Social Insecurity

- As this article indicates, current workers pay the benefits of current retirees. The boom/bust cycle of demographic trends can play havoc with a benefit system structured in this way.
- Unfortuntely, we are entering a period where fewer workers are available to pay the benefits of the baby boomers.

All of us who work feel the bite that Social Security taxes take out of our paycheck. Most of us take comfort in the hope that when we retire, Social Security will be there, giving back all the money that we paid into the system over the course of our careers. Isn't that how it works?

Well, the short answer is no, it doesn't work that way. The Social Security taxes deducted from your paycheck are not sitting in a special account someplace, earmarked to be returned to you upon your retirement. Instead, the taxes you pay today are used to pay benefits to today's beneficiaries, just as when you retire, the benefits you receive will come from the taxes paid by people who are still working. This arrangement works as long as there are enough people sending in taxes; it doesn't work so well if the number of current workers per retiree is decreasing.

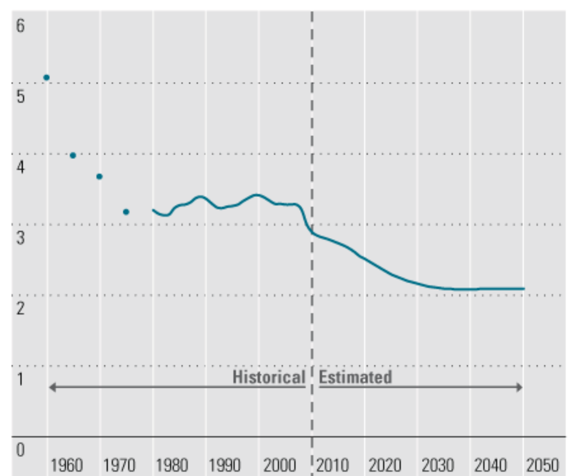
The baby boomer generation (those born between 1946 and 1964) have started to retire in 2010. This large group's retiring, coupled with increasing life expectancies and decreasing birth rates, means that the number of retirees will grow faster than the number of workers. As the graph illustrates, according to the Social Security Administration, the number of workers sending in Social Security taxes to pay each retiree's benefits has plummeted from 42 workers per beneficiary in 1945 to 2.9 in 2010. What is more is that this number is projected to go down even further to 2.1 workers per beneficiary by 2035. Since the ratio of workers to retirees is expected to continue declining, a shortfall in future Social Security funding is likely.

The trustees of the Social Security program estimate that benefits paid will exceed payroll taxes collected in 2010 and 2011, be less than payroll taxes collected in 2012 through 2014, then once again exceed tax income in 2015 and remain higher thereafter. Moreover, they are forecasting that the Social Security trust fund will be exhausted in 2037 unless changes are made.

What does all this mean for you? Well, that depends on how old you are and what changes the United States government decides to implement. If you are nearing retirement, it is unlikely that your Social Security benefits will change dramatically. Younger workers, however, are more likely to see sweeping changes in the way Social Security works in the form of higher taxes, lower benefits, or a combination of the two.

Bear in mind that Social Security was never intended to provide Americans with all of the income they would need in retirement. Social Security is only one leg of a three-legged stool that also includes pension plans and personal savings. With concerns mounting over the stability of one leg of the stool, you need to take control of your retirement by investing in personal savings plans such as IRAs and 401(k)s.

Ratio of Workers to Beneficiary



Source: The 2010 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds, August 2010, Social Security Administration.