

Beyond Rhetoric: The FAQs about Social Security

We've all heard about how the U.S. Social Security system is in trouble, and that somehow this is related to the fact that it is not 'fully-funded' system. What does this mean?

Funding for social security comes from current payroll taxes. As long as the revenue generated by these taxes is more than the amount paid out to retirees the system works fine. However, population projections (which are quite accurate) indicate that as the number of retirees increases, and as they live longer, the amount paid out of the system will exceed the amount collected. This shortfall is the 'crisis' in social security.

How can we deal with the crisis?

First note that the system has been, and is, collecting more than it is paying out (that is, the system is currently running a surplus). So, a reasonable thing to do would be to save these surpluses until they're needed. That however, is out of the question politically; since the rest of the Federal Government finances are also in deficit, the current social security surpluses are being used to fund current operations elsewhere. So, the future revenue shortfall will have to be financed through some combination of (a) selling bonds, (b) raising taxes, and (c) reducing payouts.

Option (a) selling bonds, will be made more difficult due to the current administration's fiscal irresponsibility. That is we are currently selling bonds to finance spending on current operations elsewhere in the budget - even though we have known for a long time of the impending crisis in social security

Option (b) raising taxes: is not a very popular notion, and in any event runs exactly opposite to what the current administration has been advocating.

Option (c) reducing payouts: is a likely possibility. However, in doing so, we would be breaking a promise to retirees. That is, people who throughout their working lifetimes paid into the system with the expectation of receiving a certain level of benefits would be denied their expected benefits. What makes this option worse, is the fact that the 'crisis' could have been dealt with in a responsible manner - without the need for large cuts in benefits!

What about privatization of Social Security? Won't that fix the system?

Plans to privatize part of Social Security all involve current workers re-directing part of their Social Security taxes into a private account that would form part of each worker's future retirement savings. The major issue for the Social Security system is that the money that gets diverted would need to be replaced, since that money is supposed to fund current (and future) retirees. This is a very big problem, because in the short run (during the next 40 years!) it would essentially bankrupt the Social Security system. Ignoring whether privatizing is a good or a bad idea, the time to implement any privatization would be when the government (and nation) could afford to do so. Currently, it obviously cannot.

What are the major objections to a privatization of Social Security?

(1) Doing so without replacing worker's re-directed taxes would bankrupt Social Security. (2) Privatization does not even work in theory.

Most proposals to privatize the system make no provisions for losses incurred by participants. That is, with a privatized system, a worker who invested wisely would be able to retire on a large income. However, a worker who invested unwisely (remember Enron?) could potentially lose all their retirement nest egg. If we (as a society) would not let these people starve, then there would still need to be a government program to 'bail-out' these people. Hence, 'privatization' would exist in theory only. Note that ALL other privatized systems existing around the world still require big government payouts.

Why is privatization of Social Security being so actively pursued?

- Political will for reform is probably motivated by the looming funding shortfall in the system. This, combined with a healthy respect for market-based solutions (and minimal government involvement in the economy) has undoubtedly led to the current privatization push. However, no private system can provide the safety-net features of the present system.
- Additionally, the major beneficiary of a privatized system would be the professional investment management industry. Hence they have a strong lobby.