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Is the Future of Social Security "Secure"?

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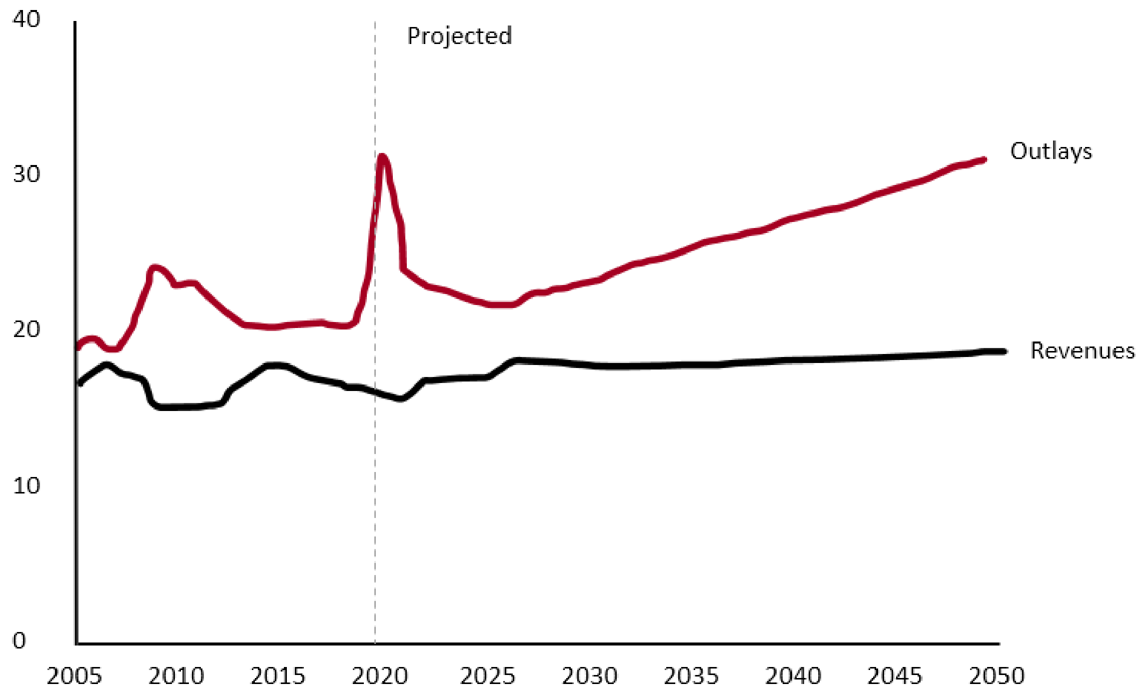
The routine of the American worker is relatively simple: Get up. Go to work. Go home. Wake up the next morning and do it all over again. They are compensated for the work they do either by the hour or bi-monthly and use that income to finance whatever type of lifestyle they choose to lead. They fall into a routine. What happens when—around the age of 65—that routine comes to an end? Most people head into retirement with hobbies they'd like to explore, clubs to join, or trips they'd like to take. But how do they prepare financially? In addition to pension plans, 401Ks, and independent savings, Social Security is a major source of income for retirees. Coincidentally, demographic changes have disrupted the "routine" under which the Social Security Administration has traditionally operated. Unless there is significant legal reform to our current Social Security System, it is not prudent for younger and future generations to bet on Social Security.

The United States currently operates under what is referred to as a pay-as-you-go system. Workers and employers pay Social Security taxes to finance benefits for retirees (OASI) and workers who become disabled before they reach retirement age (DI). This program did not always exist; It was created shortly after the Great Depression to provide workers with some sort of income to retire with. Between 1929 and 1932, national income dropped by 43%, and the unemployment rate reached 34% for the industrial workforce. Workers' savings were wiped out and there was little question that the government needed to intervene.

While the situation for modern-day Americans is not nearly that dire, the need for financial assistance among retirees is still prevalent. In FY 2020, 65 million people received Social Security benefits, which totaled over $1 trillion and 25% of federal spending. Social Security tax revenue amounted to roughly $965 billion. Currently, there are far more benefits being distributed than revenue being collected. This deficit is projected to become even more severe.



To finance this deficit, the Social Security Administration (SSA) has been investing Social Security tax surpluses from previous years into US Treasury Securities. This investment became a "trust fund" for the Administration, and the accrued interest has historically been enough to cover the deficit each year. However, 2021 was the first year the SSA had to dip into the principal in addition to the interest in order to cover the gap. If the need for additional financing continues under current legislation, the SSA projects the fund will be depleted by 2035. The Congressional Budget Office has a more conservative estimate of 2031. The fund's depletion does not mean that Social Security goes away—it means that future retirees will be receiving a fraction of the benefits they were promised.

Demographic changes in the United States are largely to blame for this sizable deficit; Americans are living longer and having less kids than the historical average. This shift, combined with the retirement of the Baby Boomers, has caused the financial needs of the retirees to be greater than the amount of money the workers can supply. As of 2018, 16% of the population was at retirement age and 62% was working age. By 2060, the retirement age percentage of the population is expected to rise to 23%, and the working age to fall to 57%, thus exacerbating the problem.

The notion that an investment has been accumulating for over 85 years could be depleted in the next 15 years is unsettling. That being said, it is worth exploring potential solutions to this impending issue. To ensure the pay-as-you-go system runs effectively, one possible solution for the SSA is to reduce benefits by promising less assistance to increase the retirement age. Another course of action could be to increase the Social Security tax or increase the maximum taxable earnings rate, which was $142,800 in 2021. When estimating future benefits and tax rates, the Administration should consider the population growth rate and monitor it on a year-by-year or decade-by-decade basis. That way, it remains flexible in the midst of a changing population and is comprised of metrics that accurately reflect the people it is trying to care for.

If the pay-as you-go system is no longer deemed viable, transitioning to a fully funded system is an attractive alternative. Under a fully funded system, each worker saves for their own retirement in their own accounts. These accounts can be run privately, publicly or a mix of the two. This system gives the individual control over the level of financial comfort they experience in their retirement, and they can independently dictate their pattern of consumption throughout their lifetime. This system does present a moral hazard in that you must account for the people that choose not to save at all. To mitigate this risk, the government should implement a minimum savings requirement that is calculated based on the minimum wage of the state in which the worker is employed.

A fully funded system sounds logical in theory, but the path to implementation is rather complex. The program would need to be structured so that it would cover disability insurance as well as the possibility that retirees would outlive their savings. The switching costs that are associated with transitioning from a pay-as-you-go system to a privatized system is significant as well because the current retirees and workers nearing retirement did not have a chance to save would still need some sort of financial assistance. A possible template lies in Chile, an example of a privatized system that funded its transition (and the workers that paid for the old system but did not have a chance to set aside sufficient savings) by making significant cuts to public spending, increasing taxes, cutting benefits, selling government assets, and issuing debt.

There is no quick fix when it comes to addressing Social Security. The unfortunate reality is that time to create change and reform the program is running low. The most important thing is to approach the issue with the best interest of retirees, workers, and America at heart. Easy task, right?