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Insecurities Surface in Social Security

Written by Diana Ransom

This week's news that the Social Security system will pay out more in benefits than it receives in payroll tax receipts gave a jolt to some retirees. By contrast, earlier reports from the nonpartisan Congressional Budget Office (CBO) projected that outlays would eclipse tax receipts in 2016.

Although the imbalance isn't expected to change the benefits levels of current retirees or those nearing retirement, it does bolster long-running fears about the health of the Social Security system. Some analysts say that younger generations of workers could face benefit cuts of 20% to 25% by 2037 if Congress does nothing to reform the system.

The reason? Social Security maintains two trust funds -- the Old-Age and Survivors Insurance fund and Disability Insurance fund -- which are both running a surplus and expanding. Combined, both trust funds are projected to grow from $2.5 trillion in 2009 to $3.8 trillion in 2020, according to the CBO. What's more, Social Security's "primary" deficit -- that is, a measure of the program's revenues excluding interest on those trust funds' assets -- should only last until 2014, when the CBO projects employment to fully recover.

Still, the downturn has taken its toll on Social Security's revenues. Perpetually high unemployment -- plus, a subsequent drop in paychecks to tax -- and an increase in the number of seniors applying for benefits earlier than they planned have depleted the program's revenues.

All told, payroll tax receipts were down 2.5% in 2008 compared to pre-recession estimates for the year, according to calculations from Monique Morrissey, an economist at the Economic Policy Institute, a Washington-based research organization. She expects 2009 receipts may be as much as 8% to 9% below what they projected in 2007, before the recession hit. Fewer tax receipts, combined with the fact that millions of baby boomers are expected to file for benefits at some point in the near future, the CBO estimates that the system's reserves will be depleted by 2037. (Note that this trust fund depletion date and some estimates may change in a few weeks, as the Social Security Administration's board of trustees may pose differing numbers when it issues its annual report.)

Morrissey and other retirement analysts contend that Social Security's trust funds were meant to be drained, as their creation was driven in part by the fact that baby boomers would eventually file for benefits and, of course, stop paying into the system. However, the significance of that 2037 date for younger generations remains. Without a cash cushion to fall back on, the whole system could revert solely to pay-as-you-go, which is a system where today's payroll taxes support the benefits of today’s retirees. That can be problematic for younger generations, says Pamela Villarreal, a senior policy analyst at the National Center for Policy Analysis. “When today's workers retire, their benefits will be paid only if the next generation of workers agrees to pay even higher taxes,” she says.

So in 2037, if outlays outpace tax receipts Americans may see a reduction in benefits by roughly 20% if Congress doesn’t do anything, Morrissey says. That could mean raising the retirement age from 67 to 70, or it could translate to an across-the-board cut in benefits, she says. For a dual-income family in 2037 that expects to receives roughly $50,000 in Social Security payments annually, that 20% reduction would reduce their annual payment to $40,000. AARP’s director of economic security, Cristina Martin Firvida, projects that if Congress does nothing, the Social Security system could fund just 75% of benefits by 2037.

It’s unlikely that Congress will do nothing, says Firvida. “We know that you can keep the program solvent through a fairly modest mix of changes including boosting revenues to the program [through a payroll tax increase] and some modifications to the way the benefits come out,” she says. “I find it hard to believe that Congress will take no action between now and then.”

But even if Congress does nothing for some time, the system should be fine for years to come, says Morrissey. “The recession has had an impact but it hasn’t been cataclysmic,” she says. “Payroll taxes are now less than benefits, but revenues in general are still larger than outlays. The CBO projections show the trust fund growing through 2020.”

While it’s likely that Social Security will stick around for years to come, don’t let yourself get caught off guard by a future benefits cut. Here are four tips to help build up your retirement in case Social Security, at least in part, falls through:

Work longer

For those who can work longer, do. By working longer, you’ll not only offset your expenses for an extended period, you’ll also prolong your ability to sock away more funds for your retirement – not to mention the benefits that stem from also having an employer match. Plus, you’re also giving your savings more time to accrue interest, untouched. Working longer will also provide greater social security benefits that you’ll (hopefully) get back down the road. If you go this route, be sure to stash funds in a tax-favored retirement account like a 401(k), an individual retirement account or a Roth IRA, in which contributions may be withdrawn tax free at any time, says Morrissey of the Economic Policy Institute.

Boost savings

If you’re faced with the possibility of needing more money during retirement, one way to boost what you’ll have then is to save more now. Working longer can bring in more revenue, while cutting your costs can help you preserve more revenue. A number of retirees these days are painting a more scaled-back version of retirement for themselves, says Mari Adam, a financial planner in Boca Raton, Fla. Although some plan to travel less, others are considering selling big-ticket items like a home or other property if they land in a bind, she says. To estimate how much you’ll need to save in lieu of not having Social Security, use this benefits calculator.

Put off taking Social Security

Even those who don't expect any changes to their Social Security benefits would gain by putting off when they apply to receive payments, says AARPs Firvida. Of course, you can start drawing Social Security payments as soon as you turn 62 years old. However, those that wait until they are 65 or 67, depending on your year of birth, could claim full benefits. "If you retire at age 62 your lifetime benefit will be the same as if you retired at 67, but your monthly benefit will be lower," she says. "You take a penalty when you retire early." (Note that if you delay taking Social Security after you reach full retirement age, the amount of your eventual benefits will increase until you reach age 70.)

Replicate an income stream

Like Social Security, a pension is consistent and often very useful for retirees that have monthly payment obligations. However, these days, few workers have pensions -- and even fewer will have them by the time 2037 rolls around. To replicate income streams similar to Social Security or a pension, try renting out a piece of property. You might also consider purchasing an immediate annuity in advance of falling into rough financial waters, suggests Adam. In exchange for handing over a portion of your retirement savings, these financial contracts, which are typically made with insurance firms, offer to provide retirees with a guaranteed stream of income for life. Note that if inflation kicks in, annuities offer some serious drawbacks and should be considered carefully.