Social Security: Top issues

By Greg Burns, Tribune columnist

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It is among the most popular and important social programs in America, yet many Americans have only a vague idea about how it works. What nearly every American knows is that it's in trouble.

"This program affects hundreds of millions of Americans," said Jason Fichtner, chief economist at the Social Security Administration. "They're paying for a system that they expect to be there for them."

Is Social Security going under? How could it be fixed? Should everybody worry?

This report addresses Social Security, explaining what you need to know and how the system may change in years to come. The good news: Social Security can afford to pay benefits for decades. The bad news: After that, without reform, it's up for grabs.

How Social Security works

Practically every American has a friend or relative on Social Security. More than 52 million of the nation's 309 million citizens received benefits from it last year. That's one in every six.

The 75-year-old program is partly retirement plan and partly insurance. About two-thirds of annual payouts go to retirees. The other third goes to disabled Americans who cannot work and to the children or spouses of people who are disabled or die prematurely. The agency employs more than 65,000 workers to keep the checks coming.

In 2009, the average retired worker got $1,164 a month from Social Security. For about one-third of those age 65 and older, Social Security accounts for practically all their income. For about two-thirds, it represents at least half their income. Women, especially, depend on the program.

For politicians, messing with Social Security is almost as perilous as, well, messing with health care. Reform inevitably creates winners and losers.

"This is all about transferring money from one group to another. It's all about whose benefit do we cut, and whose taxes do we raise?" explains Jeffrey Brown, a finance professor at the University of Illinois at Urbana-Champaign who advises policymakers on Social Security. "Given their experience with health care, how do politicians win on this?"
It's not called the "third rail" of politics for nothing.

**Where the money comes from**

Social Security collects most of its funding through the payroll tax, called FICA. If you're working, most likely you're paying, although some teachers and government workers are exempt.

The agency gets 6.2 percent of each paycheck. Employers pay a matching 6.2 percent. The self-employed pay the full 12.4 percent. Deductions stop for the year once a worker makes $106,800 in income, and monthly benefits max out at $2,413.

Funds being collected today pay for the checks being sent today. Each generation provides the money for the one that came before it. Children pay for their parents, and so on. The money is not put into a separate account in the name of the person who is paying.

That pay-as-you-go formula sets Social Security apart from other pension plans. Since a sweeping reform in 1983, Social Security has collected $2.5 trillion more than it has paid out in benefits. By law, the surplus is given to the federal government in exchange for Treasury securities — safe investments that earn interest. Those Treasuries, held in what's known as the Social Security trust fund, can be cashed in when the system needs more money to pay benefits. How the Treasury will pay off the bonds is anyone's guess, however, and some critics compare the system bitterly to a pyramid or Ponzi scheme.

**The system really is in trouble**

It is in trouble, but it's not in danger of failing anytime soon, and those receiving benefits now don't need to worry about their checks.

The big problem is the aging of the baby boom generation: 76 million Americans born between 1946 and 1964. During their expected long retirements, the payroll taxes of the remaining workers won't be enough to cover the benefits that have been promised.

Until recently, Social Security collected billions of dollars more than it spent each year. But in 2010 and 2011, expenses will exceed income for the first time since 1983, according to Congressional Budget Office projections. After that two-year dip, surpluses will be recorded until 2016 or 2017, the projections indicate, after which losses will continue for decades, growing and growing.

Who cares? If you care about America and the economic lives of future generations, then you should care, said Paul Kasriel, chief economist at Chicago's Northern Trust Corp.

"The real economic effect is that we will be transferring more and more resources to our retired population," he said. "There will be fewer resources for business to make our work force more productive by investing in technology or education. That, in turn, will have a downward bias on the long-term rate of growth."

Though economists generally disagree about the future effects of Social Security obligations, many believe that waiting for a crisis to fix it will lead to higher inflation, lower living standards and a less-competitive America.

**The outlook is shifty**
Changes in the makeup of America's population and the performance of the economy in coming decades make all the difference.

Assume, for instance, that Americans were to start having more kids. That would help pay for the baby boom retirement bubble, because those kids would go to work and support the system with their payroll taxes. So for a time, anyway, Social Security would be better off. Assume a lower fertility rate, and Social Security loses out because fewer workers would be paying in.

Another source of younger workers is immigration, which has shot up since the 1970s. If immigration were to keep expanding, those new Americans would help pay for the baby boomers. If immigration dried up, Social Security would be relying on fewer young workers to pay the bills.

The death rate is an additional swing factor. Americans live much longer on average than they did decades ago (nearly 78 years now compared to less than 71 three decades ago). As a consequence, they collect benefits for a much longer time. The strain on Social Security intensifies as life spans keep increasing. A cure for cancer would be great news for humanity but costly for Social Security.

The economy also affects Social Security's future. Generally speaking, growth is good, and recession is bad. If wages go up far beyond the level of inflation, the payroll tax throws off more cash. (Those higher wages, though, mean the government eventually will owe more in benefits). Higher interest rates help, too, since Social Security invests in Treasury securities that would then pay a greater return.

**Social Security accounts flopped**

In 2005, President George Bush proposed diverting money from Social Security into new accounts that could be invested in stocks and bonds. Under his plan, part of the payroll tax no longer would have gone to support current retirees, as it does today. It would have gone instead into these new accounts earmarked for the person paying, who would then choose how to invest it. Those opting for investment accounts would be agreeing to accept reduced Social Security payouts, including lower survivor benefits. Upon retirement, they would get a smaller government check each month, but also would collect money from the accounts.

The plan would have given Americans ownership and control over money they would otherwise pay into Social Security. But it would not have "saved" the system by covering the coming retirement of baby boomers. To accomplish that feat would require boosting revenues, cutting benefits or borrowing en masse — the same basic choices the nation faces today.

U. of I.'s Brown advised the Bush administration on Social Security, and he said other reforms that would have helped put the program on a firmer footing were rejected along with the investment-account idea. As a result, politicians have become even more cautious about addressing the long-term problem.

"It was so deeply politicized," he said. "It has definitely narrowed the options."

**Raising the payroll tax**

This is a simple way to raise more bucks. It's been done more than a dozen times since the program started in 1935 with a mere 2 percent tax on wages. One of the biggest revisions came in 1983. With Social Security just months away from insolvency, a commission headed by Alan Greenspan (later the Federal Reserve chairman) pushed through a big payroll tax increase. In addition, the Greenspan
group championed raising the future retirement age from 65 to 67, adding government and nonprofit employees to the system, and taxing the Social Security benefits of higher-income recipients.

Everybody knew the baby boom retirement bubble was coming. Those fixes were supposed to take care of it, and they worked to an extent. The higher taxes and other changes helped generate today's $2.5 trillion trust fund. But at current tax levels, that will be gone in 2037, according to projections from the Social Security trustees. Many private forecasters believe the next set of projections, due around April 1, will peg the tipping point at 2036, 2035 or even 2034.

Raising the 12.4 percent payroll-tax rate by another 1 percentage point, to 13.4 percent, would fix almost half of the system's projected shortfall over the next 75 years, according to the agency's actuaries. With unemployment at close to 10 percent and wages under pressure, however, that's unlikely to happen.

Billing the wealthy

This is a tempting option for politicians, because a seemingly small fix affecting relatively few people could make all the difference.

Reducing benefits for those with retirement income exceeding $50,000 a year, an idea that some tax hawks have pushed for years, would eliminate much of the system's projected shortfall, according to actuarial estimates. Raising the current $106,800 wage tax limit by about one-fourth would eliminate the rest of the shortfall. Alternatively, axing the cap altogether to sweep in the CEO crowd would come close to eliminating the entire shortfall.

Such steps are alluring because they would directly affect just a fraction of the population — those with the highest earnings. They also would address the regressive nature of today's payroll tax, where lower-income workers pay a relatively high share. Such options preserve benefits for those most in need.

Trouble is, Social Security has maintained widespread support, in part, because it is universal. It is generally not perceived as a welfare plan that soaks the rich to support the poor. Higher taxes also tend to undermine economic growth and productivity, tax opponents say. Means testing in any expanded form would be controversial on Capitol Hill.

Cutting benefits

In Beltway lore, touching those benefits is a little like latching onto a live wire.

For those so inclined, the simplest fix would be an across-the-board benefit cut. Pay future retirees 5 percent less per month than what is scheduled would cut the projected shortfall by almost one-third. Reducing the system's annual cost-of-living increases would have a similar effect.

Yet those solutions make plenty of enemies, no friends and tend to hit low-income recipients the hardest.

In 1983, benefits were trimmed by raising the retirement age to 67 over time. Jacking it up to 70 by 2035 would relieve about half of the shortfall. It also would address one of the biggest pressure points on the system: ever-rising life expectancies.

That change would put a special burden on those with physically demanding jobs, however. If Americans worked longer, employers would pay higher health costs. And if Americans continued...
enrolling in Social Security at the earliest possible age, as roughly half do today at 62, then their monthly benefits would be particularly meager.

A more subtle cut would involve indexing initial benefit levels to consumer prices instead of average wages, so they accrue at a slower pace than in the past. Since inflation typically grows more slowly than wages, benefits would be gradually reduced. Congress hasn't moved on that idea, though, and over a long period the change would result in greatly reduced payouts and a likely backlash.

**Doing nothing**

Throughout its history, Social Security has been subject to periodic tinkering. Bringing about revisions has been treacherous. The last major revamp in 1983 almost failed to materialize because of the political firestorm it started. Some question the urgency of making any changes. After all, the money will keep flowing to Social Security recipients for years to come under any reasonable forecast.

It's possible that exceptional economic growth could head off the shortfall. The Social Security Administration uses relatively conservative estimates. In the late 1990s, with real wages soaring and productivity booming, America enjoyed a rate of expansion far beyond any forecasts. That reversed in the 2000s, leaving America's leaders with the usual three options: cut benefits, raise taxes or borrow the necessary funding.

Relatively small adjustments now could bring about dramatic results in the future. Waiting to make changes would require more drastic steps that take effect in less time.

"Many of us have been out there ringing the alarm bell," Brown said. "The longer the delay, the bigger the benefit cuts and tax increases. Does it end gently or does it end with a boom?"

**Women and children first?**

The stakes are probably highest for women and the young.

Women rely more on Social Security income in their senior years, especially those eligible for spousal and survivor benefits. Because women live years longer than men, they are more apt to collect benefits for a longer time.

Similarly, the young have a lot riding on Social Security because they will be most exposed to the benefits of a restructuring or the consequences if nothing changes.

Although the stakes are high, no American should forget that another giant social program faces graver troubles and more painful fixes.

The problems of Medicare and Medicaid will strike harder and sooner, with severe consequences for baby boomers as well as their children.

The same aging of the population that clouds the outlook for Social Security has put the nation on the hook for a huge doctor bill.

"Medicare is the biggest challenge," Kasriel said. "We need to slow down the rate of growth in health care costs. But no one has come up with a solution."
So here's the good news about the outlook for Social Security: Troubling as it is, it's not as bad as it could be.

For explanations of more issues related to Social Security, from the failure of reform in 2005 to the consequences of soaking the rich, check out chicagotribune.com/burns online.

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