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# Who Will Brave the Third Rail?

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# Who Will Brave the Third Rail?

BY A.J. CATALDO, CMA, CPA, AND PETER F. OEHLERS, CMA, CPA

In this presidential election year, those competing for the top job will more than likely be faced with addressing an issue that has historically been referred to as a "third rail" issue—the continued funding and solvency of the Social Security system.

The "third rail" refers to the additional rail used in an electrified railroad, such as a subway, to provide power to the motor and cars. In politics, it's a metaphor that denotes an idea or topic so "charged" and "untouchable" that any politician or public official daring to broach the subject suffers politically. For a Hollywood-based illustration of what happens when contact is made with the "third rail" in a subway system, see the 1974 film, *The Taking of Pelham One Two Three*, where the character Mr. Blue, played by Robert Shaw, makes contact with the third rail of the New York City subway system and dies from electrocution.

## The Problem

Largely due to changing demographics and the aging of America's Baby Boomer generation, the Social Security system is facing eventual bankruptcy. While there might be slight variations in their projections, all sources agree that something must be done if the U.S. government is going to be able to continue providing Social Security and Medicare benefits to future generations. Here are some relevant points that illustrate the current situation:

- Social Security benefits constitute 90% of total income for approximately one-third of Americans over the age of 65.
- In 1950, there were 16 workers to support each Social Security beneficiary. In 2007, there were three to four workers to support each Social Security beneficiary. By the time today's youngest workers turn 65, there will be only two workers to support each beneficiary.
- Social Security benefits will exceed collections on or about 2017, less than 10 years from now.
- The shortfall will be approximately \$200 billion by 2017 and \$300 billion by 2033.
- By 2041, the Social Security system will be bankrupt.

## Possible Solutions

One solution to the looming financial crisis of the Social Security system is to increase the combined old-age, survivors, and disability insurance (OASDI) and hospitalization insurance (HI) rates from current levels, which are 6.2% and 1.45%, respectively (7.65% each for employee and employer; 15.3% for the self-employed). The Greenspan Commission on Social Security Reform, signed into law in 1983, solved the last Social Security crisis by providing for accelerated tax rate increases, increases in the retirement age, and the taxation of benefits. Since a modified replication of this solution involves an increase in taxes, however, it represents a "third rail" option.

Presently, the wage base, or "ceiling," for the Medicare component of Social Security (1.45% each for employer and employee; 2.9% for the self-employed) represents a flat tax. Prior to the elimination of the

Medicare component wage base, it represented a regressive tax. Medicare wage bases were increased in the early 1990s and eventually eliminated, beginning with the 1994 tax year. Therefore, a possible solution is to also raise, modify, or eliminate the wage base to which Social Security taxes (6.2%) apply (see Table 1). Elimination of the Social Security wage base would impact only the wealthiest 6%-7% of the population and would raise approximately $1.3 trillion over the first 10 years. Alternatively, an increase in the Social Security tax component, brought about by the elimination of the Social Security wage base, might be applied only to those taxpayers with earned incomes above some amount (e.g., $200,000).

Another option is to privatize all or some portion of Social Security contributions, presumably for younger workers, to generate higher returns to these beneficiaries upon retirement. This proposal is likely to be more popular during a rising stock market and less popular during a declining stock market. In recent months, the stock market has been in decline.

Contemporary liquidity problems and the failure of Bear Stearns, rising rates of home foreclosures, and ongoing subprime credit issues, along with interest rate reduction and credit-easing actions taken by the Federal Reserve to alleviate short-term stock market volatility, create an uncertain economic environment. While the long-term returns for the stock market may have provided for a historically higher rate of return when compared to that otherwise generated for Social Security beneficiaries, there's no assurance that what has held true for the past will continue in the future.

Table 1. **Social Security Wage Base by Year**

| Tax Year | Wage Base | Tax Year | Wage Base |
|---|---|---|---|
| 1937-50 | $ 3,000 | 1988 | $ 45,000 |
| 1951-54 | $ 3,600 | 1989 | $ 48,000 |
| 1955-58 | $ 4,200 | 1990 | $ 51,300 |
| 1959-65 | $ 4,800 | 1991 | $ 53,400 |
| 1966-67 | $ 6,600 | 1992 | $ 55,500 |
| 1968-71 | $ 7,800 | 1993 | $ 57,600 |
| 1972 | $ 9,000 | 1994 | $ 60,600 |
| 1973 | $10,800 | 1995 | $ 61,200 |
| 1974 | $13,200 | 1996 | $ 62,700 |
| 1975 | $14,100 | 1997 | $ 65,400 |
| 1976 | $15,300 | 1998 | $ 68,400 |
| 1977 | $16,500 | 1999 | $ 72,600 |
| 1978 | $17,700 | 2000 | $ 76,200 |
| 1979 | $22,900 | 2001 | $ 80,400 |
| 1980 | $25,900 | 2002 | $ 84,900 |
| 1981 | $29,700 | 2003 | $ 87,000 |
| 1982 | $32,400 | 2004 | $ 87,900 |
| 1983 | $35,700 | 2005 | $ 90,000 |
| 1984 | $37,800 | 2006 | $ 94,200 |
| 1985 | $39,600 | 2007 | $ 97,500 |
| 1986 | $42,000 | 2008 | $102,000 |
| 1987 | $43,800 | | |

## Defining Social Security

Criticisms and questions present themselves for all options:

- Is Social Security to remain an insurance policy or a retirement savings plan?
- Should those who contribute more receive a greater benefit or consider it a contribution toward their fellow citizen?
- Would the elimination of the Social Security wage base represent a disincentive for those receiving wages to perform at a higher level?
- Will high-income earners attempt to bypass the Social Security system by restructuring their individual compensation schemes for this purpose?

These aren't easy questions, and public debate and a dialogue will be necessary. But the question remains—which politician will brave the "third rail"? ■

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