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On the Issues

Benefit Growth That We Cannot Afford

By Alan D. Viard

Buried in the 227-page Social Security trustees' report are some dramatic numbers about Social Security's future promises. AEI resident scholar Alan D. Viard tells us that "a typical worker retiring in 2050 has been promised 47 percent more than today's retirees, and one retiring in 2080 has been promised more than double today's benefits." To address the program's financial problems, he says, the rules need to be changed to link future retirees' benefits to inflation. That move, he says, would go a long way toward solving the system's problems.

Last week, the Social Security trustees released their annual report, warning us yet again that the program is headed toward insolvency. As they did last year, the trustees projected that the trust fund will be exhausted in 2041. Unless changes are made, promised benefits will not be paid in full after that date. Fortunately, though, a close look at last week's report suggests a straightforward solution to the program's financial ills.

It is often said that the devil is in the details. In this case, that is definitely true. The hardy souls who wade through the trustees' 227-page report will find some revealing numbers tucked away in a table on page 193. By highlighting one of Social Security's problems, those numbers point the way toward a solution.

The numbers tell us that Social Security has promised benefits to future retirees considerably more generous than what today's retirees are getting. After adjusting for inflation, a typical worker retiring at age sixty-five in 2030 has been promised benefits 18 percent higher than a typical worker retiring at age sixty-five in 2008. A typical worker retiring in 2050 has been promised 47 percent more than today's retirees, and one retiring in 2080 has been promised more than double today's benefits.

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The bottom line is that benefits are scheduled to grow significantly faster than inflation.

As most people know, after a retiree starts drawing benefits, he or she gets cost-of-living adjustments to keep up with inflation—no more, no less. But completely different rules are used to set the retiree's starting benefit. The starting benefit is linked to the average worker's wage in the economy at that time.

This wage linkage drives the benefit growth described in the trustees' report. Of course, wages sometimes lag behind inflation, particularly during economic downturns like the one we are in now. Over the long haul, though, wages tend to grow about 1 percent per year faster than inflation. By linking future retirees' benefits to wages, the current Social Security rules lock in benefit growth that outpaces inflation.

If there were no demographic changes, we could afford to let benefits keep up with wages. After all, higher wages produce higher payroll tax revenue, which can be used to pay higher benefits. But that logic breaks down in the face of longer life expectancy and the baby boomers' retirement. Today, there are more than three workers supporting each retiree; by 2050, there will be only two. We cannot afford to link benefits to the average worker's wages when the number of workers earning those wages is steadily falling.

As is often true, recognizing the problem is the first step toward finding a solution. To keep Social Security in the black, we do not need to cut benefits below today's levels. All we need to do is keep them from growing. Let us change the rules to give future retirees the same benefits as today's retirees, adjusted for inflation. The actuaries estimate that this one simple step would solve Social Security's financial problems.

We would not have to apply this approach across the board. We should probably maintain scheduled benefit growth for workers with low lifetime earnings, while stopping or slowing benefit growth at the middle and the top. (That is what President Bush proposed in 2005.) With that modification, the plan would no longer close Social Security's financial gap, but it would still make a big dent in it.

Restraining benefit growth would be far better for the economy than raising taxes. As benefit growth slows, workers would do more private saving for their retirement, either on their own or through possible government-established personal accounts. The extra saving would boost business investment, expand the economy, and push up wages.

The bottom line is that Social Security benefits are scheduled to grow significantly faster than inflation.

Social Security is financially unsustainable in its current form. Benefits cannot keep going up the way they have been. Relative to today's levels, though, they do not need to go down either. By keeping benefits on an even keel, we can put Social Security on a sound financial footing.

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