

Social Security Highlights



Fixing Social Security: “Means Testing”



William F. Rainaldi, CFP®
Regional Vice President
607-760-3315 • wrainald@smlny.com

Everyone tells us that Social Security needs “fixing,” and that Social Security is going broke. Recent developments have eased these fears somewhat, but the issue is most definitely still with us. We talked about this when the Trustees’ report came out earlier this year. (See *“Social Security Releases Its Annual Report.” Form No. 0014794*).

We have previously discussed some of the proposed fixes in detail. (See *“Will It Still Be There? The Future of Social Security.” Form No. 0014365*). The Social Security Trust Fund, as it currently exists, is not projected to be big enough to cover all of its projected payouts beyond the year 2035. So something needs to be done. There are basically two schools of thought on how to handle this.

Raise The Age to Collect Social Security

Some people favor raising the age to collect Social Security. They argue that over the decades, life expectancy has increased significantly, and Full Retirement Age hasn’t kept up. That means that Social Security now covers a bigger percentage of the American people than was ever intended.

Increase Social Security Withholding

Others argue that increasing Full Retirement Age is, in fact, a de facto reduction in benefits. Their solution is to increase the 6.2 percent Social Security withholding amount beyond the current limit. In 2020, you are not taxed further on Social Security when your wages get above \$137,700. (Of course, you don’t get any corresponding Social Security benefit on those amounts either.) So one powerful way to shore up the Trust Fund is to increase or eliminate that limit.

Means Testing

Some pundits have made a third suggestion: Social Security benefits should be “means tested.” In other

words, if someone makes a million dollars a year, they don’t need Social Security, and shouldn’t be able to get it.

There is certainly some populist political appeal to this. But it doesn’t seem to be getting as much popular support in Washington as the other two. And there’s a good reason for this: disqualifying people who make a million dollars a year won’t actually do very much. Let me explain.

The problem is the math. The maximum Social Security benefit for anyone turning 66 in 2020 is \$3,011 per month, or \$36,132 per year. So that would be the approximate amount the government would save for every individual disqualified due to means testing. Some would lose more than that (some people wait until age 70 to collect); and some would lose less (some people, even wealthy people, start at age 62). Note that there would likely be some additional administrative costs to such a new system, and that would offset some of the gains.

Meanwhile, the Social Security Trust Fund, the place where all the problems are found, is currently underfunded at a value of approximately \$3 trillion. So at an estimated rate of \$36,132 per year,

how many people would it take to make an impact on the \$3 trillion Trust Fund shortfall? In ballpark figures, disqualifying approximately 825,000 people would save about 1 percent per year on the Trust Fund. By all estimates, that's more than the total number of Americans who make more than \$1 million per year,¹ and of course, many of them are not old enough to collect Social Security yet.

Because of this, among the three major "fixes," this would seem to be the one that's least likely to be implemented. It could actually work, but in order for means testing to have any real impact, it would have to affect a significant number of people. This is simply because they would be chipping away at a multi-billion dollar problem at a rate of \$36,000 apiece.

In other words, to have any real impact, a lot of people would have to lose their benefits. Means testing can do only so much unless they disqualify a significant portion of

Social Security beneficiaries. And that could make it difficult to sell politically.

It is also clear that whatever is going to be done, it's a case of the sooner the better.

It's simply an example of how the time value of money works. But that's not how they do things in Washington. My best guess is that nothing is going to happen until the problem is staring us in the face.

People have long since forgotten this, but that is exactly what occurred the last time this happened. In fact, most people seem unaware that there was a last time. But in 1983 the Trust Fund was nearly depleted. Washington solved the problem with a combination of increases in both the tax and the retirement age. A solution like that could certainly happen again.

One final point. In one sense, Social Security is already means tested. The benefit is calculated using what is called your "Average

Indexed Monthly Earnings," or AIME. After this number is calculated, Social Security applies a series of "bend points" to determine what your benefit will be. The bend points are at 90 percent, 32 percent and 15 percent of your AIME. The 90 percent rate applies up to a certain amount (up to \$960 of AIME for 2020). The 32 percent amount applies for amounts between \$960 and \$5,785. The 15 percent rate applies to any AIME over \$5,785. A lower income worker will have most of their benefit calculated at 90 percent of AIME; a higher income worker will have most of their benefit calculated at 15 percent. Thus, while a higher income worker will still get a higher overall benefit, a lower income worker will get a bigger percentage of what they actually paid in.



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¹ Quora Inc. "How Many People in the U.S. Make Over \$1 Million a Year?" Quora.com. <https://www.quora.com/How-many-people-in-the-U-S-make-over-1-million-per-year> (accessed November 4, 2019.)

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0014924XX_122019



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P.O. BOX 1625 • BINGHAMTON, NY 13902-1625
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