

## Social Security: A Brief Overview

*Mikki D. Waid*  
AARP Public Policy Institute

- ✓ **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.<sup>1</sup> For example, Social Security income keeps more than 1 million children under age 18<sup>2</sup> and 14 million older Americans<sup>3</sup> (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









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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<sup>29</sup>) 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<sup>30</sup> 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.

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## Endnotes

<sup>1</sup> Selena Caldera, *Social Security: Who's Counting on It?* (AARP Public Policy Institute, April 10, 2011). Accessed March 9, 2012, at <http://assets.aarp.org/rgcenter/ppi/econ-sec/fs178-socsec.pdf>.

<sup>2</sup> Statistic is for the year 2009. U.S. Census Bureau, "Income, Poverty, and Health Insurance Coverage: 2009." Accessed March 9, 2012, at [http://www.census.gov/newsroom/releases/pdf/09-16-10\\_slides.pdf](http://www.census.gov/newsroom/releases/pdf/09-16-10_slides.pdf).

<sup>3</sup> Statistic is for the year 2010. Selena Caldera, AARP Public Policy Institute, unpublished tables using U.S. Bureau of the Census, March 2011, Current Population Survey.

<sup>4</sup> Because of a steep drop in overall prices during the last quarter of 2008 and low inflation thereafter, no cost-of-living adjustment to benefits was made in 2010 and 2011. Social Security Administration, "Latest Cost-of-Living Adjustment." Accessed March 9, 2012, at <http://www.ssa.gov/OACT/COLA/latestCOLA.html>.

<sup>5</sup> Social Security Administration, "Annual Scheduled Benefit Amounts for Retired Workers With Various Pre-Retirement Earnings Patterns Based on Intermediate Assumptions." Accessed March 15, 2012, at <http://www.ssa.gov/OACT/TR/2011/lr6f10.html>.

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<sup>6</sup> In 1984, the federal government introduced a new retirement system—the Federal Employees Retirement System (FERS), which is covered under Social Security. All new federal employees hired in 1984 and later are covered under FERS. The federal government allowed workers the option of switching from the Civil Service Retirement System, which does not include Social Security benefits, to FERS. Nationally, approximately 27 percent of state and local government employees are not covered under Social Security. Alison M. Shelton, “Social Security: The Government Pension Offset (GPO)” (Congressional Research Service, RL32453, 2011). An older (2010) version of the paper is available at <http://aging.senate.gov/crs/ss12.pdf>.

<sup>7</sup> Social Security Administration, “Social Security Basic Facts.” Accessed March 9, 2012, at <http://www.ssa.gov/pressoffice/basicfact.htm>.

<sup>8</sup> 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.

<sup>9</sup> Social Security Administration, “Social Security Basic Facts.”

<sup>10</sup> Ibid.

<sup>11</sup> Social Security Administration, “Benefits Paid by Type of Beneficiary.” Accessed March 9, 2012, at <http://www.ssa.gov/OACT/ProgData/icp.html>; Social Security Administration, “Social Security Basic Facts.”

<sup>12</sup> Social Security Administration, “Benefits Paid by Type of Beneficiary.”

<sup>13</sup> Social Security Administration, “Disabled worker beneficiaries in current payment status at the end of December 2011, distributed by age and sex.” Accessed March 9, 2012, at [http://www.ssa.gov/OACT/ProgData/benefits/da\\_age201112.html](http://www.ssa.gov/OACT/ProgData/benefits/da_age201112.html).

<sup>14</sup> Social Security Administration, “Benefits Paid by Type of Beneficiary.”

<sup>15</sup> Ibid.

<sup>16</sup> 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.

<sup>17</sup> 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.”

<sup>18</sup> Social Security Administration, “Number of Beneficiaries by Age.”

<sup>19</sup> Social Security Administration, “Benefits Paid by Type of Beneficiary.”

<sup>20</sup> Ibid.

<sup>21</sup> The Congressional Budget Office estimates that almost \$600 billion in benefits was paid out of the OASI Trust Fund and almost \$130 billion in benefits was paid out of the DI Trust Fund. Accessed March 14, 2012, at [http://www.cbo.gov/sites/default/files/cbofiles/attachments/43062\\_Old-AgeSurvivorsInsurance.pdf](http://www.cbo.gov/sites/default/files/cbofiles/attachments/43062_Old-AgeSurvivorsInsurance.pdf) and [http://www.cbo.gov/sites/default/files/cbofiles/attachments/43061\\_DisabilityInsurance.pdf](http://www.cbo.gov/sites/default/files/cbofiles/attachments/43061_DisabilityInsurance.pdf).

<sup>22</sup> Congressional Budget Office, “Combined OASDI Trust Funds, January 2012 Baseline.” Accessed March 9, 2012, at <http://www.cbo.gov/sites/default/files/cbofiles/attachments/OASDI.pdf>.

<sup>23</sup> 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.

<sup>24</sup> Congressional Budget Office, “Combined OASDI Trust Funds, January 2012 Baseline.”

<sup>25</sup> The Social Security Amendments of 1983 established the taxation of Social Security benefits. Up to 50 percent of Social Security benefits can be subject to the federal income tax for individual taxpayers with combined income greater than \$25,000 or for taxpayers filing a joint return with combined income greater than \$32,000. Accessed March 15, 2012, at <http://www.ssa.gov/planners/taxes.htm>.

<sup>26</sup> For example, the life expectancies of 65-year-olds (men and women) increased 5 years (from 12.8 to 17.7 years for men and 15.1 to 20.0 years for women) between 1950 and 2011. Life expectancies are

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projected to increase approximately another 2 years between 2011 and 2036. Accessed March 14, 2012, at <http://www.ssa.gov/OACT/TR/2011/lr5a3.html>.

<sup>27</sup> Board of Trustees, Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds, *The 2011 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds* (Washington, DC, May 2011). Accessed March 9, 2012, at <http://www.ssa.gov/OACT/TR/2011/tr2011.pdf>.

<sup>28</sup> Ibid.

<sup>29</sup> 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.

<sup>30</sup> Ibid.

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AARP Public Policy Institute  
601 E Street, NW, Washington, DC 20049  
[www.aarp.org/ppi](http://www.aarp.org/ppi)  
202-434-3846, [ppi@aar.org](mailto:ppi@aar.org)  
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