Chapter 2

Social Security Old-Age and Survivors Insurance Program

Social Security (OASI[a]) by the Numbers (2007)

Workers Paying Social Security Taxes	163.2 million
OASI Tax Rate	5.3 percent (in 2009)
Maximum Wage Taxed	$ 106,800 (in 2009)
Total Receiving Benefits	40.9 million
Retired workers	31.5 million
Wife, husband, child of retired worker	2.9 million
Survivors	6.5 million
Average Monthly Benefit	
Retired workers	$ 1,055
Benefits as a Percentage of GDP	3.49 percent
Administrative Costs as Percentage of Taxes Collected	0.5 percent

Source: Social Security Administration, *The 2008 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds* (Baltimore, MD: U.S. Social Security Administration, 2008).

[a] Old-Age and Survivors Insurance.

Introduction

Social Security is an income replacement program designed to provide basic support for former workers and their dependents. It is the core of the federal government's social safety net and the largest single entitlement program in the nation. It pays benefits to more Americans than any other program. For many workers, Social Security taxation exceeds their federal income tax bill.

From the time of its enactment as a New Deal program in 1935, the Social Security law has been used as the legislative basis for many other social programs. There are three major programs under Social Security: Old-Age and Survivors Insurance (OASI), which provides retirement income to the elderly; Disability Insurance (DI), which provides support to Social Security participants who are disabled and unable to earn enough to support themselves; and Medicare, the federal health care insurance program for the elderly and disabled. In its annual report, the Social Security Administration provides data on each program separately but also combines data from the retirement and disability programs to provide overall numbers on retirement income and disability assistance (OASDI, or Old Age, Survivors and Disability Insurance). This chapter deals only with the OASI portion; also see the chapters on Disability Insurance and Medicare.

Social Security collects taxes from nearly all workers and their employers (each pays 6.2 percent on earnings below an annual ceiling, currently $106,800 in 2009), and uses this money to pay benefits to those with a work history who have become eligible because they have reached a minimum age threshold (62), and to those who are no longer able to work and to their dependents. The benefits, which are adjusted upward annually to track inflation, are paid monthly. The program is administered by the Social Security Administration.

Historically, the program's income has typically exceeded the amount needed to pay current benefits, and any surplus is loaned to the government to help finance the federal debt. Current projections suggest that tax payments will be inadequate to finance promised benefits within the next decade or so, and that the program will not have adequate resources to pay the full amount of promised benefits by mid-century even after the money now loaned to the federal government is repaid with interest. This has generated a debate on how to reform the program to assure continued solvency.

The History

In 1935, President Franklin D. Roosevelt proposed, and Congress expeditiously enacted, the law creating today's Social Security program. This law contained several other important programs, including the basis of today's unemployment insurance and programs to provide aid to families with dependent children. As initially written, the program covered more than 30 million workers but excluded large groups, including the self-employed, government workers, and agricultural and domestic employees.

The law called for covered workers—and their employers—to begin paying taxes on their earnings. This money would accrue and would be used to pay for benefits that would first be available in 1942. The lag between the onset of tax collection and the payment of benefit was designed to assure that the program was self-funded and did not create demand on general federal revenues.

Starting in 1937, workers and employers each paid a 1 percent tax on the first $3,000 of earnings. Today, each pays 5.3 percent for retirement benefits and an added 0.9 percent for the subsequently added disability coverage, for a total levy of 6.2 percent.

From the start, it was agreed that Social Security benefits would be adequate to fund a modest lifestyle, but not a comfortable one: The program was never intended to be retirees' sole source of income. Instead, it was assumed that personal savings, sometimes augmented by employer-provided pensions, would be required to guarantee a retiree the standard of living previously enjoyed as a worker.

It was also agreed initially that the program would have redistributive features that would help alleviate poverty by providing more generous benefits to low-income workers. So while it is true that high-income workers receive the biggest benefit check, low-income workers get more benefit per dollar paid in taxes. Stated another way, Social Security replaces a far higher proportion of low-income retirees' previous salaries than it does of high-income retirees' salaries.

Congress began to expand benefits under the program in 1939, before any had yet been paid, making benefits initially available in 1940 and making dependents and some survivors of beneficiaries eligible for benefit payments as well.

Because the benefit payment formula was a fixed one, the value of benefits deteriorated as wages and prices rose. Congress increased benefits from time to time in an effort to maintain their purchasing power. In 1972, these ad hoc adjustments were abandoned when the program was modified to annually adjust benefit payments upward so as to track inflation. Basing this adjustment on prices rather than wages guaranteed that recipients' purchasing power would remain constant even if wages rose more slowly than prices. This decision first accelerated the program's financial problems, but has had a positive impact in recent years. The adjustment formula has been tinkered with subsequently, and in 1977, the program was modified so that incomes were indexed when benefits were computed, thereby maintaining the purchasing power of benefits relative to wages. Social Security taxes were raised repeatedly over the same period to finance this richer benefit package.

In 1983, when the program was on the cusp of financial instability, several major changes were made to expand the tax base and reduce "full" benefits, leading to the program that is in place today, including these features:

- Nearly all workers are required to participate in the program, including government workers and those employed by nonprofit entities. Today, more than 95 percent of all U.S. workers are in the program; when the program began, slightly more than half were in it.

- The normal retirement age, when beneficiaries could receive “full” benefits, would gradually rise from 65, reaching 67 in 2012. Reduced benefits continue to be available at age 62. Workers who delay the onset of benefit payments receive a larger benefit.
- Some Social Security benefits received by wealthier beneficiaries were subjected to federal income tax for the first time. The money raised augments the Social Security trust funds.

While those who created Social Security anticipated a system in which benefits would be paid to those who had quit the work force, changing retirement patterns resulted in subsequent changes that allowed older Americans to simultaneously receive Social Security benefits and wage income. Currently, workers over 62 can earn a limited amount of income without jeopardizing their Social Security benefit payments, while those at or above the normal retirement age can earn an unlimited amount. In recent years, more than three of every four beneficiaries have elected to receive benefits before age 65.

Insofar as Social Security faces a problem paying future promised benefits, as many projections now suggest, the cause is basically demographic change as the post-World War II baby boom generation retires and increased longevity has caused the aged population to dramatically expand. Basically, today’s workers are paying taxes that become payments to today’s beneficiaries. When the ratio between workers and beneficiaries declines, as has been happening lately, it becomes more probable that taxes ultimately will prove inadequate to pay benefits. In 2007, there were 3.3 workers per retirement beneficiary. Government figures project that number will decline to 2.2 by 2030.

Participation

Mandatory participation in Social Security is required for nearly all workers, and their participation rate will grow in the years ahead as those whose non-participation in the program was “grandfathered” leave the work force. More than 96 percent of all workers are already included. Although some churches are exempt from responsibility for paying the employer portion of Social Security, their workers must file and pay taxes as self-employed workers. A declining number of long-time state and local government employees in localities that did not participate in Social Security in the past currently still remain exempt. However, certain state and local worker categories remain exempt even for new employees. Many railroad employees are covered by the Railroad Retirement Program instead of Social Security, but both the costs and benefits involved closely resemble those of Social Security.

Benefits

Each year, the Social Security Administration provides each participating worker with a statement of account, indicating how much has been paid on his or her behalf and what retirement benefits can be anticipated. This mechanism is designed to help prepare workers for retirement while encouraging them to correct faulty Social Security records in a timely fashion rather than waiting for the period immediately prior to planned retirement to detect mistakes made years or even decades earlier.

The amount of benefits earned depends on a formula based on the number of *years* that Social Security taxes have been paid, the amount of *taxes* paid, and the *age* when benefits are first paid. As a general rule, a worker is considered fully insured when he or she has paid Social Security taxes on a minimal income (adjusted annually, currently below $1,000) for 40 quarters. Once this threshold is met, earnings over a 35-year period are considered in determining the benefit amount. Those who have earned the most get the biggest benefits. But the system provides a greater relative benefit to those at lower income levels (there is some research indicating that, on a lifetime basis, the high- and low-earners get the same rate of return, as higher earners are more likely to live longer than lower earners). The computation indexes prior earnings so as to give pension payments purchasing parity for a salary earned at an earlier time when prices were substantially lower.

Additional benefits are available for spouses and other dependents as well as dependent survivors of Social Security recipients. Benefits are also paid to divorced spouses if they are at least 62 years old and the marriage lasted at least 10 years.

Reform Options

By the beginning of the 21st century, there was widespread belief that, unless changes were made, by mid-century the Social Security retirement fund would become insolvent and unable to pay the benefits that future beneficiaries are eligible for under current law. If the existing program were left in place, benefit cuts of roughly 30 percent would be required to balance income with outgo or taxes would have to be raised—perhaps to nearly 20 percent of taxable payroll during the latter half of this century.

Similar problems in the past have resulted in plans that either reduced costs (by cutting benefits or raising the eligibility age), increasing income (by increasing the wage base or the tax rate) or, as was done by Congress in 1983, both.

But some have suggested that more basic changes in the program are in order and argued for gradual replacement of the centralized, government-run program with individualized tax-advantaged savings plans. Advocates said this would allow workers to get a greater return on their savings, and provide greater options. Under current law, for instance, there are no benefits provided when a worker lacking dependents dies before reaching Social Security eligibility age. Some proposals would allow funds saved by a deceased individual to go to his or her estate. Moving toward such a "privatized" system could also reduce or repeal the redistributive aspects of the current programs, which would be advantageous to high earners (Ferrara, 1999).

Critics of a privatized Social Security system argue that individual accounts would fundamentally alter the basic design of the program as a self-supporting social insurance program, would benefit the wealthy at the expense of low-income individuals, would put low-income elderly (especially women) at greatest risk, and ultimately would fail to solve or could even worsen the program's financial problems (Social Security Network, 2002).

Little noted in the political debate are the potentially massive administrative and record-keeping issues that would be involved in changing the world's largest defined benefit retirement system (which can tolerate years of delays in crediting Social Security tax payments to individual workers) to one which was even a partially defined contribution system (where speed and accuracy of individual contribution deposits are essential). Whatever kind of plan Congress enacted, a key question would be how and at what cost would the nation's payroll system be able to adapt to a fundamental restructuring of the Social Security tax payment system to allow for individual accounts. This could be a serious issue especially for small employers, who tend not to have automated payroll systems (Employee Benefit Research Institute, 2001; Howe and Jackson, 1999; and Olsen and Salisbury, 1998).

The broad idea of privatization generated substantial debate when the stock market was rising at double-digit rates, but interest seemed to abate as the market declined in 2000–2001. When the Bush administration took office in 2001, it embraced the concept of such an individual account plan, but never offered a specific proposal. A commission named by the president to study options within parameters set by the White House also failed to come up with one specific plan. Some members of Congress have recommended an intermediate approach, allowing some portion of Social Security taxes to be diverted into special individualized accounts.

While supportive of such an approach, the President's Commission to Strengthen Social Security noted that, although it might solve the program's long-term problems, it would not resolve the short- and intermediate-term shortfall. Indeed, the creation of a new program might require even greater financial support during the transition period. Ultimately, the commission presented three different reform "models" incorporating some sort of individual Social Security account to at least supplement the existing system (President's Commission to Strengthen Social Security, 2001).

The program's trustees currently estimate that the solvency problem will begin to affect benefits sometime during the decade of 2040 unless the program is modified. There is broad agreement that delay will only make all the options even more draconian, meaning even deeper benefit cuts or tax increases (U.S. Social Security Administration, 2008).

A closer threshhold, which is anticipated in the next decade, comes when Social Security starts collecting less in taxes than it is committed to paying out. At that point, the program will no longer be able to loan the federal government money to finance the federal debt and will start requiring repayment of previous loans. However, it is important to remember that none of these scenarios envisions a situation in which Social Security would be unable to pay *any* benefits. In the event of the worst-case scenario, Social Security is projected to have adequate resources to pay more than 70 percent of promised benefits because of the continuing inflow of funds from Social Security taxes.

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Additional Information

American Association of Retired Persons
601 E Street, NW
Washington, DC 20049
(202) 434-2277
www.aarp.org

CATO Institute
1000 Massachusetts Avenue, NW
Washington, DC 20001
(202) 842-0200
www.cato.org

The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002
(202) 546-4400
www.heritage.org

National Academy of Social Insurance
1776 Massachusetts Avenue, NW, Suite 615
Washington, DC 20036
(202) 452-8097
www.nasi.org

National Committee to Preserve Social Security and Medicare
10 G Street, NE, Suite 600
Washington, DC 20002
(202) 216-0420
www.ncpssm.org

President's Commission to Strengthen Social Security
734 Jackson Place, NW
Washington, DC 20503
(202) 343-1255
www.csss.gov

Social Security Network
c/o The Century Foundation
41 E. 70th Street
New York, NY 10021
(212) 452-7743
www.socsec.org

U.S. Social Security Administration
6401 Security Boulevard
Baltimore, MD 21235
(800) 772-1213
www.ssa.gov