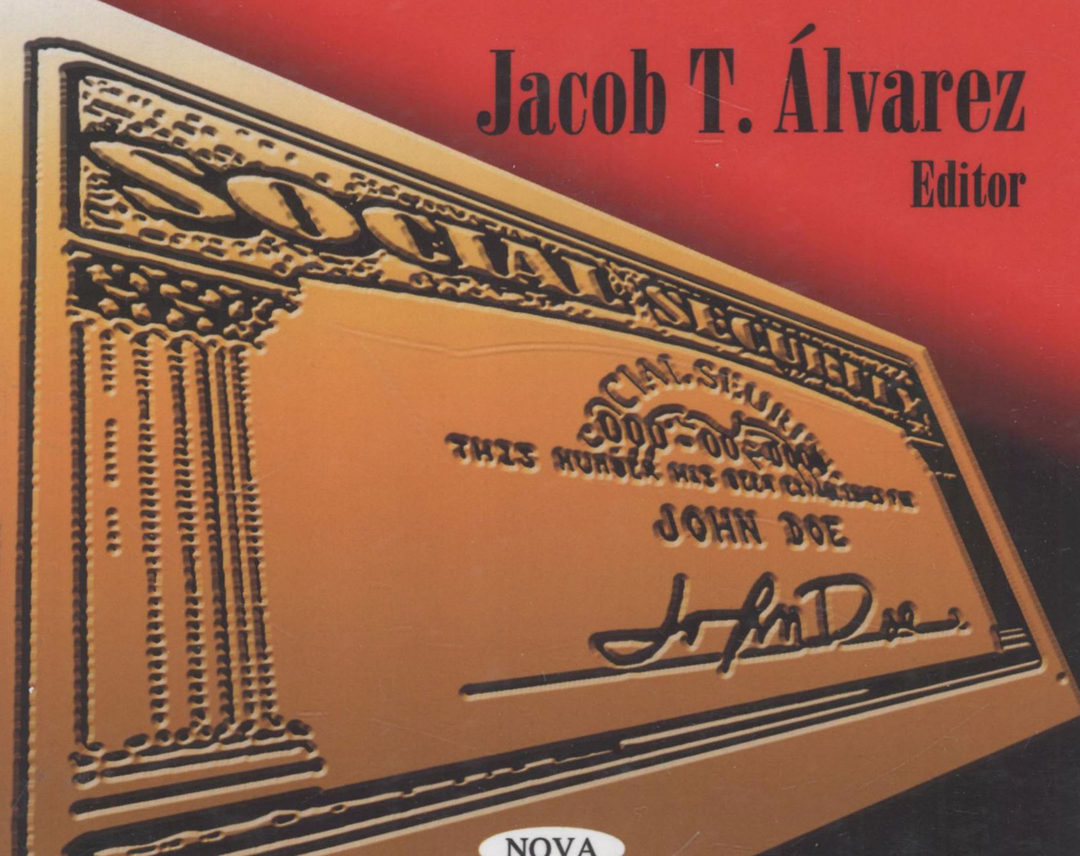
Social Issues, Justice and Status

SOCIAL SECURITY

Background, Issues and Proposals

Jacob T. Álvarez
Editor



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SOCIAL ISSUES, JUSTICE AND STATUS

SOCIAL SECURITY: BACKGROUND, ISSUES AND PROPOSALS

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PREFACE

The Social Security program pays benefits to retired and disabled workers and their family members, and to family members of deceased workers. The Social Security program is financed primarily through payroll taxes that are deposited in the U.S. Treasury and credited to the Social Security trust fund. Any revenues credited to the trust fund in excess of program costs (benefit payments and administrative expenses) are invested in special U.S. government obligations (debt instruments of the U.S. government). This book examines the basics of how the Social Security program is funded and how the Social Security trust fund works.

Chapter 1- The Social Security program pays benefits to retired and disabled workers and their family members, and to family members of deceased workers. Program income and outgo are accounted for in two separate trust funds authorized under Title II of the Social Security Act: the Federal Old-Age and Survivors Insurance (OASI) trust fund and the Federal Disability Insurance (DI) trust fund. This chapter refers to the two trust funds as an aggregate Social Security trust fund and discusses the operations of the OASI and DI trust funds on a combined basis.

The Social Security program is financed primarily through payroll taxes that are deposited in the U.S. Treasury and credited to the Social Security trust fund. Any revenues credited to the trust fund in excess of program costs (benefit payments and administrative expenses) are invested in special U.S. government obligations (debt instruments of the U.S. government).

Chapter 2- The Social Security Act has always required surplus Social Security revenue (revenue in excess of the program's expenditures) to be invested in U.S. government securities (or U.S. government- backed securities). In recent years, however, attention has been focused on alternative investment practices in an effort to increase the interest earnings of the trust funds, among other goals. This chapter explains trust fund investment practices under current law.

Chapter 3- One issue that never seems far from the minds of policymakers is Social Security. At the heart of the issue is the large shortfall of projected revenues needed to meet the mounting costs of the system. For the moment, the amount of Social Security tax receipts exceeds the amount of benefits being paid out. The Social Security trustees estimate that, beginning in 2024, the amount of benefits being paid out will exceed tax collections. According to the trustees' best estimate, the trust fund will be exhausted in the year 2037.

Some have argued that because the Social Security trust fund is intended to meet rising future costs of the program, its surplus should not be counted as offsetting official measures of the budget deficit. With regard to current saving, however, it makes no difference whether the surplus is credited to the trust fund or simply seen as financing current federal government outlays (including Social Security benefits). Off-budget surpluses contribute to national saving in exactly the same way as on-budget surpluses do. The additional saving they represent adds to the national saving rate and allows current investment spending to be higher than it would otherwise be.

Chapter 4- Under the Social Security Retirement Earnings Test (RET), the monthly benefit of a Social Security beneficiary who is below full retirement age (FRA) is reduced if he or she has earnings that exceed an annual threshold. In 2010, a beneficiary who is below FRA and will not attain FRA during the year is subject to a $1 reduction in benefits for each $2 of earnings above $14,160. A beneficiary who will attain FRA in 2010 is subject to a $1 reduction in benefits for each $3 of earnings above $37,680. The annual exempt amounts ($14,160 and $37,680 in 2010) generally are adjusted each year according to average wage growth.

Chapter 5- Social Security taxes are levied on covered earnings up to a maximum level set each year. In 2010, this maximum—or what is referred to as the taxable earnings base—is $106,800. The taxable earnings base serves as both a cap on contributions and a cap on benefits. As a contribution base, it establishes the maximum amount of each worker's earnings that is subject to the payroll tax. As a benefit base, it establishes the maximum amount of earnings used to calculate benefits.

Since 1982, the Social Security taxable earnings base has risen at the same rate as average wages in the economy. However, because of increasing earnings inequality, the percentage of covered earnings that are taxable has decreased from 90% in 1982 to 85% in 2005. The percentage of covered earnings that is taxable is projected to decline to about 83% for 2014 and later. Because the cap was indexed to the average growth in wages, the share of the population below the cap has remained relatively stable at roughly 94%. Of the 9.5 million Americans with earnings above the base, roughly 80% are men and only 9% had any earnings from self-employment income. The District of Columbia has the highest share of the population above the maximum (12%) and South Dakota has the lowest share (2%).

Chapter 6- According to the Social Security Trustees, assets in the two Social Security trust funds will be exhausted by 2037, and, thereafter, Social Security payroll tax revenues will cover about three-quarters of promised benefits. Over the past decade several proposals have been put forward which could help to close the Social Security program's long-term financing gap. One proposal would increase the Social Security payroll tax base so that 90% of covered earnings are taxable— the same proportion as in 1982. This policy would increase the payroll taxes paid by higher- earning workers and not affect workers earning less than the current Social Security maximum taxable limit, which is $106,800 in 2010.

Some analysts have proposed raising the Social Security payroll tax base and reducing the payroll tax rate. This policy would increase the taxes paid by higher-earning workers and reduce taxes paid by low- and middle-income workers. This policy proposal could raise revenue for the Social Security program or be revenue neutral.

Chapter 7- Social Security provides monthly benefits to qualified retirees, disabled workers, and their spouses and dependents. Until 1984, Social Security benefits were exempt from the federal income tax. In 1983, Congress approved recommendations from the National Commission on Social Security Reform (also known as the Greenspan Commission) to tax Social Security benefits above a specified income threshold. Specifically, beginning in 1984, up to 50% of Social Security and Railroad Retirement Board (RRB) Tier 1 benefits are taxable for individuals whose provisional income exceeds $25,000. The threshold is $32,000 for married couples. Provisional income is defined as the total income from all sources recognized for tax purposes plus certain otherwise tax-exempt income, including half of Social Security and RRB Tier 1 benefits. The proceeds from taxing Social Security and Railroad Retirement Tier I benefits at the 50% rate are credited to the Old-Age and Survivors Insurance (OASI) trust fund, the Disability Insurance (DI) trust fund, and the Railroad Retirement system respectively, based on the source of the benefit taxed.

Chapter 8- Most Social Security beneficiaries pay Medicare premiums. Beneficiaries who participate in Medicare Part B (Supplementary Medical Insurance) or Part D (prescription drugs) must pay monthly premiums, unless they qualify for low-income assistance. Part B participants who also receive Social Security must have the Part B premiums automatically deducted from their Social Security checks. Part D participants may choose to have their premiums deducted from their Social Security checks.

Medicare premiums are absorbing a growing share of Social Security benefits. To see the effect of growing premiums, consider a Social Security beneficiary who earned the average wage throughout his or her career. If this retiree chose to participate in Part B—as the vast majority of Social Security beneficiaries do—the standard Part B premium would have absorbed almost 5% of benefits upon retirement in 2000 and about 8.5% in 2010 after over a decade of retirement. For a new retiree in 2010, the Part B premium absorbs about 9% of the Social Security benefit, and combined premiums for both Part B and Part D absorb about 12% of the average initial Social Security benefit check. Medicare's trustees project that premiums for Parts B and D will grow at a faster rate than average Social Security benefits in the future, thus consuming a greater proportion of benefits over time. In 2078, a retired worker receiving the average initial Social Security benefit amount is projected to need 22% of benefits to pay the Part B premium and 31% of initial benefits to pay combined Parts B and D premiums.

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Chapter 1

SOCIAL SECURITY: THE TRUST FUND

Dawn Nuschler and Gary Sidor

SUMMARY

The Social Security program pays benefits to retired and disabled workers and their family members, and to family members of deceased workers. Program income and outgo are accounted for in two separate trust funds authorized under Title II of the Social Security Act: the Federal Old-Age and Survivors Insurance (OASI) trust fund and the Federal Disability Insurance (DI) trust fund. This chapter refers to the two trust funds as an aggregate Social Security trust fund and discusses the operations of the OASI and DI trust funds on a combined basis.

The Social Security program is financed primarily through payroll taxes that are deposited in the U.S. Treasury and credited to the Social Security trust fund. Any revenues credited to the trust fund in excess of program costs (benefit payments and administrative expenses) are invested in special U.S. government obligations (debt instruments of the U.S. government).

The Social Security trust fund represents funds dedicated to pay current and future Social Security benefits. However, it is useful to view the trust fund in two ways: (1) as an internal federal accounting concept, and (2) as the accumulated holdings of the Social Security program.

For internal accounting purposes, certain accounts within the U.S. Treasury are designated by law as trust funds to track revenues (and

expenditures) dedicated for specific purposes. There are a number of trust funds in the U.S. Treasury, including those for Social Security, Medicare, unemployment compensation, and federal employee retirement.

By law, any surplus Social Security revenues must be invested in U.S. government obligations. The accumulated holdings of U.S. government obligations are often viewed as being similar to assets held by any other trust on behalf of the beneficiaries. However, the holdings of the Social Security trust fund differ from those of private trusts because (1) the types of investments the trust fund may hold are limited, and (2) the U.S. government is both the buyer and seller of the investments.

This chapter covers the basics of how the Social Security program is funded and how the Social Security trust fund works.

INTRODUCTION

The Social Security program pays benefits to retired and disabled workers and their family members, and to family members of deceased workers. The program is financed primarily through payroll taxes that are deposited in the U.S. Treasury and credited to the Social Security trust fund. Any revenues credited to the trust fund in excess of program costs (benefit payments and administrative expenses) are invested in special U.S. government obligations (debt instruments of the U.S. government). The Social Security trust fund is both a designated account within the U.S. Treasury and the accumulated holdings of special U.S. government obligations. Both represent the funds designated to pay current and future Social Security benefits.

HOW THE SOCIAL SECURITY PROGRAM IS FINANCED

The Social Security program is financed primarily by revenues from Federal Insurance Contributions Act (FICA) taxes and Self Employment Contributions Act (SECA) taxes. FICA taxes are paid by both employers and employees, but it is employers who remit the taxes to the U.S. Treasury. Employers remit FICA taxes on a regular basis throughout the year (for example, weekly, monthly, quarterly or annually), depending on the employer's level of total employment taxes (including FICA and federal personal income tax withholding). The FICA tax rate of 7.65% each for employers and employees has two components: 6.2% for Social Security and 1.45% for Medicare Hospital Insurance. In 2009, employers and employees each pay 6.2% of wages up to $106,800 in Social Security payroll taxes.[1] The SECA tax rate is 15.3% for self-employed individuals, with 12.4% for Social Security and 2.9% for Medicare Hospital Insurance. In 2009, self-employed individuals pay 12.4% of net self-employment income up to $106,800 in Social Security payroll taxes, with one-half of the SECA taxes allowed as a deduction for federal income tax purposes.[2] SECA taxes are normally paid once a year as part of filing an annual individual income tax return.

In addition to Social Security payroll taxes, the Social Security program has two other sources of income. Certain Social Security recipients must include a portion of Social Security benefits in taxable income for the federal income tax, and the Social Security program receives part of those taxes.[3] In addition, the Social Security program receives interest from the U.S. Treasury on its investments in special U.S. government obligations.

The Internal Revenue Service (IRS) processes the tax returns and tax payments for federal employment taxes and federal individual income taxes. All of the tax payments are deposited in the U.S. Treasury along with all other receipts from the public for the federal government.

The Social Security Trust Fund as a Designated Account

Within the U.S. Treasury, there are numerous accounts established for internal accounting purposes. Although all of the monies within the Treasury are federal monies, the designation of an account as a trust fund allows the government to track revenues (and expenditures) dedicated for specific purposes. In addition, the government can affect the level of revenues and expenditures associated with a trust fund through changes in the law. Social Security program income and outgo are accounted for in two separate trust funds authorized under Title II of the Social Security Act: the Federal Old-Age and Survivors Insurance (OASI) trust fund and (2) the Federal Disability Insurance (DI) trust fund.[4] This chapter refers to the two separate trust funds as an aggregate Social Security trust fund and discusses the operations of the OASI and DI trust funds on a combined basis.

Social Security Trust Fund Revenues

The Social Security trust fund receives a credit equal to the Social Security payroll taxes deposited in the U.S. Treasury by the IRS. The payroll taxes are allocated between the OASI and DI trust funds based on a proportion specified by law.[5] Currently, of the 6.2% tax rate, 5.3% is allocated to the OASI trust fund and 0.9% is allocated to the DI trust fund.[6]

Social Security Trust Fund Costs

The U. S. Treasury makes Social Security benefit payments to entitled individuals on a monthly basis. The Treasury is directed by the Social Security Administration (SSA) as to whom to pay and the amount of the payment. When benefit payments are made by the Treasury, the Social Security trust fund is debited for the payments. Periodically, the Social Security trust fund is also debited for the administrative costs of the Social Security program. These administrative costs are incurred by several government agencies, including SSA, the U.S. Treasury, and the IRS.

Social Security Trust Fund Operations

The annual revenues to the Social Security trust fund are used to pay current Social Security benefits and administrative expenses. If, in any year, revenues are greater than costs, the Secretary of the Treasury (as the Managing Trustee of the Social Security trust fund) is *required* to invest surplus Social Security revenues in securities backed by the U.S. government.[7] The purchase of government securities allows surplus Social Security revenues to be used for other government spending needs at the time.[8] If, in any year, costs are greater than revenues, the cash flow deficit is offset by selling some of the accumulated holdings of the trust fund (government securities) to pay benefits and administrative expenses.

There are two measures of Social Security trust fund operations: the annual cash flow operations and the accumulated holdings (or trust fund balance).[9] The annual cash flow operations of the Social Security trust fund are a measure of current revenues and current costs. The cash flow operations are positive when current revenues exceed costs (a cash flow surplus) and negative when current costs exceed revenues (a cash flow deficit). In years with cash flow deficits, the Social Security program (unlike other federal programs that operate without a trust fund) may use the accumulated holdings of the Social Security trust fund from prior years to pay benefits and administrative expenses.[10]

Although Social Security is often referred to as a pay-as-you-go system (meaning that current revenues are used to pay current costs), changes made to the Social Security program in 1983, including the coverage of federal workers, an increase in the full retirement age, and the taxation of Social Security benefits, began a sustained period of annual cash flow surpluses. In the 2009 Annual Report, the Social Security trustees project annual cash flow surpluses to continue through 2015. Beginning in 2016, however, program costs are projected to exceed revenues and annual cash flow deficits are projected to continue throughout the remainder of the 75-year projection period (under the intermediate assumptions).[11]

On average, over the 75-year projection period (2009 to 2083), the Social Security trustees project that program costs will exceed income (tax revenues plus interest income) by an amount equal to 2.00% of taxable payroll (costs are projected to exceed income by 14%).[12] The gap between income and costs, however, is projected to increase over the 75-year projection period. For example, in 2030, the cost of the program is projected to exceed income by an amount equal to 3.56% of taxable payroll (costs are projected to exceed income by 27%). By the end of the projection period, in 2083, the cost of the program is projected to exceed income by an amount equal to 4.34% of taxable payroll (costs are projected to exceed income by 33%). According to the Social Security trustees, the Social Security program could be brought into actuarial balance over the next 75 years with changes equivalent to an immediate 16% increase in the payroll tax (from a rate of 12.4% to 14.4%) or an immediate reduction in benefits of 13% (or some combination of the two options). The Social Security trustees point out that larger changes would be needed to maintain trust fund solvency beyond the next 75 years.[13]

As shown in Table 1, during the 1957 to 1983 period, the cash flow operations of the Social Security trust fund (annual revenues less annual costs) were negative in 21 of the 27 years.

Table 1. Annual Revenues, Costs, and Cash Flow Surplus or Deficit for the Social Security Trust Fund, 1957-1983 ($ in billions)

Year	Annual Revenues (not including interest)	Annual Costs	Annual Cash Flow Surplus or Deficit (annual revenues less annual costs)
1957	$7.50	$7.60	($0.10)
1958	8.50	8.90	(0.40)
1959	8.90	10.80	(1.90)
1960	11.90	11.80	0.10
1961	12.30	13.40	(1.10)
1962	13.10	15.20	(2.10)
1963	15.60	16.20	(0.60)
1964	16.80	17.00	(0.20)
1965	17.20	19.20	(2.00)
1966	22.60	20.90	1.70
1967	25.40	22.50	2.90
1968	27.00	26.00	1.00
1969	31.50	27.90	3.60
1970	34.70	33.10	1.60
1971	38.30	38.50	(0.20)
1972	42.90	43.30	(0.40)
1973	51.90	53.10	(1.20)
1974	58.90	60.60	(1.70)
1975	64.30	69.20	(4.90)
1976	71.60	78.20	(6.60)
1977	78.70	87.30	(8.60)
1978	88.90	96.00	(7.10)
1979	103.00	107.30	(4.30)
1980	116.70	123.60	(6.90)
1981	139.40	144.40	(5.00)
1982	145.70	160.10	(14.40)
1983	156.30	171.20	(14.90)

Source: Table prepared by the Congressional Research Service (CRS) from data provided in *The 2009 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, Washington, DC, May 12, 2009, Table VI.A4.