WHY SAVE SOCIAL SECURITY? WE HAVE NO CHOICE!

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ABSTRACT

This paper details several adjustments that could be considered to lengthen the solvency and increase the viability of the Social Security program. Of course, it may take some combination of these adjustments to resolve the issues. While arguments for or against any specific possible change may be given, we do not propose to argue the politics of any specific adjustment. However, adjustments made sooner rather than later will require less pain for those funding the benefits and/or for those receiving the benefits.

Keywords: Social Security, Solvency, Adjustments to fix Social Security

INTRODUCTION

There can be no question that caring for our aging population is an issue of global magnitude. Scientific advancements in medical care, nutrition, and living conditions have led to an exploding senior population such that, by the time we reach the middle of the 21st Century, the number of seniors will exceed the number of young people for the first time in the history of the world [2]. At the same time, the great experiment with employer sponsored defined benefit pension plans that most thought in the 1960s would be the panacea to the nation's retirement problems did not pan out. Furthermore, while wise individuals who are healthy, educated, and endowed with the necessary talents may take advantage of employer-sponsored 401(k) or 403(b) plans along with personal savings and investments, which can easily provide for their own retirement, they are clearly not in the majority. In spite of these opportunities, more than half of those reaching full retirement age (FRA) today have less than $100,000 in personal accounts [3].

Because of the lack of success of these other avenues for supporting our aging senior population, the responsibility falls upon the Social Security system that has been the most successful government program since its inception in 1935; during that period of more than 80 years, only four times have revenues not exceeded expenditures [14]. While we argue that due to the above issues our fail-safe Social Security program will not disappear, we do acknowledge, however, that unless changes are made to the way the Social Security system is currently being funded and benefits are being distributed, the program would not have a long-term survival. Fortunately, we do not have to fear that task is impossible. For example, if, in order to receive benefits, people would have to: (1) provide evidence of the inability to secure employment or to continue in a self-employed occupation, and (2) also demonstrate that they did not have the personal resources to completely provide a modest but comfortable lifestyle for themselves, no other adjustments would have to be made. This "means test" alone would make the program financially viable for the foreseeable future. Of course, we believe that such a drastic change will not be necessary. There appear to be a plethora of potential changes and tweaks that can continue the financial stability of the program as it provides Social Security benefits for the purpose originally envisioned when it was enacted in 1935. In this paper, we explore how several such changes might be considered.

THE CURRENT SOCIAL SECURITY SITUATION

Social Security taxes are used to pay Social Security benefits to those who are retired or disabled and to those who are surviving dependents. Those who are employed pay 6.2% of their compensation, up to a maximum earnings base each year ($127,200 for 2017) for Social Security taxes [1]. The employer matches this tax, so the total remitted to the government is 12.4% of compensation, up to the maximum earnings base [1][13]. Self-employed individuals are treated as both the employee and the employer, so they pay 12.4% of their net earnings from self-employment, up to the maximum earnings base each year [13] for Social Security taxes [1].

Because of declining birth rates over many years and increasing life spans, the amounts collected in taxes will not be enough to pay future promised Social Security benefits under current laws. Projections vary, but the Social Security Administration estimates that Social Security's total income will exceed its total costs through 2021. However, after that, annual deficits will occur, funded by interest income and a redemption of trust fund assets. The estimate for the depletion of the trust fund assets is 2034. Starting then, without legislative changes to either taxes received or benefits paid, projected revenues will be able to cover only approximately 75% of the projected benefits [9]. Adjustments to the Social Security program have been made over time to strengthen its financial viability [4]. It is apparent that additional adjustments are needed. Common sense tells us that the sooner adjustments are legislated, the less drastic the adjustments will need to be. However, it seems that adjusting Social Security is a political hot potato that politicians are unwilling to work on. This paper details several adjustments that could be considered to lengthen the solvency and increase the viability of the Social Security program. Of course, it may take some combination of these adjustments to resolve the issues. While arguments for or against any specific possible change may be given, we do not propose to argue the politics of any specific adjustment.

PERSPECTIVES ON SOCIAL SECURITY

While many view Social Security as a government-sponsored retirement program, assuming they are supposed to get back what they paid in plus earnings, it is also a welfare and insurance program designed to provide some minimum income during retirement years to those covered by the program. Depending on an individual's lifespan, his/her marriage and family status, and other factors, there may be anywhere from no benefits to significant benefits that are paid after the individual's death. Therefore, an individual may pay Social Security taxes for many years and never receive any benefits from the program. Others may receive benefits for extended retirement periods, with survivor's benefits also paid after death.

No matter which view a person takes—that the Social Security program is a retirement program, an insurance program, or a welfare program—it is obvious that it fits within what we call entitlement programs: people feel the government has made promises to them based on their past payment of these taxes over time. However, the government does not have unlimited funding, even for programs viewed as entitlements. Therefore, it makes sense for the government to make sure its entitlement programs are sustainable or that appropriate adjustments are legislated and phased in over time to allow change in individuals' expectations of their taxes and their entitlements.

POSSIBLE ADJUSTMENTS TO SOCIAL SECUIRTY TAXES AND BENEFITS

The Social Security Administration website includes "A Summary of the 2017 Annual Reports: Social Security and Medicare Boards of Trustees." In this summary, the boards admit to the solvency problems mentioned above, along with the need for action to be taken:

> Both Social Security and Medicare face long-term financing shortfalls under currently scheduled benefits and financing. Lawmakers have a broad continuum of policy options that would close or reduce the long-term financing shortfall of both programs. The Trustees recommend that lawmakers take action sooner rather than later to address these shortfalls, so that a broader range of solutions can be considered and more time will be available to phase in changes while giving the public adequate time to prepare. Earlier action will also help elected officials minimize adverse impacts on vulnerable populations, including lower-income workers and people already dependent on program benefits [9].

Adjustments to the financing and benefits of the Social Security program could be made in three major areas: (1) various factors affecting the employment taxes collected, (2) various factors affecting the benefits paid, and (3) various factors affecting the taxability of Social Security benefits paid.

Employment Taxes

Social Security Tax Rate. The original Social Security tax rate was 1%, but it has increased over time. Since 1990, the rate has been 6.2% each for the employee and the employer, except that for 2011 and 2012 the employee portion was reduced by 2% [1][8]. With the long history of a constant rate and the fact that tax increases are not popular, it may be difficult to increase this rate. However, increasing the tax rate would certainly increase the revenues available to fund Social Security benefits.

Maximum Earnings Base. From the inception of the Social Security program, there has been a maximum earnings base on which the Social Security tax has been levied. The earnings based started out at $3,000 when Social Security taxes were first collected but has been increased over time, either directly by legislation or through legislated indexing [8][13]. The maximum earnings base for 2017 is $127,200 [10]. While this earnings base is increased over time through indexing, it could be increased legislatively more quickly than it would be by indexing. Proposals have even been made to eliminate the maximum earnings base for the Social Security tax as was done with the Medicare tax maximum earnings base in 1994 [8]. Federal income taxes are progressive; higher tax rates are charged for higher income brackets. However, the Social Security tax is a regressive tax; as income increases (beyond the maximum earnings base), the rate drops from 6.2% for employees (12.4% for those who are self-employed) to 0%. This regressive tax makes sense if Social Security is considered a retirement program, because individuals are only taxed on income for which they will receive benefits. However, if Social Security is considered more of a welfare program, perhaps a regressive tax, more onerous to low-income taxpayers, is not as appropriate. Eliminating or reducing the regressivity of the Social Security tax could increase Social Security revenues.

Corrected Net Earnings from Self-Employment. Smith and Smith [6][7] demonstrated how net earnings from self-employment (NESE) is miscalculated using current tax laws. Because of this miscalculation, NESE and self-employment taxes are both understated. The self-employment tax rates (12.4% for Social Security and 2.9% for Medicare) are double the employee rates for employment taxes (6.2% for Social Security and 1.45% for Medicare) because employers match the amounts paid by employees, and those who are self-employed are treated as both the employee and the employer. Current tax laws allow those who are self-employed to multiply their earnings from self-employment by 92.35% in calculating NESE. They then pay the self-employment taxes on the NESE calculated.

This reduction in calculating NESE was legislated because employees do not have to pay employment taxes on the employment taxes paid by their employer, so it makes sense that those who are self-employed should not have to pay self-employment taxes on the amounts representing the employer’s share of the self-employment taxes [12]. However, the legislated reduction is not mathematically consistent with this argument. In calculating the correct NESE for amounts below the Social Security maximum earnings base, the formula should divide by 1.0765 [1 + 7.65%] rather than multiply by 0.9235 [1 – 7.65%], as these are not mathematically equivalent. The mathematical inconsistency gets even worse for amounts above the Social Security maximum earnings base, as NESE is still calculated by multiplying by 92.35%. However, the 6.2% Social Security tax is not levied for amounts beyond the maximum earnings base, so reducing the earnings from self-employment by 7.65% no longer makes sense, as the employer's share of the self-employment tax for amounts above the earnings base would only be 1.45% (the Medicare portion). Because the current law understates self-employment income, whether or not the individual also has employee income, collections for Social Security taxes would increase if the law were changed to calculate NESE in a way that is mathematically consistent with the argument for the adjustment.

Treat Employer of Self-Employed as Separate Employer. While the Social Security maximum earnings base for an individual employee is set for any given calendar year ($127,200 in 2017), if an employee has two employers (or more), the employers combined can pay more than 6.2% of $127,200 for this individual for a given year. For example, if an employee has two employers during 2017, with each employer paying this individual $75,000, the employee will have $4,650 [6.2% x $75,000] withheld by each employer and then matched by each employer. In total, this individual will have had too much withheld for Social Security taxes for the year—$9,300 instead of $7,886.40 [6.2% x $127,200]—but will be able to get the excess back when filing an income tax return for the year. However, even though the employers combined have paid more than the annual maximum for this individual, they cannot get any excess back, as the employer portion of the Social Security tax is for each employee of each employer.

However, someone who is both an employee and self-employed is treated differently. Even though the individual pays self-employment taxes for both the employee and employer portions, the employer of the self-employed is treated as an extension of the employer of the employee rather than as a completely separate employer [5]. For example, if someone has $100,000 of employee income and $50,000 of NESE, the self-employment taxes, both the employee portion and the employer portion, are only paid on the NESE up to the maximum earnings base in total. In this case, self-employment taxes would only be paid on $27,200 of the $50,000 of NESE. While it makes sense that the employee portion of the Social Security would only be paid up the maximum earnings base in total, laws could be changed to treat the employer of a self-employed individual as a completely separate employer. This change would make the employer of the self-employed individual liable for the Social Security tax up to the maximum earnings base for all NESE, not just the amount up to the maximum earnings base when combined with employee income. While this could be a large tax increase for some of those who are both employed and self-employed, it might be a more consistent treatment of multiple employers. It would also increase the amount of Social Security tax generated to pay Social Security benefits [5].

Social Security Benefits

Social Security benefits include retirement benefits, survivor benefits, and disability benefits. While survivor and disability benefits are very helpful to those who qualify, the focus here will be on retirement benefits. However, survivor benefits are, to some extent, calculated using the retirement benefits earned by an employee, so the focus on retirement benefits might be appropriate.

Social Security retirement benefits are calculated using a worker's average indexed monthly earnings (AIME). The highest 35 years of earnings (with the maximum amount per year being the maximum earnings base for that year) are indexed and used to calculate this amount, which is then used to calculate the primary insurance amount (PIA). The PIA is calculated using three set percentages multiplied by different brackets of the AIME. If someone first becomes eligible for Social Security benefits (turns 62) in 2017, the bend points for calculating PIA are $885 and $5,336. The PIA for this individual would be 90% of the first $885 of AIME plus 32% of the amount of AIME in excess of $885 up to $5,336, plus 15% of the AIME in excess of $5,336. As a specific example, if someone turns 62 in 2017 and has AIME of $8,000, the PIA would be $2,620.42 [(90% x $885) + (32% x ($5,336 - $885)) + (15% x ($8,000 - $5,336))]. The PIA is the amount of benefit the individual would receive monthly if retirement takes place at the full retirement age (FRA).

FRA was 65 up until 1983. FRA is the age at which someone who retires can take full Social Security retirement benefits without any reduction. However, individuals can elect early retirement benefits as early as age 62 (with a reduction in benefits for taking them early) or late retirement benefits as late as age 70 (with an increase in benefits for postponing them). In 1983, an increased FRA was phased in over time, but this increase in FRA did not affect those who were already 45 or older, giving those who were younger and would be affected by the increased FRA more time to prepare. The FRA gradually rises to age 67 for those born in 1960 and after. The options for early retirement benefits or late retirement benefits still exist, but the discount for early retirement benefits is larger for someone with a FRA later than 65, and the increase in benefits for postponing them is smaller for someone who has a later FRA, because this individual can't postpone the benefits as long before reaching age 70.

Increase FRA. FRA has been increased over time up to age 67. An additional phased-in increase in the FRA could be considered.

Change Early Retirement Age. With or without an increase in FRA, a change in the early retirement age could also be considered. If a phased-in increase in the early retirement age were made, retirement benefits under the Social Security program would be reduced.

Change Early Retirement Discount. When someone retires early, the amount paid is discounted for the time benefits are received before the FRA. If the discount were adjusted, it is possible that fewer retirement benefits would be paid.

Change Latest Retirement Age. If individuals are living longer, it would be possible to change the latest retirement age, either up or down to reduce benefits paid.

Change Delayed Retirement Credits. Currently for each year an individual postpones Social Security benefits beyond FRA, an 8% increase in benefits accrues. A change in this percentage might encourage a change in behavior for delayed retirement and reduce benefits paid.

Small, Phased-In Reductions of PIA. If small phased-in reductions were made to the PIA calculation, either in the percentages used or in the bend points, benefits paid could be reduced. To avoid hurting the lower-income beneficiaries, it might be best to implement these decreased rates and bend points at the upper end of the scale.

Increase Number of Years of Salary Averaged into AIME. If an increase in the FRA is justifiable, perhaps we expect people to work more years before retiring. If so, an increase to the number of years of salary averaged into AIME could be considered. Anyone working fewer years than those averaged in would have more years of no income averaged in when calculating AIME and PIA.

Increase Number of Credits Needed to Qualify for Benefits. Typically workers need 40 credits (usually 10 years of work) to qualify for Social Security benefits. The number of credits required to claim benefits could be adjusted, especially if people are expected to work longer before retiring.

Benefits for Those Still Working. Once someone reaches FRA, there is no penalty for working while receiving Social Security benefits. However, those who have not yet reached FRA but who are still working while claiming Social Security benefits can lose some of their benefits if they are earning amounts above a threshold limit. These policies could be changed to reduce benefits paid out to those who are still working.

Taxability of Social Security Benefits

Social Security benefits were not taxable from the inception of the Social Security program up until 1984. However, the 1983 amendments to the Social Security Act made up to 50% of Social Security benefits taxable. In 1993, the law was modified further, making up to 85% of Social Security benefits taxable. Many recipients of Social Security benefits still pay no income taxes, as there are income thresholds which determine when 50% or 85% of the benefits become taxable [11].

Increase Income Taxability of Social Security Benefits. One way to increase Social Security revenues would be to increase the taxability of Social Security benefits. Perhaps instead of using the current 50% and 85% levels, the levels of taxability could be increased.

A way to means test this would be to tax the entire Social Security and allow a credit equal to 10%, the lowest tax bracket, or 15% (previously the lowest tax bracket), or some other amount. This would have higher income taxpayers paying the difference between their marginal tax rate and the credit amount, while lower income taxpayers would pay little or nothing. It also removes the uncertainty during the tax year for planning by recipients and the potential for a double tax.

Change the Thresholds for Taxability of Social Security Benefits. Changing the thresholds for limiting the taxability could also increase the Social Security revenues. Of course, if the thresholds were lowered, this could adversely impact lower-income taxpayers, perhaps even some who need protection from increased taxes.

CONCLUSION

While we have not proposed any specific set of adjustments to the Social Security program to make it viable for longer than current projections, we have detailed many possible adjustments that could be considered, either separately or in combination, to resolve the long-term problems with this government entitlement program. The longer we wait for legislation to resolve issues that are leading to Social Security insolvency, the more drastic the measures will need to be to save it. Since both sides of the political spectrum seem to feel that Social Security is not a program that we can allow to fail, we need cooperation among the different factions to choose quickly a set of adjustments that will be acceptable and successful. Unfortunately, while all factions likely agree that adjustments are needed soon, that does not guarantee that these factions will negotiate any compromise that can be legislated.

REFERENCES

References available upon request from Sheldon R. Smith.