Social Security Q&A

How Big Is the Problem, and How Good Are the Potential Solutions?

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What's the matter with Social Security? The fundamental problem is demographic. In 1960, there were five workers for every Social Security beneficiary. Today there are slightly more than three. In 30 years, there will be only two. That means fewer tax-paying workers to support more benefit-receiving retirees.

If tax rates and benefits remain as they are under current law, the system will begin paying out more in benefits than it collects in taxes around 2018, according to Social Security actuaries.

Today, Social Security collects more in taxes than it spends in benefits. It invests the surplus in U.S. Treasury bonds to be cashed in when the big baby boom generation retires, a way of prefunding their benefits. Cashing in bonds will allow the system to pay promised benefits until about 2042 or 2052. If changes aren't made sooner, benefits at that point would have to be cut about 30% so they don't exceed revenue devoted to the program.

A typical worker born during the 2000s is promised about $24,300 (in today's dollars) in initial Social Security benefits at retirement, the Congressional Budget Office estimates, but there would be money to pay only $18,300.

Important Questions

So what's the urgency? Although Social Security can pay promised benefits for many years, changing retirement programs abruptly is a bad idea. Workers need time to save more from their paychecks if government benefits are to be reduced, and they deserve notice about changes to the retirement age.

President Bush and members of Congress are promising that any changes they make will leave current retirees largely untouched; the same goes for workers older than 55. But the longer the government delays, the bigger the eventual tax increases or benefit cuts have to be.

Over 75 years, the usual time horizon for Social Security forecasts, the agency's actuaries say the government has made promises that cost about $3.7 trillion (in today's dollars) more than projected tax revenue. Some critics say the Social Security actuaries are too pessimistic, particularly in forecasts about the pace of economic growth and immigration. Others counter that the trustees' expectations about life spans underestimate medical progress; if they're wrong on that, the hole is bigger.

How big a tax increase would stabilize Social Security?
Social Security today depends on the payroll tax, income taxes collected on benefits paid to the highest-income elderly and interest on government bonds held by the agency. The system could be financed by other federal taxes. An immediate increase in the payroll tax--from today's 12.4% on wages to about 13.9%--would stabilize the system for 75 years, according to Social Security's trustees.

The tax rate would have to go much higher if the increase were phased in over several years. Today's payroll tax applies only to the first $90,000 of wages, a ceiling adjusted annually for inflation. An alternative to higher tax rates is moving the ceiling to $140,000 over a decade--which would solve about 40% of Social Security's problem.

How much would benefits have to be cut to stabilize the program for 75 years? The Social Security trustees say it would take an immediate and permanent reduction in benefits of 13%. If the changes were phased in gradually, the cuts would have to be bigger. And fixing the program so it would be sustainable after 75 years would take even bigger changes.

There are lots of ways to reduce benefits promised by current law. The formula used to calculate a retiree's initial benefit could be altered. The annual cost-of-living adjustment could be reduced. The age of eligibility for full benefits could be increased. Benefits for upper-income retirees could be reduced.

Potential Solutions

What is President Bush proposing? Nothing specific yet. He has ruled out raising taxes and insists on private accounts. Aides make clear that he will also seek other reductions in benefits from levels promised in current law.

The White House has praised an option crafted by a commission Mr. Bush appointed in his first term. This plan would allow workers to divert part of their payroll taxes—up to $1,000 a year--into private retirement accounts, in exchange for accepting smaller Social Security benefits in the future. It would also reduce Social Security benefits promised to all future retirees. And to help people at the bottom, it would sweeten benefits promised to some low-wage and disabled workers and widows.

What would private accounts do to stabilize Social Security's finances? In the short run, they would cause a problem. Social Security depends on taxes paid by today's workers to pay today's retirees. If those taxes are diverted to private accounts, then the government has to find another way to cover those retirees' benefits. Mr. Bush proposes to bor-

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row the money, perhaps $1 trillion or $2 trillion over 10 years.

Over the long run, private accounts are a wash, at best, for the system. Diverting payroll taxes to private accounts would reduce the flow of tax money into the system in exchange for reducing government benefits when workers with private accounts retire. That's why the White House, to the consternation of some Republicans, says the president will seek other money-saving changes to the program.

But for individuals, accepting smaller government benefits in exchange for the right to divert some payroll taxes to a private account could be a winner. If the stock and bond markets do well, growing private accounts could offset some of the likely cuts in government benefits. But if markets do poorly, workers would be expected to absorb the losses.

What are the leading alternatives to Mr. Bush's proposal? Economists Peter Diamond and Peter Orszag offer a detailed plan to raise the payroll tax rate to 14.2% (split between employer and employee) by 2055, increase the base on which taxes are levied, lift the age for the full retirement benefit, and trim benefits for higher-income recipients while increasing them for low-income workers.

Sen. Lindsey Graham, a South Carolina Republican, would offer workers under age 55 a choice: Stay in today's Social Security program and pay two percentage points more in payroll taxes or accept lower benefits or divert four percentage points of payroll taxes into a personal account.

Two other Republicans, Rep. Paul Ryan of Wisconsin and Sen. John Sununu of New Hampshire, would allow workers to divert an average of 6.4% of wages to private accounts in exchange for accepting lower benefits. They say they would guarantee that all workers would get at least as much from combined government benefits and personal accounts as Social Security promises today. To pay for all this, they vow to restrain the growth in other government spending and count on a tax windfall from the added saving and corporate investment generated by private accounts.

What is the Social Security trust fund? The trust fund is an accounting device, but one with enormous political significance. Franklin D. Roosevelt wanted a program that workers would see not as a welfare program, but as one into which they made contributions and got old-age pensions. The creation of a Social Security trust fund in 1939 to serve as a holding pen for worker contributions solidified this notion.

Social Security revenues began to exceed benefits after 1983 when President Reagan and Congress increased payroll taxes, reduced benefits and began a gradual increase (to age 67) in the age at which workers are eligible for full benefits. Last year, Social Security collected $151.1 billion more in taxes and interest than it paid out.

The growing Social Security trust fund, now about $1.5 trillion, is invested in interest-paying U.S. Treasury bonds, or, essentially, lent to the rest of the government.

If investing retirement funds in the stock market is such a good idea, why not invest the trust fund in the market? President Clinton proposed just that, arguing that the higher returns on stocks would help solve the Social Security financial problem. And the idea continues to circulate. But opponents fear it would lead inevitably to undesirable government interference in business.

Who Gets Social Security?

Four Examples of Who Benefits From This Government Program

BY CHRISTOPHER CONKEY AND JESSICA MINTZ
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Social Security is more than just a retirement program. Today, one in every six Americans--47.7 million people in all--receive Social Security benefits. They include not only retirees, but also their dependents, survivors of deceased workers, disabled people and their dependents. Here are four examples:

A Cushion

Eighty-year-old Fred Schofield has been collecting Social Security for 13 years, ever since he retired at age 67 from a job as financial vice president at an electrical-apparatus repair firm. He and his wife, Dorothy, age 74, collect about $3,300 a month in Social Security, but that's far from their only income. Mr. Schofield rolled his pension plan into an Individual Retirement Account. His wife has one, too. Combined, the two accounts amount to some $700,000, from which the couple draws out about $34,000 a year.

Mrs. Schofield still works full-time as an office manager at the law firm she joined 50 years ago. "We're pretty well set," Mr. Schofield says. Like other couples in their circumstances, earning taxable income of more than $44,000 a year, the Schofields pay federal income tax on 85% of their Social Security benefits as well as their other income. Their expenses go mostly toward medical and dental care, their family and transportation.

While Social Security makes up an important part of the Schofields' income, Mr. Schofield figures he could survive without it, given his savings, his wife's income and support from his children, if he needed it. Poor people need Social Security more than he does, he notes.

A Lifeline

Edward Valick, 67 years old, depends on his Social Security check as his only source of income, as do 20% of the system's beneficiaries age 65 and over.

Throughout an up-and-down career selling used cars and vacuum cleaners in upstate New York, Mr. Valick says he and his wife saved what they could but were never able to purchase health insurance. "What we were putting away was for retirement," he says. "But it didn't work out that way."

Mr. Valick lost his wife to cancer in 1993. The medical bills drained his savings and eventually he declared bankruptcy. In 2000, he retired and moved into a government-subsidized retirement community in Pensacola, Fla., to be near family. Each month, Mr. Valick gets a check for $599 from Social Security, of which $113 goes for rent. His sister and their 92-year-old mother live in separate units on floors above him.

Mr. Valick's health care is covered by the government's Medicaid and Medicare programs. "If it wasn't for that, I couldn't exist," he says.

A Safety Net

The wear-and-tear of 30 years in carpentry caught up with Stuart Dicker in 2001. He began receiving a monthly Social Security check because physical disabilities prevented him from working.

Mr. Dicker, 59, spent 22 years as a millman. In 1992, he set out on his own. Over time, a condition known as joint deterioration began to limit his ability to stand, kneel and lift, until he was forced to get his hips replaced, starting in 2001. A dangerously low heartbeat complicated matters. Doctors implanted a pacemaker in 2004. "I never meant to be in this circumstance," Mr. Dicker says. "I figured I'd be working until I was at least 62."

Nearly 17% of Social Security's beneficiaries are disabled workers or their dependents. A $400-a-month pension benefit from his carpenters' union, plus $1,389 a month in disability benefits, provide Mr. Dicker with annual income of roughly $21,000. Medicare cuts his health-care expenses to less than $200 per month. He's able to pay a $227 monthly car loan and the $600 mortgage on a two-bedroom house in Sacramento, Calif.

Divorced in 1990, Mr. Dicker has two adult children and a daughter in high school. Like other children of disabled beneficiaries, his daughter will continue to receive about $400 a month in Social Security benefits until she graduates, he says. Mr. Dicker's disability benefit will continue for as long as he lives, provided he continues to qualify.

A Bridge to Adulthood

Amanda Sonnega was 17 when her mother died. Her father, a pharmaceutical sales representative, "was working hard trying to make up her income," but it wasn't enough, says Ms. Sonnega, now 41. She couldn't keep paying tuition at Hamilton College, a private school in Clinton, N.Y., where she had just finished her freshman year. Social Security survivor benefits, about $400 a month, were enough for her to transfer to Drew University, Madison, N.J., where she finished a degree in psychology.

About 6.7 million survivors of deceased workers collect such benefits today, many of them children. Children of deceased workers can get benefits until they reach the age of 18 (or, if they are in school, 19). Survivor benefits also may be paid to parents, if the deceased worker paid half their support, and to spouses, when they reach retirement age.

Ms. Sonnega, who now lives in Plymouth, Mich., remembers what it felt like when the envelope arrived from Social Security each month. "I remember getting those checks and taking them right to the bank account. What a good feeling to have some money ... to be able to write that check when it was needed, money for books" and tuition.