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SOCIAL SECURITY'S SLOW DEATH SPIRAL

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The trustees of the Social Security retirement program estimate that by 2037 all of the assets in the trust fund – more than $2.2 trillion in special U.S. securities – will have been redeemed to pay retirement benefits which cannot be paid from payroll taxes. With no assets left in the fund and with tax revenues insufficient to pay scheduled benefits, beneficiaries in 2037 will be paid 75¢ for every $1 promised.

Virtually everyone familiar with the retirement program knows that there are only two remedies for this shortfall: raise taxes or reduce benefits. Neither one has friends, both have enemies. Thus, the program for years has been known as "the third-rail of American politics" – touch it and you're politically dead.

The Social Security Administration's chief actuary in 2009 estimated the internal rate of return for different types of workers at different earnings levels under the present tax/benefit schedule. The internal rate of return is the rate a worker would have to receive on contributions into a savings account to accumulate a balance to match SS benefits. We present the actuary's estimates for (a) very low, medium, and maximum annual earnings – indexed to wages in 2007, (b) one-earner and two-earner couples, and (c) persons reaching age 65 in 2038. Indexing wages to 2007 means that the internal rates of return are *real* rather than nominal. The estimated rates of return assume that workers enter the labor force at age 21, work until retirement at age 65, both wife and husband are the same age and married at age 22.

	Rate of Return	
	One-earner couple	Two-earner couple
Very low annual earnings ($9,662)	6.13	4.50
Medium earnings ($38,651)	4.10	2.36
Maximum earnings ($85,885)	2.51	0.77

The rate of return under the present tax/benefit benefit schedule is lower for couples with higher earnings because the formula used to calculate benefits is weighted in favor of low-earnings workers. It is lower for two-earner couples for the same reason – the formula is weighted in favor of one-earner couples. A higher internal rate of return, however, does not

mean a higher monthly benefit. The monthly benefit amount in general is higher for beneficiaries with higher earnings.

The SSA actuary also calculated the rate of return based on (a) increased payroll taxes and (b) decreased benefits. We present those rates for one-earner and two-earner couples reaching age 65 in 2038 with maximum earnings compared to the rates with no change in the tax/benefit schedule.

	Annual earnings: $85,885	
	One-earner couple	**Two-earner couple**
No change in tax/benefit schedule	**2.51**	**0.77**
Increased payroll tax	**2.51**	**0.77**
Reduced benefits	**1.95**	**0.17**

The viability of SS retirement depends on persons with higher earnings subsidizing benefits for persons with lower earnings. The dilemma is that the program will not be able to pay scheduled benefits after 2037 unless taxes are increased or benefits are decreased, *and* high-earners care enough to subsidize low-earner benefits even though those high-earners might have achieved a higher return if they were free to invest their SS contributions in private investment accounts. This is especially difficult for the self-employed who pay the full 12.4 percent payroll tax.

The following table shows rates of return across generations -- grandparents, children, and grandchildren – for one-earner and two-earner couples. These estimates confirm the complaint by adult grandchildren that even with much higher annual earnings they will not be able to recoup from SS retirement what their grandparents are getting.

	One-earner couple	**Two-earner couple**
Grandparents born in 1920: $9,662 earnings	**9.05**	**6.39**
Child born in 1949: $38,651 earnings	**4.40**	**2.39**
Grandchild born in 1973: $85,885 earnings	**2.51**	**0.77**

Why should any sensible person support cutting benefits now when the rate of return in the future would be even lower for persons born after 1949 regardless of annual earnings? And why should anyone support raising taxes when the rate of return would be even lower for persons born after 1985 regardless of annual earnings? In the extreme, under the higher tax scenario for single males with maximum annual earnings who were born after 1973 those rates turn *negative*!

SS retirement's slow death spiral might not be reversed even with the life-support of higher taxes or lower benefits. To explain, why wouldn't higher-income couples facing even lower rates of return deliberately hide income to reduce their payroll tax liabilities, particularly if they are self-employed? Wouldn't that reduce SS and federal income tax revenues, further draining the trust fund and adding to the budget deficit and the public debt?

It's time to scrap this failing program born in the Depression, and start over.

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