The Daily Dish

“Saving” Social Security

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Eakinomics: “Saving” Social Security

I received the following (very reasonable) question recently: “For Social Security and Medicare, in order for there to be NO changes to current retiree and near-retiree benefits, what key variables must be adjusted for Millennials and GenXers in order to save the programs for those generations? Is it possible to create sustainable growth rates in benefits given life expectancies over the next 50 years?”

Put Medicare aside for the moment (waaaay too complicated) and focus on Social Security. The structure of Social Security is quite simple: Payroll taxes are collected and benefits are paid. Historically, payroll taxes exceeded benefits and the Social Security program was credited for this surplus in the so-called Social Security Trust Fund. In reality, this is nothing more than an accounting ledger. At present and going forward, benefits exceed payroll taxes and the credits are being used up as general revenue fills the gap.

The credits will be used up – meaning the Social Security Trust Fund will be exhausted – in the early 2030s. At that point, benefits can only be paid up to the amount of payroll taxes collected. Thus, to hold harmless current retirees and those near retirement, payroll taxes would have to be raised.

As shown in this Congressional Budget Office (CBO) projection, the shortfall will be about 1.8 percent of gross domestic product (GDP), so the payroll tax increase would have to match that. At present, this would amount to a tax increase of over $350 billion annually. There are lots of ways to raise payroll taxes – raise the tax rate, raise the maximum amount of earnings subject to tax, etc. – but to give a flavor of what is at stake, the payroll tax rate would have to be raised by 6 percentage points – from 12.4 percent to 18.4 percent – to keep a cash-flow balance and avoid benefit cuts. Since the Social Security payroll tax is split evenly between the employer (6.2 percent) and employee (6.2 percent), one can think of this as simply doubling the employee’s payroll tax.

That would be quite a blow to today’s and future young workers. But that is what it would cost to forestall any further changes in the program for roughly 50 years. Social Security is designed to have benefits grow as fast as wages over the long term, which has been faster than prices have been rising. So current and near-retirees would be held harmless and future retirees would have rising real benefits. However, having bought five decades of time, new deficits are projected and the same kind of challenge would re-emerge.

That’s the good news. Medicare is way worse, and the subject for a future Eakinomics.