Does the Government Steal from Social Security?

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The program's trust fund contains real assets, but its effect on the economy is complicated

When people discuss the federal government's fiscal issues, frequently heard complaints include: "Social Security would be fine if the government stopped raiding the trust fund" or "Make the government give back the money it borrowed/stole from Social Security." Since the program is the backbone of the nation's retirement system, it is important to understand whether these concerns are legitimate. The basic answer is "no," but the full answer is a little complicated.

Let's start with the easy part – looking just at the Social Security program in isolation. Here the answer is uncontroversial. Yes, a trust fund really exists. It holds 15-year government bonds, which the Treasury has issued in exchange for the excess payroll taxes collected. And when the Commissioner of Social Security needs money to pay benefits, he can take his bonds to the Secretary of the Treasury and redeem them for cash.   In this sense, the trust fund is "real;" nobody has stolen or borrowed the bonds. The bonds will be there to pay benefits.

The controversy arises when considering Social Security in the context of the federal budget and the broader economy. The mechanics are clear. When the Social Security Commissioner redeems his bonds, the Secretary of the Treasury must get the money from somewhere. One obvious option is to go out and borrow it. At this point reasonable people may ask: "What good is the trust fund buildup if when the time comes to use the bonds to pay benefits the Secretary of the Treasury has to borrow the money?

To answer that question requires moving beyond the budget into the economy more generally. The idea of building up a trust fund to pay benefits when the Baby Boom started to retire was never one of stockpiling cans of tomato soup, playing cards, and walkers, but rather to increase national saving and investment so that the economy would be larger than it would have been otherwise. The dynamic at work here is that trust fund surpluses reduce the government's need to borrow from the private sector, which makes more private capital available to finance private investment and boost economic growth. The mechanics for the Social Security program would be the same as described above: the Commissioner of Social Security would take his bonds to the Secretary of the Treasury who would borrow money to redeem the bonds, but more additional output would be left over for the non-elderly than would have been without the additional saving.

Now here is the controversial part: Did the surpluses in the Social Security trust funds really increase national saving and produce more output? Critics say "no" – they argue that the existence of the surpluses, and their inclusion in the total federal budget, led Congress to either keep taxes lower or spend more on non-Social-Security programs than it would have otherwise. Economists have tried to estimate how the surpluses affected congressional behavior, but the results are not very persuasive. My best assessment is that, before 2000, the Social Security surpluses added to national saving.

After 2000, when the entire budget appeared to be moving toward rising surpluses, the optics made large tax cuts too tempting. In other words, I think that the Social Security surpluses enabled the Bush tax cuts. To the extent that saving did not occur, the burden of the Baby Boomers was not prefunded.

This issue of prefunding will arise again when Congress turns its attention to eliminating Social Security's long-term financing problem. An immediate increase in taxes will once again produce an increase in trust fund reserves. If these reserves are to increase saving rather than just cover current expenditures, we need a better set-up. One option is to change the budgeting so that Social Security is taken completely off the books as is the case of the pensions sponsored by state and local governments. Another option is to change the trust fund's investments. When the money is invested in government bonds, it becomes immediately available for government spending. If it were invested in corporate bonds or even equities – an idea I like a lot – the money would not be available for government spending.

So while the government does not actually steal money from the Social Security trust funds, the prefunding exercise probably has not worked as well as envisioned. If we are going to build up trust fund reserves again, we need to do a better job of structuring the deal.