Policy Focus

The Need for Social Security Reform

RECIPES FOR RATIONAL GOVERNMENT FROM THE INDEPENDENT WOMEN'S FORUM

Carrie Lukas, Managing Director, Independent Women's Forum

August 2011

Volume 1, Number 8

IN THIS ISSUE

independent women's forum

WHAT YOU NEED TO KNOW

Republicans and Democrats increasingly acknowledge that reforming Social Security needs to be a part of our long-term debt solution.

As we start this discussion about the future of Social Security, seniors need to understand that Social Security reform is really about how the program will work for future generations. No one proposes cutting benefits for those depending on Social Security today.

However, Social Security cannot last as currently structured. Social Security operates under what's called a "pay-as-you-go" system, which means it relies on revenue from today's payroll taxes to pay current beneficiaries. As the number of retirees grows, there won't be enough people paying in to pay all promised benefits.

This problem will get worse unless something is done to bring Social Security's costs down. The good news is changes to Social Security's benefits can be structured so reductions in future benefits affect only those well above the poverty line.

Ultimately, people should consider if Social Security is really the best retirement plan that we can give the next generation. Young workers would be better served by an ownership system, in which a portion of their payroll taxes are saved in a personal account for their own retirement.

But in the short-term, Washington needs to have serious conversations about how to reform Social Security so that it is sustainable and doesn't bury the next generation under debt.

WHY YOU SHOULD CARE

Social Security is the largest federal government program and provides important income for millions of Americans. However Social Security cannot continue as currently structured and needs reform:

- **Social Security's Financial Problem:** Social Security already isn't taking in enough from payroll taxes to cover benefits. The Social Security Administration has to cash in bonds from the Social Security Trust Fund to fill the hole. Since that money comes from the general treasury, taxpayers are on the hook for paying back the trillions in the "trust fund."

- **A Trillion Dollar Shortfall:** As more Baby Boomers retire, Social Security's problems are going to get worse. Much worse. Over the next two decades, taxpayers will have to come up with trillions extra, on top of payroll taxes, to fulfill Social Security's obligations.

- **We Can Do Better:** Social Security taxes are a big financial burden for American families. Americans deserve a retirement system that's on sound financial footing and provides workers, particularly low-income workers, the opportunity to save and invest.

MORE INFORMATION

What's Wrong with Social Security

Social Security's pay-as-you-go structure depends on having a lot of people paying in to the system, with fewer people taking benefits out of the system. That was exactly the case when Social Security was designed. In 1940, there were more than 150 workers paying in to Social Security per beneficiary. By 1960, there were just five workers per beneficiary. By 1990, it was 3.4 workers for each beneficiary. And today, there are less than three workers.

With people living longer, a growing number of retirees, and a lower birth rate, that ratio is going to continue to get worse. This means that if Social Security is going to pay someone a monthly check for $1500, the Social Security Administration needs to collect $500 each month from three workers. As the number of workers-per-retiree falls, the amount that each worker will have to pony up will also increase.

Already today Social Security payroll taxes aren't generating enough money to cover benefits. The current shortfall is in part due to high unemployment, but over the long term, this is a problem that will continue to get worse.

Social Security's financial problems are just one of the system's flaws. Social Security also doesn't provide a very good deal for many Americans—and the outcomes from Social Security are often simply unfair. Those who die young tend to get the worst deal from Social Security, and those with lower incomes and minorities tend to have shorter life expectancies. Social Security also rewards some family structures over others.

As policymakers consider how to reform Social Security, they should consider more than just getting Social Security's books to balance. They need to try to create a system that is equitable and helps Americans become a nation of savers.

What About the Trust Fund?

The Social Security Administration has a Social Security Trust Fund with about $2.6 trillion in assets. When payroll taxes aren't enough to pay benefits (there was a nearly $50 billion hole in 2010), SSA can just cash in the bonds in the trust fund to make up the difference.

That's great news, right?

Not exactly. When SSA goes to cash in those bonds, the general treasury has to come up with the money to pay SSA back. That means that it has to take the money out of the general budget or issue new debt. In other words, the trust fund may be an asset for Social Security, but it's a liability for American taxpayers. When SSA cashes in trust fund assets, you have to pay the bill.

This means that in addition to paying payroll taxes, in future years, Social Security will become a major line item in the general budget. This will put additional pressure on our already stretched budget and increase our enormous deficit and national debt. It will mean that Congress will have less money to spend on other priorities—whether that's fighting a war or addressing natural disasters—since tens of billions, and then ultimately hundreds of billions, will have to go to pay back Social Security's trust fund.

Social Security's trust fund is expected to run out in around twenty-five years. At that point, payroll taxes would cover about 77 percent of promised benefits. So if nothing if done to change Social Security, future beneficiaries will see their checks slashed.

Reducing Social Security's Costs

Instead of allowing Social Security to continue on this path of burdening American taxpayers, adding to our debt, and ultimately disappointing beneficiaries, Congress should make prudent changes to bring Social Security's costs down.

There are many ways to reduce Social Security's costs. For example, Congress could consider raising the age of eligibility for Social Security.

In 1940, a man who reached age 65 was expected to live an average of 12.7 more years, and a woman was expected to live 14.7 years. By 1990, the 65-year-old man is expected to live 15.3 years and the woman 19.6. That's two and a half more years of payments for the man and five more years of payments for the woman. Those extra checks add up.

Adults today also are much more likely to reach retirement age. In 1940, a 21-year-old man had a 54 percent change of reaching 65, while a 21-year-old woman had a 61 percent chance. By 1990, a man who made it to 21 had a 72 percent chance of reaching 65, and the woman had an 84 percent chance. That means that in the past, many workers who paid Social Security taxes never collected benefits while today the vast majority of young workers live long enough to collect benefits.

These trends are great news for all of us who can expect to live longer and healthier, but it's obviously a strain on Social Security's finances. When Social Security was envisioned, no one expected millions of Americans to receive retirement checks for more than thirty, or even forty, years. Yet that's increasingly the case today, and will become more commonplace as life expectancies continue to rise.

Social Security's age of eligibility could be gradually raised and indexed to life expectancy to help bring costs down and return the system to its original intentions.

There are also numerous proposals to change how cost of living increases are calculated. Many estimate that current beneficiaries who earned the same Social Security payments get more today in real dollars than beneficiaries in years past, because of the method used for determining inflation. Congress should consider more accurate ways to estimate inflation so that benefits are stable, and not artificially inflated.

Congress should also consider explicit reductions in benefits that are paid out to high-income retirees. Social Security isn't meant to be a welfare program, and the benefits that are received are supposed to bear a relationship to taxes paid in during one's working life. Yet given Social Security's bleak prospects, changes have to be made, and those seniors with the highest incomes will be better able to withstand reduced benefit payments. It may not be fair, but it may be necessary.

The Retirement Plan Americans Deserve

Reducing Social Security's future costs will be necessary to avert economic disaster and make sure that the program is sustainable in the long-term. But these changes alone aren't enough. And in fact, while necessary, such changes will exacerbate some of Social Security's other flaws.

For example, reductions in the growth of future benefits will make the system a worse deal for program participants. Those who die before or immediately after retirement age will still have nothing or little to show for a life-time of contributions to Social Security. How much someone receives from Social Security will still be influenced by marital status and life expectancy, creating unfair outcomes for many.

That's why simply making the current Social Security system sustainable shouldn't be the only goal of reform. Ultimately, policymakers should consider how to move toward a system that allows people to save and invest on their own. A system of personal retirement accounts, for example, would allow someone to put money away for retirement and could grow during their working lives. That account would be someone's personal property and could be passed on at death.

There are many ways to incorporate a system of personal accounts into Social Security while maintaining a basic safety net (to make sure that, regardless of the performance of the financial markets, everyone eligible for Social Security receives income support that keeps them out of poverty). While policymakers address Social Security's immediate financial challenges, they should also consider how to turn this often arbitrary pay-as-you-go system into a system that gives the American people ownership of their retirement assets.

Why Don't We Raise the Income Cap on Social Security Payroll Taxes?

Americans typically pay a 12.4 percent payroll tax on the first $106,800 they earn, so that after someone has paid a maximum of $25,440, they're done paying Social Security taxes for the year. Social Security's payments are also based on taxes paid in, so millionaires receive the same Social Security benefit as someone who made just the earnings cap throughout their lives.

Some propose raising, or even eliminating, the income cap so people pay payroll taxes on more (or all) of what they earn. Yet as The Cato Institute's Michael Tanner explains, eliminating the cap would give the U.S. one of the highest marginal tax rates in the world, and these high taxes would bring down our GDP and cost more than a million jobs. And unless Social Security's benefit formula was radically changed, eliminating the cap would only put off Social Security's financial crisis by about seven years.

We need to find better solutions to fix Social Security.

WHAT YOU CAN DO

You can help reform Social Security!

- **Get Informed:** Get the facts about our the high costs of employment regulations. Visit:
  - The Independent Women's Forum (www.iwf.org)
  - The Cato Institute (www.socialsecurity.org)

- **Talk to Your Friends:** Help your friends and family understand how we can improve Social Security. Tell them about what's going on and encourage them to join you in getting involved.

- **Become a Leader in the Community:** Get a group together each month to talk about a political/policy issue (it will be fun!). Write a letter to the editor. Show up at local government meetings and make your opinions known. Go to rallies. Better yet, organize rallies! A few motivated people can change the world.

- **Remain Engaged:** Too many good citizens see election time as the only time they need to pay attention to politics. We need everyone to pay attention and hold elected officials accountable. Let your local government officials and national representatives know your opinions!

ABOUT THE INDEPENDENT WOMEN'S FORUM

The Independent Women's Forum (IWF) is dedicated to building support for free markets, limited government, and individual responsibility.

IWF, a non-partisan, 501(c)(3) research and educational institution, seeks to combat the too-common presumption that women want and benefit from big government, and build awareness of the ways that women are better served by greater economic freedom. By aggressively seeking earned media, providing easy-to-read, timely publications and commentary, and reaching out to the public, we seek to cultivate support for these important principles and encourage women to join us in working to return the country to limited, Constitutional government.

We rely on the support of people like you! Please visit us on our website www.iwf.org to get more information and consider making a donation to IWF.

SUPPORT IWF NOW!

OUR PARTNERS

independent women's voice — A VOICE FOR THE MAINSTREAM

NeW — Network of enlightened Women

SGP — SMART GIRL POLITICS Action

Contact us if you would like to become a partner!

CONNECT WITH IWF!
FOLLOW US ON: