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We Need To Reform Social Security

By: Veronique de Rugy - June 26, 2013

In 1994 the youth advocacy group Third Millennium commissioned a poll that is still widely quoted. One of the questions found that more members of Generation X (ages 18 to 34 at the time) believed in UFOs (46 percent) than thought that Social Security would be solvent when they started to retire around 2030 (9 percent).

But even if Social Security is around when Gen Xers finally stop working, it is unlikely to be a good deal for them. Take, for instance, the work of C. Eugene Steuerle and Stephanie Rennae, researchers at the liberal Urban Institute. They calculated what Americans at various levels of income (high, average, and low) and in various types of households (single or married) can expect to pay into and receive from Social Security and Medicare over the course of their lifetimes. Their calculations assume that individuals retire at the age when full benefits kick in (originally 65, but rising past 67 under current law) and their results should be depressing to everyone who works hard in hope of building savings for their retirement. A single man earning the average wage ($43,500 in 2011) who retired in 1980 would have paid a total of $96,000 in Social Security taxes and received lifetime benefits of $203,000, or about 211 percent of contributions. A single man earning the average wage but retiring in 2010 faces a vastly different situation: He would have paid $294,000 in taxes to receive benefits of just $265,000, or about 90 percent of contributions. For the same person retiring in 2030, taxes of $398,000 yield $336,000 in benefits, or just 84 percent of contributions. (Because they tend to live longer, women fare slightly better than men, but single women earning the average wage and retiring in 2010 and 2030 also face negative returns on their lifetime tax contributions to Social Security.)

In other words, for the most part and with few exceptions it is not a good financial deal. In addition, the program is on terrible financial ground. As my colleague Jason Fichtner, a former deputy commissioner of Social Security, explained earlier this week, no matter how you look at the Trustees' Report, the program is on the path to insolvency and the numbers may be worse than they look on paper. He writes:

The Trustees now estimate that the 75-year financial shortfall for the combined trust funds is $9.6 trillion in present value terms. That's a lot of money! If we indefinitely extend past the 75-year period, the so-called "infinite horizon," the short fall is a whopping $23.1 trillion. Keep in mind, our nation's gross domestic product is approximately $16 trillion — and our gross national debt (not including unfunded liabilities) is $16.7 trillion.

As bad as those numbers are, the commonly reported figures for trust fund insolvency are based on "intermediate assumptions" — not too high, not too low — the Trustees also calculate high- and low-cost assumptions. Social insurance experts are well aware that the high-cost projections of Social Security's future don't represent a worst-case scenario — the combined trust fund-insolvency date under the high-cost assumptions is 2027, just 14 years from now. Many of these same experts nonetheless claim that the worst-case future for Social Security is that promised benefits would have to take a 25-percent haircut if the trust funds go insolvent in 2033. Though a 25-percent reduction in benefits is scary enough, it is possible that Social Security's finances could be catastrophically worse.

As if this isn't bad enough, this morning over at Yahoo Finance, Laurence Kotlikoffexplains that the program is insanely complicated. In fact, it is so complicated that even the advice that one gets from the Social Security Administration about retirement and benefits isn't necessarily the best. He writes:

Social Security was, it appears, designed to be incomprehensible to the American public. Why else would it have a Handbook with 2,728 incredibly obtuse rules and a Program Operating Manual System with tens of thousands of even more obtuse rules meant to clarify the 2,728 incredibly obtuse rules?

Thanks to this breathtaking public disservice, I routinely get emails from people who have, it seems, been given bad to very bad advice by people at Social Security. Note, the technical experts and actuaries at Social Security know the rules cold. They are brilliant. But getting to them is not easy.

He goes on to give a few examples of very bad advice given by the agency to retirees and asks the most important question about the program: "Is Social Security worth retaining in its current form if it's too complicated for anyone to get straight? And, guess what, it's utterly broke?" His answer is no. And I agree. Now, the question is, what should we replace it with? The great news is that the free-market movement has provided many alternatives to the current system. Fichtner for instance favors retaining the program after serious structural reforms that would improve working and saving incentives. The scholars at the Cato Institute have provided many reform ideas over the years. Kotlikoff has a plan, too: the Purple Social Security Plan. And there are many other plans out there.

The bottom line is that Social Security should be reformed, and there are many good ways to do it. As Kotlikoff tells his readers: "Social Security, in its current form, is a scandal. Don't be complicit in its preservation." Let's hope some of those readers work for Congress.