



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 Choicework Discussion Guide

Social Security, the federal program providing income security for retirees, the disabled, and their survivors, is one of the most effective 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.

Social Security benefits are the backbone of the nation's income security system, and are central to what is often called "social insurance"—the transferring and pooling of risks by an entity, generally the government, that is legally required to provide certain benefits. Social Security benefits are paid monthly to more than 50 million people, including about 31.7 million retired workers, 4.6 million widows and widowers, 7.1 million disabled workers, 3.1 million children, and approximately 800,000 adults who have been disabled since childhood.

Social Security was originally designed to provide one leg of a "three-legged stool" for retirement security, backed up by personal savings and employer pension programs. Increasingly, Americans have come to depend on Social Security. People generally are saving and investing less [even counting 401(k) and IRA plans], are less able to rely on their investments being successful, are carrying more debt, and are less likely to have employer-provided 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. That is part of the great success of Social Security: It has dramatically reduced poverty among, and provided a cushion of income security for, older Americans, people with disabilities and their children, as well as surviving spouses and children of workers who have died.

The Demographic Clock Is Ticking

A big question looming over the program is whether it can be sustained as baby boomers enter their retirement years and put an unprecedented strain on the system. It is also often asked: **Is Social Security going bankrupt?** Technically, the answer is no, but paying for benefits could become an overwhelming strain on government in the absence of reforms. And, will benefits have to be cut significantly for future generations?

A 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.*

This can be seen either as reinforcing intergenerational bonds or as burdening current workers with the retirement benefit costs of older Americans. This "pay as you go" system 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. As the entire baby boom generation reaches retirement age during the next two decades, America's elderly population will double from its current size to about 80 million.

The board of trustees that oversees the Social Security system projects 2017 as the year in which the program's expenditures will exceed its income. The Social Security Trust Fund provides a cushion against these needs, but according to current estimates, the trust fund would be exhausted as well by the year 2040 and the system would only be able to cover about three-quarters of the promised benefits. With a national debt that is *already* close to \$11 trillion (and \$7 trillion in implicit fiscal exposures) for future Social Security benefits, we cannot afford to simply borrow money to cover the shortfall.

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 lays out three sets of alternative approaches. These are merely intended to be discussion starters. You should not think that you need to adopt every idea under any one approach.

You can mix and match ideas from different approaches, and toss other ideas in as you consider this question: *What do you think are the best courses of action to meet the challenges facing the Social Security system and the federal budget, and why?*

Option 1: Maintain Our Commitments, Through A Combination Of Benefit Cuts And Tax Increases

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 to every American of income security in retirement years must be honored. The size of the baby boom generation does create financial pressure, but it would be immoral and unthinkable to arbitrarily reduce benefits.

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 how benefits are calculated, reducing benefits for those who need them least.
- Have state and local government workers pay Social Security taxes.
- Gradually raise to 70 the retirement age for the healthy and able-bodied, or control costs by indexing the retirement age to rising life expectancy.
- Decide which federal programs to cut to ensure that there's enough money to support Social Security. For instance, we might decide to cut federal education programs (leaving it to state and local governments to pick up the slack), or cut back on military spending.

Arguments for:

- Providing for individuals as they age, children of deceased workers, and people with disabilities 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, is very important now with the economy in a downturn of a size not seen since the 1930s, and will be even more important in the future. Unemployment is high and fewer companies are offering pension plans. Personal savings rates meanwhile aren't high enough and people can lose their savings because of economic events over which they have no control.
- Keeping people out of poverty yields long-term benefits for society as a whole. Ensuring that survivors of deceased workers, including children, can continue to go to school, receive health care, eat well, and stay in their homes yields a more educated and productive future workforce. When older adults have income security, their working-age children spend less time out of work and have more time to raise their own children.

Arguments against:

- Providing for vulnerable citizens is not one of the fundamental responsibilities of government. The income security of retirees, people with disabilities, and children of deceased workers is the primary responsibility of those individuals, along with their families.
- 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 to 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.

Option 2: Make Social Security Affordable By Focusing On Those Who Need It Most

To avoid difficult choices in years ahead when it comes to tax hikes and reductions in government programs, we must start to think of Social Security in new ways.

Most importantly, we should change Social Security's retirement benefits from a universal program that every worker is entitled to when he or she reaches a certain age, to a targeted one for people who would otherwise be living in poverty during old age. In other words, the program should be reserved for lower income people who would not otherwise be able to live securely in later life. Social Security should not provide extra income to those who are fortunate enough to be relatively well-off and who are able to fund their own retirement.

We should:

- Make Social Security benefits dependent on one's income and reduce benefits for the wealthy.
- Gradually raise the age at which people are eligible for Social Security retirement benefits, now that people are living and working much longer than used to be the case.

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 providing income security for older adults, survivors of deceased workers, and people with disabilities.
- Well-to-do retirees don't really need Social Security – these changes would focus 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. It also 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 completely take care of your retirement - you would be 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.

Option 3: Make Retirement Security More Of A Personal Responsibility

We need a dramatic rethinking of Social Security. Americans -- whose savings rates had fallen to zero before the current financial crisis, and many of whom are plagued by personal debt -- need to save more for retirement and for other lifetime needs.

We need a system of mandatory personal savings accounts, which make individuals much more responsible for their own financial security, even though Social Security would be retained to provide some benefits.

Mandatory personal savings accounts either could wholly or partially replace the current system, putting responsibility for retirement security where it should be, on each of us individually.

True, some people would make out better than others under this plan, because some people are better savers and investors than others. But if they do their homework and invest prudently, they ought to be able to retire in an acceptable fashion.

Therefore, we should:

- Create personal retirement accounts that require individual saving as a supplement (or alternative to) to Social Security.
- Create mandatory savings accounts for every working American, similar to the 401(k) plans many employers offer, but 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. The income security of retirees, people with disabilities, and children of deceased workers is the primary responsibility of those individuals, along with their families.
- 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.
- Despite the current financial crisis, historically, investments in stocks and mutual funds have yielded higher returns.

Arguments against:

- This approach undermines our commitment to community and belief in government's role in taking care of vulnerable citizens – basic values America has embraced throughout its history.
- Under a self-financed retirement system lower-income retirees, survivors of deceased workers and people with disabilities would suffer disproportionately, as would those who do not have access to or understand information about personal finances and investing in the stock market and do not have the income to hire someone to help them. Others 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, people with disabilities and survivors of deceased workers should be a community responsibility. We've made promises that people are depending on for their security.
- The economy has tanked, and in many cases, people who invested in the stock market through private accounts have seen their savings completely disappear. Many workers who relied on their pension plans are now struggling to adapt to new rules their companies have had to implement in order to survive (for example, in the auto industry). Many employers are no longer matching the contributions of their employees to 401k plans. All this shows why we can't rely on private investment to take care of everyone's retirement needs. The government has to play a major role.

For more information on **Facing Up to the Nation's Finances** and **Students Face Up to the Nation's Finances** – nonpartisan educational and civic engagement projects on the budget deficit and the national debt – go to **FacingUp.org** or contact Shaheen Hasan at 212-686-6610, extension 50, or via e-mail at shasan@publicagenda.org.