Fixing Social Security- Once and For All

Chances are you know that the Social Security trust fund is due to run out of money—or "deplete its reserves" as economists put it—by the year 2035. The actual time frame depends on some forecasts, including economic growth, number of workers who remain in the workforce and the number who retire—but the clear point is that Congress is going to have to take action in the next few years if it wants to prevent a lot of angry seniors from heading vengefully to the polls.

What would happen if no action was taken and the trust fund were depleted? Right now, there is a surplus of funds above what is needed to pay current retirees. Each year, the Social Security system collects FICA taxes from American workers, which comes to about 10.6% of earnings, and pays out somewhat more than that amount to Social Security beneficiaries—in the form of the checks that were promised. It is the difference between the amount collected and the amount being paid out—currently about 3.7 percentage points—that is moving us toward a crisis.

Once the trust fund can no longer make up the difference, Social Security recipients would simply receive, however much was collected by workers. Based on those same complex economic projections, economists guesstimate that this will be about 25% lower than the Social Security benefits that people had been promised and expecting.

A new paper prepared by the Center for Retirement Research at Boston College offers Congress a few choices when they finally decide to perform surgery on the nation's retirement program. The paper focuses on the difference between what is paid out and what is collected, and says that this difference is due to "Social Security's Missing Trust Fund"—a pool of assets that should have been set aside at the outset to generate enough interest to make up the difference. The paper suggests various ways to create a Missing Trust Fund of roughly $2.7 trillion.

One is to raise the payroll tax rate on existing workers. The calculations say that Social Security can be restored to full self-sufficiency in 75 years if the payroll tax were raised on all workers by 6.5 percentage points. If you wanted to take a more gradual approach, the payroll tax could be raised by just 4.5 percentage points over the next 150 years. In both cases, the payroll tax could then be restored to current levels going forward.

The paper looks at not only raising the payroll tax, but also eliminating the cap on how much of a person's income is subject to FICA taxes. (Currently, only the first $132,900 is subject to the tax). In that case, the payroll taxes would only have to be raised by 5.3 percentage points (for a 75-year solution) or 3.7 percentage points (for a 150-year solution). Again, after that time period, both the tax rate and the inflation-indexed income limit would be restored.

Finally, the paper looked at raising income taxes to help fund Social Security's Missing Trust Fund. According to its calculations, simply raising the payroll tax would force the top quartile of workers to take on 54% of the burden of restoring Social Security back to solvency, compared with 29% for the second quartile, 13% for the third and 4% for the bottom quartile. Raising the payroll tax plus eliminating the cap on income would shift those figures to 65% (top quartile), 22%, 10% and 3%. Raising income taxes plus the payroll tax plus eliminating the income cap would throw 84% of funding the Missing Trust Fund into the collective lap of top quartile earners, with the second, third and bottom quartiles shouldering 12%, 4% and 1% of the burden, respectively.

Which of these will Congress adopt? Will it act at all? The debate is worth watching as the Presidential race heats up—and now you know the most workable proposals that are likely to be discussed.

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