Social Security: A Brief Overview

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✓ Social Security protects individuals and their families from loss of earnings due to retirement, disability, or death.
✓ Social Security has been effective at keeping Americans of all ages out of poverty.
✓ Social Security will be able to pay full benefits until 2036, after which it can pay about three-quarters of scheduled benefits.

What Is Social Security?

Social Security is a federal program designed to protect individuals and their families from loss of earnings due to retirement, disability, or death. When signed into law in 1935, Social Security covered only retired workers. However, in 1939 Social Security became a family benefit by expanding benefits to include the spouses and minor children of retired and deceased workers. In 1956, Social Security was further expanded by including benefits for disabled workers.

Since its inception, Social Security has been a vital tool for promoting the well-being of those who can no longer work. Serving as the major source of income for half of the U.S. population aged 65 and older, Social Security enables older Americans to live independently. In addition, Social Security has been effective at keeping Americans of all ages out of poverty. For example, Social Security income keeps more than 1 million children under age 18 and 14 million older Americans (roughly 35 percent) out of poverty.

Key Features of Social Security

For more than 75 years, Social Security has ensured that the basic protections that were important when the program first began continue for present and future beneficiaries. Moreover, by its design, Social Security provides a lifeline for low-income retirees, disabled workers, and survivors of a deceased worker and is the basis for a secure retirement for countless others. These characteristics are reflected in three key features of the Social Security program:

1. The benefit formula is progressive, which means that Social Security benefits replace a higher proportion of the preretirement earnings of low-lifetime earners than higher lifetime earners. This feature is important because low-lifetime earners are less likely to have other sources of retirement income (such as pensions, savings, and assets) in addition to Social Security. The progressivity of the Social Security benefit formula ensures that the income of low earners will not be significantly diminished by their loss of earnings.

2. Social Security provides a guaranteed source of income that is protected against inflation. Since 1975, Social Security benefits have been automatically adjusted to reflect...
increases in prices (as measured by the Consumer Price Index for Urban Wage Earners and Clerical Workers, or CPI-W). In 2012, beneficiaries received a 3.6 percent increase in benefits to account for inflation.  

3. Social Security benefits reflect current living standards. The proportion of preretirement earnings replaced by Social Security is approximately stable across generations. For example, Social Security benefits replaced more than 42 percent of past earnings for an average earner in 2011. Twenty years later, in 2031, benefits will replace almost 41 percent of past earnings for an average earner and are projected to replace about the same amount in 2051. Thus, Social Security benefits will be just as valuable to current workers as their parent’s, grandparents’, and children’s benefits.

Who Is Covered under Social Security?

The majority of workers (94 percent) in paid employment and self-employment are covered under the Social Security program. Workers not covered include some state and local government workers and federal workers under the Civil Service Retirement System. In 2011, about 158 million people worked in Social Security-covered employment.

Generally, to receive retirement benefits, a person must have worked for about 10 years. The number of years necessary to be eligible for disability benefits or benefits for surviving family members depends on the age at which the disability or death occurred but is generally less than 10 years.

About 91 percent of workers age 21 to 64 in covered employment (about 128 million workers) have worked enough to receive disability benefits so that they and their families are protected in the event of a long-term disability.

About 97 percent of individuals age 20 to 49 in covered employment (almost 98 million) have worked enough to receive survivors insurance protection for their families in the event of death of the Social Security-covered worker.

Who Receives Social Security Benefits?

In February 2012, more than 55 million Americans received monthly Old Age, Survivors, and Disability Insurance (OASDI) benefits. About 90 percent of those age 65 and older received Social Security benefits.

Retired Workers

More than two-thirds (64 percent) of Social Security beneficiaries (almost 36 million) are retired workers, of whom more than half (51 percent) are men. The average monthly benefit for retired workers was $1,231 in February 2012.

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**Figure 1**

Who Benefits from Social Security, February 2012

- **Spouses**: 4%
- **Children**: 8%
- **Widow(er)s and Parents**: 8%
- **Disabled Workers**: 16%
- **Retired Workers**: 64%

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Disabled Workers
Approximately 16 percent of Social Security beneficiaries (almost 9 million)—52 percent of them men—are disabled. At the end of 2011, more than half of disabled workers were age 55 or younger. The average monthly benefit for a disabled worker was $1,111 in February 2012.

Spouses
More than 4 percent of beneficiaries (almost 2.5 million) received spouse benefits in February 2012. The vast majority (97 percent) of these spouse beneficiaries were women. Of those receiving spouse benefits, more than 93 percent were the spouses of retired workers and 3 percent were the spouses of disabled workers. The average monthly benefit for a spouse was $588 in February 2012.

Survivors
Almost 8 percent of Social Security beneficiaries (more than 4 million) received Adult Widow(er), Young Widow(er), Disabled Widow(er), or Parent benefits. The vast majority of these beneficiaries (91 percent) were aged widows or widowers. Due to the longer life expectancies of women, 98 percent of survivor beneficiaries were women. The average monthly benefit for a survivor in February 2012 was $1,148.

Children
The children of retired, disabled, and deceased workers can receive Social Security benefits as long as they are under age 18 (or 19 and a high school student) or can be any age provided the child was disabled before the age of 22. Children make up almost 8 percent of Social Security beneficiaries (more than 4 million).

Most child beneficiaries are under age 18.
- Seventy-four percent are under age 18.
- Three percent are students age 18 or 19.
- Twenty-two percent are disabled children age 18 or over.

Most child beneficiaries qualify either as survivors or children of disabled workers.
- Thirteen percent are the children of retired workers.
- Forty-four percent are the children of deceased workers.
- Forty-three percent are the children of disabled workers.

The average monthly child benefit in February 2012 was $566.

What Are the Social Security Trust Funds?
The income and expenses of the Social Security program are accounted for through Social Security’s Old-Age and Survivor’s Insurance (OASI) Trust Fund and Disability Insurance (DI) Trust Fund. The Social Security Administration credits each trust fund for revenue received and debits them for expenditures.

The OASI Trust Fund pays monthly benefits to retired workers and their spouses and children and to the survivors of deceased workers. The DI Trust Fund pays monthly benefits to disabled workers and their spouses and children. At the end of 2010, the combined OASDI Trust Funds held more than $2.6 trillion in assets. The trust fund assets resulted from surpluses between 1984 and 2009, during which total noninterest revenues exceeded total expenditures. These assets are held as special issue...
government securities, which are available only to the trust funds. The special securities earn guaranteed interest (by the federal government), which is used to pay for benefits and administrative costs.

The primary expense to the OASDI Trust Funds is the payment of Social Security benefits. The Congressional Budget Office (CBO) estimates that $720 billion (98 percent of total outgo) was paid in benefits in 2011. The remainder of the trust fund expenses consisted of administrative costs (less than 1 percent) and miscellaneous transfers.

How Is Social Security Financed?

Social Security is primarily financed through payroll taxes on workers’ earnings. CBO estimates that in 2011 Social Security received about $581 billion in payroll tax contributions, accounting for 71 percent of total income received by Social Security.

Workers and employees are each responsible for paying half of the Social Security payroll tax (6.2 percent each, for a total of 12.4 percent), while the self-employed pay the full 12.4 percent. In 2012, workers and employers paid payroll taxes on up to the first $110,000 of earnings (known as the “taxable maximum”). The taxable maximum is increased each year based on increases in average wages in the economy. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 temporarily reduced the employee share of the payroll tax from 6.2 percent to 4.2 percent (employers continue to pay 6.2 percent) for 2011. This payroll tax rate reduction later was extended through 2012. Thus, the combined total payroll tax rate for 2011 and 2012 is 10.4 percent rather than the normal 12.4 percent. The payroll tax is scheduled to return to 12.4 percent in 2013.

In addition to payroll taxes, there are two other major sources of income for the trust funds: (1) interest from trust fund assets and (2) the taxation of Social Security benefits.

The Social Security trust funds are invested in special issued interest-
bearing U.S. securities. CBO estimates that in 2011, the trust funds earned $116 billion (15 percent of total income) in interest from the U.S. securities.

A smaller proportion of income comes from the taxation of Social Security benefits. The taxation of benefits accounted for another $23 billion (3 percent) of total income in 2011.

As previously mentioned, legislation in 2010 decreased the share of employees’ payroll taxes from 6.2 percent to 4.2 percent for 2011. By law, this lost payroll tax revenue to the system must be made up by transfers from general revenues. The estimated amount of these transfers in 2011 was $79 billion (10 percent of total income). In years without the payroll tax rate cut, this transfer would be payroll tax revenue, thereby increasing the portion of total income accounted for by the payroll tax in a typical year.

**Financial Condition of the Program**

Demographic changes will put a strain on the Social Security system. In particular, the U.S. population is aging as a result of the decline in fertility rates from the highs in the decades after the end of World War II (Baby Boom Generation) and increasing longevity. These changes result in fewer workers (taxpayers) supporting each beneficiary. In the 1960s, there were approximately 4 workers per beneficiary. Today, there are about 2.9 workers per beneficiary, and by 2036, the number of workers per beneficiary will reach a low of 2.1 before stabilizing around this ratio.

As a result of these demographic changes, the Social Security Administration projects benefits to increase much faster than revenue. One way to make this comparison is in relation to earnings subject to Social Security payroll taxes. The Social Security Trustees project that annual income will rise from 12.5 percent of taxable payroll in 2011 to 13.3 percent in 2036. Meanwhile, total expenditures are expected to rise more quickly—from 13.4 percent of taxable payroll in 2011 to 17.0 percent in 2036. The gap between income and expenditures is expected to stabilize around 2035.

Despite this gap between income and total expenditures, Social Security will be able to pay full benefits until 2036 by relying on Trust Fund assets and the interest income they generate.

**Key Dates for the Trust Funds**

Beginning in 2010, Social Security paid out more money in benefits than it received from payroll taxes and the taxation of benefits. To make up for the shortfall, the Social Security system relied on part of the interest earned by the trust fund assets to finance full benefits. The rest of the interest earned that was not used to pay benefits resulted in additional trust fund assets.

As more baby boomers begin receiving benefits (and for longer periods of time), the amount of interest required to make up for the shortfall will grow. Eventually, the amount of benefits that have to be paid will be greater than the amount of income received from payroll taxes and interest from the assets. The first year that the amount of benefits is projected to exceed income from payroll taxes and interest is 2023.

After 2023, the Social Security system will have to depend on the principal from the securities (thus, the U.S. securities will have to be redeemed) to make up for the difference between the income from the payroll tax (and the taxation of benefits) and the benefits that must be paid. Eventually, all of the U.S. securities held in the trust funds will be redeemed and the trust funds will be exhausted.
The Social Security Trustees project that the OASDI trust funds will be exhausted in 2036. After 2036, the only income will come from payroll taxes and the taxation of benefits, at which time it will be possible to pay only about three-quarters (77 percent) of scheduled Social Security benefits.

Balancing the Social Security System

Despite the fiscal challenges, the Social Security system could be balanced through an increase in revenues, a decrease in costs, or a combination of the two. Revenue-increasing options include increasing the payroll tax, expanding the tax base by increasing the taxable maximum, and expanding covered earnings to include contributions to voluntary salary and reduction plans (such as Cafeteria 125 plans and Flexible Spending Accounts).

Cost reduction plans generally entail reducing initial benefits or the growth of benefits over time. Such plans include reducing benefits to account for increases in longevity, decreasing benefits for high earners while keeping the benefits of low earners the same, including more years of earnings in the benefit computation, and raising the full retirement age.

Reducing the cost-of-living adjustment (for example, by using an alternative such as the Chained CPI\(^2\)) is an example of a plan that does not alter a person’s initial benefit but rather alters future benefits by slowing the growth of benefits in response to inflation.

The timing of changes to the system will help to determine the magnitude of revenue increases and/or cost reductions. The sooner changes are made, the less severe they will have to be. For example, if action is taken immediately, the Social Security system could be balanced\(^3\) by (1) increasing the payroll tax rate from 12.4 percent to 14.6 percent, (2) reducing benefits by 13.8 percent, or (3) a combination of the two. On the other hand, if nothing is done until 2036, then the payroll tax will have to be further increased or benefits further decreased. In 2036, the Social Security system could be balanced by (1) increasing the payroll tax rate from 12.4 percent to 16.4 percent, (2) reducing benefits by 23 percent, or (3) a combination of the two.

Regardless of when action is taken, lawmakers will have to make changes to bring the system back into balance. It is important that these changes keep Social Security on a sustainable path without sacrificing the key features of the program.

Endnotes


To be eligible for Social Security benefits, individuals must earn a certain number of quarters of coverage or “credits.” In 2012, a person receives a quarter of coverage for each $1,130 in annual covered earnings up to a maximum of four quarters ($4,520) in a year. To qualify for retirement benefits, individuals need to earn 40 quarters. Since up to four quarters can be earned in a year, for most individuals, this translates to 10 years of covered employment. The number of quarters needed to qualify for disability and survivor benefits depends upon age but is less than 40 for those who die or become disabled at younger ages.

The parents of a deceased retired or disabled worker can receive Social Security benefits provided they can prove that they were financially dependent on the worker and are at least age 62.

The average benefits were $1,186.60 for aged widow(er)s, $873.55 for young widow(er)s, $703.02 for disabled widow(er)s, and $1,053.87 for parents. Social Security Administration, “Benefits Paid by Type of Beneficiary.”

The formal names for the payroll taxes are the Federal Insurance Contributions Act (FICA) and the Self-Employment Contributions Act (SECA) for the self-employed.

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28 Ibid.

29 Experts predict that the increase in Social Security benefits would be an average of 0.3 percentage points lower, per year, under the Chained CPI.

30 Ibid.