



Fixing Social Security

The bipartisan congressional “super committee” has begun its work, and it’s clear that Social Security reform will be on the table. The first thing to understand about Social Security is that there is a long term solvency problem. Alice Munnell, Director for the Center for Retirement Research at Boston College University points out that, according to the Congressional Budget Office, the Office of Management and the Budget and the Government Accountability Office, the benefits promised to future retirees exceed the scheduled taxes that are projected to be taken in.

In fact, last year, Social Security began paying out more in benefits than it received in payroll taxes -- years earlier than projected, due to the 2008 Great Recession. That shortfall is being made up by the program’s surplus, which is projected to be depleted in 2037, at which point payroll taxes will cover only about 75% of scheduled benefits.

The second thing to understand is that Social Security is not going away; too many people today and in the future depend on it for a crucial part of their retirement income. Munnell notes that Social Security accounts for 87% of non-earned income for the poorest third of households over age 65, 70% for the middle third and 37% for the highest third.

So the question becomes: how can Congress bring Social Security back into revenue balance? To help illustrate some of the trade-offs, the American Academy of Actuaries web site includes a game that allows all of us to fix Social Security -- you can make your own adjustments here: <http://www.actuary.org/socialsecurity/game.html> and discover a variety of ways to balance the books, some more painful than others. You could, for example, move up by one year the day when people have to wait until age 67 to claim maximum benefits, and after that index the retirement age to maintain today's ratio between expected retirement years and work years. This, alone, would solve 20% of the funding problem, and some would argue that it should have been done years ago.

As an alternative, you could reduce the annual cost of living adjustments in Social Security payments by half a percentage point. This would reduce the projected deficiency by 40%. Of course, it would also erode the purchasing power of elderly people who count on Social Security for a significant part of their income.

We could reduce benefits by 5% for future retirees, which would solve 31% of the problem.

Or we could reduce the benefit formula for the top half of earners, who theoretically are less dependent on Social Security in retirement. That would solve 43% of the projected Social Security deficit. It would also mean that people who are able to fund a comfortable retirement will get much less out of the system than they put into it.

On the other side of the ledger, we could incrementally increase the revenues going into the Social Security system. For instance, if we raised the payroll tax rate from the current 6.2% to 6.7% for employees and employers, 48% of the shortfall would go away. As an alternative, we could tax Social Security benefits like we do IRA and pension benefits, which would make up 14% of the projected shortfall.

As you can see, none of these proposals, by itself, will bring Social Security back to fiscal health. If you're looking for an out-of-the-box solution to add to the mix, consider an article in the Christian Science Monitor, where former U.S. Secretary of Labor Robert Reich notes that a big (and largely undiscussed) problem with Social Security is the shifting balance of workers paying into the system to retirees collecting from it. Forty years ago, he says, there were five workers for every retiree; today, there are three. In 20 years, perhaps less, the ratio will be 2: -- that is, every two workers in America will have to pay whatever is required to support one retiree's Social Security benefits.

How would you fix this problem? Reich proposes that we allow more immigrants into the U.S. -- that immigration reform and entitlement reform are linked.

As the deficit debate goes forward, you'll hear a lot more about how to "fix" Social Security. Consider this a cheat sheet on the options that various parties will eventually put on the table.

-- Bob Veres. Posted 08/15/11.