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Social Security Jitters? Better Prepare Now

By TARA SIEGEL BERNARD

If you are worried about the future of Social Security, join the crowd.

With the nation's debt swelling, the pressure on Washington to cut spending will only rise. Social Security may not be the first place lawmakers look. But the program, which has provided a significant financial cushion for retirees and others since the first checks were mailed in 1937, will surely be part of the discussion.

The program, which has its own dedicated stream of income, is projected to pay out more this year than it is taking in, but that is a function of the weak economy. Social Security will, according to the last annual report from its trustees, be able to pay full benefits through 2037. Then, if there are no changes in the program in the meantime, the taxes collected will be enough to pay out only about 75 percent of benefits through 2083.

So while Social Security's finances are stable in the short term, most experts agree that the program needs to be bolstered for the long term. Among the proposals circulating is one from Representative John Boehner of Ohio, the House Republican leader, who recently suggested raising the retirement age to 70 for people at least 20 years from retirement.

Other options include increasing Social Security payroll taxes, subjecting more income to the tax,

reducing initial benefit payments or cutting cost-of-living increases (which would affect current retirees).

But even if it's not clear yet what, if anything, will be done to Social Security and when, we thought it would be useful to look at a worst-case possibility — to assume that benefits will not continue to be as generous. This is especially important as pensions continue to fade away.

So what are the financial implications of pushing back the full retirement age? What happens if the government reduces benefits for future retirees? What will that mean to people in the middle of their careers, beyond the rote response that they're going to have to work longer and save more?

Yes, it means fewer dinners out and driving a more economical car. But it also may mean that people in their 20s, 30s or even older have to put aside a lot more money to partly make up for any cut to benefits. Otherwise, people may risk a sudden drop in their living standard when they retire.

And while lawmakers may, in the end, not decide to make drastic changes in Social Security, many of the financial advisers and other experts we talked to said they were erring on the side of caution and were already recommending that their clients start saving more now.

"People 50 and below should change their planning now to incorporate a benefit cut," said Laurence J. Kotlikoff, an economics professor at Boston University who ran some numbers for us to see what life would be like if the retirement age were immediately raised to 70. That change would translate into a nearly 20 percent cut in benefits, because you would have to wait an extra three years to get the same amount of money, he added.

Several financial planners told us they were assuming that clients in their 30s and 40s might receive just 50 to 80 percent of their full benefits. Or, the advisers say, they may figure that the cost-of-living adjustments applied to benefits won't keep pace with inflation, or some other combination of adjustments. (For the record, executives from AARP said their polls had long shown that younger people were skeptical about receiving full benefits.)

"It's better to be conservative now than risk being underfunded for retirement," said Jorie Johnson, a financial planner in New Jersey.

Mr. Kotlikoff's calculations looked at how a couple's spending and saving patterns might have to change if the government raised the full retirement age to 70 (we assumed it was imposed right away, though such a change would probably be phased in over many years). That would essentially translate to a 19 percent cut in monthly benefits, according to Mr. Kotlikoff. He performed the calculations using his company's retirement planning software, ESPlanner, which shows what people need to save to ensure a consistent standard of living over the course of their lives.

Our examples illustrate how a cut in benefits might feel if you had longer to plan for it — say, you were 35 years old when the system changed. We also looked at the repercussions for a 45-year-old or a 55-year-old.

In all cases, we based our assumptions on a married couple with two children and a $350,000 mortgage on a house in New York State. They save 10 to 15 percent of their income during their careers (the rate rises as they age) as well as an additional $100,000 for their children's college education. They earn a conservative 2 percent above inflation on their retirement savings and retire at 65 but take Social Security benefits at 67, three years before full retirement age.

Some people may not have the wherewithal to save a whole lot more. Indeed, about half of all recipients start collecting benefits as soon as they're eligible, at age 62, because in some cases Social Security is their main income.

But here's how a family with more flexibility might fare:

AT 35 YEARS OLD At this stage, our couple are earning $120,000 ($60,000 each) and they have $75,000 in total retirement savings. But to make up for the decline in Social Security benefits, they need to save about $84,474 above and beyond what they are already saving before they retire. We assume they save the extra money in a taxable account that allows for easy access, because they are

already saving 10 percent or more of their total income in a 401(k). That extra money saved is equivalent to about a 7.8 percent increase in total retirement savings, across all accounts. This also means they'll have less discretionary income — about 9.4 percent less to be exact — to spend each year, over the course of their lives.

AT 45 YEARS OLD Our couple now earn $140,000 and has amassed about $255,000 in a 401(k) account. But if they learn their Social Security benefits are going to be cut by nearly 20 percent, they will need to save nearly an extra $90,000 — which is about 8.3 percent more in their taxable and tax-deferred accounts — by the time they retire. To do that, they need to cut their discretionary spending by about 9.7 percent a year for the rest of their lives.

"They have a larger permanent reduction in their living standard than the 35-year-olds because they have fewer years to adjust," Professor Kotlikoff said. "They can't spread out the loss in spending power over as many years."

AT 55 YEARS OLD Informing people a mere decade from retirement that their Social Security payments will be cut or that the retirement age will rise, is not likely, experts said. Even so, let's assume the worst for a moment.

At 55, our couple are earning about $175,000, and has nearly $525,000 in total retirement savings. But to help offset the lost Social Security money, they will need to save $82,900 more — or nearly 7.7 percent across all accounts — over the next decade. To do that, they will have to spend 10.4 percent less each year.

"Increases in Social Security's retirement age is another way to say Social Security benefit cut," Professor Kotlikoff said. "And big benefit cuts, like those being contemplated, will mean big hits to the spending power of the affected generations. Younger cohorts would suffer less pain, but for a longer time, while older cohorts experience more pain for a shorter time. Either way you cut it, it hurts."

One financial planner, who has dual citizenship in the United States and Greece, said he was not taking

chances. “Having seen what happened in Greece, I feel even more strongly today that I should not count on any Social Security for me and my younger clients,” said the planner, George Papadopoulos, 43, of Novi, Mich. “I will continue to tell clients not to highly rely on Social Security and think of any money coming their way as gravy.”

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