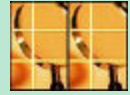


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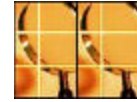
# Special Report 05/01



## **SOCIAL SECURITY: ANOTHER CASE OF INNOCENT FRAUD?**

BY  
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# SOCIAL SECURITY: ANOTHER CASE OF INNOCENT FRAUD?

By Warren Mosler\* and Mathew Forstater†

In his recent book, *The Economics of Innocent Fraud*, John Kenneth Galbraith surveys a number of false beliefs that are being perpetuated among the American people about how our society operates: innocent (and sometimes not-so-innocent) frauds. There is perhaps no greater fraud being committed presently—and none in which the stakes are so high—as the fraud being perpetrated regarding government insolvency and Social Security. President Bush uses the word “bankruptcy” continuously. And the opposition agrees there is a solvency issue, questioning only what to do about it.

Fortunately, there is a powerful voice on our side that takes exception to the notion of government insolvency, and that is none other than the Chairman of the Federal Reserve. The following is from a transcript of a recent interview with Fed Chairman Alan Greenspan:

RYAN... do you believe that personal retirement accounts can help us achieve solvency for the system and make those future retiree benefits more secure?

GREENSPAN: Well, I wouldn't say that the pay-as-you-go benefits are insecure, in the sense that **there's nothing to prevent the federal government from creating as much money as it wants and paying it to somebody**. The question is, how do you set up a system which assures that the real assets are created which those benefits are employed to purchase. (emphasis added)

For a long time we have been saying there is no solvency issue (see *C-FEPS Policy Note 99/02* and the other papers cited in the bibliography at the end of this report). Now with the support of the Fed Chairman, maybe we can gain some traction.

Let us briefly review, operationally, government spending and taxing. When government spends it credits member bank accounts. For example, imagine you turn on your computer, log in to your bank account, and see a balance of \$1,000 while waiting for your \$1,000 Social Security payment to hit. Suddenly the \$1,000 changes to \$2,000. What did the government do to make that payment? It did not hammer a gold coin into a wire connected to your account. It did not somehow take someone's taxes and give them to you. All it did was change a number on a

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computer screen. This process *is operationally independent of, and not operationally constrained by*, tax collections or borrowing.

That is what Chairman Greenspan was telling us: *constraints on government payment can only be self-imposed.*

And what happens when government taxes? If your computer showed a \$2,000 balance, and you sent a check for \$1,000 to the government for your tax payment, your balance would soon change to \$1,000. That is all—the government changed your number downward. It did not “get” anything from you. Nothing jumped out of the government computer into a box to be spent later. Yes, they “account” for it by putting information in an account they may call a “trust fund,” but this is “accounting”—after the fact record-keeping—and has no operational impact on government’s ability to later credit any account (i.e., spend!).

Ever wonder what happens if you pay your taxes in actual cash? The government shreds it. What if you lend to the government via buying its bonds with actual cash? Yes, the government shreds the cash. Obviously, the government doesn’t actually need your “funds” *per se* for further operational purpose.

Put another way, Congress ALWAYS can decide to make Social Security payments, previous taxing or spending notwithstanding, and, operationally, the Fed can ALWAYS process whatever payments Congress makes. *This process is not revenue constrained.* Operationally, collecting taxes or borrowing has no operational connection to spending. Solvency is not an issue. Involuntary government bankruptcy has no application whatsoever! Yet “everyone” agrees—in all innocence—that there is a solvency problem, and that it is just a matter of when. Everyone, that is, except us and Chairman Greenspan, and hopefully now you, the reader, as well!

So if solvency is a non-issue, what are the issues? Inflation, for one. Perhaps future spending will drive up future prices. Fine! How much? What are the projections? No one has even attempted this exercise. Well, it is about time they did, so decisions can be made on the relevant facts.

The other issue is how much GDP we want seniors to consume. If we want them to consume more, we can award them larger checks, and vice versa. And we can do this in any year. Yes, it is that simple. It is purely a political question and not one of “finance.”

If we do want seniors to participate in the future profitability of corporate America, one option (currently not on the table) is to simply index their future Social Security checks to the stock market or any other indicator we select—such as worker productivity or inflation, whatever that might mean.

Remember, the government imposes a 30% corporate income tax, which is at least as good as owning 30% of all the equity, and has at least that same present value. If the government wants to take a larger or smaller bite from corporate profits, all it has to do is alter that tax—it has the direct pipe. After all, equity is nothing more than a share of corporate profits. Indexation would give the same results as private accounts, without all the transactional expense and disruption.

Now on to the alleged “deficit issue” of the private accounts plan. The answer first—it’s a non-issue. Note that the obligation to pay Social Security benefits is functionally very much the

same as having a government bond outstanding—it is a government promise to make future payments. So when the plan is enacted the reduction of future government payments is substantially “offset” by future government payments via the new bonds issued. And the funds to buy those new bonds come (indirectly) from the reductions in the Social Security tax payments—to the penny. The process is circular. Think of it this way. You get a \$100 reduction of your Social Security tax payment. You buy \$100 of equities. The person who sold the equities to you has your \$100 and buys the new government bonds. The government has new bonds outstanding to him or her, but reduced Social Security obligations to you with a present value of about \$100. Bottom line: not much has changed. One person has used his or her \$100 Social Security tax savings to buy equities and has given up about \$100 worth of future Social Security benefits (some might argue how much more or less than \$100 is given up, but the point remains). The other person sold the equity and used that \$100 to buy the new government bonds. Again, very little has changed at the macro level. Close analysis of the “pieces” reveals this program is nothing but a “wheel spin.”

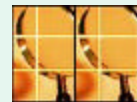
Never has so much been said by so many about a non-issue. It is a clear case of “innocent fraud.” And what has been left out? Back to Chairman Greenspan’s interview—what are we doing about increasing future output? Certainly nothing in the proposed private account plan. So if we are going to take real action, that is the area of attack. Make sure we do what we can to make the real investments necessary for tomorrow’s needs, and the first place to start for very long term real gains is education. Our kids will need the smarts when the time comes to deal with the problems at hand.

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