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The Social Security Trust Fund Myth

Social Security Is a Legal Ponzi Scheme

BY ROMINA BOCCIA

EXECUTIVE SUMMARY

The Social Security trust fund is often misunderstood. Many believe it to be a genuine financial asset ensuring future benefits. This paper challenges that misconception, showing that the trust fund is more of a political construct than a true repository of savings or investments. The trust fund essentially consists of IOUs or promissory notes that represent claims on future tax revenues. Regardless of the trust fund balance, when Social Security's annual expenses exceed its annual income, the government must either raise taxes, increase borrowing, or cut spending to fund promised benefits. This fiscal reality can be illustrated with several analogies to convey the complexities of Social Security's financing in simple and accessible terms.

The key takeaway is that legislators should focus on closing the gap between annually scheduled benefits and

annually projected revenues by addressing the structural imbalances that threaten to drive Social Security's spending to exceed revenues in perpetuity. Instead of setting out to achieve superficial 75-year solvency by proposing to raise revenues in the short term without addressing long-term deficits (which is what raising or eliminating the payroll tax cap would do), policymakers should focus on reducing the Social Security program's burden on taxpayers. Effective reforms should address cost-growth factors such as increasing life expectancy (especially among higher-income earners), the dwindling worker-to-retiree ratio, and the automatic real growth of benefits (exceeding inflation). This paper argues for a more honest discussion about the program's future that considers difficult choices, such as reducing benefits for higher-income earners, slowing the growth in future benefits, and raising the retirement age.



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INTRODUCTION

Imagine a charismatic salesperson promising sky-high returns to early investors, only to use the money from new investors to pay them off. This is the infamous story of Charles Ponzi, whose name became synonymous with fraud.¹ Now, consider the US Social Security system. Current workers' payroll taxes fund the benefits of current retirees, much like how Ponzi's scheme used new money to pay off old promises. While differences exist between the two, this analogy highlights a fundamental truth: Social Security's ability to make new benefit payments and its sustainability hinge on a steady flow of new contributions. But unlike Ponzi's fraud, Social Security's challenges are legal and transparent and rooted in poor program design, economics, and demographic realities.

“The Social Security trust fund is a figurative piggy bank that holds only IOUs issued by the Treasury to the Social Security Administration, not actual money.”

The phrase “Social Security trust fund” is misleading and often confuses the public. It conjures images of money or securities held in a trust on behalf of beneficiaries. In reality, the government takes every cent of Social Security taxes collected from current workers and passes the money immediately to current retirees. Until 2010, workers paid more in Social Security taxes than what the federal government paid out in benefits, but the government spent all that surplus money in other areas. The government has never saved or invested the Social Security tax surplus. Today, all benefits are paid by current tax collections or borrowing since Social Security taxes no longer fully cover the cost of benefits. Based on Congressional Budget Office (CBO) data, the government will borrow \$4.1 trillion, including associated interest costs, between now and 2033 to pay for Social Security benefits. Congress should consider reducing the growth in benefits as soon as possible rather than waiting until the so-called trust fund balance is depleted in nine years. The longer legislators wait, the more severe the financial adjustments will need to be,

with implications for workers, retirees, and the federal government's fiscal solvency.

This policy analysis examines the true nature of Social Security's funding mechanisms, shedding light on the program's actual income sources and the commonly misunderstood trust fund. The purpose is to advocate for benefit reductions and discourage superficial fixes that claim to ensure 75-year solvency but ultimately lead to larger deficits.

SOCIAL SECURITY'S FINANCES

To understand the real story behind Social Security, let's simplify its income and expenses. Imagine Social Security as a household budget. The main source of income is payroll taxes coming out of workers' paychecks. This money goes straight to paying benefits to retirees, their eligible spouses and dependent children, or their survivors. It's like people in a household using their monthly salaries to pay bills every month—there's no magic pot of gold, only a cycle of money coming in and going out.

Now, there's also some extra income from taxes on benefits. People with higher incomes have to pay taxes on most of their Social Security benefits, adding a bit more to the system's monthly revenue. However, this only covers a small part of the total cost. You might think of this as the household's side gig.

So what about the so-called trust fund? It's often misunderstood. Think of it as an IOU or a promise to pay. When Social Security collected more money than it needed to provide benefits, as it did before 2010, the surplus wasn't saved in a vault or invested. Instead, the government spent it on other expenses, and the Department of the Treasury wrote an IOU note to the Social Security Administration. Now that Social Security is cashing in those IOUs to cover the shortfall between income and expenses, it's like borrowing money to pay off credit cards—the trust fund adds to the government's overall debt.

Part of the confusion comes from thinking of Social Security and the Treasury as separate entities, with Social Security having assets on its balance sheet that the Treasury is on the hook for. However, taxpayers are on the hook for the government's spending and borrowing. Since Social Security and the Treasury are both part of the government,

we should think of them as one entity to fully understand Social Security’s financial impact on the American people.

In short, Social Security’s real financial health depends not on these IOUs but on the steady flow of payroll taxes and taxes on benefits. Understanding this is crucial for any discussion about reforming Social Security, reducing its size and scope, and making it sustainable for future generations of American taxpayers and retirees.

A Recurring Misunderstanding: The Trust Fund Balance Is Not a Source of Income

Those who debate Social Security’s future often misunderstand where the program’s money comes from, especially when it comes to the so-called trust fund. Many people think that the trust fund’s balance—which is made up of special government bonds and the interest they earn—represents real, usable money. However, counting these as actual resources is misleading. The real issue with Social Security isn’t about what’s in the trust fund; it’s about the growing cost of benefits.

From 1993 to 2022, Social Security benefits accounted for approximately 4.5 percent of the country’s gross domestic product (GDP). This cost increased to 5.1 percent in 2023 and is expected to reach 6.2 percent by 2053. According to the CBO, closing Social Security’s long-term fiscal gap would require a \$2,600 annual tax increase on median wage earners, who make about \$60,000 a year.² This would bring the total annual payroll tax these workers must pay to more than \$10,000. The fiscal challenge we face is about closing the gap between the benefits promised to retirees and the money coming in from workers’ taxes and finding a more sustainable and equitable balance between what workers are asked to pay and what Social Security recipients receive.

As noted, Social Security’s relevant income sources include payroll taxes on workers’ wages and the taxes some beneficiaries pay on their Social Security benefits. We should ignore the so-called trust fund balance. When Social Security “redeems” the bonds in the trust fund or collects the interest those bonds earn, this does not add new money—it means the government is borrowing more, which adds to the overall national debt. Simply put, when the government spends from the trust fund balance, it isn’t

withdrawing saved money; it’s just borrowing more, and the additional debt falls on taxpayers.

Writing an IOU to Yourself Does Not Generate Real Wealth

To illustrate how IOUs that you write on your own behalf do not create real wealth, imagine you set aside \$10,000 in a savings account when your daughter is born to give her a head start when she turns 18. But instead of leaving that money in the account, you withdraw it immediately to spend it on something else and write yourself an IOU. Once your daughter turns 18, if the money still isn’t there, you’re confronted with three choices: renege on your promise, borrow the money, or work more to pay yourself back.

This is similar to how the government operates Social Security’s trust fund, creating a cycle of borrowing that adds to the taxpayer debt burden. Social Security’s trust fund is a taxes-in/benefits-out pipeline. When the government collected more in Social Security payroll taxes than it needed to provide benefits, the Treasury spent the surplus on other government activities and wrote an IOU promising to repay the Social Security Administration. With the Social Security Administration now calling on those IOUs, the Treasury must borrow more money to provide Social Security benefits. This adds to the publicly held debt. As the Congressional Research Service explains:

The annual revenues to the Social Security trust funds are used to pay current Social Security benefits and administrative expenses. If, in any year, revenues are greater than costs, the surplus Social Security revenues in the US Treasury are available for spending by the federal government on other (non-Social Security) spending needs at the time.³

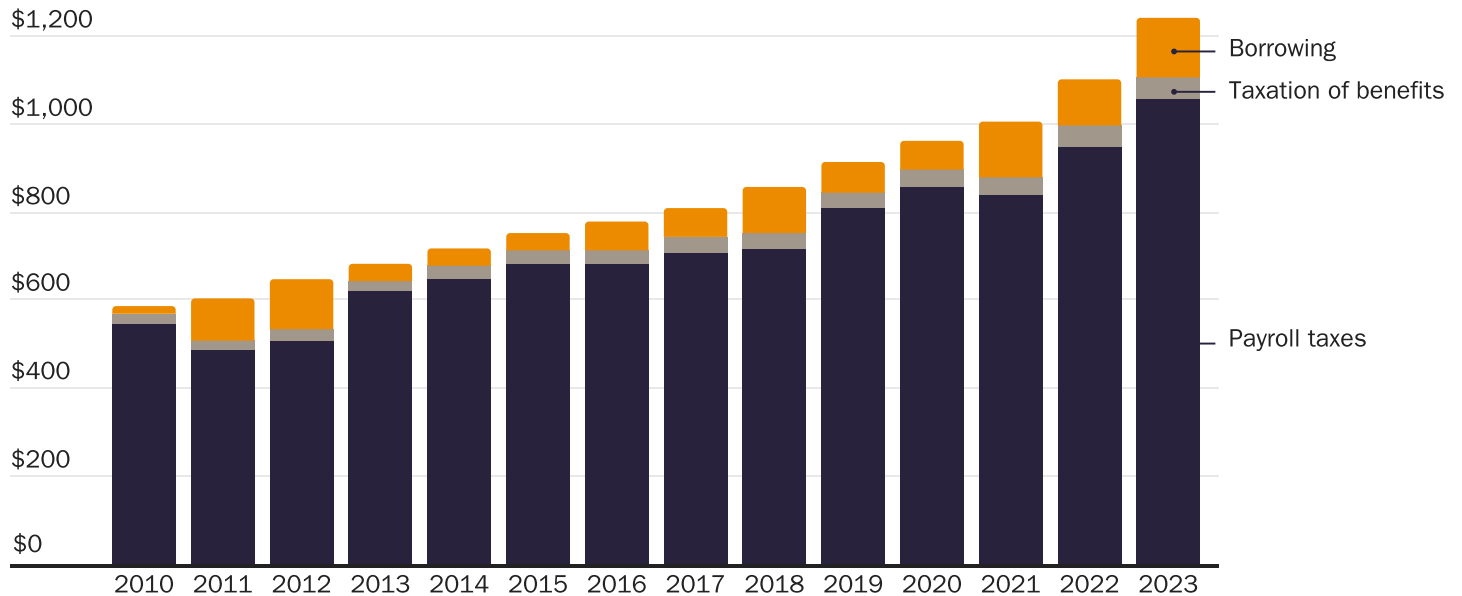
SOCIAL SECURITY’S OFFICIAL INCOME STREAMS

In 2023, Social Security payroll taxes totaled \$1.054 trillion and covered 85.2 percent of the program’s total costs. Social Security also receives income from taxes on benefits that are collected from individuals and couples whose incomes exceed certain thresholds.⁴ In 2023, revenue from the taxation

Figure 1

Social Security has borrowed \$1.08 trillion to bridge cash flow deficits since 2010

Income sources for the Old-Age, Survivors, and Disability Insurance program costs, billions of US dollars



Source: Data were obtained from the Social Security Administration's *Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds* for 2010–2023.

of benefits totaled \$49.8 billion, covering 4 percent of the program's spending. These are the only economically relevant income streams that Social Security received; combined, they covered 89.2 percent of the program's spending.⁵

The government covers the remaining 10.8 percent cash-flow deficit by borrowing from the public. Social Security relies on interest income from the Treasury on the IOUs recorded in the trust fund and the redemption of these IOUs. The interest income amounted to \$63 billion in 2023, or 5.1 percent of total spending. Additionally, the Social Security Administration redeemed \$70.4 billion in special-issue bonds, which accounted for 5.7 percent of total spending.

Here's another way of looking at Social Security's income streams: Imagine that your main job pays you \$0.85 for every dollar you plan to spend this year. You also have a side gig selling handcrafted greeting cards on Etsy, which brings you an additional \$0.04 for every dollar you budget for spending. That leaves a gap of \$0.11 on the dollar between your income and budgeted spending. To cover this gap, you put the rest of your expenses on your credit card. That's basically how Social Security budgeted in 2023. It doesn't matter that you wrote an IOU to yourself for the money you

spent 14 years ago from your savings account. That money is long gone.

Since Social Security started running cash-flow deficits in 2010, the program has cashed in more than \$1 trillion in IOUs, primarily in the form of collecting on the interest—with the Treasury borrowing the entire amount. This trillion-dollar cash-flow deficit also entailed about \$140 billion in associated interest costs from the bonds the Treasury sold to investors. See Figure 1 for a breakdown of Social Security's income. The data are separated into payroll taxes, income taxes on benefits, and the amount the Treasury has had to borrow for Social Security to continue providing benefits in full (excluding associated interest costs).

Figure 2 breaks down Social Security's \$1 trillion deficit since 2010 into different categories. The largest portion of this deficit is the interest income generated from Treasury IOUs. Notably, there was a significant general revenue transfer to Social Security in 2012 when Congress temporarily reduced payroll taxes to stimulate the economy following the Great Recession.⁶

Over the next decade, Social Security will contribute more than \$4 trillion to federal deficits, including interest costs. By 2033, Social Security's borrowing authority will be depleted

Figure 2

Breakdown of Social Security’s \$1.08 trillion borrowing to cover cash-flow deficits from 2010 to 2023

Borrowing categories, US dollars



Source: Data were obtained from the Social Security Administration’s *Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds* for 2010–2023.

Note: There was a significant general fund transfer to the Old-Age, Survivors, and Disability Insurance trust fund in 2012 to compensate for the temporary payroll tax cut, which comprises nearly the entire amount in the general fund transfers category.

at trust fund exhaustion. Figure 3 shows the CBO’s 10-year projections for deficits, with a breakdown of the portion that can be attributed to Social Security cash-flow deficits and associated interest costs.

THE TRUST FUND ILLUSION

At a recent subcommittee hearing, government experts from the Social Security Administration and the CBO confirmed that redeeming Social Security’s trust fund assets adds to the federal debt.⁷ The use of the term “trust fund” implies that payroll taxes are contributions that are safely stored away for taxpayers’ future use, but the reality is that the system operates on a pay-as-you-go model. Such wording obscures the true financial challenges of the system. As Andrew Biggs, former principal deputy commissioner for the Social Security Administration, explains:

Social Security and Medicare were designed to be viewed as contributory social-insurance programs, not welfare, even though both redistribute money significantly from rich to poor. Over the years, politicians have portrayed their payouts as “earned

benefits” that seniors receive via working and paying into the programs.

This framing was no accident. President Franklin D. Roosevelt said that funding Social Security with a dedicated payroll tax was “politics all the way through.” “We put those payroll contributions there so as to give the contributors a legal, moral, and political right to collect their pensions,” he added. “With those taxes in there, no damn politician can ever scrap my Social Security program.”⁸

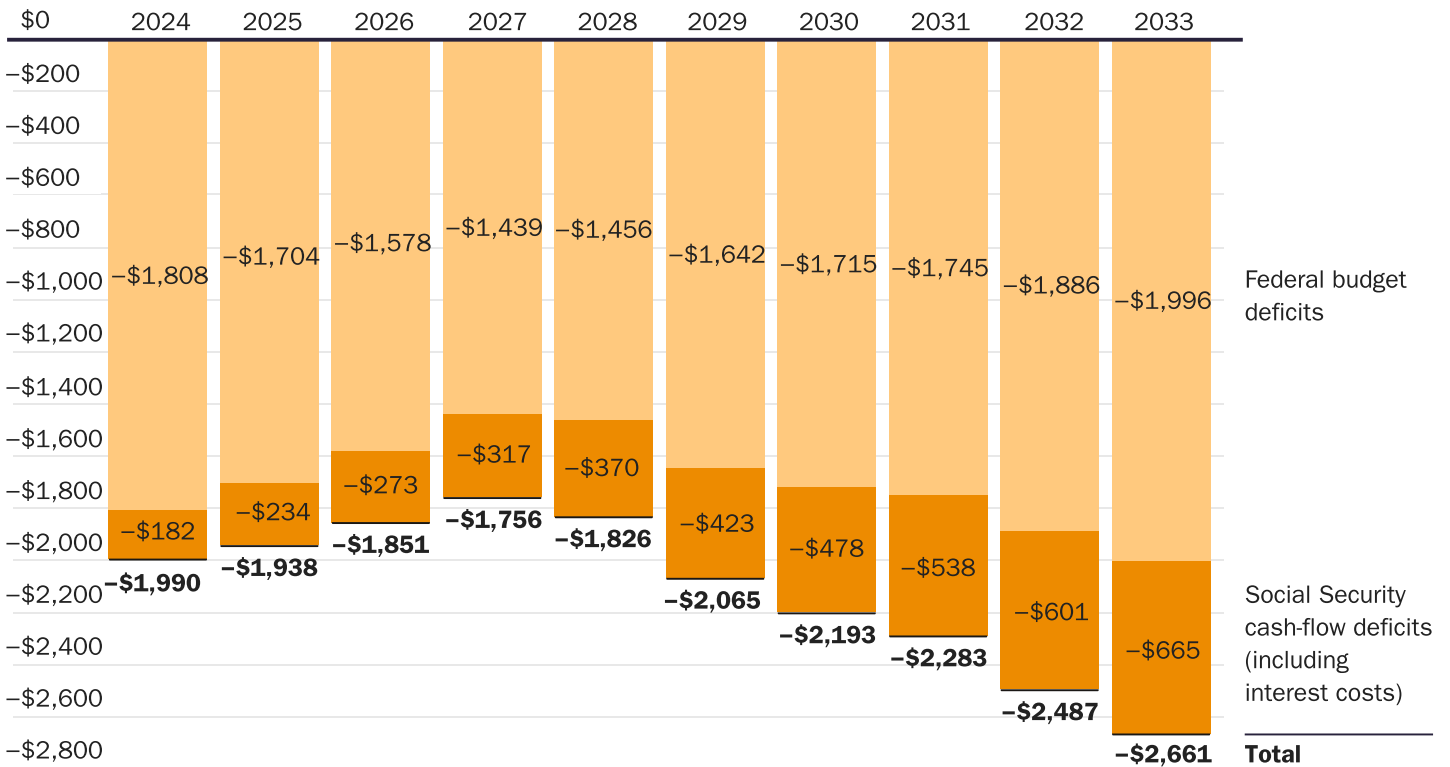
Social Security’s trust fund holds government bonds, which are essentially IOUs from the federal government to itself. These bonds do not provide additional economic resources. Rather, they transfer resources from one part of the government to another. Because the Treasury operates on a net deficit basis, every dollar needed to repay Social Security’s IOUs adds to the publicly held debt. Interest income from these IOUs is also an accounting fiction—it further adds to the debt.

Imagine a child who puts earnings from mowing the neighbors’ lawns into a piggy bank every week to save up for a big purchase, such as a new bike. However, whenever

Figure 3

Social Security will add \$4.1 trillion in deficits over the next decade

Projected federal and Social Security deficits, billions of US dollars



Source: *An Update to the Budget and Economic Outlook: 2024 to 2034* (Congressional Budget Office, June 18, 2024).

Note: Social Security refers exclusively to the Old-Age and Survivors Insurance trust fund.

the child puts money into the piggy bank, the parents take it out to pay for household expenses and leave an IOU note behind. When the time comes to buy the bike, the child opens the piggy bank and finds it full of IOU notes from the parents. To get the money for the bike, the parents must find it elsewhere or risk deeply disappointing their child.

That’s similar to how Social Security’s trust fund operates. It’s a figurative piggy bank that holds only IOUs issued by the Treasury to the Social Security Administration, not actual money.

The Treasury has three main ways of repaying Social Security. First, it can collect taxes authorized by Congress. Second, it can issue bonds and borrow money from the public, thus increasing the national debt. Third, it can sell bonds to the Federal Reserve, which is akin to printing new money. When the Fed buys bonds, it increases the reserve balances held by the banking system, thereby increasing the money supply. Too much of this kind of money creation causes inflation, a general increase in the price level.

Inflation acts as a hidden tax that primarily affects lower-income and working-class Americans, who spend more of their income than wealthier Americans and are less able to protect their income and assets from the loss of purchasing power caused by inflation.⁹

A Pay-as-You-Go Program After All

Focusing solely on payroll taxes and income taxes on benefits and contrasting these inflows with projected benefit outflows reveals the true challenge to funding Social Security. To ensure long-term viability, reforms to Social Security must address the structural drivers of rising costs—these include increasing life expectancy, the steadily shrinking ratio of workers paying in to beneficiaries taking out benefits, and the increasing generosity of benefits baked into statutory formulas. Addressing these structural issues is essential for Social Security’s long-term sustainability and to alleviate the burden on current and future taxpayers.

Counting interest income and bond redemptions as if these were economically relevant sources of income to the program merely delays the impetus for reform because Social Security is entitled to borrowed funds until its trust fund balance is depleted. Interest earned on intragovernmental IOUs recorded as the trust fund balance merely adds to the burden on taxpayers. The trust fund is a liability for taxpayers, not an asset.

75-YEAR SOLVENCY SHOULD NOT BE THE STANDARD OF SUCCESSFUL REFORM

As the Manhattan Institute’s Brian Riedl points out, in Social Security debates, success is often defined as 75-year solvency.¹⁰ However, due to the program’s pay-as-you-go operation, even achieving 75-year solvency on paper can still result in trillions in new federal debt. When the federal government runs a payroll tax surplus, it immediately spends any excess funds and replaces the funds with IOUs. This was evident after the 1983 reforms, which produced a \$3 trillion surplus through 2009, only for Congress to spend it. Now, taxpayers are repaying that \$3 trillion with interest. Riedl emphasizes the importance of maintaining an annual balance and explains that eliminating the payroll tax cap would only provide a temporary solution to avoid deficits. In the long run, this approach would result in higher taxes for workers both now and in the future.¹¹

This is one of the catch-22s of Social Security reform. If Congress were to collect more money from payroll taxes than necessary to fund current benefits, thereby generating a surplus, this surplus would not be saved on behalf of workers. Without locking those surplus funds away, Congress would spend any excess revenues. Taxpayers would still get stuck with repaying the Social Security trust fund down the road. Researchers looking at what happens to Social Security surpluses have found that Congress spends them, both through higher spending and by lowering other taxes.¹² As Biggs explains:

So, while it’s an empirical question, the basic takeaway seems to be the [*sic*] that Social Security trust fund doesn’t save money as conventionally thought.

It has real legal meaning in terms of the authority

to pay benefits, but the money still has to come from additional taxes.¹³

Any policy that creates Social Security surpluses in the short term but leaves behind deficits over the long term hits workers twice: once for the payroll taxes in excess of annual benefits that will be spent on something else, and again when the government relies on the trust fund balance—namely, interest income and bond redemptions from special-issue securities that beget new borrowing to pay full benefits.

Focusing on achieving 75-year solvency instead of matching the annual balance is a flawed reform approach that risks repeating past mistakes. The Social Security Expansion Act, proposed by Sens. Bernie Sanders (I-VT) and Elizabeth Warren (D-MA), aims to build up the trust fund through massive tax increases, only to spend it down again. This strategy fails to address the underlying issue—excessive benefit increases that are out of balance with available revenues. Their plan, which includes four benefit expansions and significant tax hikes, would impose a \$33.8 trillion burden on workers, savers, investors, and small business owners.¹⁴ Even with these tax hikes, the system would revert to cash-flow deficits by 2038, demonstrating that long-term solvency isn’t a sustainable goal for a system that operates on a pay-as-you-go basis with no real savings or investments.¹⁵

Policymakers should focus on achieving an annual balance primarily by reducing benefits. This will ensure that Social Security can fulfill its purpose of keeping seniors out of poverty without placing undue strain on the economy or making American workers more dependent on the government.

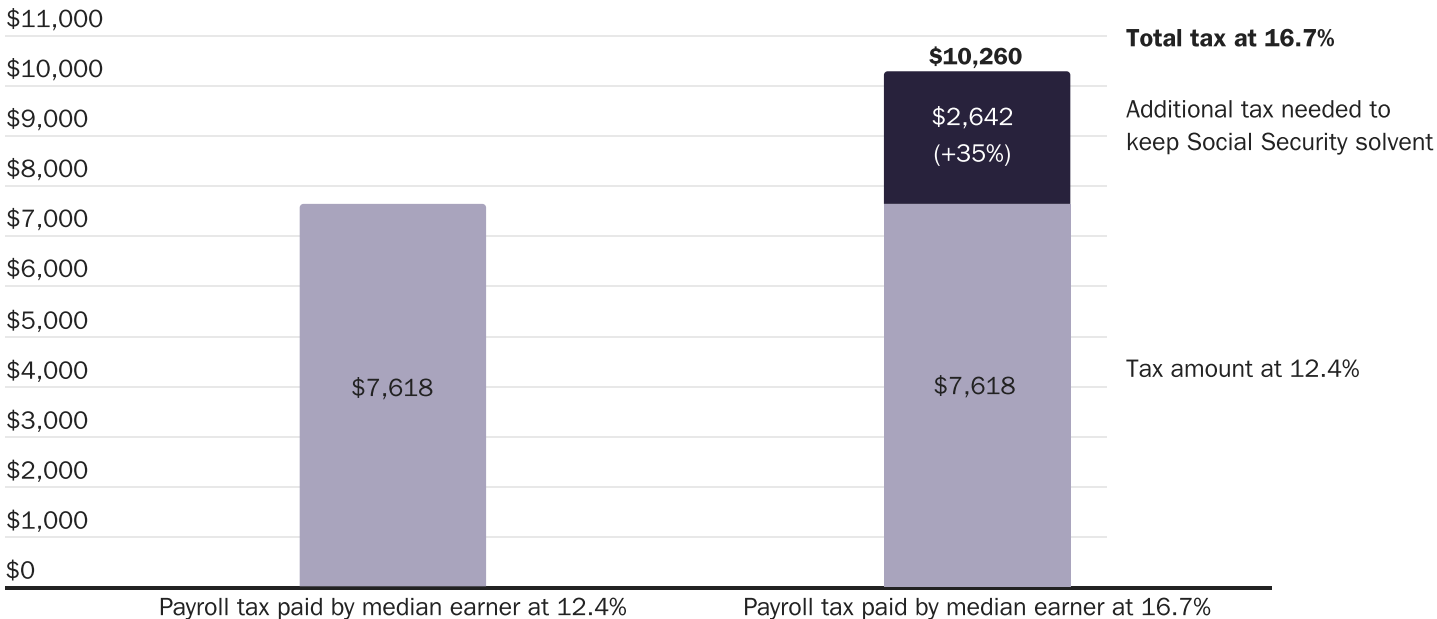
REDUCING SOCIAL SECURITY’S BENEFIT BURDEN SHOULD BE THE STANDARD OF SUCCESSFUL REFORM

Focusing on Social Security’s fiscal benefit costs and economically relevant cash-flow income streams, which are payroll taxes and income taxes on benefits, provides a clearer picture of the program’s fiscal health. Legislators should worry less about the trust fund balance and more about closing the gap between annually scheduled benefits and annually projected revenues. This gap, according to the CBO, amounts to 4.3 percentage points of taxable payroll if Congress were

Figure 4

Keeping Social Security benefits unchanged threatens median wage earners with \$2,642 in higher taxes

Payroll tax, US dollars



Sources: Author’s calculations; CBO’s *2024 Long-Term Projections for Social Security* (Congressional Budget Office, August 28, 2024); and Gloria Guzman and Melissa Kollar, *Income in the United States: 2023* (US Census Bureau, September 2024).
 Note: The tax amounts displayed for an individual earner are calculated based on the 2023 median earnings of \$61,440 for full-time, year-round workers.

to raise payroll taxes immediately and permanently to 16.7 percent for the next 75 years. As Figure 4 illustrates, this is equivalent to raising a median-wage earner’s payroll taxes to \$10,260, an increase of more than \$2,600 per year.¹⁶

To reduce rising benefit costs, reforms must address the structural issues driving Social Security’s spending. These issues include increasing life expectancy and the relatively slower increase in the eligibility age, the dwindling worker-to-retiree ratio, and the automatic real growth of benefits resulting from the calculation of initial benefits. Rather than striving for 75-year solvency, policymakers should focus on reducing the growing costs of benefits, thus relieving workers from having to shoulder ever higher costs. American workers are forced to fund unsustainable benefits that often transfer resources from poorer working Americans to wealthier retirees. This leaves room for benefit reforms that uphold Social Security’s original promise to keep seniors out of poverty and reduce benefits, primarily for higher-income earners. Moreover, benefits are becoming more expensive in absolute terms. This is due to Social Security’s benefit formula, which provides new recipients with a one-time productivity increase based on wage growth in the economy.

Additionally, life expectancy is increasing, but Social Security’s eligibility age is not keeping pace.

Researchers with the American Enterprise Institute and the Manhattan Institute recently proposed reform plans that emphasize benefit reductions for higher-income earners. These plans would reduce Social Security’s costs to 4.3 percent of GDP by 2054. That translates to a 1.9 percentage point reduction from current estimates that show Social Security’s costs rising to 6.2 percent of GDP in 30 years.¹⁷ These plans have the right approach and end goals in mind. Effective policy adjustments that would reduce program costs include:

- **Indexing initial benefits to prices instead of wages.** By slowing the growth of future benefits, this proposal avoids benefit cuts for current retirees.¹⁸
- **Transitioning to a flat benefit to prevent senior poverty.** By moving away from an earnings-related benefit toward one based on years worked, this change would better distribute benefits to those who need financial aid in old age the most.¹⁹
- **Discontinuing cost-of-living adjustments for**

wealthier beneficiaries. By discontinuing cost-of-living adjustments at the top end, this change avoids benefit cuts for current retirees and reduces real benefits for higher earners.²⁰

- **Adopting a more accurate inflation index for cost-of-living adjustments.** By updating Social Security’s inflation measure to the more accurate Chained Consumer Price Index for All Urban Consumers, this change would protect benefits from inflation while saving taxpayers money.²¹
- **Capping survivor and dependent benefits.** The current system was designed to serve single-earner households by providing substantial survivor and dependent benefits based on one individual’s earnings without making actuarially fair adjustments, as is common in private pension systems. This can lead to unintended redistributive effects. For example, a single-earner high-income family may receive disproportionately larger benefits than a lower-income dual-earner household with the same combined income, exacerbating inequality within the system.²²
- **Raising eligibility ages to account for longer life expectancies.** Life expectancy has increased significantly, and Social Security’s eligibility ages have not kept pace.

CONCLUSION

Legislators and the public should confront the fiscal realities of Social Security by focusing on reducing the program’s rising fiscal burden on taxpayers. The illusion that trust fund balances and their interest income are independent funding sources must be dispelled to pave the way for meaningful reforms during the next Congress, not nine years from now when the so-called trust fund is exhausted. The longer legislators wait, the more painful the eventual reforms will be. By addressing the structural issues driving rising costs—including increasing life expectancy, the imbalance between the number of workers and the number of retirees, and unaffordable benefit increases—we can ensure Social Security’s sustainability for those Americans who rely on benefits the most while enabling more workers to save for their own retirements in accounts they own and control.

Reforms should prioritize reducing Social Security benefits and their burden on workers rather than striving for superficial 75-year solvency goals that perpetuate fiscal mismanagement. Proposals such as indexing initial benefits to prices, transitioning to a flat benefit system, and adjusting eligibility ages can help realign Social Security with its original mission—preventing senior poverty without unduly burdening current and future taxpayers.

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