

FACING UP TO THE Nation's Finances

A nonpartisan project on the long-term challenges of the federal budget

Social Security, the Budget, and an Aging Population A Facing Up to the Nation's Finances Discussion Guide

Social Security, the federal retirement system, is one of the most popular government programs in U.S. history. Unfortunately, it's also in trouble and no consensus has emerged, either in Washington or among the public at large, on what approach the nation should take to fix it.

The Demographic Clock is Ticking

Social Security benefits, which are paid monthly to nearly 47 million people (plus another 4 million receiving Supplemental Security Income), are the backbone of the nation's retirement income system. Social Security was originally designed to provide one leg of a "three-legged stool" for retirement security, backed up with personal savings and employer pension programs. Increasingly, Americans have come to depend on Social Security. People generally are saving less (even counting 401(k) and IRA plans), carrying more debt, and are less likely to have corporate pensions than they were several decades ago. Federal statistics show that more than 40 percent of those 65 and older would fall below the poverty line without their Social Security check.

The big question looming over the program is whether it can be sustained when the baby boomers enter their retirement years and put an unprecedented strain on the system. The crucial factor is the ratio of current workers to retirees. Contrary to what people sometimes think, Social Security does not create individual retirement accounts from the social security (FICA) taxes that are withheld from people's paychecks. Rather, it was designed so that *the current workforce pays for the benefits of current retirees*. That works fine when there are significantly more workers than retirees. But what happens when there are fewer workers paying into the system than there are retirees drawing down on the fund? Current projections show that by 2030, there will be only two workers for every one retiree.

The first baby boomers became eligible for Social Security in 2008. By the time the entire baby boom generation retires during the next two decades, America's elderly population will double from its current size to about 80 million, and the ratio of people drawing Social Security benefits to those working and paying into the fund will fall to 2-to-1. The board of trustees that oversees the Social Security system projects that the program's expenditures will exceed income in around 2017. The Social Security Trust Fund provides a cushion against these needs, but by about 2040, the trust fund will be exhausted as well and the system will only be able to cover about three-quarters of the benefits promised. With a national debt that is *already* approaching an

unprecedented \$10trillion, we cannot afford to simply borrow money to cover the shortfall. So something is going to have to change, because as time goes on the math will simply not add up.

This guide will help you consider the kinds of hard choices that the nation will need to make to ensure the long-term stability of Social Security and the federal budget. It suggests three alternative approaches we could take, and you might also have additional ideas you'd like to add to the discussion. *What do you think is the best course of action to meet the challenges facing the Social Security system and the federal budget, and why?*

1. Maintain our Commitment to All Seniors, Even if it Means Raising Taxes and Cutting Other Programs

Our government should keep social security intact so that all Americans can have a stable retirement. Even if it requires raising taxes significantly, or slashing spending on other government programs, the promise of income security in retirement years for every American must be honored. It is immoral and unthinkable to arbitrarily reduce benefits to older Americans because of the financial pressures created by the size of the baby boom generation.

Therefore we should:

- Increase taxes dedicated to Social Security—to keep the Social Security program solvent.
- Increase the Social Security payroll tax cap, so that earned income above \$102,000 a year is taxed
- Change the formulas for benefits—e.g., index benefits to price inflation instead of wage inflation; and increase the Average Indexed Monthly Earnings Primary Insurance Amount formulas
- Have state and local government workers pay Social Security taxes
- We'll also need to decide which federal programs to cut in order to ensure that there's enough money to support the Social Security, or else the sales tax will be unreasonably large. For instance, we might decide to cut federal education programs (leaving it to state and local government to pick up the slack), or cut back on military spending.

Arguments for:

- Providing for individuals as they age is one of the fundamental responsibilities of government.
- Everyone who has paid into Social Security, regardless of their income, deserves to get the benefits of the program and to have a secure retirement at public expense.
- Social Security already keeps millions out of poverty and will be even more important in the future, since Americans don't save enough and fewer companies offer pension plans.

Arguments against:

- Unless we rethink how we handle Social Security, the costs will become unreasonably high in the years ahead, resulting in taxes that are too high, cuts in other important programs that are too severe, or a national debt that is much too large.
- It doesn't make sense for wealthy retirees get benefits at the nation's expense—as they do under the current system—while so many Americans struggle to make ends meet.
- Social Security is important, but not to the point where we sacrifice other important needs. Economic growth and vital services might get sacrificed if we have to raise taxes or cut spending elsewhere to maintain Social Security.

2. Make Social Security Affordable by Focusing on Those Who Need it the Most

To avoid stark choices in the years ahead hikes in taxes and reductions in other government programs, we must start to think of Social Security in new ways.

Most importantly, we should change Social Security from a universal program that every worker is entitled to when they reach a certain age, to a targeted one aimed at people who would otherwise be living in poverty during old age. In other words, the program should be reserved for working-class and lower-income people who would not be able to live securely in their senior years without it. Social Security should not provide extra income to those who are fortunate enough to be relatively well-off and are able to fund their own retirement.

Therefore, we should:

- Make Social Security benefits dependent on one's income, reducing benefits for the wealthy.
- Gradually raise the retirement age at which people are eligible for Social Security benefits now that people are living and working so much longer than used to be the case.
- Increase the Social Security payroll tax cap, so that earned income above \$102,000 a year is taxed

Arguments for:

- We can only make Social Security affordable by making some fundamental changes in how it operates. Incremental changes in things like the retirement age or the size of cost-of-living increases will not be enough.
- While this approach is a dramatic change from the past, it does preserve Social Security's essential mission of keeping American seniors out of poverty.
- Well-to-do retirees don't really need Social Security – this focuses the program on the people who need it most.

Arguments Against:

- Linking benefits to retirees' income will undermine support for Social Security, with many upper-income people likely to question why they're paying taxes for a system that won't pay them benefits. Furthermore, it punishes those who have worked hard and been financially prudent.
- This solution avoids the fundamental question of why government is handling something that individuals should be doing for themselves. Whatever your income, it's foolish to trust the government to manage your retirement; you're better off handling it yourself.

People have made plans for retirement based on the system as it is today. We can't just suddenly change the rules on people.

3. Make Economic Security in Retirement a Personal Responsibility Rather than a Social Program

We need a dramatic re-thinking of Social Security. Current retirees would still get benefits, but for the future we need a system of mandatory personal savings accounts, which make individuals responsible for their own financial security in retirement. Mandatory personal savings accounts would either wholly or partly replace the current system, putting responsibility for retirement security where it should be, on each of us individually.

True, some people will make out better than others under this plan, because some people are better investors than others. But if they do their homework and invest prudently, they ought to be able to retire in an acceptable fashion, allowing for the removal of this government program, which is going to be harder and harder to pay for as more and more baby boomers retire.

Therefore, we should:

- Create personal retirement accounts that require individual saving as a supplement to Social Security
- Create mandatory savings accounts for every working American, similar to the 401(k) plans many employers offer now and funded with a portion of Social Security taxes.
- Allow individuals to decide how to invest their Social Security taxes, possibly through an approved list of mutual funds.

Arguments for:

- This approach emphasizes personal responsibility and limited government, basic values America has embraced throughout its history.
- Many people feel better handling their own financial affairs rather than trusting that the government can be relied on to do it for them, and they should be allowed to do so.
- Many people will be able to get a much better return on their money this way than in the current system.

Arguments against:

- Under a self-financed retirement system lower-income retirees would suffer disproportionately, as would those who are simply bad planners or have bad luck. The result would be more personal tragedies and greater societal problems.
- The costs for the transition from the current system to one based on personal savings accounts will cost billions of extra dollars (because we'll still need to pay Social Security for current retirees while we transition to the new system). While this strategy might help bring down the national debt years from now, in the meantime it will drive it much higher.
- Providing for the elderly should be a public responsibility. We've made promises that people are depending on for their retirement.