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Social Security: The Topic du Jour, Part 1

BY ROBERT BLOOM AND DAVID SCHIRM

In 1935, Congress passed the Social Security Act during Franklin Roosevelt's administration, providing a welcome relief from the Depression. The first deductions from employees' paychecks, matched equally by employers (each contributing 1% of the employee's wage), were taken in 1937.

In 1939, the Federal Insurance Contributions Act, which had been enacted in 1937, expanded Social Security to cover dependents and survivors. In 1950, the tax was raised to 3% (1.5% for the wage earner, with the same share borne by the employer). By 1956, the tax became 4%, but Social Security was expanded to include disability insurance. Also in 1956, women were allowed to retire early at age 62 with 70% of their benefits. That wasn't the case for men until 1961, when the tax also was hiked to 6%. In 1972, cost of living adjustments began, and the tax increased to 9.2%; in 1977, the tax was 9.9%; 1983, 10.8%; 1985, 11.4%; and 1993, 12.4%, where it has remained with increased wage ceilings for tax computation—for example, the wage ceiling in 2005 is $90,000. The 1983 amendments set the retirement age for full Social Security benefits at 67 for those born in 1960 or later.

Since the Act's inception, the worker and employer have shared the tax burden equally. Social Security has been a defined benefit plan, guaranteeing payments to employees who have contributed to the plan and who retire at age 62 (since 1956 for women, 1961 for men), 65, or later. The tax payments go into a trust fund from which the benefits are paid to retirees. There currently is a surplus in the fund. This is used to finance federal government programs such as defense and education. The federal government "borrows" from the present fund for such expenditures, giving the fund "IOUs" to be repaid in the future. It should be emphasized that Social Security operates on a "pay-as-you-go" basis. In contrast to defined benefit plans in private enterprises, there is no provision for funding future payments.

With baby boomers retiring in the current decade and fewer and fewer workers available to fund the benefits for each retiree, a deficit is anticipated beyond the next decade, and bankruptcy could ensue within the next four decades unless significant changes are made in the program (as reported by the Social Security Administration in the 2005 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds). If changes aren't made and retirees then receive the same benefits as current retirees, the government would have to borrow significantly or raise the payroll tax astronomically (perhaps to 30% of wages) to support the program.

Different parties have completely different views (or forecasts) of how serious the crisis is. This year, the Bush administration has made Social Security reform Topic A on its Congressional agenda, warning that a crisis looms for the program. Do we want this approach to continue? Should Social Security be a federal program? Are we satisfied with it in its present form? Some view Social Security as the most successful federal program in American history, and, thus far, Americans have yet to be convinced that Social Security needs to be completely overhauled. And neither has Congress. The only area that Congress agrees with is that Social Security has long-term funding problems. At this point, though, the Bush administration has yet to lay out a specific proposal for reform.

Comptroller General David Walker, head of the Government Accountability Office, recently asserted in his March 2005 testimony before the House Ways and Means Committee that President Bush was wrong to claim there's an immediate Social Security funding crisis. Walker did admit, however, that the current program isn't sustainable in its present form and that Congress will have to act at some point in the future.

In his March 15, 2005, testimony before the Senate Special Committee on Aging, Federal Reserve Board Chairman Alan Greenspan addressed the future of the Social Security program and the economics of retirement, stating, "At present, the Social Security trustees estimate the unfunded liability over the indefinite future to be $10.4 trillion. The shortfall in Medicare is calculated at several multiples of the one in Social Security." Medicare is composed of two trust funds: the Hospital Insurance Trust Fund, which provides reimbursement for qualified inpatient hospital and related care, and the Supplementary Medical Insurance Trust Fund, which pays for physician and outpatient services and will cover prescription benefits beginning in 2006.

In their summary of the 2005 annual reports of Social Security and Medicare, the trustees of these plans point out that the underfunding of Medicare is considerably more severe than Social Security, and it also will encounter funding problems sooner. By 2014, assets of the Hospital Insurance Trust Fund are projected to fall below the following year's expenditure. By 2020, the fund is projected to be exhausted. The Supplementary Medical Insurance Trust Fund is adequately funded through individual insurance premiums and a 75% general revenue funding from Congress (with financing being set each year based on projected expenditures for the following year), but to meet the projected funding needs of the Supplemental Fund by 2079, it is projected that general revenue will have to increase by six times—even with substantial increases in individual premiums.

The Social Security and Medicare Fund trustees also asserted (March 23, 2005) that Social Security will go broke in 2041, during which time only 74% of the benefits will be paid. As early as 2017, Social Security will pay out more benefits to retirees than it will receive in tax receipts from wage earners.

For a long time, Social Security has been an untouchable subject. Changes were made in its provisions, but no one would dare talk about overhauling the plan. It is now a hot topic very much open to public debate. The Bush administration has made Social Security reform one of the major goals—if not the focus—of its second term. In the past two months, the President has visited 20 states to sell "reform" to the public.

Now that we have given the historical background for Social Security, we will present specific proposals for its reform next month in Part II. ■

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