finally forced some action. Only 5 years after the last round of Social Security tax increases, which at the time President Carter said would keep the system “sound” for 50 years, another “quick fix” is needed. And another “quick fix” is in the making. ...

...The Commission’s proposals [the President’s National Commission on Social Security Reform] in many instances, amount to tapping general revenues for funding the system in part, something that has been vehemently opposed in the past. It has been opposed by support-

ers of the Social Security scheme, claiming they wanted to preserve the “integrity” of the system, i.e., to perpetuate the myth that Social Security is like an insurance program, paid for by its participants.

**From the Feb. 2, 1987
Research Reports**

In this article, AIER dispels the myth that because part of the Social Security tax is paid by employers, it relieves workers from the tax’s burden.

In 1937, a 1 percent tax was levied on the first \$3,000 of wages and salaries and employers were required to contribute an additional 1 percent.... A half century later, in 1987, the tax rate stands at 7.15 percent on both employees and employers on the first \$43,800 of earnings, for a combined tax rate of 14.3 percent and a maximum levy of \$6,263 per individual worker. ...

...Most analysts believe that employee compensation would increase, in the absence of the employer’s forced “contribution,” [to Social Security] which, from the employer’s point of view, clearly is an expense associated with hiring someone. Some analysts believe that employers recover their Social Security tax payments in higher prices for the goods and services that workers purchase. But virtually no student of the question believes that the employer’s “contribution” is paid from profits (or from the surpluses of nonprofit organizations)....

...Social Security taxes act as a “wedge” between employers and employees representing the difference between what it costs employers to obtain an employee’s services and what the employee actually receives by rendering them. The 2 percent of wages levied when the system began probably had little impact on employers’ decisions to hire or employees’ decisions to work. The 14.3 percent levied today (soon to be 15.3 percent) already constitutes a strong incentive to work “off

the books”—especially for young people who have little regard for the system’s benefits or for those who stand to lose relatively few benefits by evading taxes on a second job. At some point, raising Social Security tax rates further would become self-defeating as the adverse effects (on employment and compliance with the law) would begin to outweigh the higher rates.

**From the April 25, 2005
Research Reports**

In the new century AIER’s economists stepped up their scrutiny of the Social Security System by taking a close look at how politicians use a vocabulary carefully chosen to mislead the public about the nature of the system. This has resulted in a cascade of misconceptions. Social Security is not insurance, and the Trust Fund essentially amounts to money the government owes to itself.

Politicians have assiduously cultivated the public’s confusion concerning the Social Security Trust Fund. But that is by no means the only aspect on which the public has been misled. In fact, much of the vocabulary of the Social Security system was purposely designed to give it the trappings of insurance and to create the impression that it is somehow based on the principles that private individuals might follow to provide for their old age.

For example, calling Social Security taxes “contributions” and requiring employers to “contribute” an equal amount suggests not only that the money deducted from one’s paycheck is somehow a form of saving, but that it is matched by one’s employer. (There is not a shred of evidence that an employer’s contribution to Social Security is born by the employer and not the employee—if an employer is willing to pay the full cost of an employee, it should make little difference to the employer how that cost is divided.)

Social Security is not genuine insurance, it is “social insurance”. . . . Politicians may have felt it necessary to cloud this fact in order to get the public to accept a massive income transfer program. But they have also made the program far more costly than it needed to be to achieve what President Roosevelt said the system would provide when he signed the Social Security Act of 1935: “some measure of protection to the average citizen and his family against the loss of a job and a poverty-ridden old age.”

From the 2007 book *What You Need to Know About Social Security*

In AIER’s far-reaching survey of the outlook for Social Security, we detail the nature of the Trust Fund, discuss the intentions behind it, and contrast it with a common law trust:

The truth is that the Trust Fund is a Treasury account called a “trust fund” for public relations purposes, to defuse the reserve fund controversy of the 1930s. During the Senate hearings on the 1939 Amendments, Senator Arthur Vandenberg asked Arthur Altmeyer what the purpose of the proposed trust fund was. Altmeyer replied: “Well, to allay the unwarranted fears on the part of some people who thought Uncle Sam was embezzling the money.”

The language in the 1939 Amendments creating the Old-Age and Survivors Insurance Trust Fund was almost identical to that in the Social Security Act of 1935 which created the Old-Age Reserve Account at the Treasury. It necessarily follows that the OASI Trust Fund is simply a Treasury account.

A true common-law trust is an arrangement whereby one party (a settlor) gives his own assets to one or more trustees to be managed according to certain stipulations (terms of trust) on behalf of one or more beneficiaries. The trustees hold legal title to the property in the trust and

the beneficiaries hold an equitable title to it—a claim that could be sustained in a court of law. None of these things is true of the Social Security Trust Fund. Congress is not the settlor, since it does not own the Treasuries in the “trust fund.” Nothing in the 1939 Amendments creating the OASI Trust Fund gave the Board of Trustees a legal title to anything. *Flemming v. Nestor* ruled that there is no accrued property right to benefits—and if that is so, there necessarily cannot be a property right to the assets in the OASI Trust Fund from which the benefits are supposedly paid.

Also, the “trust fund” represents no true forward funding. Social Security’s surpluses have not been invested in productive assets with any tangible value. They are not held, as private financial reserves typically are, in stock, bonds, real estate, mortgages, etc.—assets representing real, wealth-producing capital.

Instead, they have been loaned to the U.S. Treasury, which in turn uses them to finance other government spending and reduce its need to borrow from the public. In exchange, Social Security receives from the Treasury “special issue” government securities. As critics of the old-age reserve pointed out in the 1930s, these are simply claims by the government on itself. These Treasury “securities” are nonmarketable promissory notes backed by nothing of tangible value—“IOU nothings” that cannot be used in any market transaction whatsoever. They have no price, and therefore no value.

When the time comes to use the phantom “surplus” to pay benefits, Social Security will present its “IOU nothings” for payment, and the Treasury will have to extract the money from the private economy, through higher taxes or borrowing from the public. And borrowing from the public will entail higher interest costs, a legally binding claim on federal revenues.

The Social Security “trust fund’s” only real assets, then, are the government’s power to tax and the public’s willingness to be taxed.

Finally, we predicted the crisis in Social Security. We warned and prepared our readers. That is our mission. That is our history.

The coming crunch in Social Security means that retirement will be increasingly difficult for most Americans. Most of us will have to work longer and retire later, if we are able to retire at all. The likelihood is that Social Security’s shortfalls will be financed by borrowing. At some point, the option of inflating the national debt away may become irresistible. This obviously carries grim implications for the purchasing power of your savings and investments, and therefore for your ability to retire.

The all but inevitable benefit reduction makes it very likely that workers will need to save and invest much more than they do now to provide for old age. At the same time, higher taxes, and the possibility of inflationary stagnation caused by massive borrowing to cover the coming deficits, will make it harder to do. The painful but necessary implication is the need to curtail your current personal consumption so as to offset the inroads which these higher burdens will make on your investment funds.

In short, the coming Social Security crisis implies that to be in a position to enjoy a comfortable retirement you will have to work harder, save more and live more austere than you do now.

The American Institute for Economic Research has many articles on Social Security. Find more information at

