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# Social Security: Strengthen Not Dismantle

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*Social Security has benefited more than 55 million people. It has lifted about 14 million seniors and 6 million more people out of poverty without adding a penny to the federal budget. Social Security is increasingly becoming an important source of income for many people. Despite the projected shortfall, the program will continue to meet its obligations for the next two decades, and with minor adjustments, it can be on solid footing for the next 75 years. Cutting the benefits or privatizing may not be the best approach. This paper discusses the structure and function of Social Security and what can be done to strengthen the program.*

*Key words: Social Security, retirement income, old age, income security, social insurance*

The Social Security program has been one of the most successful national social insurance programs to date, but it has been highly misunderstood by lay persons as well as politicians and even professionals who study the issue. For more than 77 years, despite economic ups and downs and political turmoil, it has never missed a single payment to eligible recipients. Furthermore, with minor adjustments this program will be able to pay out promised benefits for the next 75 years and beyond (The Board of Trustees, 2012). Social Security is not broken; it is doing what it was designed to do. Yet for several decades opponents have systematically mounted attacks on Social Security in the belief that it is the cornerstone of a welfare state and that when it is dismantled, the rest of the welfare programs will follow (Bandow, 2012; Laursen, 2012; Pollin, 2012).

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Over the years critics of Social Security have tried to dismantle the program through strategies of misinformation or exaggerated statements. Recently, Tanner (2011) contended that Social Security is nothing more than a criminal enterprise like a Ponzi scheme since it generates no investments and the current recipients rely on future contributors' ability to pay. Some have argued that the only reason the program has lasted this long is because workers were forced to pay higher and higher taxes over the years. They also point out that even though there are nominal interest earnings reserved for Social Security, they are generated by a worthless non-negotiable Treasury bond that cannot be sold or redeemed. As such, they believe that the only way to pay the full benefit is to either borrow or increase taxes (Bandow, 2012; Gokhale, 2010; John, 2011). Critics have declared that the system is now plummeting toward insolvency because it is presently paying out more than it brings in (since 2010), and if nothing is done about it, the trust fund will be depleted by 2033 (Bandow, 2012; Tanner 2011). To keep the program solvent for the next 75 years, they project that it will require an additional \$15 trillion or more to be financed through the federal budget, further contributing to an already unsustainable national debt burden. For decades, opponents of Social Security have reminded taxpayers that Social Security is broken and will not be there for them (Gokhale, 2010; Tanner, 2012).

Despite their claims, many of the critics' observations are erroneous. For instance, the critics of Social Security have overstated their case when they say Social Security is insolvent. Supporters point out that, in reality, Social Security has remained solvent not only because of increased taxes, but more importantly because more people have paid into the system than drawn out, creating a surplus. However, the Social Security program does face several challenges that need to be addressed. The Trustees of Social Security (2012) agree that both moderate and long-term financing solutions must be found to put the program on sound footing for the future. This paper discusses the structures and functions of the Social Security program and then considers policy options that are coherent with the current reality.

## Structure and Function of Social Security

### *Social Security is Self-Funded*

Social Security operates independently from the unified federal budget, with its own dedicated funds, even though it still appears under the unified federal budget for the purpose of accounting. Social Security is not a line-item expense in the federal budget. Unlike other government programs, it is authorized to spend only what income it is able to generate, primarily through payroll taxes and earned interests. The Social Security Administration (SSA) is prohibited from borrowing, thus it cannot deficit spend. When there are any shortfalls in the fund, the benefit is automatically reduced (U.S. Senate, 2010). From the beginning, Social Security has paid out everything it owes from its own resources; it has not borrowed a single penny from the government or anyone else. Hence, Social Security has nothing to do with the current, or any past, budget deficits or long-term federal debts.

Over the life of the program, Social Security has collected \$15.5 trillion and spent \$12.8 trillion, leaving about \$2.7 trillion in the reserve at the end of 2011 (National Academy of Social Insurance, 2012). The current federal budget deficit may have stemmed from tax cuts given to the wealthy, two unfunded wars, the Medicare drug program, high unemployment, the Wall Street bailout and other programs—certainly not from Social Security. Cutting Social Security benefits will not help the budget deficit; it will only hurt recipients who are now just getting by with modest benefits. Whereas, if unwarranted subsidies to special interest groups were cut today, it would lower the budget deficits by a corresponding amount immediately.

### *Social Security is an Insurance Program*

Social Security is more than a pension paid to support the income of retired workers. The program is designed also to insure and protect families. The Social Security program, also known as OASDI, covers survivors of deceased workers (about 6 million), disabled workers and their dependents (11 million), and retired workers and their dependents (38 million). All together about 1 out of 6 people, or 55 million, received some form of Social Security benefits in 2011 (The Board of Trustees, 2012).

Social Security is a relatively comprehensive insurance package that is designed to provide financial security and peace of mind at a relatively reasonable cost. Purchasing private insurance that would cover the full extent of Social Security protection would be cost-prohibitive for average wage earners. If a retired person at age 65 was to purchase a private annuity that paid \$1,230/month (2012 SS payout) with a cost-of-living increase, and which paid the widowed spouse for the rest of his or her life, that person would be expected to pay a lump sum of about \$430,000 (Thrift Savings Plan, 2012). Furthermore, a worker at age 30 with children would need to purchase about \$450,000 in life insurance and \$330,000 in disability insurance to receive the same protection as that provided by Social Security (Nicols, 2008). In all, beneficiaries typically get more from OASDI than they contribute to the system over their lifetime. For example, a one-earner couple earning an average of \$43,000 (2011 earnings) will contribute \$299,000 into the system, but the lifetime benefit will be \$448,000. This is typical of almost all earners except for single male earners and two earner couples who earn on the average of \$43,000 each (Steuerle & Rennane, 2011).

### *Cash Reserve not Critical*

Social Security outlay exceeded revenue at the end of 2010 and the costs of the program are projected to exceed income for the next 75 years (John, 2012), but the program is neither insolvent nor was this problem unanticipated. The detractors of the program have incorrectly concluded that the program had finally reached an intractable crisis as Social Security went "cash negative" in 2010. They also claim that funding will continue to deteriorate as baby boomers move into retirement (Bandow, 2012; John, 2012). It is true that a cash imbalance occurred sooner than was originally forecasted, but what is missed by the critics of Social Security is that even if no changes are made, it will continue to pay out full benefits in a timely manner for the next 20 or more years. Social Security has about \$2.7 trillion in the reserve, which will continue to grow to about \$3.1 trillion by 2021 (The Board of Trustees, 2012).

What is also missed by the critics is that the interest income earned each year from the reserve has helped the growth of the

trust fund. This interest income is guaranteed by the full faith and credit of the United States government. Together with payroll taxes and interest income, Social Security will continue to pay out in full until the reserve is finally exhausted in 2033. At that point, Social Security will continue to make payments because the current workers will keep paying into the system. Even if nothing is done today to make the program solvent for the next 75 years, Social Security will still be able to pay out benefits equal to 75% of the full amount by 2033 and at a 73% level by 2086 (The Board of Trustees, 2012). Given the widespread support of this program, it is highly unlikely that no action would be taken to make it solvent.

Operating “cash negative” is not an illegitimate or controversial practice among financial industries. The nation’s private pension system, for example, collected slightly less than it needed to pay out, but then used investment income to balance its operating costs (Burtless, 2011). Burtless (2011) notes that between the years 1985 and 2008, the private pension was “cash negative” in 23 out of 24 years, yet it was able to meet all of its obligations on the strength of \$4.5 trillion in earned investment income.

From 1937 to 1983, Social Security paid its own way primarily through payroll taxes with a limited reserve. In fact, in the first 47 years of the program, Social Security was “cash negative” for 21 years. Operating “cash negative” is not always an ideal practice, but it is not a hindrance either if there are other dedicated funds, like interest earnings, to meet the obligations. Historically, having a large trust fund for Social Security has been the exception rather than the rule. It was in 1983 that Social Security began building up a large reserve to address the immediate shortfall and to principally pre-fund benefits for the pending retirement of a large number of baby boomers (Burtless, 2011; Michel, Morrissey, & Ballantyne, 2012).

### *Benefits are Important to Seniors*

Social Security benefits are modest but do provide a base income for retired workers. The average retired worker at age 65 receives about \$1,230 per month, which does not provide a secure living but, when supplemented with an employer-based pension and personal savings, can maintain a decent

standard of living (The Board of Trustees, 2012). In the climate of economic downturns and ever-decreasing traditional defined-pension plans from employers, Social Security is increasingly becoming an important source of income for seniors.

The Social Security benefit is particularly important to retired low-wage workers for three compelling reasons. First, the program is designed to provide proportionally larger cash benefits to low-income retired workers, even though they contribute less than high-wage earners to Social Security taxes. This progressive redistributive feature has made it possible for retired low-income workers to maintain some degree of independence and dignity. This outcome is commonly measured by comparing a worker's pre-retirement income with the after retirement benefits, or the replacement rate. The Social Security benefit replaces about 55% of pre-retirement income to those who earned on the average \$19,400. The rate is about 41% for those with average earnings of \$43,000, about 34% for earnings of \$68,000, and about 27% for those who earn more than \$106,800 (The Board of Trustees, 2012).

Second, Social Security makes up a significant portion of seniors' incomes. Nearly two in three seniors get at least half of their income from Social Security, and one in three relies on Social Security for almost all of their income (SSA, 2012). Third, Social Security is one of the most effective anti-poverty programs for seniors. Ruffing (2012a), by using various 2010 government documents, calculated that Social Security has lifted nearly 14 million seniors out of poverty. Without Social Security, it is estimated that about 44% of seniors would be in poverty (U.S. Senate, 2010). Moreover, Social Security has kept about one million children and more than five million people in the 18-to-64 age group out of poverty. In all, Social Security has lifted about 20 million people out of poverty (Ruffing, 2012a).

While the Social Security program has helped countless people, it should be noted that there is a need for modernization of the program because of the changing demographics in our society. For instance, the program is inadequate in meeting the needs of the more vulnerable populations, such as low-income single workers, caregivers, and people who don't have a long work history for various reasons, or are lifetime low-income workers (United States Senate, 2010).

## Analysis of Proposed Options

In 2012, Social Security Trustees (2012) declared that policy-makers should take reasonable approaches to strengthen Social Security so that the program will have sufficient funds for the next 75 years and also to secure greater public confidence in the program. This, along with the mounting national debt, has resulted in a bipartisan call for cutting Social Security benefits to protect the program, even though Social Security is currently good for roughly two more decades and has not contributed to the national deficit in any degree. The most often stated recommendations are raising the retirement age, modifying the cost-of-living adjustment index (COLA), and privatizing the program.

### *Raising the Retirement Age*

Raising the retirement age has already generated economic hardships for seniors. Raising the retirement age from 65 to 66 has amounted to cutting the benefits by roughly 6–7%, and for those who must wait until 67 the loss will be about 13%. For example, by waiting to claim the benefit at 66 instead of 65, one's real benefit will be \$933 (if the base benefit was \$1000). The real benefit would be \$867 if seniors must wait until 67 to make a claim. Similarly, the penalty for choosing to apply for early benefits at age 62 will be steeper and the bonus received for claiming late benefits will be smaller (Ruffing & Van de Water, 2011). Further, raising the retirement age to 69 or 70 as recommended under the Bowles-Simpson plan would bring even greater economic hardship to seniors (Kingson & Morrissey, 2012; Ruffing, 2012b). Using a baseline of 67 as a retirement age which will phase in shortly, the 69-year-old retiree's real benefit would be cut by 14%, and 70-year-old retirees would see their real benefits cut by 20% (Ruffing & Van de Water, 2011).

Increasing the retirement age will also escalate income inequality among various income groups, since Social Security benefits will have a differential impact on overall household assets. By using the Federal Reserve Board's 2007 Survey of Consumer Finances, Rosnick and Baker (2012) show that the lowest wealth quintile of non-homeowner couples in the 35–44 age cohorts in 2012 will lose about 18% of their wealth, while



the top quintile will lose only 8%. These kinds of patterns displayed consistently when each cohort was compared to all other income cohorts. Any delay in Social Security benefits through increase in retirement age will have greater impact on the economic well-being of low to moderate income households, since Social Security income is the largest source of their wealth. Many low to moderate income families do not have pensions or savings, and any assets they may have accumulated over the years have disappeared with housing bubbles and market slides (Rosnick & Baker, 2012).

Ostensibly, proponents for raising the retirement age argue that the increase is warranted, since life expectancy has risen but retirement age has not (Gokhale, 2010). What they don't say is that overall life expectancy appears to be higher mainly because fewer children die today than 70 years ago. The life expectancy for seniors of earlier decades as compared with today's is not very different. Any real gains in life expectancy are largely made by high-income workers (6.5 years), whereas low-income workers gained less than two additional years of life expectancy (Rosnick, 2010). Therefore, the retirement age increase from 65 to 67 which is currently phasing in will mostly nullify any life expectancy gains made by low-income workers.

#### *Change the Cost of Living Adjustment (COLA) Index*

Changing the Cost-of-Living Adjustment (COLA) from Consumer Price Index (CPI-W) to CPI-U, or "chained" CPI, is economically harmful to seniors whose Social Security benefits have already dropped sizably by raising the retirement age. Supporters of this approach argue that the change will more accurately reflect the true cost of living (Reno, Bethell, & Walker, 2011; Reno & Walker, 2011). By changing the index, it is assumed that seniors will minimize the impact of inflation by making a different choice of similar products or purchasing dissimilar products in response to price changes, so that instead of purchasing a name brand toothpaste, they would purchase a no-name brand or choose to purchase food instead of fuel. If this assumption holds, the Chief Actuary of Social Security estimates that it can reduce about .3% in the cost-of-living pay schedule (U.S. Senate, 2010; Veghte, Reno, Bethell, & Walker, 2011).

Thus far, there is no evidence of shifting purchases taking place to hedge against inflation among seniors. Unlike average families who might more easily respond to price changes, seniors with a modest income already have limited purchasing options, as they pay out a bigger share of their income on health care. They not only spend two to three times more for health care now, but the price of health care is expected to continue to grow faster than other consumer products and services. Medicare Part B, for instance, grew more than 15 fold from \$7.20 in 1976 to \$115 in 2011, and it is not expect to level off anytime soon (Veghte et al., 2011).

If the switch from CPI-W to chained CPI takes place, it can be expected that all seniors will lose benefits immediately even though it is a modest .3% in the first year. However, it will be about 3% after 10 years, 6% after 20 years, and after 30 years, seniors would lose about 9%. Social Security income is a particularly large portion of total income for older seniors and any cut could decrease their standard of living substantially. The traditional COLA index adopted in 1972 to calculate Social Security benefits may have been an important factor in keeping seniors from falling into poverty and other economic hardships (Baker & Rosnick, 2011).

### *Privatize Social Security*

A full or partial privatization of Social Security was a flawed idea in 2005 and it is still a poor idea today. The proponents of privatization argue that workers would have more money in their retirement accounts if they put their money in the stock market rather than in the Social Security system. Tanner (2012) notes that real long-term investment in stocks has yielded almost a 7% return rate, so that if the hypothetical middle income earners had invested half of their payroll taxes in a private investment beginning in 1968, they would have received \$2,067 each month from investment income in 2011 instead of the \$1,338 Social Security payment. Low-income earners who did the same would receive \$1,096 investment income instead of \$891 from Social Security.

While private investment appears to be advantageous, this approach has two major concerns. One, the return on the private investment is often overstated. Krugman (2005) claims that when certain factors are taken into account (such as when

the market corrects itself, investment is diversified for safety, management fees are taken out, and the like), the real return rate might be about 2.7% rather than 7%—not much different than what one might get from the Social Security Treasury bill. Empirical evidence from the Chilean study seems to support Krugman's claim. Though Chile is a small economy compared to the United States, its experience shows that individual accounts invested in the market had little or no economic advantage over those who stayed in the traditional Social Security system. While individual accounts provided more economic benefit for mostly affluent workers, Social Security was a better option for low-income workers (Cerda, 2008; Dattalo, 2007; Laursen, 2012).

Two, having choices and a higher return on the investment is desirable, but it usually comes with higher risks and many uncertainties. Some may benefit from this arrangement, especially the fund managers and brokers, but the real risk is that many seniors may lose. Seniors must understand that the market is volatile and past market performance is no guarantee that it will continue to perform at the same rate. The market meltdown of 2008-2009 is instructive to all. A mistake made in the market can lead to economic devastation for seniors. Stiglitz (2005) believes that people who lack a proficient knowledge in the nuances of markets and financial instruments are vulnerable to making mistakes. The problem is compounded if they are misinformed or deceived. They then become susceptible to exploitation and may eventually end up losing assets they have already accumulated. Investing in the market is inherently risky. Any failed private investment account or severe stock market downturn would inevitably pull the government into bailing out liabilities created from such events as was the case in Great Britain. Stiglitz (2005) quips that if the stock market was safe and always would yield a promised high return, the federal debt could be wiped out in a few years by the government investing in the indexed stock exchange. Thus far, no one has advocated such a plan.

Table 1. Policy Options

Description	Income as % of Taxable Pay Role	% of Decrease in Shortfall
Raise Revenue		
Increase worker/employer tax by 1.1%	2.09	104
Increase worker/employer tax by 1% in 2022 and by additional 1% in 2052	2.06	103
Increase worker/employer tax by 1/20% annually over 20 years	1.39	69
Enhance collection of existing taxes	n/a	n/a
Broaden the Revenue Base		
Eliminate the cap (do not count additional earnings)	2.32	116
Eliminate the cap (count the earnings toward benefit)	1.89	95
Eliminate the cap (count the earnings toward benefit but use different formula)	2.17	108
Gradually restore the cap to cover 90% of earnings for workers and eliminate cap for employers	1.37	69
Gradually restore the cap to cover 90% of earnings	60	28
Extend coverage to newly hired non-covered state and local government workers	.17	9
Treat all salary reduction plans as income [e.g., 401(k)]	.25	12

Adapted from U. S. Senate Committee on Aging (2010).

### *Strengthening Social Security*

There are several workable options to strengthen Social Security. Turning the program into a private enterprise, reducing benefits through raising the retirement age, or switching the COLA index would not be the best approaches. There are other promising options. Raising revenue and broadening the revenue base are more reasonable policy options for strengthening the Social Security program without hurting those who rely on the program the most. Table 1 presents several notable options identified by the Special Committee on Aging of the United States Senate in 2010.

### *Raise Revenue*

The unfunded obligation of \$8.6 trillion over the next 75 years can be resolved with several variations of revenue increase or in combination with other options (The Board of Trustees, 2012; U.S. Senate, 2010). For instance, as seen in Table 1, increasing worker and employer payroll contributions by 1.1 % alone would be more than sufficient to take care of the entire shortfall for the next 75 years. Despite the clear-cut nature of this approach, in the current political environment any lump sum tax increase may not be acceptable. Therefore, to avoid any political opposition, it may be more agreeable to increase the tax rate at 1/20<sup>th</sup> of one percent for the next twenty years beginning in 2015. This would raise contributions by \$26.50 per year, or about 50 cents a week for average workers, and would cover the shortfall by 69% (U.S. Senate, 2010). Adjustments to make Social Security more viable are nothing new. Throughout the life of the program, timely tax increases have been put in place to meet the benefit obligations. Since the last tax increase took place in 1990, a small adjustment now would not be unreasonable (Baker & Rosnick, 2011; Reno & Walker, 2012).

### *Broadening Revenue Base*

Table 1 also shows that there are several ways the Social Security revenue base can be expanded to address the long-term financial shortfall. Though each has several positive features, one of the most fair and effective ways to settle the long-term shortfall is to rework the cap on taxable earnings, which is set at \$110,100 (The Board of Trustees, 2012). While there are several variations, gradually setting the cap to tax 90% of all

earnings will decrease the shortfall by about 28%. This would be sufficient to take care of any shortfall when combined with the incremental tax increase (1/20 of one percent) already suggested and/or other options identified in Table 1 (U.S. Senate, 2010).

In 1977 Congress authorized Social Security to broaden its revenue base by taxing 90% of all wages and providing for a cap to rise with inflation. Currently about 85% of all earnings are taxed instead of 90% because most of the income increase went to the top 6% of earners (Reich, 2011). In other words, most of the income increase went to those who were earning more than the \$110,100 cap; as a consequence, any income above the cap is not taxed. If the 90% taxing level is set now, the cap would be at about \$180,000 (Reich, 2011). The proposed plan would fully phase in over about 40 years, naturally with a different cap amount. Under the proposed plan, there would be no change for 94% of the people who are earning under the new cap (U.S. Senate, 2010). Raising the ceiling to generate additional revenue is a logical response to the concentration of wealth at the top. This approach is consistent with the intent of the Congress and is reasonably workable. Parenthetically, if a different option were chosen, such as eliminating the cap all together and not increasing the benefits on those additional contributions, it could be more than enough to make the program solvent for the next 75 years and beyond, but it may not be politically expedient. It is plain that adopting any of the available options or a combination of options found in Table 1 would effectively mend any long-term shortfalls found in Social Security.

## Conclusion

For nearly 78 years the Social Security program has paid out its financial obligations to seniors and qualified families with full fidelity in a timely manner within their budget structure. Therefore, unlike many federal programs, Social Security has not contributed to federal deficits or debts. In fact, over the years the federal government has used Social Security surplus funds to balance the budget, pay down debts, finance various federal programs, and to generally keep the other taxes low (Bergmann, 2005). After having benefited from the Social Security assets, the government should not blame Social

Security nor should it turn its back on the promise it made to pay back what it has borrowed from social security surplus funds. The government could come up with the revenue as needed either by levying additional taxes or cutting other programs. It is true that the program will face a sizable shortfall as the program moves into the next 75 years, but Social Security is neither broken nor in crisis. Social Security can be on solid footing for many years by making a few modest changes.

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