Rodney's Take

February 21, 2023

Note: Harry is traveling; his regularly scheduled Harry's Take will be available tomorrow.

What Social Security Isn't

As the debt-ceiling debate heats up, Social Security and other social safety net programs are back on the front page. We're provided with a daily dose of the back-and-forth between "The program will go broke in a decade!" and "They want to cut programs for seniors!" Lost in all of this is a clear-eyed conversation about what Social Security is, what it isn't, and what we want it to be in the decades ahead. Before we come up with a solution, we need to define the problem.

There's no doubt that Congress enacted Social Security in 1935 to combat old-age destitution. At the time, one third of seniors were considered poor. Today, largely because of Social Security, that number is 9%, which is less than the national average. The Social Security Administration reports that without Social Security, two thirds of seniors today would be considered poor. But Social Security was not envisioned as welfare, which would have involved qualifying for benefits based on income or savings. You (or your beneficiaries, in some instances) cannot not claim benefits if you did not pay into the trust fund. The program was and remains a modified savings plan, with benefits tied to your average annual earnings… up to a point.

Last year, Social Security replaced a declining portion of your average career annual earnings to a maximum of about $148,000. People with low career earnings receive about 75% of their average annual earnings each year, while people with “maximum” career earnings receive just 27%. There are three tiers in between. Benefits are very progressive, but they remain tethered to our income. Because benefits max out at $148,000, we don’t pay the Social Security tax of 6.2% on earnings above that amount ($160,000 for 2023). Numerically, anyone who earns less than the maximum income will pay a higher percentage in Social Security taxes than those who earn less, but they also will receive benefits based on all of their earnings, which high earners will not. The Social Security tax can be considered regressive only if we ignore the fact that those who earn more than the maximum do not get benefits on earnings beyond their “extra” income.

Whether the system is fair, progressive, regressive, or whatever, there’s no way we’re going to get rid of it. Social Security is one of the most successful anti-poverty programs in history, and it requires workers to save for the future. But we’re staring down insolvency in a decade, and any “fix” will be financially painful. We can cut benefits, raise taxes, or some combination of the two. If the past is any guide, we’ll cut benefits and raise taxes, but just on high earners.

The most-often discussed possibility is a “donut hole” for taxes, which will keep the current maximum income for Social Security tax, which increases every year with average wages, and add on a Social Security tax for all income over $400,000. The higher amount would stay put, so over time the “maximum” income amount would converge with the $400,000, closing the donut hole. The Peter G. Peterson Foundation reports that this could raise $1 trillion for Social Security over the next decade, which would dramatically reduce the shortfall in the trust fund, but only if people don’t react.

Taxpayers and business owners have a habit of reacting to financial prompts. When governments tack on higher fees or taxes, people do what they can to minimize the impact. In the face of Social Security taxes on all income, it’s reasonable to assume that people will take steps, such as moving some of their compensation to retirement benefits, to reduce their tax liability.

The donut hole option, or even just eliminating the cap on earnings subject to Social Security tax, usually doesn't include a conversation about increasing the maximum career average annual earnings on which benefits are based. By raising taxes without raising benefits, such moves hit high earners twice. But hey, the money's got to come from somewhere, right?

Left out of all this is the possibility that we do nothing. While Social Security will go bankrupt in a decade, it's not the same as what happens in the private sector. The U.S. has been able to pay its annual bills just a time or two over the last 80 years, and we're considered financially strong (people still buy our bonds). Even though Social Security will spend down its trust fund to zero, it still will bring in between 75% and 80% of the money needed to pay benefits. It is possible Congress will choose to finance Social Security by selling even more debt rather than doing the hard work of fixing the system. As crazy as that might sound, our Federal Reserve has created more than $8 trillion since 2008 to buy bonds, and our national debt is now more than 100% of GDP, over $30 trillion. Things can change a lot in just a decade.

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Got a question or comment? You can contact us at info@hsdent.com.