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The Risk of Reduced Social Security

Are you afraid that social security benefits will disappear? You're not alone. A 2023 survey from the Nationwide Retirement Institute found that 3 in 4 people over age 50 are concerned about social security reductions and payments stopping in their lifetime. Negative headlines about social security, especially recently, are further stoking fears.

Concerns that the Social Security trust fund may deplete are legitimate, but media outlets tend to overstate how this could impact benefits. Social security benefits are mainly funded by taxes on earned income, not the trust fund. However, over the past few years payroll tax collections have been insufficient to cover benefit payments. As a result, the Social Security program has withdrawn from its trust fund. The Social Security trustees' latest report estimates that the trust fund will deplete in 2033. At that point the current plan is to reduce benefits by about 25%.

Economists proposed solutions to avoid reducing benefits, but Congress hasn't acted yet. One solution is taxing a larger portion of income by raising the cap on the amount of income that is taxed, from up to $168,600 today to a larger number. This forces higher-income taxpayers to allocate more of their salary to FICA taxes. Another solution is to increase the full retirement age so that benefits start later. Increasing the retirement age impacts those who are further away from retirement the most. Lastly, an option is reducing the annual cost-of-living adjustment on social security benefits. The adjustment helps keep income in-line with inflation, and a reduction decreases a recipient's purchasing power over time.

A less popular idea is reducing benefits for high income earners by implementing some form of wealth or income thresholds. Another plan raises the payroll tax rate. This could affect all workers. The social security tax rate is currently 6.2% for the employer and 6.2% for the employee, 12.4% total, and all earners could see that rate increase.

In summary, Congress may consider various solutions to keep the social security program intact. The question is what option they will choose, and when they will act. If past behavior is an indicator, Congress is unlikely to act until the fund is nearly depleted, presumably in 2031 or 2032.

For those who are nervous about losing a portion of social security benefits, a comprehensive retirement plan can help understand the impact. Those over age 55 likely have less to be worried about since they are in or close to retirement. Those under the age of 55 might see a reduction in their benefits in some form, but it's unlikely that benefits will go away. Clients whose retirement plan depends on receiving 100% of a social security benefit might need to save more and spend less. Some will need to rely more on their investment portfolio to cover expenses.

Planning for reduced social security benefits will help improve the resilience of your plan and may require a different planning focus. Increasing your dependence on portfolio assets requires an understanding of safe withdrawal rates, managing income tax brackets, and calculating the withdrawal ratio from taxable, pre-tax, and tax-fee accounts to minimize taxes over the long term.

We cannot control the federal government's decisions, but we can prepare and guard against risks that could jeopardize your lifestyle in retirement.

Please reach out to your Wealth Manager with questions about social security.

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