The Myth of the Social Security Trust Fund

by JOHN ATTARIAN

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In my mail the other day, I received a hint of why Social Security reform isn't happening.

It was an unsolicited letter from a lobby for the elderly called The Seniors Coalition, warning that "something terrible is happening in Washington . . . . Something sinister and dangerous is happening as you read this note." The Coalition had "exposed the truth about the looting of the Social Security Trust Fund." But when the Coalition's founder died, "our enemies saw an opportunity . . . . [T]he Washington Insiders stole another $1.2 billion from the Social Security Trust Fund." After railing for four pages about these nefarious "insiders," the author exhorted me to send money and to sign and return the enclosed petition demanding that Congress "Stop the raid on the Social Security Trust Funds. Immediately repay all monies that were illegally diverted from these Trust Funds."1

The Seniors Coalition claims to represent three million elderly people.2 Imagine their constituents who read this scare mailing about how "they" are looting Social Security's "Trust Fund." Imagine three million signed petitions reaching Congress. Multiply that a few times to cover other elderly lobbies' efforts—and you start to see why changing Social Security is so hard.

Much of the public is convinced that a perfidious Congress is rifling a "trust fund" where our Social Security taxes are "held in trust" to pay future benefits, that this is why Social Security is headed for trouble, and that all Congress has to do to fix Social Security is put this stolen money back. These beliefs crop up perennially in letters to editors.

In July 1998, Carolyn Lukensmeyer, director of the Americans Discuss Social Security project, told the Senate Special Committee on Aging that this alleged raiding of the trust fund to finance other spending is "the real focus of the public's concern." Her poll found that 79 percent of respondents believe that this is one reason why Social Security might experience financial crisis, and 45 percent believe it is the main reason. (Just 26 percent answered, correctly, that the main reason is that the elderly population is growing faster than the number of workers financing the program.)3

Obstacle to Reform

This mentality is a serious obstacle to Social Security reform. If a looted trust fund is the problem, why bother overhauling Social Security? Just make Congress return the money.

Yet this popular belief is utterly mistaken. There is no trust fund, and Congress is doing nothing wrong. What's more, the source of this misunderstanding is the government's own public-relations efforts to create support for Social Security.

The Social Security Act of 1935 created an "Old-Aged Reserve Account" in the Treasury and required that every year an amount determined sufficient to pay that year's benefits was to be appropriated to it. Any of this money not needed for benefits was to be invested in federal debt (including unmarketable debt issued for this purpose) earning 3 percent interest, or other government-guaranteed debt.4

Presently, criticism arose. Winthrop Aldrich of Chase National Bank argued that the reserve would be fictitious; the government would just be issuing promissory notes to itself. As for interest on the bonds, which would supposedly help pay future benefits, the government would get the interest money from "the only source it could obtain it—the general taxpayer. The whole elaborate reserve set-up would not relieve him of any burden whatever." Finally, the tax revenue the Treasury got in exchange for the bonds would be a standing temptation to extravagant spending.5 In his Milwaukee speech on Social Security during the 1936 presidential campaign, Republican candidate Alfred "Alf" Landon said much the same thing. It was as if, he charged, a father took deductions from his children's wages to invest for their old age, "invested" them in "his own IOU," and spent the money, leaving his kids nothing but those IOUs. Hence Social Security's forced savings were "a cruel hoax."6 President Franklin Roosevelt retorted that Social Security tax dollars "are held in a Government trust fund solely for the social security of the workers."7

Yet attacks kept coming. Critics such as General Hugh S. Johnson, former head of the National Recovery Administration, and journalist John T. Flynn pointed out that unlike insurance companies, which invest their premiums to build a reserve to pay on their policies, the government was only issuing claims on itself. Hence the Social Security reserve was merely worthless IOUs. To pay future benefits, Americans would have to be taxed all over again.8

Defenders responded that the IOU talk was misleading; aren't all private investment instruments, such as stocks, notes, and bonds, really IOUs, their value dependent on the resources and ethics of the firms issuing them? In investing in government bonds, the Treasury was behaving just like a bank, which invests its depositors' money rather than hoard it as cash.9

The critics were right. Of course the Treasury spent the money obtained in exchange for the bonds in the reserve; what else could it do? Of course, the bonds were IOUs; all debt instruments are. Of course, the interest would come from the taxpayers; where else could it come from?

Embezzled Funds?

When in 1939 the Roosevelt administration proposed various amendments to Social Security, congressional hearings and debate on the proposals saw extensive airing of the reserve fund controversy. Critics accused the administration of "embezzlement" and repeated the charges that the reserve was merely IOUs, and that Americans would be taxed twice. No embezzlement was occurring, defenders retorted; there wouldn't be any double taxation, and the much-maligned IOUs were the safest investment around—U.S. government bonds. They raised a valid point: holding the surplus as cash was silly, and buying private securities was not allowed. So where else could the Reserve Fund money go but into Treasuries?10 By now three years old, the reserve-fund controversy had become a serious blow to Social Security's prestige.

On the recommendation of Treasury Secretary Henry Morgenthau, the Social Security Amendments of 1939 created an Old Age and Survivors' Insurance Trust Fund at the Treasury. This was done for the express purpose of ending the controversy. Testifying before the Senate Finance Committee during the hearings on the amendments, Social Security Board Chairman Arthur Altmeyer stated that the purpose of the trust fund was "to allay the unwarranted fears of some people who thought Uncle Sam was embezzling the money."11

Creation of Social Security's trust fund, then, was a public-relations ploy.

What happened exactly? Section 201 of the Social Security Act, "Old-Age Reserve Account," was replaced by a new Section 201, "Federal Old-Age and Survivors Insurance Trust Fund." The only substantial change was elimination of the transfer of revenues from the Treasury's general fund via specific annual appropriation to the Reserve Account. Instead, a sum equivalent to the Social Security taxes received and put into the Treasury "is hereby appropriated" to the Trust Fund for the fiscal year ending June 30, 1941, "and for each fiscal year thereafter"—that is, automatically. The only other new features were a Board of Trustees (the secretaries of the treasury and labor and the chairman of the Social Security Board) to manage the fund, replacement of the 3 percent interest rate with the average rate on interest-bearing federal debt, and a provision for paying money from the fund into the Treasury to defray Social Security's administrative expenses.

Otherwise, the Trust Fund operated just like the old Reserve Account. Indeed, it was the Reserve Account; its assets as of January 1, 1940, were transferred to the Trust Fund. Since the Reserve Account was, according to the Act, "an account in the Treasury" and the Trust Fund was "on the books of the Treasury," the transfer was a formality. It was as if a shoebox full of bonds labeled "Reserve Account" was relabeled "Trust Fund." Moreover, the key paragraphs of the new Section 201, for example, regarding the duties of the Trust Fund's "Managing Trustee" (the treasury secretary) to invest the fund's surplus in only certain types of U.S. government debt, correspond almost verbatim to paragraphs in the old one.

Social Security's Trust Fund, then, is really a Treasury account, nothing more.

What's a Trust Fund?

Is it a real trust fund? A trust fund is money, investments, or other property held in a trust, a trust being “A fiduciary relationship with respect to property, subjecting the person by whom the property is held to equitable duties to deal with the property for the benefit of another person, which arises as a result of a manifestation of an intention to create it.” All trusts must have a “settlor,” who sets up the trust and puts property into it; a “trustee,” who manages the trust and has legal title to the property in it; a “beneficiary,” who holds equitable title to the property and for whom it is managed; property; and terms of trust stating its purpose and duties, the powers of the trustee(s), and the beneficiary’s rights.12

Does Social Security’s Trust Fund meet these criteria? You judge.

Though Congress legislated the Trust Fund, it is not the settlor, because a settlor puts his own property into a trust, which Congress did not do.13 As for the Board of Trustees, who in a true trust would hold the legal title to its property, Section 201 of the 1939 Amendments did not even mention its having title to anything.

Nor do the purported trust “beneficiaries” have property in the fund to which they have an enforceable property right, as beneficiaries of a true trust do. Under questioning by Representative John McCormack of Massachusetts during the 1939 hearings, Board Chairman Altmeyer revealed that Social Security maintains no accounts containing funds earmarked for individuals, and never had.14 Its accounts, then, are just record-keeping entities: file folders, not piggy banks. No individual funds necessarily means no individual property in the Trust Fund.

Section 201 said nothing about property rights—for good reason. In arguing Helvering v. Davis (1937), the Supreme Court decision that upheld Social Security’s constitutionality, Assistant Attorney General Robert Jackson stated that under Social Security, “There is no contract created by which any person becomes entitled as a matter of right to sue the United States or to maintain a claim for any particular sum of money. Not only is there no contract implied but it is expressly negatived, because it is provided in the act, section 1104, that it may be repealed, altered, or amended in any of its provisions at any time.”15

And the government’s brief for the Supreme Court case Flemming v. Nestor (1960) argued that a current or prospective Social Security beneficiary does not acquire an interest in the Trust Fund—that is, a property right to its assets—and that the belief that Social Security benefits are “fully accrued property rights” is “wholly erroneous.”16 The Court concurred.17

All this confirms the observations by Suffolk University Law School Professor Charles Rounds, a fellow of the American College of Trust and Estate Counsel:

Despite the term “trust,” the Social Security system contains nothing that remotely resembles the common law trust. There is no segregation of assets, no equitable property rights, no private right of enforcement (all characteristics of the common law trust). It is merely a system of taxation and appropriation sprinkled with trust terms to hide its true nature.18

Moreover, Social Security's Trust Fund does not operate as a trust fund does. Social Security revenues go into the Treasury's general fund and are automatically credited to the Trust Fund in the form of Treasury bonds. The Treasury pays Social Security benefits and administrative outlays out of general revenue and debits the Trust Fund an equivalent value of bonds. Any leftover Social Security revenue finances general government operations, with an equivalent value of bonds remaining in the Trust Fund as Social Security's "surplus;" to cover any revenue shortfalls.19 This is how a Treasury account, not a trust fund, works. And calling a Treasury account a "trust fund" to influence public opinion does not make it one.

In all respects, then, Social Security's Trust Fund is bogus.

The adoption of the label "trust fund" for what was in fact a Treasury account was intended to cash in on the public's understanding of this term—that assets are absolutely safe, invested on one's behalf, and held for one's future use—and to reassure the public that Social Security was sound and trustworthy. It worked. The reserve controversy disappeared. Over the following decades, Social Security continued to make public-relations capital out of the term by repeatedly telling the public that benefits are paid out of a trust fund built up from their tax payments.20

But after the 1983 Social Security rescue, when Social Security revenues began exceeding outlays and sizable Trust Fund surpluses began accumulating, the charge of Congress's stealing Social Security's reserve money reappeared.21 Talk of Congress's "raiding" or "dipping into" the Trust Fund to cover federal budget deficits continues to this day.22 Spending the Social Security surplus, no real reserve, nothing but worthless IOUs—the old reserve-fund controversy all over again. With one decisive difference: the emotional evocations of the phrase "trust fund."

The New Dealers did not foresee that this phrase might some day work to weaken rather than strengthen faith in the government and in Social Security. Lifting assets from a trust fund is a serious crime and a breach of faith and trust. The more firmly people believe that the Social Security Trust Fund really is a trust fund, the angrier they will be at stories of Congress's looting it, and the more they will be inclined to believe that this is the reason that Social Security's financial prospects look shaky.

But as we have seen, there is no trust fund to be looted, only a Treasury account. And Congress is only doing what the Social Security law requires.

In adopting trust language to cure a Social Security public-relations problem 60 years ago, the federal government sowed the seeds of today's grave misunderstanding over the Trust Fund. This dishonest and misleading language should be abandoned immediately, the better to clear our minds of cant and false issues and enable us to see Social Security as it really is, grasp its real problems, and do what needs to be done.

Notes

The Seniors Coalition, unsolicited mailing, received September 10, 1999.

1. Ibid.
2. U.S. Congress, Senate, Living Longer, Retiring Earlier: Rethinking the Social Security Retirement Age: Hearing before the Senate Special Committee on Aging, 105th Congress, 2nd session, 1998, pp. 84, 93, 121, 127.
3. Department of Health, Education and Welfare, Social Security Administration, Social Security Act of 1935: Reports, Debates, Act, and Supreme Court Decisions (Washington, D.C.: U.S. Government Printing Office, n.d.), 2 vols. Vol. 2 at VI, "Public—No 271—74th Congress," text of Social Security Act of 1935, pp. 3-4.
4. Winthrop W. Aldrich, "Social Security: An Appraisal of the Federal Act," Vital Speeches of the Day, August 1, 1936, p. 687.
5. Alfred M. Landon, "I Will Not Promise the Moon," Vital Speeches of the Day, October 15, 1936, pp. 26, 27, 28.
6. Franklin D. Roosevelt, The Public Papers and Addresses of Franklin D. Roosevelt, vol. 5; The People Approve 1936 (New York: Random House, 1938), p. 536.
7. General Hugh S. Johnson, "A Hokus-Pokus: The Social Security Tax," Vital Speeches of the Day, December 1, 1937, pp. 116—17; John T. Flynn, "The Social Security 'Reserve' Swindle," Harper's, February 1939, pp. 238-48.
8. See, for example, Beulah Amidon, "Old Age Reserve," Survey Midmonthly, September 1938, p. 284.
9. For discussions in Congress of "embezzlement" and IOUs, see, for example, U.S. Congress, House, 76th Congress, 1st session, February 27, 1939, Congressional Record, 84:1954-1961, and U.S. Congress, House, Social Security amendments debate, 76th Congress, 1st session, June 8 and 9, 1939, Congressional Record, 84:6854-6856, 6862, 6890-6893. For a defense of investing the reserve in Treasuries as the only feasible option, see, for example, U.S. Congress, House, Representative John William McCormack speaking on Social Security amendments, 76th Congress, 1 st session, June 8, 1939, Congressional Record, 84:6855.
10. U.S. Senate, Committee on Finance, Social Security Act Amendments: Hearings before the Senate Finance Committee on H.R. 6635, 76th Congress, 1st session, 1939, p. 81.
11. Charles E. Rounds, Jr., and Eric Hayes, Loring: A Trustee's Handbook, 8th (centennial) ed. (New York: Aspen Publishers, Inc., 1998), pp. i-2, 5, 79; Gilbert Thomas Stephenson, Estates and Trusts, 4th ed. (New York: Appleton-Century-Crofts, 1965), pp. 63-66.
12. Per author's telephone conversation with Professor Charles E. Rounds, Jr., of Suffolk University Law School.
13. U.S. Congress, House, Committee on Ways and Means, Social Security: Hearings, 76th Congress, 1st session, 1939, 3 vols., III: 2205-2206.
14. U.S. Congress, Senate, Oral Arguments in Helvering et al. vs. Davis involving the Old Age Benefit Provisions of the Social Security Act before the Supreme Court of the United States, May 5, 1937, S. Doc. 71, 75th Congress, 1st session, 1937, p. 16.
15. U.S. Supreme Court, Records and Briefs, October Term, 1959, No. 54, Flemming v. Nestor, Brief for the Appellant, pp. 10-11.
16. Flemming v. Nestor, 363 U.S. 603, at 608.

17. Professor Charles E. Rounds, Jr., "Will the Institution of the Trust Survive the Clinton Presidency?" The Advocate, Spring 1995, p. 31.

18. U.S. Congress, House, Committee on Ways and Means, 1998 Green Book." Background Material and Data on Programs Within the Jurisdiction of the Committee on Ways and Means, pp. 73, 75.

19. See, for example, Social Security Board, Changes in the Social Security Act: Old-Age Insurance, I.S.C. no 35, temporary edition, September 1939, p. 3; Social Security Board, 2 Plans for Old-Age Security, I.S.C. 42, n.d., p. 3; Social Security Board, What Is Social Security? A Brief Explanation of the Social Security Act, I.S.C. 1, July 1940, p. 10; Social Security Board, Old-Age and Survivors Insurance for Workers and Their Families, I.S.C. no 35, January 1943, p. 4; Social Security Administration, A Brief Explanation of the Social Security Act, 1947, p. l 0; and Social Security Administration, A Brief Explanation of Social Security, I.S.C. no. 1, July 1957, p. 14.

20. See "The $12 Trillion Temptation," Time, July 4, 1988, p. 58; Paul Magnusson, "We Are Plundering the Social Security Till," Business Week, July 18, 1988, p. 92; and Alan S. Blinder, "Congress Should Keep Its Hands Off this Nest Egg," Business Week, July 4, 1988, p. 20.

21. "Social Security Crisis Is Bogus, Experts Say," The Detroit News, October 11, 1999, p. 3A.