Committee on Ways and Means

Overview of the Social Security Program

The Basics

- Social Security was enacted in 1935 to provide continuing income during retirement. It was expanded over time to cover disabled workers, spouses and dependents.

- The program was designed to:

  - Provide an entitlement to benefits – workers who pay into the program for a certain amount of time are entitled to benefits regardless of economic need.

  - Achieve social insurance goals – such as replacing income lost due to retirement, death, or disability; reducing poverty; and providing progressive benefits.

  - Supplement other income – enhances pensions and personal savings with a minimum floor of income.

Who benefits?

48.4 million people:

- 30.5 million retirees
- 6.5 million disabled workers
- 11.5 million survivors and family members

Note: For additional information see SSA Actuary *Fact Sheet on the Old-Age, Survivors, and Disability Insurance Program* http://www.ssa.gov/OACT/FACTS/index.html.

Social Security Taxes and Benefits

Social Security is Primarily Funded with Dedicated Payroll Taxes

- The Social Security payroll tax is 12.4 percent of wages up to $94,200 (in 2006), divided equally between employers and employees.

- The $94,200 cap is adjusted each year to reflect the growth in average wages.

- Workers are entitled to benefits after paying into the system for a certain amount of time (generally 10 years).

- In addition, Social Security beneficiaries pay income taxes on their benefits if income exceeds certain thresholds ($25,000 for singles; $32,000 for married couples). A portion of the revenue is dedicated to Social Security and a portion to Medicare. For additional information see IRS Publication 915 *Social Security and Equivalent Railroad Retirement Benefits* http://www.irs.gov/publications/p915/index.html.

Benefits Are Based on Career Earnings

- The Social Security Administration calculates your average monthly wage over your career. Wages above the $94,200 cap are ignored.

- Your Social Security benefit is calculated by applying a formula to this average monthly wage. The formula is adjusted each year to reflect the growth in average wages.

    - The formula is very progressive. It replaces 90 percent of the lowest earnings and only 15 percent of the highest earnings. It does not replace any wages above the $94,200 cap.

- Retirees receive a benefit increase each year (called a "COLA") to reflect inflation.

Note: For additional information, see SSA publication *Your Retirement Benefit: How it is Figured* http://www.ssa.gov/pubs/10070.html

Why Is Social Security in Trouble?

- Social Security is not a savings plan; the payroll taxes paid by each worker are not set aside to finance that worker's retirement.

- Instead, Social Security is financed on a pay-as-you-go basis.

    - The payroll taxes paid by today's workers are used to pay benefits for today's retirees; future workers will pay for future retirees.

- The program is in trouble, because the population is aging. Women are having fewer children, and people are living longer. Between now and 2035, the population age 65 and older is expected to double, while the population age 20-64 is expected to grow by about 11 percent. As a result, there are fewer workers supporting each beneficiary.

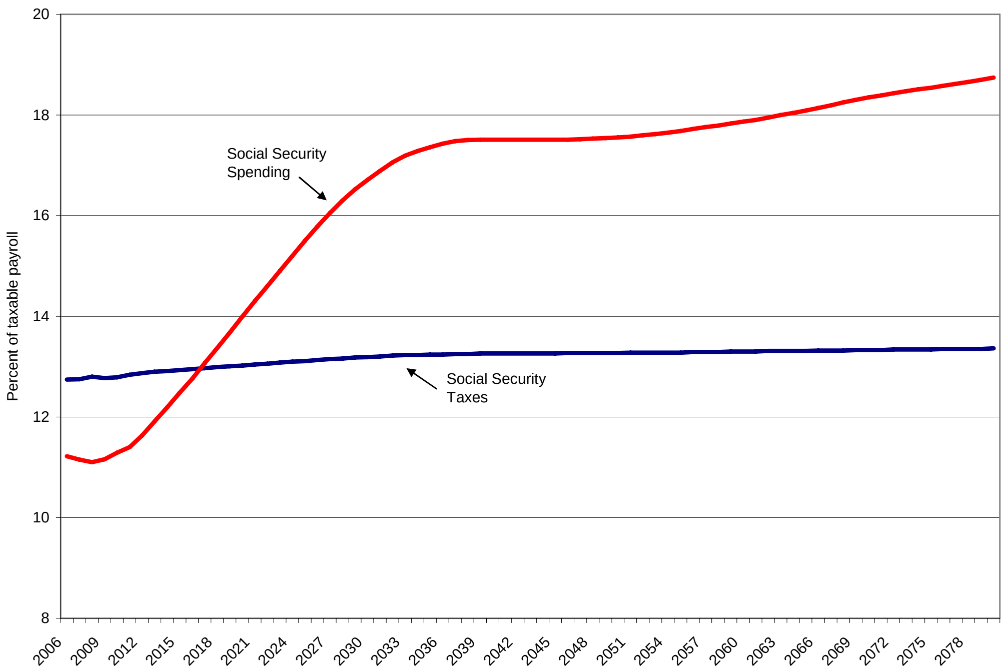
<u>WORKERS PER BENEFICIARY</u>

	1945	Today	2045
Workers per retiree	42	3	2
Total payroll tax	2%	12.4%	16.7%*

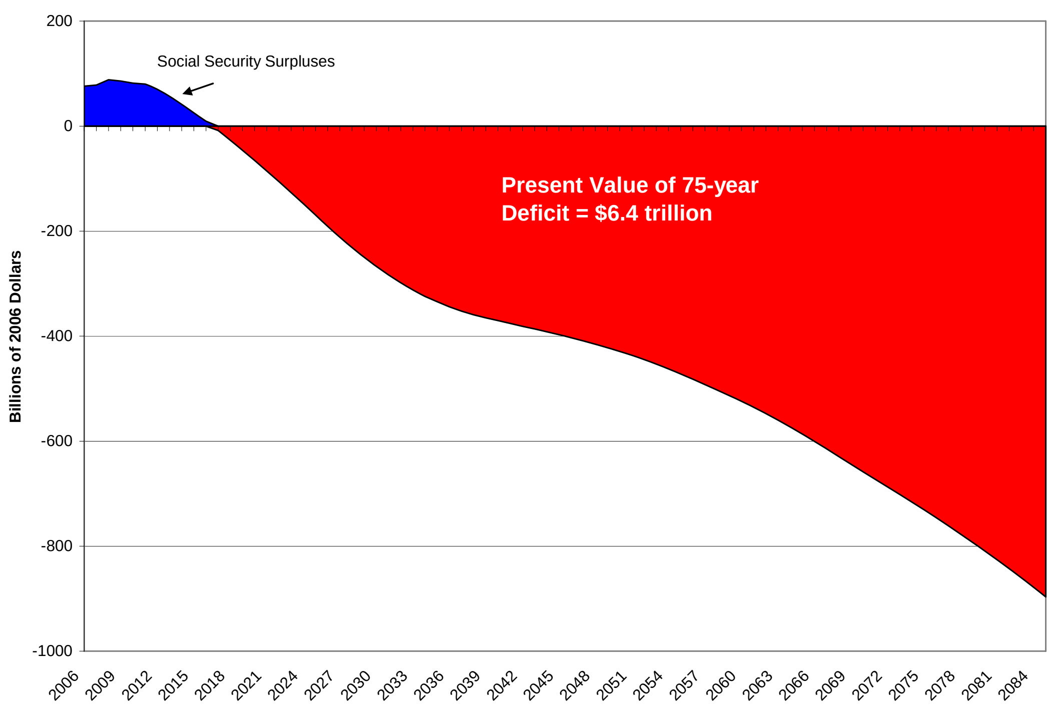
*This is the amount that will be needed to cover full benefits in 2045.

- A pay-as-you-go system does not work well when the population is aging, because the program's revenue cannot keep up with its growing costs. Without reform, Social Security is not sustainable in the long run.

Social Security Spending Is Growing Faster than Tax Revenues, Leading to Unsustainable Cash Flow Deficits



We Would Need to Invest $6.4 Trillion Today to Cover these Deficits over the Next 75 Years



Source: Data from the Social Security Trustees' 2006 Annual Report

Social Security's Financial Picture

TODAY: Social Security is Running Surpluses

- The taxes paid by today's workers are more than enough to pay promised benefits. The Social Security cash surplus was $78 billion in 2005.

- These surpluses are invested in Treasury bills (as required by law), which are credited to the Social Security Trust Funds.

    - The Treasury bills in the trust fund represent an IOU from one government account (the general fund) to another (the trust funds). This IOU is backed by the full faith and credit of the government, but no cash has been set aside to pay it.

Starting in 2017: Social Security Surpluses Turn to Deficits

- Starting in 2017, Social Security's revenues will fall short of the amount needed to pay promised benefits.

- To make up the shortfall, the Treasury bills in the trust funds will have to be cashed in. Since no money has been set aside to pay these obligations, the government will have to raise taxes, cut spending or increase the debt to honor the obligations.

By 2040: Social Security Trust Funds Will Be Bankrupt

- The Treasury bills in the trust funds will be depleted by 2040 (or 2052 according to CBO's more optimistic economic assumptions).

- At this point, payroll taxes will be sufficient to pay only 74 percent of benefits. In other words, if no action is taken to reform Social Security, benefits will have to be cut by 26 percent in 2040 or the payroll tax would have to increase to 16.65 percent to pay full benefits at that time. The cash shortfall will continue growing thereafter, requiring steeper tax increases and larger benefit cuts over time.

Which Date Matters?

- Although Social Security will be "solvent" until 2040 (2052 according to CBO's more optimistic assumptions), <u>2017 is the date that matters</u> because this is when Social Security will start straining the rest of the Federal budget.

  - Opponents of reform claim that Social Security is fine until 2040, because the Treasury bills in the trust funds can be used to pay benefits until then.

  - However, benefits cannot be paid in Treasury bills – they must be paid in cash. Starting in 2017, the government will have to come up with the cash needed to honor the Treasury bills, so that promised benefits can be paid.

<u>What Is the Size of the Problem?</u>

- The Treasury bills that have already accrued in the Social Security trust funds total $1.9 trillion. In other words, the government is already committed to raising taxes, increasing the debt, or finding funds elsewhere in the budget to cover $1.9 trillion of Social Security's cash shortfalls.

- In addition to this existing $1.9 trillion obligation, the government would have to invest an *additional:*

  - $4.6 trillion today to cover full benefits for the next 75 years and
  - $13.4 trillion today to cover full benefits over the infinite future.

<u>Why Do We Need to Act Now?</u>

- The Social Security Trustees and the Comptroller General of the United States have said the sooner we address the problem, the smaller and less abrupt the changes will be for individuals and their families.