Social Security Is a Popular and Effective Program

"Social Security provides a foundation of retirement protection for people at all earnings levels."

President Franklin Roosevelt signed the Social Security Act on August 14, 1935. Almost eight decades later, Social Security remains one of the nation's most successful, effective, and popular programs. It provides a foundation of income on which workers can build to plan for their retirement. It also provides valuable social insurance protection to workers who become disabled and to families whose breadwinner dies.

Fact #1: Social Security is more than just a retirement program. It provides important life insurance and disability insurance protection as well.

In June 2012, 56 million people, or about one in every six U.S. residents, collected Social Security benefits. While three-quarters of them received benefits as retirees or elderly widow(er)s, another 11 million (19 percent) received disability insurance benefits, and 2 million (4 percent) received benefits as young survivors of deceased workers.

Workers earn life insurance and disability insurance protection by making Social Security payroll tax contributions:

About 96 percent of people aged 20-49 who worked in jobs covered by Social Security in 2011 have earned life insurance protection through Social Security. For a young worker with average earnings, a spouse, and two children, that Social Security protection is equivalent to a life insurance policy with a face value of $476,000. About 91 percent of people aged 21-64 who worked in covered employment in 2011 are insured through Social Security in case of disability.

The risk of disability or premature death is greater than many people realize. Of recent entrants to the labor force, almost four in ten men (37 percent) and three in ten women (31 percent) will become disabled or die before reaching the full retirement age.

Fact #2: Social Security provides a guaranteed, progressive benefit that keeps up with increases in the cost of living.

Social Security benefits are based on the earnings on which you pay Social Security payroll taxes. The higher are your earnings (up to a maximum taxable amount, currently $110,100 and slated to rise automatically to $113,700 in 2013), the higher will be your benefit.

Social Security benefits are progressive: they represent a higher proportion of a worker's previous earnings for workers at lower earnings levels. For example, benefits for someone who earned about 45 percent of the average wage and then retired at age 65 in 2012 replace about 55 percent of his or her prior earnings. But benefits for a person who always earned the maximum taxable amount replace only 27 percent of his or her prior earnings, though they are larger in dollar terms than those for the lower-wage worker.

In recent years, fewer employers have offered defined-benefit pension plans, which guarantee a certain benefit level upon retirement, and more have offered defined-contribution plans, which pay a benefit based on a worker's contributions and the rate of return they earn. Thus, for most workers, Social Security will be their only source of guaranteed retirement income that is not subject to investment risk or financial market fluctuations.
Once someone starts receiving Social Security, his or her benefits automatically increase each year to keep pace with inflation, helping to ensure that people do not fall into poverty as they age. In contrast, most private pensions and annuities are not adjusted for inflation or are only partly adjusted.

Fact #3: Social Security provides a foundation of retirement protection for nearly every American, and its benefits are not means-tested.

Almost all workers participate in Social Security by making payroll tax contributions, and almost all elderly people receive Social Security benefits. The near-universality of Social Security brings many important advantages.

Social Security provides a foundation of retirement protection for people at all earnings levels. It encourages private pensions and personal saving because it isn't means-tested—in other words, it doesn't reduce or deny benefits to people if their current income or assets exceed a certain level. Social Security provides a higher annual payout for a dollar contributed than private retirement annuities because the risk pool is not limited to those who expect to live a long time, no funds leak out in lump-sum payments or bequests, and its administrative costs are much lower.

Indeed, universal participation and the absence of means-testing make Social Security very efficient to administer. Administrative costs amount to only 0.9 percent of annual benefits, far below the percentages for private retirement annuities. Proposals to means-test Social Security would undercut many of those important advantages.

Finally, the universal nature of Social Security assures its continued popular and political support. Large majorities of Americans say that they don't mind paying for Social Security because they value it for themselves, their families, and millions of others who rely on it.

Fact #4: Social Security benefits are modest.

Social Security benefits are much more modest than many people realize. In June 2012, the average Social Security retirement benefit was $1,234 a month, or about $14,800 a year. (The average disabled worker and aged widow received slightly less.) For someone who worked all of his or her adult life at average earnings and retires at 65 in 2012, Social Security benefits replace about 41 percent of past earnings. This "replacement rate" will slip to about 36 percent for a medium earner retiring at 65 in the future, chiefly because the full retirement age, which has already risen to 66, will climb to 67 over the 2017-2022 period.

Moreover, most retirees enroll in Medicare's Supplementary Medical Insurance (also known as Medicare Part B) and have Part B premiums deducted from their Social Security checks. As health-care costs continue to outpace general inflation, those premiums will take a bigger bite out of their checks.

Social Security benefits are modest by international standards, too. The United States ranks 30th among 34 developed countries in the percentage of a median worker's earnings that the public-pension system replaces.

Fact #5: Children have an important stake in Social Security.

Social Security is important for children and their families as well as for the elderly.

About 6 million children under age 18 (8 percent of all U.S. children) lived in families that received income from Social Security in 2011. That number included over 3 million children who received their own benefits as dependents of retired, disabled, or deceased workers, as well as others who lived with parents or relatives who received Social Security benefits.

Social Security lifted 1.1 million children out of poverty in 2011.

Without Social Security benefits, more than 40 percent of Americans aged 65 and older would have incomes below the federal poverty line, all else being equal. With Social Security benefits, less than one-tenth of the elderly do. The program lifts 14 million elderly Americans out of poverty. Almost 90 percent of people aged 65 or older receive some income from Social Security. Those not receiving Social Security mostly comprise recent immigrants, state and local government retirees (and federal retirees hired before 1984) who are covered by separate retirement systems, people under age 66 with significant earnings, and people who are so seriously disabled that they never worked and also have never married.

Fact #7: Most elderly beneficiaries rely on Social Security for the majority of their income.

For nearly two-thirds (65 percent) of elderly beneficiaries, Social Security provides the majority of their cash income. For more than one-third (36 percent), it provides more than 90 percent of their income. For one-quarter (24 percent) of elderly beneficiaries, Social Security is the sole source of retirement income.

Reliance on Social Security increases with age, as older people are less likely to work and more likely to have depleted their savings. Among those aged 80 or older, Social Security provides the majority of income for 76 percent of beneficiaries and nearly all of the income for 45 percent of beneficiaries.

Fact #8: Social Security is particularly important for minorities.

Social Security is a particularly important source of income for groups with low earnings and with less opportunity to save and earn pensions, including African Americans and Hispanics. Among beneficiaries aged 65 and older, Social Security represents 90 percent or more of income for 35 percent of elderly white beneficiaries, 42 percent of Asian Americans, 49 percent of blacks, and 55 percent of Hispanics.

Blacks and Hispanics benefit substantially from Social Security because, on average, they have higher rates of disability and lower lifetime earnings than whites. Hispanics also have longer average life expectancies than whites, which means that they have more years to collect retirement benefits. Blacks are much more likely to benefit from survivors insurance. In 2010, African Americans made up 12.6 percent of the population, but 23 percent of children receiving Social Security survivor benefits were African American.

Fact #9: Social Security is especially beneficial for women.

Because women tend to earn less than men, take more time out of the paid workforce, live longer, accumulate less savings, and receive smaller pensions, Social Security is especially important for them. Women constitute 56 percent of Social Security beneficiaries aged 62 and older and 67 percent of beneficiaries aged 85 and older.

Women pay 41 percent of Social Security payroll taxes but receive nearly half of Social Security benefits. This is because women benefit disproportionally from the program's inflation-protected benefits (because women tend to live longer), its progressive formula for computing benefits (because they tend to have lower earnings), and its benefits for non-working spouses and survivors.

Fact #10: Social Security can pay full benefits through 2033 without any changes. Relatively modest changes would place the program on a sound financial footing for 75 years and beyond.

Social Security's costs will grow in coming years as members of the large Baby Boom generation (those born between 1946 and 1964) move into their retirement years. Since the mid-1980s, however, Social Security has collected more in taxes and other income each year than it pays out in benefits and has amassed combined trust funds of $2.7 trillion, invested in interest-bearing Treasury securities. The trust funds will enable Social Security to keep paying full benefits through 2033 without any changes in the program, even though one of the two funds, the Disability Insurance (DI) trust fund, faces exhaustion in 2016. (The much bigger Old-Age and Survivors Insurance trust fund would last until 2035. Combined, the two funds would be exhausted in 2033.) Policymakers should address DI's pending depletion in the context of action on overall Social Security solvency. If they are unable to agree on a
sensible solvency package in time, however, they should reallocate revenues between the two trust funds, as they have often done in the past.

After 2033, when the combined trust funds will be exhausted if no changes are made, Social Security would still be able [to] pay three-fourths of its scheduled benefits using its annual tax revenue. Alarmists who claim that Social Security won't be around when today's young workers retire either misunderstand or misrepresent the projections.

The long-term gap between Social Security's projected income and promised benefits is estimated at 1 percent of gross domestic product (GDP) over the next 75 years (and 1.5 percent of GDP in 2086). By coincidence, that only slightly exceeds the revenue loss over the next 75 years from extending the Bush tax cuts for people making over $250,000.

Letting the tax cuts expire would not "pay for" fixing Social Security, which has different sources of revenues; conversely, letting them continue would not directly harm Social Security. Nevertheless, members of Congress cannot simultaneously claim that the tax cuts for the richest 2 percent of Americans are affordable while the Social Security shortfall constitutes a dire fiscal threat.

A mix of tax increases and modest benefit reductions—carefully crafted to shield the neediest recipients and give ample notice to all participants—could put the program on a sound financial footing indefinitely. As Social Security approaches its 80th birthday, policymakers have an opportunity to reassure future generations that they, too, can count on this successful program.

Further Readings

Books


Periodicals


Brian Palmer "What Would Happen If Social Security Disappeared?" Slate, September 8, 2011.


Jacob Sullum "Is Social Security a Ponzi Scheme?," Reason, December 2011.


USA Today "Social Security Far from a 'Ponzi Scheme,'" September 11, 2011.
