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Impact of Pandemic on Social Security

The financial effects of the coronavirus pandemic can be more far-reaching and long-lasting than many people realize. Perhaps the longest-lasting and stealthiest negative effect of the economic downturn from the coronavirus will fall on those born in 1960. They are likely to feel the effect for the rest of their lives through lower Social Security retirement benefits.[1] If Congress does nothing to shore up the Social Security Trust Fund, benefits will be cut 21% when the fund is depleted, which could happen as soon as a dozen years from now if not sooner. Pre-retirees born in 1960 face an additional risk due to the complicated formula the Social Security Administration uses to calculate benefits.[2]

TURNING 60 THIS YEAR?

Pre-retirees born in 1960 may suffer a blow to benefits. That's because the Social Security Administration employs a complicated formula to calculate benefits, which includes using the top 35 years of a retiree's earnings, adjusted by an indexing factor. That factor, in turn, is based on the Average Wage Index for the year an individual turns 60, which will be 2020 for those born in 1960.

Job losses and declines in average wages this year due to the pandemic will affect the average wage index, which has risen almost every year since the 1950s, according to Wade Pfau, director of the Retirement Income Certified Professional (RICP) program at the American College of Financial Services. The index fell in 2009 but only slightly, according to Pfau. "We don't know what will happen this year but if the average wage index has a dramatic drop, then suddenly those born in 1960 would have a lot lower benefit than those born in 1959," said Pfau.

Social Security benefits for those beneficiaries could decline by 13% and "smaller benefit reductions" were possible for those born after 1960 "at least until average economy-wide wages recover to their previously projected levels," according to a study from the Wharton School of the University of Pennsylvania. The study assumed a 15% decline in the Social Security Administration's measure of average wages for 2020.[1]

COLA NEAR ZERO

A more immediate concern, and one that will affect all Social Security beneficiaries, is the expectation of a near-zero cost-of-living adjustment for 2021. The COLA, which is tied to the Consumer Price Index for Urban Wage Earners and Clerical Workers, may be half of this year's COLA, which was just 1.6%, said Heather Schreiber, president and founder of HLS Retirement Consulting, who also participated in the webinar. The Senior Citizens League, an advocacy group to protect Social Security, Medicare and retired veterans benefits, has reported that the recent plunge in oil prices has "all but wiped out" the prospect of a Social Security COLA for next year.[2]

Impact on Lifetime Retirement Benefits

The Social Security Administration uses your lifetime earnings record as the foundation for calculating retirement benefits. Of course, your benefits are likely to be lower than they would have been if you lost your job or your income declined during 2020. While this might reduce your lifetime benefits by some amount, the loss of or a reduction in one year's earnings isn't the worst effect from the pandemic.

After Social Security compiles your lifetime earnings record, each year's earnings is indexed to the growth or inflation of national average earnings during your lifetime. In other words, your earnings of years ago are adjusted to make them equivalent to today's earnings.

After the wage inflation adjustment, Social Security makes a few other calculations to arrive at your monthly retirement benefit. But for those born in 1960, the wage indexing is the key step. The indexing takes place for the year you turn age 60 and ends there. Those born in 1960 reach their 60th birthdays in 2020. Earnings after age 60 aren't indexed. Instead of having an increase in national average earnings for 2020, we're likely to have a decrease from 2019. The large amount of unemployment and reduction in economic activity from the pandemic probably will cause this decline in average earnings, though we won't know for sure until after the end of the year.

The reduction in national average earnings will reduce the indexed lifetime earnings of everyone born in 1960 and reduce their monthly Social Security retirement benefits, regardless of the age at which each claims the benefits. If the negative economic effects of the pandemic match the negative scenarios anticipated by some analysts, average earnings could decline for another year or so, reducing the benefits of those born after 1960.[1]

RUNNING DRY

The 21% benefit cut would affect retirees already collecting benefits as well as future beneficiaries, according to former Sen. Kent Conrad, D-N.D. “When Social Security can’t meet its legislated obligation, then there will be an across-the-board cut to match income and revenue,” Conrad said. “All of us believe Congress won’t allow Social Security to become insolvent, but if it fails to act, we would face those cuts.”

A fix for Social Security is a challenge in ordinary times, but during the COVID-19 pandemic it may be impossible. The pandemic and subsequent lockdowns have pushed the U.S. economy into a recession, leaving 20 million unemployed Americans who, along with their employers, are no longer contributing the taxes that are funneled into the Social Security Trust Fund on their behalf.

Another Wharton study, published in late May, found that the Old Age, Survivors, and Disability Insurance Trust Fund, which includes two separate trusts — one for retirees and one for disabled individuals — could be depleted as much as four years earlier than expected because of the impact of the pandemic, in 2032.[2]

WHAT’S YOUR PLAN?

Like Medicare, Social Security is a key decision in retirement planning. And similar to Medicare, its very strength can be its weakness – namely, the number of options available to you. Now that we have the additional issue of a potential reduction in Social Security benefits, you have one more concern to factor into your retirement planning. Everyone has their own decisions to make regarding Social Security, but below are some thoughts on general principles to consider in your planning.

- Social Security benefits are not likely to stay as is. Either benefits are going to decrease, or taxes on the benefits will increase.
- Consider factoring in a cushion between the government projected benefit and the amount you assume for your retirement income plan. The size of the cushion should increase the more years you have until you retire.
- If you are experiencing cash flow constraints during the pandemic, claiming Social Security early is an option, but one to avoid. While you can potentially unwind the election, there are challenges with doing so.

WHAT'S YOUR PLAN?

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- Claiming Social Security early to lock in some benefits before the system fails is not a sound strategy.
- Because of the significant increase in benefits afforded by waiting, it is usually better to delay claiming Social Security for as long as possible.
- Get some help. The SSA is a great starting place, but professional advice is usually needed as well.[3]

SOURCES:

[1]Carlson, Bob. "The Pandemic Could Slash Social Security Benefits of Some Current and Future Retirees." Forbes. May 15, 2020.

[2]Napach, Bernice. "Clients Born in 1960 Could Take a Big Social Security Hit." ThinkAdvisor. June 15, 2020.

[3]Parrish, Steve. "How To Build Social Security's Insecurity Into Your Retirement Plan." Forbes. June 16, 2020

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