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Social Security's Future and its Impact on Yours

By now, you've probably heard rumblings about America's Social Security system, along with various proposals of how to sure it up for future generations. It is a favorite topic of debate between rival politicians, and everyone from analysts to accountants to actuaries has weighed in. But what is really going on, and what might it mean for your retirement?

Where It Began

Social Security Insurance began in 1935, during Franklin D. Roosevelt's administration. It was a controversial program even then, and in an attempt to sway public opinion in its favor, FDR promised that the program would be completely voluntary with no more than 1% ever being taken from a worker's annual salary. Not all promises are kept: today 6.2% is taken directly from a worker's pay while another 6.2% is contributed by their employer.

Initially, all collected revenues were to be used exclusively for the Social Security program. However, during Lyndon Johnson's presidency, Congress was allowed for the first time to withdraw funds from the surplus Trust Fund and deposit them into the country's General Fund to bankroll various unrelated endeavors. This practice continues today. As funds are borrowed from the Trust Fund, they are replaced by IOU's in the form of non-callable, non-expiring Treasury Bonds. As of 2005, the cumulative surplus of the Trust Fund was over $1.8 trillion.[i]

Since the government is borrowing money from itself, there really is no pressing obligation to pay itself back. Instead, Social Security continues to be a pay-as-you-go program where today's revenues pay for today's benefits.

The Original Purpose

The intent of Social Security's was to provide social insurance benefits for those who paid into the system and others whose unfortunate circumstances necessitated extra assistance. The three main components of Social Security are retirement, disability, and death insurance. Though the original plan provided for unemployment insurance as well, that benefit has since been separated from the program.

Who Can Collect, and When

Based on dollars paid, Social Security is the largest government program in the world, having paid over $520 billion in benefits in 2005.[ii] The predominant component of Social Security is the Retirement benefit, which is calculated based on the average of a worker's top 30 years of earnings. (These are not necessarily the last 30 years of earnings, since disability or maternity leave could significantly reduce the amount of annual earnings.) Retirement age – the age at which you are eligible to begin receiving your Social Security benefits – is determined by your birth year. Those born before 1938 were eligible to receive full benefits at age 65.

The eligibility age increases by two months per year of birth after 1938. For example, people born in 1940 would be eligible to receive benefits at age 65 and four months. For anyone born after 1960, eligibility does not begin until age 67. The older you are when you begin receiving monthly benefits, the higher the amount will be. However, while you can receive reduced benefits as early as age 62, you must begin taking benefits no older than 70.

Contributing workers are not the only ones eligible for Social Security. Spouses of taxpaying workers are eligible for their own benefits even if they have never worked. Divorcees who were married for 10 or more years are still eligible for Social Security benefits based on their ex-spouse's benefit amount. Also, surviving spouses and dependent children are entitled to Social Security, as are immigrants who may not have contributed to the program.

The Dependency on Social Security

For many elderly Americans, Social Security is critical to their quality of life. Over 15 million individuals and couples rely on Social Security for more than half of their income.[iii] One third

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of the elderly population depends on Social Security for over 90% of their income. [iv] Considering the average monthly benefit is just over $1,000 before taxes,[v] many seniors find it difficult to preserve their pre-retirement lifestyle on Social Security alone.

Social Security's Survival

Since Ronald Regan's presidency, recommendations have been made to reform and restructure our Social Security system. The situation is making headlines today because the first of the Baby Boomers have turned 60 and are heading into retirement. As this largest American generation begins leaving the workforce, the ratio of Social Security contributors to beneficiaries will shift dramatically. Consider this: in 1950, the worker to beneficiary ratio was 16.5:1. Today, it's 3.3:1. In 40 years, it is projected to be just 2:1.[vi]

At current tax and benefit rates, Social Security is projected to remain intact until 2042.[vii] Thereafter, policymakers will keep the program going either by increasing taxes or decreasing benefit amounts. Unless something is done, today's 35-year old worker will experience a benefit reduction between 26-30% by the time they retire.[viii]

Supporters of reform argue that small changes now will prevent the need for drastic changes years from now. Those opposing reform acknowledge that the Trust Fund will eventually be depleted and cash outflows may ultimately exceed inflows, but claim there is no urgency to implement fixes just yet.

Regardless of whether our lawmakers remedy Social Security funding now or later, more than likely the program with survive in some form. However, it is difficult to predict exactly how much of your income will be replaced by Social Security if your retirement will extend to 2042 and beyond. Ultimately, your retirement is your responsibility. Therefore, the safest bet is to structure your retirement plan without emphasis on Social Security.

Think of your retirement strategy as a three-legged stool where Social Security, pensions, and savings all play equally important roles. Without any one of the legs, the stool becomes unstable. Since Social Security is intended to replace only 40% of your pre-retirement income,[ix] you need to find alternatives to fund the other 60%. A qualified financial professional can discuss savings, insurance, and investment options with you to help you determine the mix that will help you reach your goals. **-OC**

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[i] *http://www.ssa.gov/OACT/STATS/table4a3.html; Updated February 7, 2006*

[ii] *http://www.ssa.gov/OACT/STATS/table4a3.html; Old-Age, Survivors, and Disability Insurance Trust Funds, 1957-2005*

[iii] *"Social Security and the Income of the Elderly," Michael Ettlinger and Jeff Chapman, EPI Issue Brief #206, March 23, 2005.*

[iv] *"Social Security and the Income of the Elderly," Michael Ettlinger and Jeff Chapman, EPI Issue Brief #206, March 23, 2005*

[v] *http://www.ssa.gov/pressoffice/factsheets/colafacts2006.htm; 2006 Social Security Changes*

[vi] *www.ss.gov/fq.htm. Retrieved 8/15/06*

[vii] *"Social Security: Crisis? What Crisis," http://money.cnn.com/2004/12/15/retirement/what_crisis/*

[viii] *www.ssa.gov/htm. Retrieved 8/15/06*

[ix] *"Social Security: Crisis? What Crisis," http://money.cnn.com/2004/12/15/retirement/what_crisis/*