- **Social Security** faces challenges.
- Retirement **for future generations** is at stake.
- Here are **10 options** on the table.

Time for a Tune-Up

By Jonathan Peterson

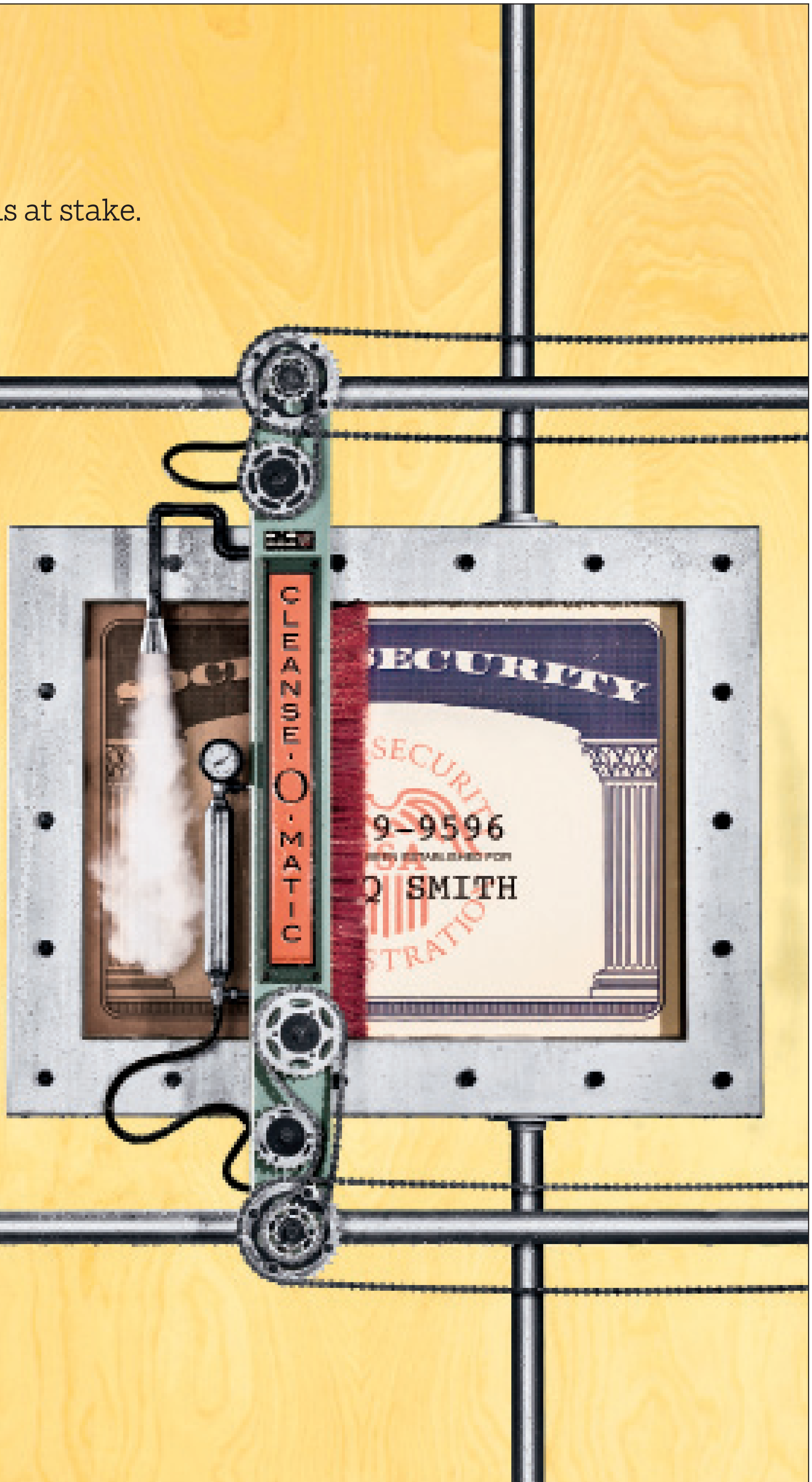


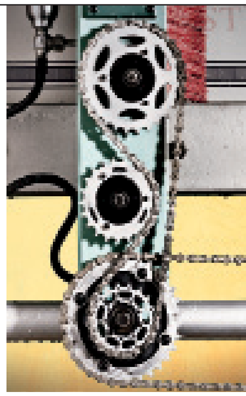
Photo illustration
By Dan Winters

In just 21 years, Social Security will be able to pay only three-fourths of its promised benefits, an outlook that guarantees debate about the future of—and the meaning of—Social Security in American life. Yet the projected shortfall is not the only challenge facing the program and those who depend on it. Changes in lifestyle, demographics and the economy are bringing *insecurity* to many older Americans.

Experts have put forth a number of proposals that in some combination could sustain Social Security for the long haul, while making it more helpful and fair. Here are 10 options now on the policy table in Washington:

1. Increase the cap

You make payroll tax contributions to Social Security on your earnings up to a limit ($110,100 in 2012). If you're like most workers, you earn less than the cap. Increasing the cap to $215,400—so that 90 percent of U.S. earnings are covered—would reduce Social Security's shortfall by about 36 percent. Eliminating it altogether would end almost all of the shortfall in one stroke. Supporters say that raising the cap would be fair and that the amount would not be onerous. The main argument against such a rise is that high earners already get less of a return on contribu-



tions than lower-income workers, because benefits are progressive by design. Also, raising the earnings base would amount to a big tax hike on high earners.

2. Raise the payroll tax rate

In recent years, wage earners have paid a Social Security tax of 6.2 percent on earnings up to the income cap, as have their employers. (Congress temporarily cut the employee share to 4.2 percent in 2011 and 2012 as a way to boost the economy.)

Raising the tax rate to 6.45 percent for both employees and employers would eliminate 22 percent of the shortfall and could be phased in. Critics voice concerns about the economic impact and say employers might respond by cutting other payroll costs, such as jobs.

Other ways to raise revenues include increasing income taxes on benefits. Taxing the money that goes into "salary reduction plans," which let you divert pretax income to health care, transit and other uses, could reduce the shortfall by 10 percent. But such a move would hit consumers who may rely on such accounts.

3. Consider women's work patterns

Women workers—single or married—tend to get lower benefits because they're paid less over the course of their careers and because they are more likely than men to take time off from paid employment for caregiving or child-rearing. One proposal would give workers credit for at least some of the time spent caregiving or child-rearing. At the same time, a non-married woman potentially gets a much smaller benefit (depending on her earnings history) than a nonworking wife because she can't rely on a higher-earning spouse for benefits. Measures addressing these issues would be gender-neutral, so they could also help some men. The cost of such a proposal would have to be offset, however, or it could increase the shortfall.

4. Adjust benefits

Benefit cuts are nothing to cheer about, but they would save money. They could be structured in a way that doesn't hurt current or near-retirees and low-income individuals. Any changes could be phased in after a long lead time, giving younger workers years to adjust their financial plans.

Still, reducing benefits for modest-income people could affect their standard of living in retirement. Reducing benefits for higher earners could undermine the broad public support for Social Security as a program in which everyone pays in and everyone gets benefits.

5. Set a minimum benefit

People who had low incomes during their working lives—perhaps one in five earners—now may end up with benefits that are still below the poverty line. A minimum benefit might be set at 125 percent of the poverty line, indexed to wage increases to keep it adequate over time.

6. Modify the COLA formula

Social Security benefits generally rise to keep up with the cost of living. This cost-of-living adjustment, known as the COLA, is currently based on the Consumer Price Index for Urban Wage Earners and Clerical Workers (known as CPI-W).

One proposal would switch to a different measure, the "chained CPI," which assumes consumers alter their buying patterns if a price goes up too much. Say the price of beef soars—people may switch to chicken. The chained CPI rises about 0.3 percentage point more slowly each year than the CPI-W, meaning benefits would grow more slowly, too—about 6 percent less over the course of 20 years. Adopting a chained CPI would reduce the shortfall by about 23 percent.

Another approach would substitute a formula known as CPI-E. It takes into special account the type of spending that is more common among people 62 and older, such as medical care, which continues to rise faster than other costs. This could increase benefits, expanding the shortfall by about 16 percent.

7. Raise the full retirement age

The age at which you can get full Social Security benefits is gradually rising to 67 for people born in 1960 and later. Pushing it up even further would save money and provide an incentive for people to keep working.

A full retirement age of 68 could reduce the shortfall by about 18 percent. Raising it to 70 would close 44 percent. Such increases could be phased in, and proponents say this approach makes sense in an era of increased life expectancy. A healthy 65-year-old man, for example, is expected to live beyond 82. But not everyone has benefited equally from increases in longevity—lower-income, less educated workers have not gained as much as their more affluent, more educated counterparts. And a later full retirement age could be onerous for workers with health problems or physically demanding jobs. A related proposal—longevity indexing—would link benefits to increased life expectancy.

8. Give the oldest a boost

Americans are living longer, and the oldest often are the poorest. They may have little savings left; usually they no longer work and any pensions they have are likely eroded by inflation. A longevity bonus, for example, a 5 percent benefit increase for people above a certain age, say 85, could help them.

9. Establish private accounts

Free-market advocates have long pushed to make Social Security more of a private program, in which some of your payroll taxes would go into a personal account that would rise and fall with the financial markets. Supporters believe that stock market returns could make up for benefit cuts. You would own the assets in your personal account and could pass them on to your heirs. Personal accounts could be introduced gradually and become a choice for younger workers, while retirees and near retirees could remain in the current system. Opponents worry that they would replace a guaranteed, inflation-protected benefit for workers and, potentially, family members, with more limited protections. Private accounts only pay out the amount in the account. Also, diverting money to private accounts means additional funding could be needed to pay currently promised benefits.

10. Cover more workers

Not all workers take part in Social Security. The largest uncovered group is about 25 percent of state and local government employees who rely on state pension systems. Bringing new hires into Social Security would raise enough new revenue to trim about 8 percent of the long-term shortfall (though down the road, when these people claim benefits, costs would rise). State and local governments may oppose such a measure because it would divert dollars from public pensions that are already underfunded. □

Jonathan Peterson *wrote* Social Security for Dummies *© 2012 by AARP/John Wiley & Sons Inc. He is an executive communications director at AARP and a former correspondent at the* Los Angeles Times.