



# **The Free Enterprise Nation**

## **The Social Security Crisis**

**POSITION PAPER**

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The Free Enterprise Nation, Inc.  
1511 N. West Shore Blvd., Suite 700  
Tampa, FL 33607  
[TheFreeEnterpriseNation.org](http://TheFreeEnterpriseNation.org)

## SUMMARY

Most Americans believe that their Social Security benefits are guaranteed. Social Security was still new when the first “baby boomers” were born in the late 1940s and entered the workforce beginning in 1964. These baby boomers are now approaching retirement. As they see it, they and their employers have “paid in” to Social Security via payroll taxes for their entire working lives, and they will finally reap the benefits when they begin retiring in 2011.

References to “The Social Security Trust Fund” have added to the myth that Social Security benefits are well-funded and can be counted on to be there when called upon to pay retirement benefits. Most Americans believe that the “Social Security Trust Fund” is what it implies itself to be ... a pool of funds that are held in trust. In reality, Social Security benefits are explicitly NOT guaranteed, and the “Trust Fund” actually represents a \$2.4 trillion loan, an IOU, from one federal government department to another. And this IOU is growing. In 2009, for the first time since Social Security began in 1935, the government paid out more in Social Security benefits than it received from payroll taxes. If the current unemployment rate continues, the Social Security deficit in 2009 and 2010 may approach \$20 billion.<sup>1</sup>

If Social Security were the only unfunded debt of the federal government, hopes to provide benefits via deficit spending might be conceivable. Unfortunately, the U.S. national debt, if one includes unfunded Social Security and Medicare obligations, is currently \$56.4 trillion.<sup>2</sup> This is four times our Gross Domestic Product (\$14.2 trillion)<sup>3</sup> and 23 times our 2008 federal tax revenues (\$2.5 trillion).<sup>4</sup> What this means, in simple terms, is that the U.S. has accumulated so much debt that it cannot grow itself out of its current debt situation. The only options available for handling this debt crisis are increasing taxes and/or reducing expenditures. The ability of retirees to depend on Social Security is, therefore, seriously threatened.

The Free Enterprise Nation has determined that the Social Security Crisis is one of the top five economic threats to America in 2010. More than 77 million Americans who will reach age 65 in the next 15 years will face untold economic hardship if their benefits are reduced or if their taxes are increased. Additionally, the active employers and

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<sup>1</sup> Heritage Foundation, John, David C., September 29, 2009, “Social Security's Unexpected Deficits Show Urgent Need for Reform”, WebMemo #2632, <http://www.heritage.org/Research/SocialSecurity/wm2632.cfm>.

<sup>2</sup> Peter G. Peterson Foundation, “National Debt”, Based on 2008 Financial Report of the United States Government. Social Security and Medicare benefits are present values as of January 1, 2008. Burden per person calculated using estimated December 2008 US Census Bureau data, other data as of September 30, 2008, <http://www.pgpf.org/about/nationaldebt/>.

<sup>3</sup> U.S. Department of Commerce, Bureau of Economic Analysis, “National Economic Accounts”, <http://www.bea.gov/national/index.htm#gdp>.

<sup>4</sup> Tax Policy Center, Urban Institute and Brookings Institution, The Tax Policy Briefing Book, April 22, 2009, “The Numbers: What are the Federal Government’s Sources of Revenues”, <http://www.taxpolicycenter.org/briefing-book/background/numbers/revenue.cfm>.

employees who could be forced to bear the burden of payment for 77 million retirees would provide a crippling impact on the sustainability of our free enterprise economy. The Free Enterprise Nation believes that long-term sustainability of Social Security should be one of the highest priorities of the federal government, and that the solvency of Social Security must be guaranteed.

### OVERALL U.S. FINANCIAL PICTURE

The U.S. national debt most frequently quoted in the press is the government’s publicly held debt of \$13.5 trillion as of the end of 2008. However, this number does not include Social Security and Medicare obligations, which are an “off the balance sheet” part of the national debt. As Figure 1 shows, when these additional obligations are counted, the U.S. national debt in 2008 was \$56.4 trillion. Figure 1 was developed by the Peter G. Peterson Foundation based on the 2008 Financial Report of the United States Government. The Social Security and Medicare benefit obligations listed were present values as of January 1, 2008.

Medicare	\$36,300,000,000,000
Social Security	\$6,600,000,000,000
Publicly-held debt, civilian and military retirement benefits and other liabilities and miscellaneous exposures	\$13,500,000,000,000
<b>Total</b>	<b>\$56,400,000,000,000</b>

Source: U.S. Dept. of the Treasury

The U.S. federal budget deficit was a record \$1.4 trillion for fiscal year 2009 (13% of GDP). For fiscal 2010, the Congressional Budget Office (CBO) projects a \$1.4 trillion deficit, assuming the economy will begin to recover.<sup>5</sup> Over the next 10 years, the administration is forecasting that budget deficits will total \$9.05 trillion.<sup>6</sup>

<sup>5</sup> The New York Times, July 22, 2009, “U.S. Federal Budget”, [http://topics.nytimes.com/top/reference/timestopics/subjects/f/federal\\_budget\\_us/index.html](http://topics.nytimes.com/top/reference/timestopics/subjects/f/federal_budget_us/index.html).

<sup>6</sup> CBS News.com, December 10, 2009, “Federal Budget Deficit Hits \$120.3 Billion”, <http://www.cbsnews.com/stories/2009/12/10/national/main5963445.shtml>.

The federal government collected \$2.5 trillion in tax revenues in 2008, an amount equal to 17.7% of GDP. As shown in Figure 2, using data from the Congressional Budget Office, individual income taxes have been the largest single source of federal revenue since 1950, averaging just over 8% of GDP. Payroll tax revenues grew significantly after 1965 when Medicare was created. Those Medicare taxes, together with periodic increases in Social Security taxes, led to the growth of payroll tax revenue from 1.6% of GDP in 1950 to more than 6% of GDP currently.<sup>4</sup>

Individual Income Tax	45%
Payroll Tax <sup>7</sup>	36%
Corporate Income Tax	12%
Excise Taxes	3%
Other Taxes	4%
Total (in dollars)	\$2,500,000,000,000

Source: Congressional Budget Office

<sup>7</sup> Payroll taxes are the state and federal taxes that an employer is required to withhold and to pay on behalf of his employees. Social security and Medicare taxes, also known as FICA taxes, are withheld from employees' wages. An employer must also pay a matching amount of FICA taxes for its employees. Currently the social security tax rate is 6.2%. The employer withholds 6.2% of an employee's wages for social security taxes and pays a matching amount in social security taxes until the employee reaches the wage base for the year. The wage base for social security tax is \$97,500 for the year 2007. Once that amount is earned, neither the employee nor the employer owes any social security tax.

The Medicare tax rate is 2.9% for the employee and the employer. The employer withholds 1.45% of an employee's wages and pays a matching amount for the Medicare tax. There is no wage base for the Medicare portion of the FICA tax. Both the employer and the employee continue to pay Medicare tax, no matter how much is earned.

To summarize two key points:

- Social Security and Medicare obligations comprise 76% of the U.S. national debt.
- Social Security and Medicare taxes represent 36% of current federal tax revenues.

### **SOCIAL SECURITY BENEFITS ARE *NOT* GUARANTEED**

Although frequently described as guaranteed in the press and in political debates, the truth is that Social Security benefits are *NOT* guaranteed. Although statements from the Social Security Administration have long said that Social Security payments are not guaranteed, this fact is unknown to many Americans. Most workers assume that because they pay Social Security taxes into the system their entire working careers, they have some sort of legal guarantee to the system's benefits. This is not the case.

As Michael Tanner, Director of the Cato Institute's Project on Social Security Choice stated:

“Social Security benefits are not guaranteed. They are not guaranteed legally because workers have no contractual or property rights to any benefits whatsoever. In two landmark cases, *Flemming v. Nestor* and *Helvering v. Davis*, the U.S. Supreme Court ruled that Social Security taxes are not contributions or savings, but simply taxes, and that Social Security benefits are simply a government spending program, no different than, say, farm price supports. Congress and the President may change, reduce, or even eliminate benefits at any time. As a result, retirees must depend on the goodwill of 535 politicians to determine how much they will receive in retirement. And what could be less guaranteed than a politician's promise? In fact, Congress has voted to reduce Social Security benefits in the past. For example, in 1983, Congress raised the retirement age.”<sup>8</sup>

### **SOCIAL SECURITY IS RUNNING A DEFICIT**

In 2009, for the first time since Social Security began in 1935, the government paid more in Social Security benefits than it received from payroll taxes. If the current unemployment rate continues, the deficit in 2009 and 2010 may approach \$20 billion. Even if the economy recovers, and millions of workers begin once again paying payroll taxes, Social Security will run at a deficit beginning in 2016.<sup>1</sup>

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<sup>8</sup> Cato Institute, Tanner, Michael, D., May 29, 2005, “Social Security's Sham Guarantee”, [http://www.cato.org/pub\\_display.php?pub\\_id=3785](http://www.cato.org/pub_display.php?pub_id=3785).

In 1983, in anticipation of the “baby boom” retirements that would begin in 2011, the federal government dramatically increased payroll taxes paid by both employers and employees to create a massive “trust fund” so that assets would be there when needed. During the ensuing 25 years they collected \$2.4 trillion more in payroll taxes than was required to support the then current Social Security recipients. This \$2.4 trillion was to be deposited into a Social Security “Trust Fund” in order to have assets available when baby boomers begin retiring in 2011. However, the federal government spent the entire \$2.4 trillion and nothing remains in the trust fund except government’s IOUs to itself.

The Social Security Administration estimated in May 2009, that after adjusting for inflation, Social Security deficits would reach \$68 billion in 2020, \$170 billion in 2030 and \$293 billion in 2035. However, since then, the picture has worsened. A projected surplus in 2009 turned into a \$9 billion deficit, just a few months after the “surplus” estimate was made. It is now clear that the deficits will be larger, and come sooner, than the Social Security Administration predicted in May 2009.<sup>1</sup>

Of the estimated 77 million “baby boomers” (born between 1946 and 1961) who will reach age 65 in the next 15 years, an estimated 12 million are or were public sector employees. The taxpayers of the entity that promised the pensions in the first place guarantee most public sector retirement plans. Ironically, taxpayers in the private sector have unwittingly (they never voted to do so) guaranteed pensions for their “public servants” while relying for themselves on an un-guaranteed Social Security. Virtually all public sector employees had/have pension plans allowing them to “retire” with as little as 20 years of service. Public sector baby-boomers began retiring in 1984. By 2011, the last public sector “baby boomers” will have already retired. Public sector workers born AFTER 1961 (“Gen X”), actually began retiring in 1999. This additional layer of taxpayer-supported retirees will be added to the 65 million private sector baby-boomers who retire at age 65 on Social Security beginning in 2011. The impact of this creates a financial burden on taxpayers that has not been recognized or disclosed by the federal government. The result is that the often-discussed Social Security financial “crisis” is actually significantly understated.

### **NEED FOR CONGRESS TO GUARANTEE THE SOLVENCY OF SOCIAL SECURITY**

Experts have agreed that there are three ways to fix Social Security: they can (1) reduce benefits, (2) increase taxes, or (3) both of the above. No one can be certain what Congress will do, but a tax increase seems likely. American Enterprise Institute scholar Andrew Biggs estimates that “to make Social Security solvent over the long term would demand an immediate and permanent payroll tax increase of around 3.4 percent (that is a 27% increase over the current 12.4 percent Social Security tax rate)”<sup>9</sup> or a tax increase

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<sup>9</sup> Biggs, Andrew. (2009, November 30). Why Kevin Drum Is Right on Social Security. The Enterprise Blog. <http://blog.american.com>.

of about \$270 billion a year. However, due to the growing federal budget deficit, a tax increase alone may not be enough, and other debts also require tax increases to support. Therefore, it is also possible that Congress may vote to reduce benefits.

The Free Enterprise Nation suggests a fourth alternative: The federal government can and must dramatically reduce its spending, thus reducing overall deficits and debt. It must determine what is “good debt” and what is “bad debt” and eliminate the “bad debt.” The Free Enterprise Nation believes that the highest debt that the federal government has is the debt it owes to its own citizens. It owes it to the companies and workers from whom it took \$2.4 trillion in the last 25 years for a “Social Security Trust Fund” and then recklessly spent. This \$2.4 trillion must be seen as “Senior Debt” and must be included in the federal budget as a stated obligation. The total debt of the federal government would then be seen and fully recognized, forcing a reduction in deficit spending in all other areas. There are many unfunded and under-funded benefits and entitlement programs that must be curtailed or eliminated. There are many “pork” and “earmark” dollars spent each year that must be eliminated. If the federal government accepts the fact that it has an inviolable obligation to provide Social Security benefits as promised, and that it cannot burden current and future generations under the COMBINED weight of promised Social Security obligations as well as virtually limitless deficit spending in other areas, it will be forced to recognize that it is impossible to justify deficit spending of any kind for the foreseeable future. The Free Enterprise Nation calls for Congress to guarantee the solvency of Social Security by supporting the Guarantee the Solvency of Social Security Act.



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