

Financially Speaking

With Trisha Arndt

What does it really mean if Social Security “Goes Broke”?

I recently met with someone that has worked for over 30 years for a local company, tried to save money and not accumulate debt along the way, and is now starting to seriously contemplate retirement. As we discussed what he wanted to be able to spend and what sources of income he could potentially have, the topic of social security eventually came up. The initial conversation was a fairly typical one, and went something like this;

Me: “Have you received a social security benefit statement recently or ever logged onto the social security website to look at what you are projected to receive?”

Client: “Yes, but I can’t count on any of that can I? I mean I see things on the news all of the time about how Social Security is going to be bankrupt soon.”

Me: “Sigh... Let’s talk about how those news reports are misleading.”

In my experience, one of the most common concerns that people have as they think about retirement is what is going to happen with Social Security. Most people that I talk to have some awareness of, or have seen news reports about, the risk of Social Security “going bankrupt” but very few people understand what that really means. Most people see the headline and assume that it means that Social Security as we know it will cease to exist and there will be no further benefits paid out.

That is not the case.

Social Security has three very general components – inflows (in the form of the payroll taxes paid by employers and employees every day), outflows (in the form of benefits paid to retirees and other qualified recipients) and the trust fund, which is the piece that is in danger of “going broke”.

When Social Security was originally designed the idea was for more money to be paid in (inflows) than benefits paid out (outflows) for a long time. The extra money that was collected was intended to accumulate within the Social Security Trust Fund to collect interest and be a buffer in case the outflows started exceeding the inflows.

On a high level this plan worked and a Trust Fund did accumulate, but people fairly quickly lived longer than what had been expected and the shift to outflows exceeding inflows happened much sooner than expected. Because all of the potential fixes to this issue are politically difficult congress has historically not wanted to address it until it is literally forced to, which is exactly what happened in 1983. Just four months before the Social Security Trust Fund was slated to run out of money, congress enacted a series of amendments which shored up the plan and put it on track until the mid-2030s, which is where we are today.

In April of this year the federal government announced that if no changes are made that the Social Security Trust Fund will again face running out of money in 2035.

That means that there will be no extra money sitting there any longer to be used to help pay benefits – but it doesn't mean that no benefits could be paid. Remember that Social Security has three general working parts – inflows, the Trust Fund (pool of money) and outflows. Even if the Trust Fund were gone there would still be inflows, because people are working and paying into the system every day, so there would still be cash flow available to pay benefits (outflows). They just wouldn't be able to pay the full amount of benefits that they have been projecting.

Current estimates say that if no fixes are made to the system and all benefits have to eventually only from inflows that monthly payments will be reduced to 79% of what they are currently projected to be. Not ideal certainly but also no where near the "I can't count on anything" level of fear that I think many people have.

Realistically there are changes that could be made to Social Security that would fix it, either incrementally or more comprehensively. Some of those changes, like adjusting the inflation index used to determine cost of living increases, have bipartisan support and would probably not cause too much political turmoil, but people get upset any time touching Social Security comes up so I doubt anything will happen soon.

Most likely congress will wait until the last minute to address the issue again but even if they do, keep in mind that some amount of Social Security benefits will still be there, even if the Trust Fund is not.

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