Financial Wellness Essay Collection

2017 Call for Essays

Retirement Readiness and the Value of Future Social Security Benefits

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Nine out of 10 individuals age 65 and older receive Social Security benefits. Among that age group, 53% of married couples and 74% of unmarried individuals receive 50% or more of their income from Social Security. In addition, 22% of married couples and 47% of unmarried individuals receive 90% or more of their retirement income from Social Security.[1]

A major goal of financial education and financial literacy is to help people prepare for retirement. However, scoring 100% on a standard financial literacy examination is not going to be much help for middle- or lower-income individuals if they do not have a good basis for forecasting their future Social Security benefits.

Policy analysts, financial planners and individuals all encounter the problem that, without change, according to the intermediate projections of its actuaries, Social Security will be insolvent in 2034. At that point, in the absence of legislative changes, current and future retirees will receive less than 80% of their statutorily promised benefits.

Social Security trustees traditionally have reported on the status of the combined Old-Age and Survivors Insurance (OASI) Trust Fund and the Disability Insurance Trust Fund (DI). After the last major reform of Social Security in 1983, Social Security (OASDI) was projected to have adequate financing through 2063. As of 2016, however, the combined funds are projected to run out of money in 2034. Starting then, current and future retirees will take a 21% cut in their benefits if financing reforms are not made.[2] That cut would be an average of $10,000 a year for a couple retiring that year,[3] or a $100,000 cut in lifetime benefits for the typical 50-year-old.[4]

Responsible commentators recognize that fixing Social Security will most likely involve both revenue increases and benefit cuts.[5] As seen later, however, a number of retirement readiness tools make the extreme assumption of no benefit cuts.

Retirement Readiness Tools

The U.S. Department of Labor (DOL) in its "Savings Fitness" guide and worksheets[6] does not mention the issue of the future insolvency of Social Security benefits. It implicitly directs users to assume there will be no future cuts in Social Security benefits and no increases in Social Security payroll tax rates, assuming the impossible situation that the status quo will be maintained. The U.S. General Accountability Office in its review of the DOL's savings guide[7] also makes no

1 Social Security Administration, "Fact Sheet: Social Security," 2015, *http://www.ssa.gov/news/press/basicfact.html.*

2 Board of Trustees, Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds, "The 2016 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds," June 22, 2016, *https://www.ssa.gov/OACT/TR/2016/tr2016.pdf.*

3 Maya MacGuineas, "Statement by Maya MacGuineas on Vice Presidential Debate," Committee for a Responsible Federal Budget press release, Oct. 5, 2016, *http://crfb.org/press-releases/statement-maya-macguineas-vice-presidential-debate.*

4 Marc Goldwein, "These 5 Supposed Fixes for Social Security Won't Solve Its Problems," Committee for a Responsible Federal Budget's Social Security blog, Oct. 31, 2016, *http://crfb.org/blogs/marc-goldwein-these-5-supposed-fixes-social-security-won%E2%80%99t-solve-its-problems.*

5 Steve Vernon, "Can Social Security Survive Without Benefit Cuts?" CBS Money Watch, March 9, 2015, *http://www.cbsnews.com/news/can-social-security-survive-without-benefit-cuts/.*

6 Employee Benefits Security Administration, U.S. Department of Labor, "Savings Fitness: A Guide to Your Money and Your Financial Future," 2016, *http://www.dol.gov/ebsa/publications/savingsfitness.html.*

7 U.S. General Accountability Office, "Retirement Security: Better Information on Income Replacement Rates Needed to Help Workers Plan for Retirement," Report to Congressional Requesters, GAO 16-242, March 2016, *http://www.gao.gov/assets/680/675526.pdf.*

mention of the future insolvency of Social Security. This approach, in the author's opinion, can mislead people using the guide into believing they are better prepared for retirement than they would be if, in fact, Social Security benefit cuts occur.

Under the heading of "Planning for Retirement," the Consumer Financial Protection Board (CFPB),[8] an agency of the federal government, provides Social Security retirement benefit estimates assuming there will be no benefit cuts. Thus, CFPB assumes the best-case scenario from the perspective of the users of its projections. It doesn't alert users to the possibility there will be benefit cuts. Financial planners generally assume what they consider to be reasonable or conservative assumptions, rather than best-case assumptions.

To provide people an estimate of what their Social Security benefits would be, Social Security sends out benefit statements to people every five years, starting at age 25, and annually to people age 60 and over who are not receiving benefits. These statements base the estimate on the assumption that there will be no cuts in future benefits, but they do indicate the possibility of future benefit cuts.

Critique of No-Benefits-Cut Assumption

This section assesses how likely it is that Social Security reform will not involve benefit cuts. One approach to analyzing this question is to look at the historical record. In particular, that approach would consider the outcome of the 1983 reform and whether a similar package is likely, or how the next reform might be different given the different circumstances under which it will occur. The 1983 reforms, coupled with an increase in Medicare premiums, reduced the Social Security replacement rate, as measured by the Social Security Administration, for an average worker retiring at age 65 from 40% in 2005 to 32% in 2030.[9]

While the 1983 reforms are often described as a balanced approach, only the short-term changes were balanced. The short-term reforms to get Social Security through the 1980s were roughly balanced between their effects on contributors and beneficiaries, with 44% of the changes due to increased revenue from contributors and 39% due to decreased benefits for beneficiaries, through postponing the cost-of-living adjustment and taxing some benefits. Part of the short-term increase in revenues came from extending Social Security coverage to newly hired federal government employees (16%).[10]

The longer-term reforms, occurring through the increase in the normal retirement age, were entirely benefit cuts. Combining the long-term and short-term reforms, 10% of the shortfall was made up by increases in revenues, while 70% was made up by decreases in benefits, with the remainder made up by extending coverage.[11]

The current financing problem is more difficult to resolve than the problem in 1983. The shortfall in 1983 was estimated by Social Security's actuaries to be 2.09% of taxable payroll over the 75-year period.[12] By comparison, if reform is postponed to the last moment, as was done in 1983, the shortfall indicated in the 2016 Trustees Report[13] is 3.58% of taxable payroll, or 71% larger.

Benefit cuts can take various forms. In the 1983 reform, current beneficiaries at the time of the reform did not have a nominal benefit cut. They did have a real benefit cut in that the cost-of-living adjustment was postponed six months. Future beneficiaries faced substantial benefit cuts due to the increase in the normal retirement age.

8 Consumer Financial Protection Board (CFPB), "Planning for Retirement: Before you Claim," accessed Jan. 23, 2016, *http://www.consumerfinance.gov/retirement/before-you-claim/*.

9 Daniel Marans, "The Reagan-O'Neill Myth of Bipartisan Social Security Reform," *The Blog*, Huffingtonpost.com, Nov. 20, 2012, *http://www.huffingtonpost.com/daniel-marans/the-reaganoneill-myth-of-_b_2162028.html*.

10 Janice M. Gregory, Thomas N. Bethell, Virginia P. Reno, and Benjamin W. Veghte, "Strengthening Social Security for the Long Run," National Academy of Social Insurance, *Social Security Brief* no. 35 (November 2010), *https://www.nasi.org/sites/default/files/research/SS_Brief_035.pdf*.

11 *Ibid*.

12 *Ibid.*

13 Board of Trustees, Federal OASDI, "The 2016 Annual Report."

A survey conducted by the National Academy of Social Insurance (NASI),[14] an organization opposed to Social Security benefit cuts, has found that 69% of Republicans and 84% of Democrats agree "it is critical to preserve Social Security benefits for future generations even if it means increasing the Social Security taxes paid by working Americans." However, another survey finds that most Americans expect a future reform will involve both benefit cuts and revenue increases. That survey finds that more than half of American workers (58%) expect Social Security reform will involve both financing increases and benefit cuts, while 18% think reform will mostly or entirely involve benefit cuts, and nearly a quarter think it will mostly or entirely involve revenue increases.[15]

Conclusion

The topic of Social Security reform is controversial, the nature of future reforms is not known, and some people are adamantly opposed to benefit cuts. While the author does not attempt to predict the outcome of future Social Security reform, for the purposes of retirement readiness planning, an economic analysis of Social Security's financing problem suggests that the best-case scenario assumption of no benefit cuts has little justification. That conclusion is based on the role of benefit cuts in the 1983 reforms and considering that the shortfall now is much greater than then. It is also based on the practice of making conservative assumptions when doing retirement readiness planning. The author argues that advice to people planning for retirement based on the assumption of no benefit cuts is presenting the best-case scenario. To provide conservative advice, as is the standard practice for financial planning, better advice would be to assume that more than half of the shortfall will be made up by benefit cuts, as was done in 1983.

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14 National Academy of Social Insurance (NASI), "Hard Choices on Social Security: Survey Finds Most Americans Would Pay More to Fix its Finances and Improve Benefits," NASI press release, Oct. 23, 2014, *https://www.nasi.org/press/releases/2014/10/press-release-hard-choices-social-security-survey-finds-m*.

15 Erzo F. P. Luttmer and Andrew A. Samwick, "The Welfare Cost of Perceived Policy Uncertainty: Evidence from Social Security," National Bureau of Economic Research working paper, no. 21818 (December 2015), *http://users.nber.org/~luttmer/polrisk_paper.pdf.*