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Your financial planner: Our social safety nets are in trouble — can they be fixed?

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The Social Security and Medicare programs in the United States are important programs that provide a social safety net for workers and their families.

These benefits are often perceived as providing health care and income in retirement. While this is true, they also provide benefits to younger workers or their families in the event of disability or death.

The sustainability of these programs has been questioned in recent years as the population in the United States ages. As the Baby Boomer generation heads into retirement there are more people depending on these programs, while at the same time there are fewer workers paying in to the system.

According to the recently released 2016 Annual Report from the trustees of the programs, "Social Security and Medicare face long-term financing shortfalls under currently scheduled benefits and financing." The trustees project that the Social Security trust funds will be depleted in 2034.

After 2034, the estimated income receipts will be able to pay about three-quarters of the scheduled benefits through 2090. That means without changes, benefit payments would be reduced by 25% after 2034. It's worth noting that there are four separate trust funds that are set up for each aspect of the safety net programs. For simplicity and purposes of this article, I will refer to the funds as a single pool of resources.

A deeper analysis of the numbers presents a more alarming picture. The trustees' report indicates that these funds are expected to run out of assets in 2034. However, by law, the trust funds must invest all surpluses in bonds issued by the Federal government. In fact, the U.S. Treasury issues special bonds that are only available to the trust funds.

So, in reality, the Social Security trust funds are full of government bonds – or promises to pay at some point in the future! The government really owes this money to itself. So instead of what most consider a true savings account that banked prior surpluses, the trust fund is simply an accounting mechanism where the government is required to pay itself back with other resources.

Given the true nature of the Social Security and Medicare trust funds, a better gauge of the financial health of the Social Security and Medicare programs is when the total costs of the programs exceed the total taxes and interest collected into the programs.

According to the trustee's 2016 report, these dates range from 2019 – 2022, depending on the particular trust fund. When framed this way, the date at which this problem needs to be addressed is much closer than it appears!

No matter how you view the trust funds, changes are necessary to ensure the sustainability of our safety net programs into the future. The good news is that there are many options to address the shortfall and collectively they do not appear to be drastic moves. Let's look at some solutions.

1) Increase the retirement and Medicare ages. The full retirement age for Social Security for individuals born after 1960 is age 67. The Medicare age is 65. Increasing the age that people can start on these programs by a year or two will help reduce benefit outflows over the long-term.

Nearly all serious proposals for this type of change recommend a phase-in of these changes over time for younger workers so that people have time to prepare for the change. This solution seems to make sense given that people are living longer and that the Social Security program was not initially designed to provide decades of retirement income.

2) Immigration Reform. Make adjustments to the immigration policy in the U.S. to allow more legal immigrants into the country, especially those with higher education. Additionally, allow foreign citizens who come to the U.S. for education to stay in the country.

These changes would add more younger, educated, and likely higher-income-earning workers that would be paying in to the safety net systems.

3) Increase taxes collected by raising or eliminating the Social Security wage limit. Currently, all workers pay Social Security taxes on the first $118,500 of income. Raising the wage base would bring more revenue into the Social Security system.

4) Change the inflation index used to increase Social Security benefits. The current system uses a form of the Consumer Price Index that many argue is not an accurate measure for how consumer prices increase and how consumers substitute goods when certain prices rise.

Adjusting the inflation index to an alternative method would likely reduce the impact of inflation adjustments over time.

5) Slow the growth of benefits for higher income earners. This method would slow the increase in Social Security benefits for individuals earning higher incomes. An example would be to slow the growth of benefits for the top 25% of wage earners currently paying in to the system.

The solution to the safety net crisis will likely involve a combination of adjustments to these and other factors. Continuing to delay addressing these problems drive government spending higher and make the impact of the potential solutions more drastic.

The sooner our elected officials muster the political courage to tackle the issues, the less painful the changes will be.

Do you think you have the right solution? Check out this website to play with the numbers and see if you can come up with a workable solution to solve the problem.

http://crfb.org/socialsecurityreformer/

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Sources for the article include:

SSA's Summary of the 2016 Annual Reports

www.socialsecurity.gov

The Committee for a Responsible Federal Budget.

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