Dēmos

Social Security: Built to Last for Generations to Come

OUR FISCAL SECURITY

About Dēmos

Dēmos is a non-partisan public policy research and advocacy organization. Headquartered in New York City, Dēmos works with advocates and policymakers around the country in pursuit of four overarching goals: a more equitable economy; a vibrant and inclusive democracy; an empowered public sector that works for the common good; and responsible U.S. engagement in an interdependent world. Dēmos was founded in 2000.

In 2010, Dēmos entered into a publishing partnership with *The American Prospect*, one of the nation's premier magazines focussing policy analysis, investigative journalism, and forward-looking solutions for the nation's greatest challenges.

About the **Our Fiscal Security Project**

The Our Fiscal Security project is a collaborative effort of the Economic Policy Institute, Demos, and The Century Foundation. Our institutions are dedicated to promoting an economic path that achieves fiscal responsibility without undermining our national strength. Today, the foundation of that strength – a secure and growing middle class – is being tested by falling incomes, lost wealth, high unemployment and record foreclosures. Yet instead of rebuilding the public structures that could fortify our economy, our elected leaders are facing misguided pressure to reduce the federal budget deficit.

We believe the first priority for our nation is to secure the fundamentals of the economy: strong growth and good jobs. We also believe that in order to reduce our long-term national debt we must refuel the engine of our economy: the middle class. Finally, we strongly oppose the idea that America's fiscal challenges can be solved by cutting longstanding social insurance programs that have brought security and prosperity to millions of Americans. Putting our nation on a path of broad prosperity will require generating new jobs, investing in key areas, modernizing and restoring our revenue base and lowering the costs of our health care system. Achieving these goals, however, will require an informed and engaged public to help set our national priorities.

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Introduction

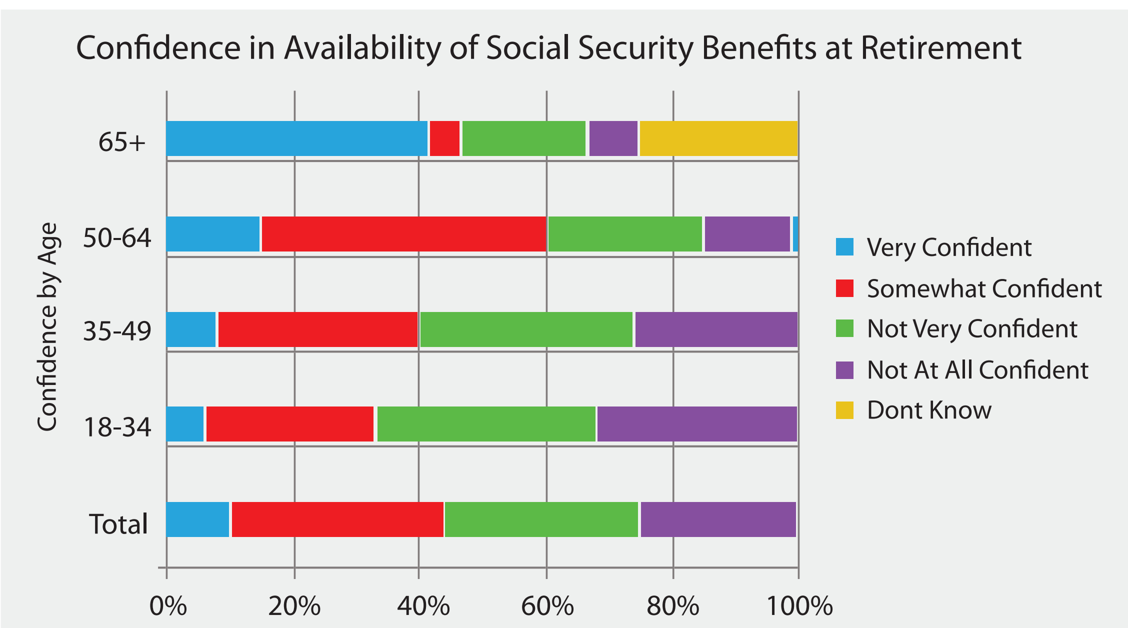
It was exactly 75 years ago that Franklin Roosevelt enacted the Social Security program. Created in part to counteract the high rate of poverty among older Americans who had left the workforce, it has proven to be one of the most successful social insurance programs ever developed, providing millions of Americans with the resources they need to survive. Despite its proven fortitude over the last several decades, the impending retirement of the baby boom generation has raised fresh concerns about the program's solvency. A recent poll commissioned by the National Academy for Social Insurance found that 55 percent of Americans do not expect that Social Security will still be paying benefits by the time they retire.[1] Young people were even more doubtful of the program's survival—two-thirds of adults age 18-34 do not expect to receive benefits.

Adding to fears about the program's stability is the heightened public debate over swollen deficits and the trajectory for public debt, as well as the mischaracterization of Social Security as one of the entitlements driving our fiscal imbalances.

However, an objective look at the structural soundness of Social Security and an understanding of the roots of our yawning budget deficit reveal that it is not a dire liability on the federal balance sheet nor is it in any imminent danger of insolvency. Social Security benefit payments are fully funded for decades to come, and under current budget projections, average lifetime benefits are slated to grow higher for each new crop of beneficiaries. Relatively modest tweaks to the program's financing will further strengthen the system for generations to come.

The Way Social Security Works

The widespread and devastating hardships of the Great Depression engendered a national consensus that the oldest among us, as well as those hurt on the job and others unable to work, should not merely be left to sink into deprivation. The result was a uniquely American solution to a mounting dilemma. Starting in 1937, workers and employers both began contributing, in the form of payroll taxes, into Social Security.



Source: National Academy of Social Insurance, "Economic Crisis Fuels Support for Social Security" August 2009, Table 5

Starting in 1940, the government administered these funds like an insurance plan, making payments to contributing workers (and, eventually, to their families) when they became unable to work due to old age, disability or premature death. From inception, Social Security was a broad means of social insurance, not a welfare program for the elderly. Americans of all ages went to work knowing that their payroll contributions would be there for them when the time came for them to stop working.

The program is almost entirely funded by contributions made by workers and employers (roughly 3 percent of funding comes from taxes on high-income beneficiaries). Workers pay 6.2 percent of their taxable earnings, and employers also pay 6.2 percent on their employees behalf. Currently, earnings in excess of $106,800 are not subject to the Social Security tax, with this "cap" increasing slightly each year. Payroll taxes are held in Social Security's Old-Age, Survivors, and Disability Insurance (OASDI) Trust Funds. By law, income to the trust funds must be invested in guaranteed, non-marketable Treasury securities, which can be redeemed at any time at face value, giving the trust funds the same flexibility as holding cash. Payroll taxpayers may start receiving benefits as early as age 62 or as late as age 70. Retirement benefits are calculated based on the highest 35 years of earnings. Monthly benefits are also affected by the chosen retirement age, and are then adjusted annually for changes in the cost of living. In 2010, over 36.9 million Americans received Social Security Old Age benefits.[2]

Social Security does not just benefit older Americans. Social Security Disability and Survivors benefits, which provide support to workers and the families of workers who become disabled and to family members of the deceased, are a great asset to today's working men and women. The Social Security Administration (SSA) estimates that a 20-year-old worker has a more than 30 percent chance of dying or becoming disabled before reaching retirement age.[3] The National Association of Social Insurance calculates that for a 30-year-old worker earning about $27,000 to $33,000 in 2008 with a spouse and two young children, the Social Security Disability and Survivor protections were each equivalent to holding a $450,000 insurance policy.[4]

"Social Security provides some form of basic support to approximately one in six Americans."

Today, Social Security provides some form of basic support to approximately one in six Americans.[5] Social Security has been identified as a major factor in the reduction of poverty rates among both seniors and children.[6] Poverty among the elderly has fallen from 35 percent in 1959, when the Census Bureau first began recording poverty rates, to about 8.9 percent by 2009.[7] The Census Bureau estimates that Social Security kept roughly 20.5 million Americans -including 14 million Americans above the normal retirement age - out of poverty in 2009.[8] Although only about four percent of children receive benefits from Social Security, it provides more income support to children than any other social program.[9] In fact, more children receive basic support from Social Security than from the Temporary Assistance for Needy Families or Supplemental Security Income [10], programs whose funding is drawn from general tax revenues. Even during this period of distressingly high unemployment, Social Security is estimated to have kept more children out of poverty in 2009 than unemployment insurance benefits.[11]

Perhaps most importantly, the promise of Social Security has provided a steady source of support through three quarters of a century of economic volatility. During the recent economic crisis, $2.8 trillion of wealth was lost from retirement savings accounts (defined contribution plans and Individual Retirement Accounts) that are subject to the volatile fluctuations of the stock market.[12] The market has somewhat recovered, but the Urban Institute estimates that retirement savings accounts are still down roughly $1.2 trillion since the market peaked in late 2007. But Social Security has maintained a guaranteed benefit through 12 recessions [13] because it is backed by the United States government rather than Wall Street. Research shows that because of the protective effect of Social Security, poverty rates among the elderly do not follow cyclical patterns, rising during recessions and falling during economic expansions, like they do for the rest of the population.[15]

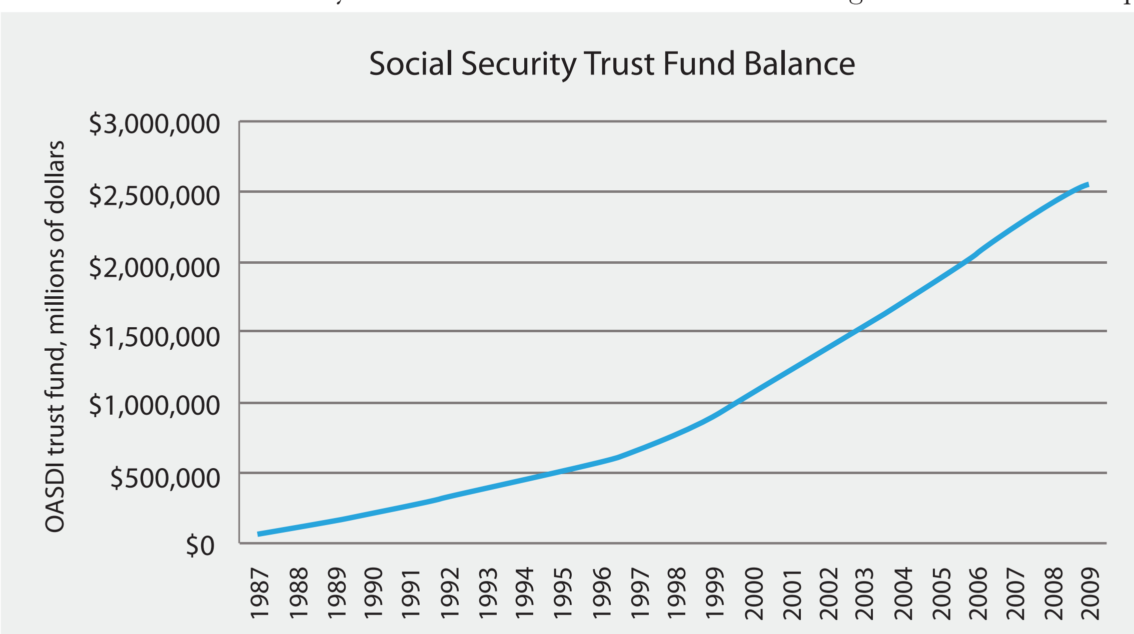
The Program's Current Financial Condition

Social Security is entirely funded by payroll taxes, taxes on high-income beneficiaries, and interest earned on invested surpluses. Outside of small administrative costs (Old Age Insurance faces administrative costs of less than one percent), payroll taxes are dedicated to paying current or future Social Security benefits. Social Security's financing is considered "off-budget," meaning it is treated separately from all general revenues, and Social Security has been insulated from the yearly budget decisions made by Congress.[16]

Nonetheless, many public figures and some in the news media conflate the long-term funding outlook of the Social Security Trust Funds with the year-to-year deficit in the federal budget. The United States is currently collecting less in general revenue (income taxes, corporate taxes, etc.) than it appropriates to discretionary spending alone. Almost the entire projected budget deficits for the coming decade can be attributed to the recession (stabilization policies, lost tax revenue, and the automatic increases in unemployment insurance, food stamps, and other safety-net program spending), the legacy cost of the Bush tax cuts (both the interest cost from the previous decade and the cost of a seemingly likely extension) and the wars in Iraq and Afghanistan.[17]

The rise in unemployment has decreased Social Security payroll tax revenue, but the trust fund is nonetheless projected to continue growing over the next decade.[18] The government's budget rules require that Social Security transactions be reported separately from the rest of the federal budget specifically to avoid using Social Security policy changes to balance the budget. In fact, Social Security cannot contribute to the current deficit; by law, it cannot draw a single dollar from general revenues, even if payroll taxes fall short of scheduled benefits.[19]

Social Security was designed for long-term sustainability. Social Security is one of only two federal programs, along with Medicare, that tallies its budget over a 75-year window. This long-term view has allowed the Social Security Administration and lawmakers in Congress to maintain the program's viability over decades with relatively minor changes. The payroll tax rate, the amount of wages subject to the tax, and benefit levels have all been tweaked in the past to at least partially account for changes in demographics, wage growth, and inflation.



Source: Social Security Administration, "Annual Statistical Supplement to the Social Security Bulletin, 2010" Table 4A.3

In 1983, Congress and President Reagan recognized that significant changes needed to be made to avoid a shortfall in funding, accommodate the retirement of the baby boom generation, and to shore up the long-term financial outlook of the program. Changes made at that time, including a increase in the payroll tax and a scheduled increase in the retirement age, significantly increased payroll tax contributions relative to outgoing Social Security benefits. As a result of the changes implemented in 1983, Social Security's OASDI Trust Funds have slowly built up a surplus, from about $25 billion in 1983 to $2.6 trillion today.[20] The Trust Funds are projected to continue to grow through 2020, to a peak surplus of $3.1 trillion.

Demographic trends over the next few decades, including the retirement of the Baby Boomer generation, will cause outgoing retirement benefits to increase faster than incoming payroll taxes [21], and over many years, Social Security will gradually draw down the surplus in the Trust Funds. Due to the built-up reserves, however, **Social Security can operate at current tax and benefit levels until 2037—more than a quarter century from now** — before outlays begin to eclipse payroll taxes and trust fund reserves.[22]

The Future Outlook: On a Stable Path

The long-term picture for the Social Security program—and more importantly, for Social Security beneficiaries—is not nearly as bleak as much of the public alarm would indicate. In fact, due to expected growth in the economy and increased life expectancy, the Congressional Budget Office (CBO) currently projects that average lifetime benefits, in constant dollars, will be greater for every successive cohort of beneficiaries—even if Congress lets benefits begin to shrink in 2037.[23] However, if Social Security outlays are held to projected payroll income and trust fund assets, benefits will represent a smaller proportion of a retired or disabled worker's average income. As the other pillars of workforce and retiree support—employer-sponsored retirement plans, long-term disability insurance and dependable nest-egg savings—are growing less reliable in today's labor market, the promise of Social Security as a backstop against poverty is more important than ever.

As has been done several times before, adjustments can be made to shore up Social Security for the better part of a century. The CBO estimates that the difference between Social Security's funding will fall short of the benefits owed to beneficiaries over the next 75 years by 0.6 percent of GDP.[24] Raising the employer and employee payroll tax rates by just 1percentage point each would nearly erase the entire 75-year projected deficit in Social Security, extending the solvency of the trust fund from 2037 to 2083. Alternatively, Congress could extend the solvency of the trust fund through 2083 by eliminating the cap on taxable payroll income. In addition, policies that reduce income inequality will have the added benefit of increasing the share of aggregate earnings that fall under the tax cap--half of the projected shortfall has stemmed from widening income inequality. Similarly, efforts to curb health care costs will boost the taxable income in every worker's paycheck. A menu of options are available to policymakers who are serious about maintaining the government's original promise that anyone who has worked hard and paid into the system will have a basic line of sustenance once their working days are behind them..

Conclusion

Social Security was born amid harsh economic times. When many in our society found themselves at risk of homelessness and starvation, our country made a deal with the American worker: no one who paid in would be left empty-handed. Over the years, the American economy, labor market and workforce have undergone a number of major changes. At 75, Social Security still means the difference between poverty and economic security for millions of retirees, children and American workers. And the deal still stands for the workers of the Great Recession as it did for the workers of the Great Depression. Social Security was built to last.

Q & A

Q: Will Social Security be there for me when I retire?

A: Yes. Social Security is on a stable path . Incoming revenue, accumulated reserves and compounding interest are sufficient to fuel the program at current tax and benefit levels for more than a quarter century, until 2037. One or more modest changes to the program between now and then will ensure solvency of the program and meaningful benefits for generations to come.

Q: How does Social Security work?

A: A percentage of an employee's taxable earnings (6.2 percent of the first $106,800 in 2010) is withheld as payroll taxes for Social Security, and matched by the employer. Payroll taxes are used to pay current benefits, with surplus income held in Social Security's Old-Age, Survivors, and Disability Insurance (OASDI) Trust Funds. Retirement benefits – which payroll taxpayers may start receiving between the ages of 62 and 70 – are calculated based on the highest 35 years of earnings over a working lifetime and retirement age.

Q: Is Social Security just for old people?

A: No. Social Security benefits Americans of all ages, providing some sort of basic support to about one in six people today. In addition to retirement benefits, Social Security also provides disability and survivor protections for workers who pay into the system and their families. The program has been a major factor in the reduction of poverty rates among children, who account for eight percent of Social Security beneficiaries and receive more benefits from Social Security than from any other social program. Finally, the program creates intergenerational benefits, as parents and grandparents can live independently of their working children and often become the child care providers for grandchildren while parents work.

Q: What does Social Security have to do with the budget deficit?

A: Social Security's financing is isolated from the yearly budget decisions made by Congress. Social Security is entirely funded by payroll taxes, taxes on benefits, and interest earned on invested surpluses. Under current law, the program cannot draw a single dollar from general revenues, even if payroll taxes fall short of scheduled benefits, and Social Security is not contributing to the current federal deficit. Rather, virtually the entire budget deficit can be attributed to the adverse economic and financial impacts of the recession, the Bush-era tax cuts, and the wars in Iraq and Afghanistan. Indeed, Social Security transactions are intentionally reported separately from the rest of the federal budget to prevent deficit considerations from influencing Social Security policy. Over the longer-term, without changes to benefits or payroll taxes, expected payouts will eventually exceed revenues, and the trust fund would eventually be exhausted (at which point benefit levels would have to be trimmed).

Q: What effect has growing income inequality had on the health of Social Security?

A: Rising income inequality in the last several decades has left revenues for the Social Security Trust funds lower than they would otherwise be if earnings were distributed more evenly among American workers. With high-income workers' salaries rising faster than the Social Security taxable earnings threshold, the share of aggregate earnings that are not taxed has increased from 9 percent to 17 percent.

Q: Isn't the Social Security Trust Fund just full of IOUs because the government has spent the surplus on other things?

A: No. Assets held in the OASDI Trust Funds are invested in interest-bearing securities, much like any other pension fund. By law, Social Security surpluses must be invested in special-issue Treasury securities guaranteed by the Federal government. These holdings can be redeemed at face value at any time, giving the trust funds the same flexibility as holding cash.

Q: Wouldn't my money be better off in a private account?

A: Probably not. Social Security is not comparable with a private investment account – it should be complemented with private savings, not replaced – Social Security is insurance. Private accounts are subject to the volatile fluctuations of the stock market and recent events have significantly undermined the long-term reliability of almost every aspect of personal finance. In fact, during the recent financial crisis, $2.8 trillion of retirement savings were wiped out of defined benefit contribution plans and Individual Retirement Accounts, much of which has not been recovered. The return on a private investment can outpace the return on government bonds, but the private market can also wipe out years of savings; Social Security guarantees an income stream regardless of the business cycle and regardless of the returns to a private account.

Q: What kinds of policies can strengthen Social Security?

A: Several modest policy options exist to ensure Social Security's solvency far into the future. For example, raising the employer and employee payroll tax rates by just 1percentage point each would nearly eliminate the projected 75-year deficit in Social Security, estimated by the CBO to total just 0.6 percent of GDP over that period. This funding gap could also be nearly closed (the trust fund would remain solvent through 2083) by eliminating the cap on payroll taxable income. Policies that reduce income inequality will also benefit Social Security by increasing the share of aggregate earnings that fall under the tax cap. Similarly, policies that bring down the cost of health care coverage will raise the taxable income in every worker's paycheck, boosting payroll revenue.

Q: Which proposals would most undermine Social Security?

A: A number of recent policy proposals would reduce the effectiveness of Social Security in the name of deficit reduction. For example, raising the age at which retirees can collect full Social Security benefits from 67 to 70 would amount to a benefit reduction of up to 45 percent for some retirees, hitting low and moderate earners for whom Social Security is the principal source of retirement income the hardest. Raising the retirement age to 70 will not, however, encourage people to work significantly longer and would eliminate less than one third of Social Security's 75-year shortfall. Likewise, reducing the annual cost-of-living benefits adjustment would impose the greatest benefit cuts on groups of beneficiaries with relatively long periods of eligibility, including older beneficiaries, women, survivors, disabled workers, and low-income beneficiaries—without fully closing the long-term funding gap. Not only do such policies fail to shore up either Social Security's long-term fiscal health or the near-term federal deficit, but by cutting benefits for those who rely most heavily on Social Security, they would undermine the program's fundamental promise of meaningful support for working Americans.

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