A Hard Look at Social Security

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Abstract for 1996 International Conference of the System Dynamics Society

Past payment of social security taxes entitles no one to future retirement benefits, either legally or financially. In 1960 the US Supreme Court ruled in *Fleming v. Nestor* that workers have no property rights to past contributions or anticipated benefits. Furthermore, the Trustees and Actuaries of the Social Security Administration state annually in their reports that social security is designed as a pay-as-you go transfer system, not a fully-funded retirement system. Current benefits are funded from current social security contributions. All future benefits will be funded by future taxes or future borrowing.

The structural shortcomings of a pay-as-you go transfer system emerge when the number of recipients rises in comparison to the number of contributors. Starting in 2015, as baby boomers begin to retire, the number of retirees will grow sharply relative to the number of young workers. By 2040 the number of retirees per worker will double over today's figure, causing huge increases in benefit payments without offsetting increases in tax revenues. In order to keep social security from collapsing, the government will face several choices:

1) double social security tax rates,
2) cut social security retirement benefits by half,
3) redirect most poverty transfers to retirees,
4) borrow enough to cause long-term disinvestment and decline in the economy, or
5) emit vast quantities of money, causing severe inflation.

In the 1980's, anticipating the problem of a shifting age structure, Congress increased social security tax rates to a level slightly higher than needed to pay current benefits. The surplus is accumulated each year in the social security (OASI) trust fund in the form of US government bonds. The fund is intended to help pay benefits to baby boomers when they retire, reducing the need for either further tax increases or benefit reductions at that time. Unfortunately, the trust fund has two fatal flaws. First, the fund balance is woefully inadequate, standing now at only $0.5 trillion. To be fully funded, the balance should be about $6-7 trillion, or approximately half of all private assets in the US. Second, the US government already owes more in debt than the value of all its assets combined, so the bonds in the trust fund are no better than future taxes.

Consensus is building for the need to overhaul or terminate the social security system before it goes bankrupt. Planning an early and orderly transition away from the present system will likely be easier than coping with a sudden collapse. A detailed system dynamics model of social security and retirement savings, developed in cooperation with the CATO Institute, tracks the impacts of various proposals to reform or privatize the social security system. The model generates quantitative estimates of the feedback effects of each proposal on the economy. Proposals tested include:

1) reducing cost of living adjustments in retirement benefits,
2) raising the retirement age faster then already scheduled,
3) raising social security tax rates on wages and/or other tax rates to pay for benefits,
4) converting the system to a means-tested welfare program for the poor elderly, and
5) terminating social security with or without compensation for past contributions.