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During the years when I was in a position of guidance for a large 401(k) plan, I argued consistently against allowing participants to borrow their balances. Perhaps in a dire emergency such borrowing could be rational, but the vast majority of circumstances that led to borrowing were neither dire nor emergency. The result of such activity is that in a typical 401(k) plan the only assets residing in the accounts of the lower-paid employees are “receivables” meaning the amount the employee has borrowed and is somehow supposed to pay back. The obvious question here is, what kind of retirement is such a person looking at? And then another question; are there any similar situations out there? Unfortunately the answer is, Yes! Social Security.

Back in the early '80's the Congress did something that seems totally foreign to the way we see that body behave today. They perceived that a problem loomed on the horizon. It was that around 2010 the baby boom generation would begin to retire and draw Social Security. Baby boomers were, and are, a population bubble which meant that as they transitioned from paying Social Security tax to drawing benefits, the system would be highly stressed. The 1980's Congress addressed this by massively raising the taxes which pay for social security; both the rate and the amount of income on which that rate is levied. The result was a huge increase in tax revenue which well exceeded the amount being paid out to Social Security recipients. This meant that there would be decades of surpluses for the system which could be set aside to confront the retirement of the baby boomers. The problem with this was, and is, that the only allowable investment for this surplus is U.S. Treasury securities. Or, put more simply, we have been borrowing our Social Security surplus funds.

If the U.S. were able to control its budget, this might not be so bad. For a short period in the early '90's, as a result of President Reagan's successful effort to bring down the Soviet Union, we were able to curb our defense spending and balance the federal budget. But, that turned out to be a passing moment. Had it continued, we could have possibly been in a situation today where a budget surplus could be applied to paying off Treasury securities in the Social Security surplus fund. Then we would have a somewhat viable system.

But, reality is far from this picture. We have a severely unbalanced budget and every member of Congress and the Administration looks upon Social Security tax revenues, going into Treasury securities, as an indispensable revenue source.

The glitch in this picture has become the fact that a high unemployment rate has severely impacted the tax revenue from Social Security with the result that we are now paying out more cash than we collect in a given year. This situation was not anticipated to occur until many more baby boomers had retired. But, here it is, and listening to one newsperson after another, you'd think there is a simple solution.

I have sat in amazement many times listening to them say, “The shortfall in tax revenue will be taken out of the Social Security fund.” Just one problem news anchor. There is no Social Security fund. Had those surpluses generated over decades been invested in high-grade corporate bonds, there would be a real fund. Instead there is a situation just like that retiree who borrowed his entire 401(k).