Will You Be Able to Rely on Social Security When You Retire?

With the Social Security trust fund reserves dwindling, younger Americans are wondering if they will be able to rely on Social Security when they retire and how they can plan around its uncertain future.

The Social Security trust fund reserves are now projected to run out in 2033, a year earlier than the estimate last year.*

By any measure, Social Security is the backbone of American retirement. It provides benefits to almost 50 million retirees and accounts for about 30% of the average retiree's income -- and 50% or more of income for about 40% of recipients. Workers and employers pay a lot for this benefit -- each is taxed on 6.2% of wages up to the taxable maximum -- and the self-employed pay 12.4%. Accordingly, all count on Social Security to be there when they retire.

But the future of the program is by no means certain. Since 2010, it has been running deficits -- amounts paid out for benefits have exceeded amounts brought in through taxes. Longer lifespans have increased demands on the program, while lower birth rates have constrained its funding. Consider that in 1950, there were 16.5 workers with earnings covered by Social Security taxes for each retiree. Today, there are only 2.8 covered workers for each Social Security beneficiary. According to the latest estimate by the Social Security Administration (SSA), the trust fund that pays retirement benefits (Old-Age and Survivors Insurance, or OASI) is projected to run out in 2033 -- just 10 years from now.

That means that the trust would only be able to pay 77% of scheduled benefits after that point. Unless changes are made before then to bolster the program, millions of Social Security recipients could see their benefits cut significantly.

Ways to Fix Social Security

Thankfully, this unappealing scenario is avoidable. There are a number of ways to shore up Social Security. Below are just some of the actions being considered.

Increase the Social Security tax. Different proposals have been made to gradually increase the FICA payroll tax rate. One offered by the SSA suggests raising the tax by 0.1 percentage point per year between 2026 and 2045 -- a total increase of two percentage points. Other proposals involve taxing other income sources besides wages.

Increase or eliminate the limit on income subject to Social Security tax. Currently, only wages of up to $160,200 (in 2023) are subject to Social Security taxes. Above that, no taxes are withheld or paid. Raising or eliminating that limit could significantly reduce the shortfall.

Raise the full retirement age. Anyone born in 1960 or later can start collecting his or her full retirement benefit at age 67. Before a 1983 law mandated a gradual increase, the full retirement age was 65. Given today's higher life expectancies and longer retirements, proposals have been made to gradually increase the age to 69.

Phase out benefits for those with higher incomes. There are no income limits for collecting Social Security. Whether your annual retirement income is $20,000 or $2,000,000, you are still eligible to receive a Social Security check, though it may be taxed differently. Phasing out benefits for those with higher incomes in retirement could significantly reduce the shortfall.

Change the formula for benefit calculations. The complex formula currently used to determine Social Security payments uses your highest 35 years of salary history to determine your retirement benefit. Changing the formula could help extend the life of the reserve.

Change the formula for cost-of-living adjustments (COLAs). Each year, the Social Security Administration adjusts its monthly payments for inflation. In 2023, for instance, payments went up 8.7%. The increase is based on the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W). But there are other measures of inflation that rise less over time by accounting for changes in consumer spending patterns as prices increase. Lower COLAs would help reduce the deficit.

There are many other proposals on the table besides these. All face political hurtles. Democrats tend to support those that boost tax collections, while Republicans lean toward those that reduce benefits. In the end, some compromise will likely be reached, as it would be political suicide for either party to let the fund run out.

Ways to Plan Around Social Security

The takeaway here is that Social Security is not going away. But benefits could be reduced or pegged to income level, and the full retirement age could be increased. That's why it's more important than ever to have your own retirement nest egg.

Take advantage of workplace plans and IRAs. Whether it's a 401(k), 403(b), or 457 plan, make sure to participate in and contribute to these tax-saving plans, if offered by your employer. Your contributions are deducted automatically from your paycheck, and many companies will match a portion of it. You can also open an IRA, which features similar tax benefits.

Start saving early and regularly. Saving for retirement should be a priority throughout your career. The earlier you start, the more you will benefit from the power of compounding.

Work with a professional. Retirement income planning can be complex, involving Social Security, pensions, annuities, and personal savings. A financial professional can help you formulate a plan and help stay on track to meet your retirement goals.

*Old-Age and Survivors Insurance Trust Fund reserves. Source: Social Security

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