U.S. Social Security Will Go Bankrupt in 2010

Economics / US Debt Dec 08, 2009 - 03:16 AM

By: Gary_North

For the third time in my life, the Social Security System will go belly-up.

The first time was in 1977 – well, almost. To head off the bust, Jimmy Carter got Congress to pass a major FICA tax increase – sorry, "contribution" increase – in order to save Social Security. The rate would be hiked in phases from 2% to 6.15% (times two: employee and employer). He promised: "Now this legislation will guarantee that from 1980 to the year 2030, the Social Security funds will be sound."

Carter's projection was off by a Georgia country mile. In 1983, the SSA program technically went bankrupt. Reagan signed a law that speeded up Carter's rate increases, added Congressional employees to Social Security, and delayed the age of eligibility. (http://tinyurl.com/ybksxs4)

Unless there is another Social Security tax increase in 2010, the system will go into red ink mode and stay there.

The public has not been informed of this, which comes as no surprise. There have been a few scattered stories on the Web, but nothing sustained. The media do not want to admit that the jointly operated Social Security program and Medicare program are going to bankrupt the Federal government if they are not cut back drastically.

They are never cut back. They always expand.

Medicare's Hospital Insurance program has been in red ink mode for two years. The public does not know this, either. To cover the program's insolvency, the government is quietly funding the Hospital Insurance Trust Fund with bailouts from the general fund.

Politically, this creates a problem. When the Treasury taps the general fund, the expenditure appears on the budget – the on-budget budget – as an expenditure. This immediately adds to the deficit, meaning the visible deficit, the one that gets recorded on those wonderful U.S. debt clocks.

When revenues flow into the four Social Security and Medicare trust funds, the money is instantly handed over to the Treasury, which issues non-marketable long-term IOU's to the trust funds. These IOU's are listed as assets by the funds. But, through the wonders of government accounting, they are not listed as liabilities on the government's on-budget budget. They are liabilities only on the off-budget budget, which most Americans are unaware of. This chicanery has been going on ever since the Johnson Administration (Lyndon's, not Andrew's).

The problem facing the politicians is this: when a trust fund is no longer showing a surplus of revenues over expenditures, it has to sell its assets back to the Treasury. The Treasury's non-listed liabilities must be converted into money to send to the legal recipients. This is a red alert of hidden red ink. The public finds out. The debt clocks speed up.

The Treasury has no money in reserve. Every dollar that it takes in immediately flows out. So, it must get Congress to provide the money for the deficit-running trust funds, either by taxing or by borrowing (increasing the legal debt ceiling).

What's a Congress to do?

HIDING THE BUST

The Congressional Budget Office released a report in July on the condition of the Social Security trust finds. There are two funds: Old Age Insurance and Disability Insurance. Think of them as "geezers and gimps." Combined, they are called OASDI. The report offered a table of numbers showing inflow and outflow. It is here.

The table is tricky to interpret. This is deliberate. The political strategy has always been concealment. But if we think through what is being reported in this table, we can spot the ringer.

The ringer is interest payments to the trust funds. The Treasury issued the IOU's, so it must pay the trust funds interest.

Think: "Where does the Treasury get the money?"

Answer: "The general fund." Up go the debt clocks.

Look at the figures projected for 2009. Income from revenues (FICA) is $653 billion. Total income is $808 billion. Where did the extra income

come from? Three sources.

Taxes on benefits: $21 billion
Federal employer share: $14 billion
Interest: $120 billion

This means that the U.S. government has to pony up an extra $134 billion to pay to itself: $14 billion in taxes paid on behalf of Federal workers plus $120 billion in interest. This is counted as revenue for the OASDI Trust Fund, but it is red ink for the government.

Neat!

Now let's do a reality check. Subtract $134 billion from the $808 billion reported as total income to the OASDI Trust Fund. Why subtract it? Because this is not income coming from outside the government. We get $674 billion.

What is the expected outgo? $670 billion. The official budget surplus for the OASDI Trust Fund: $138 billion ($808b minus $670b). This is reported by the CBO under "Surplus." This looks pretty good. For the Trust Fund, it is pretty good.

For the government, the real figure is barely in the black. The official on-budget, count-the-subsidy-as-a-subsidy OASDI surplus for the U.S. government: $4 billion ($674b minus $670b).

This is never mentioned by the CBO. We are expected to figure this out. No one does. It took me several minutes to spot the ringer.

Now let us look at the projections for 2010. Income for the trust funds: $811 billion.

Taxes on benefits: $20 billion
Federal employer share: $15 billion
Interest: $118 billion

Let us remove the U.S. government's payments into the fund: $133 billion ($15b + $118b). This must be covered by the general fund. Subtract this from total income to the OASDI fund: $811b minus $133b = $678b.

The expected outgo is $703 billion.

The deficit for the OASDI program in 2010 will be $25 billion ($703b minus $678b).

Some people will regard the "Federal employer share" as non-subsidy: $15 billion. I'll concede this in practice, although I still think this is money extracted by taxes paid into the general fund. Even with this money removed, Social Security will run a $10 billion deficit in 2010.

Social Security will go bust in 2010, if CBO projections are correct.

What do I mean by "bust"? I mean technically insolvent – you know, like the nation's biggest banks in September 2008, before the government's bailout and the Federal Reserve's swap at face value of T-bills for toxic debt held by the banks.

I mean by "bust" the inability of the Social Security System to pay its bills by means of money extracted from the public by way of FICA "contributions."

Think of the Social Security System as Oliver Twist in the workhouse, gruel bowl in hand. "Please, sir, may I have some more?" Unlike Bumble, the Treasury dips its ladle into the gruel and then fills up the bowl. For how long? Tomorrow and tomorrow and tomorrow.

THE ACCOUNTING DECEPTION WORKS

The accounting scam of the Social Security Trust Fund has worked politically for a generation. It is not just the voters who are fooled. The best and the brightest in the media have been taken in. Here is an exchange that took place on the PBS show, Nightly Business Report, on March 25, 2009.

GERSH: A negative cash flow does not mean Social Security is in crisis. The program has built up an enormous trust fund over two decades. Barbara Kennelly is president of the Committee to Preserve Social Security and Medicare. She says the trust fund is more than enough to cover any short-term financial hit.

BARBARA KENNELLY, PRES., NATIONAL COMMITTEE TO PRESERVE SOCIAL SECURITY & MEDICARE: The trustees look at it every single year, the report is going to come out at the end of this month. And you're going to still see that we can pay those benefits way out. Say it's not 2041, it's 2040 or 2039. But we have that money. There is $2.5 trillion in the trust fund for Social Security.

No problem! There is a $2.5 trillion asset base. The OASDI Trust Fund need only sell a few of these assets each year.

The interviewer with PBS never batted an eye. He did not say, "Don't try to pull the wool over my eyes, sister. I wasn't born yesterday." Yes, he was, and the scam worked just as well yesterday as it does today.

She said: "We can pay those benefits way out." How? By selling trust fund assets.

You know the old line from the financial world. "Sell!" "To whom?"

To sell an asset, there must be a market. Here is the punch line, taken directly from the 2009 Report of the Trustees: "Status of the Social Security and Medicare Programs." (In a printout, this appears on page 4.)

The Department of the Treasury invests program revenues in special non-marketable securities of the U.S. Government on which a market rate of interest is credited. The trust funds represent the accumulated value, including interest, of all prior program annual surpluses and deficits, and provide automatic authority to pay benefits.

What, exactly, are "non-marketable securities"? They are IOU's issued by the Treasury on behalf of the U.S. government. As I mentioned, these IOU's are not recorded in the government's on-budget account. The revenues that purchase these IOU's are.

But wait! There's more! Pay attention to these words: "on which a market rate of interest is credited." The Treasury applies a market rate of interest to a non-marketable security. There is no such rate. The Treasury can make it up as it goes along.

So, the trust funds are filled with assets: non-marketable IOU's from the government, issued to a government agency. The trust funds are treated as marketable assets. They are indeed marketable: to the Treasury. The bill is passed along to Congress whenever the trust fund sells any of these assets.

There are lots and lots of these IOU's in the Social Security OASDI Trust Fund. No problem!

This is a scam. It is an accounting trick to deceive the public. Does it work? Better than Congress could have dreamed back in late 1968, when the change in accounting took place. (http://tinyurl.com/yeh5sm5)

According to the lady representing the special interest group promoting Social Security and Medicare, judgment day is a depleted trust fund. That will take place is 2040, give or take a couple of years. Politically, a date this far out is irrelevant. Congress has been playing kick the can on this issue for a generation. There is no sense of urgency by the public, so there is no sense of urgency in Congress.

Judgment Day is 2010, when the general fund must start paying for those cashed-in non-marketable assets.

Let's see if Congress will kick the can some more. Let's see if Congress passes hikes in the FICA tax rates in 2010, or extends the wage base that pays the tax beyond today's $106,800 limit. My guess: Congress will kick the can. The deficit will grow.

"HOW BAD IS IT?"

Those were Ed McMahon's four words to Johnny Carson, decade after decade, setting up Carson's punch line.

Here is the punch line – lines, actually – as delivered by the notoriously humorless trustees of the Social Security and Medicare Trust Funds.

The 2009 report begins: "The financial condition of the Social Security and Medicare programs remains challenging." I worked on Capitol Hill as Ron Paul's first research assistant back in 1976. The code word "challenging" means "politically unsolvable at the present time, so Congress will kick the can."

To this assessment, add the first sentence in the Conclusion: "The financial difficulties facing Social Security and Medicare pose serious challenges." What does "serious challenge" mean? Think of December 7, 1941, on board the U.S.S. Arizona. Imagine this sound: "Aye-oo-ga! Aye-oo-ga! Abandon ship! Abandon ship!"

We are assured that Social Security's problem is merely difficult. ("Yellow alert! Yellow alert!")

For Social Security, the reform options are relatively well understood but the choices are difficult.

The Social Security options are very well understood by Congress, but not the public. These options have been understood by Congress ever since 1983, when Reagan hiked FICA taxes.

The political choice was difficult in 1983, back when Reagan still thought he could balance the budget without vetoing spending bills sent up by Congress, which he usually signed into law. That was the year that the on-budget deficit hit $200 billion, a year before my 1977 prediction that it would hit $200 billion in 1984.

Reagan knew that red ink from the sale of Social Security Trust Fund assets back to the Treasury would push his on-budget budget even deeper into the red. He hiked FICA taxes to keep this from happening. Ever since then, Congress has played kick the can.

We ain't seen nothin' yet! The Conclusion concludes:

Medicare is a bigger challenge. Its cost growth can be contained without sacrificing quality of care only if health care cost growth more generally is contained. But despite the difficulties – indeed, because of the difficulties – it is essential that action be taken soon, particularly to control health care costs.

CONCLUSION

We are on board a replica of a 19th-century Mississippi paddle wheel steamboat. Nostalgia is always popular. The illusion of the good old days still sells. The engine is chugging faster and faster. The captain and crew decided long ago never to put the engine into reverse.

We are floating down the fiscal river of no return. We are moving faster and faster. Some of us can hear the falls ahead. The sound gets louder and louder. But our companions on board say, "Let's party!" They head for the dining room. After that, they will head for the slot machines.

Americans respond favorably to these words: "Free" and "all you can eat." That is what politicians promise.

Either the falls will get us (deflationary depression) or else an explosion of the overheated engine will (hyperinflation).

Our companions are still in the dining room or heading toward the slot machines. You and I should begin to move toward the lifeboats.