Social Security 101: History, Importance, and Reform

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"We can never insure one hundred percent of the population against one hundred percent of the hazards and vicissitudes of life, but we have tried to frame a law which will give some measure of protection to the average citizen and to his family against the loss of a job and against poverty-ridden old age."[1] President Franklin D. Roosevelt, August 14, 1935

The Old-Age, Survivors and Disability Insurance (OASDI) Program

The Social Security Act of 1935 laid the foundation for the OASDI program, commonly known as Social Security and Disability Insurance. The act was amended to add protections for dependents of retired workers and survivors (1939 amendments), and disability benefits (1950-1960 amendments)[2]. In September 2023, 50 million retired workers and 8.5 million dependents and survivors received Social Security benefits, and 8.6 million workers and their dependents received disability insurance benefits[3]. These benefits are funded by 12.4 percent payroll contribution on wage income, split equally between employers and employees. Self-employed individuals pay the total rate of 12.4 percent. The payroll contribution is subject to a taxable maximum earnings cap, adjusted every year by the average wage increase in the economy. The cap for 2023 is $160,200, and individuals with wage income above the cap do not contribute to Social Security on that portion of their income and do not accrue additional Social Security benefits.

The average retirement benefit for September 2023 is quite modest at $1,841 per month. As a percentage of earnings, the U.S. Social Security program replaces on average about 40% of pre-retirement income, compared to the OECD average of 51.8 percent[4]. The Social Security benefit is a function of a worker's wage income for the 35 years with the highest earnings. If a worker does not have 35 years of wage earnings, the formula includes zeros for the years without income. This feature of the benefit formula has the largest impact on women, who may have multiple years of no work or part-time work, resulting in low annual income. The monthly benefit is calculated by applying a progressive formula, where lower levels of income are replaced at a higher rate. For 2023, a retiree eligible for Social Security will receive 90 percent of the first $1,115 (first bend point) of their average indexed monthly income, 32 percent for income over $1,115 and up to $6,721 (second bend point), and 15 percent on income above $6,721 up to the cap for 2023, $13,350. Table 1 shows three hypothetical scenarios, assuming retirement at the full retirement age (67).

Table 1: Social Security Retirement Income Scenarios

	Low Income	Middle Income	High Income
Average indexed annual income	40,000	85,000	150,000
Average indexed monthly income	3,333	7,083	12,500
Monthly retirement benefit at age 67 (full retirement age)	1,713	2,852	3,664
Replacement rate (retirement benefit/monthly income)	0.51	0.40	0.30

Although Social Security retirement benefits are modest by international comparisons, the income from the program is vital for the retirement security of Americans. Social Security is the first tier in the retirement system, with almost universal coverage (some government employees are not included due to employer retirement coverage). One in five older adults rely on Social Security for 90% of their income, and four in ten rely on it for at least half of their income[5]. Other sources of retirement income include employer retirement savings programs, other assets, and earnings. However, almost half of U.S. workers do not have employer retirement coverage[6], leaving Social Security as their primary retirement income program. Social Security also provides guaranteed income for life, insuring retirees against outliving their resources in old age.

The OASDI program is fully funded by payroll contributions and does not have the authority to borrow money or to use other revenue sources. As a result, it does not contribute to the federal debt. The funding method is known as pay-as-you-go, with current employee contributions funding current retiree benefits. This funding is typical for national retirement programs. Contributions are deposited in two trust funds (Social Security and Disability Insurance), and amounts in excess of current benefits are invested in Federal securities. The Social Security trust fund is projected to be depleted by 2033, and the Disability Insurance trust fund is solvent for the 75-year projection window. After 2033, Social Security will be able to pay 80 percent of scheduled benefits,[7] assuming no legislative action to address the revenue shortfall.

Public Opinion on Social Security Reform

Public opinion is regularly consulted about Social Security reform through general public opinion polls or surveys presenting different reform scenarios. This brief examines results from both types of public opinion studies, with an emphasis on recent surveys that have focused on tradeoffs and policy simulations for different reform options.

Gallup News conducts regular opinion polls on Social Security, and in their 2019 survey, they report that fifty-seven percent of retirees said that Social Security was a major source of income in their retirement[8]. Consistent with the progressive structure of the Social Security benefit formula, lower- to medium-income households rely more heavily on Social Security in retirement. When asked about changing Social Security in the future, majorities across demographic groups and party affiliation say that Social Security benefits should not be reduced in any way[9]. At the same time, there is low confidence in the future of the system among those who are not retired yet, with one in three respondents believing that Social Security will not be a major source of income for them when they retire. Overall, Americans believe that Social Security is an important government program, that this program needs more support now than ever, and that they are willing to contribute to stabilize it.

To examine specific preferences for reform options, the National Academy of Social Insurance conducted a comprehensive national survey in 2014, including questions focused on knowledge and attitudes towards Social Security, confidence in the system and the importance of benefits, and tradeoff analysis of fourteen specific reform proposals. Americans showed a “strong preference for strengthening the finances of the Social Security system and are willing to contribute” as well as wanting to close the system’s financing gap[10]. In addition to confirming existing public opinion poll data cited above, the survey showed that there are features of the program that are not widely known, including disability and life insurance benefits. In order to balance the program for the long term, respondents chose a package that increased revenues by eliminating the maximum taxable cap and increase the payroll tax rate from 6.2 percent to 7.2 percent for employers and employees. The package also included increasing the cost-of-living adjustment (COLA) to reflect higher inflation for the elderly and an increase in the minimum benefit (which affects lifetime low-wage workers). The second most preferred package was similar, but included an across-the-board benefit increase. The first package would completely eliminate the funding gap, and the second package would cover 90 percent of the funding gap.

A similar survey focused on the respondent’s knowledge of the Social Security program and reform proposals was conducted by the Program for Public Consultation in 2022. In this survey, more than 2,500 respondents were exposed to a policymaking simulation, which included a briefing on the Social Security program, and arguments for and against proposals that could be used in the future to balance the trust fund[11]. The range of proposals included increasing taxes on the wealthy, raising the payroll tax, raising the retirement age, reducing benefits to high earners, and increasing the minimum monthly benefit for low-income earners, among others. Majorities of Democrats and Republicans favored two proposals to increase revenue: (1) making more wages subject to the payroll tax, and (2) increasing the payroll tax from 6.2% to 6.5%. There was also bipartisan support for two proposals to cut benefits: (1) raising the retirement age from 67 to 68, and (2) reducing benefits for high earners. The combination of reforms would eliminate 85 percent of the trust fund shortfall. Importantly, there was significant opposition to further increases in the retirement age (up to 70 years and/or indexing to longevity).

Given the strong bipartisan support for Social Security reforms that would result in sustaining and marginally strengthening the program, the lack of legislative action to address the funding shortfall may seem like a paradox. One of the main issues regarding decisions to increase funding for the program is that legislators feel immense pressure not to impose costs on their constituents because they are worried they will not be re-elected. Furthermore, over the years insolvency has been a long-term problem without short-term consequences. However, the window for action has narrowed significantly, with only 10 years left to address the trust fund shortfall. Without congressional action, an estimated 83 million Social Security recipients will face automatic across the board benefit cuts of 20 percent.

Reform Options to Balance the Trust Fund

The reform options that specifically focus on balancing the trust fund fall into two broad categories: revenue increases and benefit cuts. The two primary revenue changes would increase the tax base by either raising or eliminating the taxable maximum or by increasing the payroll tax. There are other revenue sources that have been added to the discussion, such as taxing investment income or possibly adding funding from general revenues, but the focus here is on the current funding model. Benefit cuts include raising the full retirement age (from the current age of 67 up to 70) and indexing the retirement age to longevity increases. As a general rule, a one-year increase in the retirement age is an effective seven percent reduction in benefits. Other benefit reductions have been targeted to higher earners, reducing the rate at which benefits are accrued at the top of the income distribution by adding another bend point.

The original normal retirement age (NRA) for Social Security was 65, and it was gradually increased to 67 with the 1983 amendments that passed in anticipation of the increased costs for the Baby Boomer generation. Since the inception of the program, life expectancy at age 65 has increased from 11.9 years for men and 13.4 years for women to 18.1 years for men and 20.6 years for women in 2019[12]. An increase in life expectancy results in higher lifetime benefits as individuals receive benefits over more years in retirement, while an increase in the retirement age reduces benefits by shortening the number of years that benefits are received. While the logic of increasing the retirement age to compensate for longer lifespans seems easy to grasp, the distributional effects are much more complex. The net effect depends on the life expectancy of different groups, which is not uniform and is highly correlated with income. Most of the gains in life expectancy have gone to higher earners and are more pronounced for men than women. The gains are concentrated in the top two income quintiles, while there has been a small reduction in life expectancy for men in the first quintile and for women in the first two quintiles[13]. Given an overall small increase in life expectancy at the bottom half of the income distribution, further increases in the retirement age would result in effective lifetime income cuts in Social Security benefits for the group of beneficiaries who rely most extensively on the program as their major source of income.

There are several variations focused on targeted reductions for higher income earners. They involve a combination of reducing the dollar range for the second bend point and inserting a third bend point, and a lower benefit factor (as low as 5 percent). However, some versions of the third bend point proposals would set the cutoff at the 50th percentile of the income distribution, which would significantly reduce Social Security benefits to moderate income families, not only high-income families[14]. Overall, it is possible to design a benefit cut that can be directed to higher income earners, but it reduces the link between Social Security contributions and benefits, a feature of the program that is considered essential for its widespread support.

The most commonly featured legislative proposal to raise revenue includes some version of raising the taxable maximum earnings cap or a phased-out elimination of the cap. The 1983 amendments to Social Security also updated the taxable maximum and brought total taxable payroll up to 90 percent of all wage income. Additionally, the taxable maximum was indexed to average wage growth. As discussed by the SSA Chief Actuary, Steve Goss, since these last adjustments, total taxable payroll has decreased to 82.5 percent due to the significant income growth at the top of the income distribution and minimal income growth in the rest of the income distribution[15]. Increasing the payroll tax cap to 90 percent of payroll (equivalent to annual income of $300,000) would bring more revenue into the program, while also generating additional Social Security benefits for those earners. Other proposals have included creating a donut hole that is not taxed (between the current taxable maximum and $400,000 for example), and then taxing income above $400,000. Eventually, as the taxable maximum increases with average wage growth, all income will be taxed[16]. Expanding the tax base to include more earnings from payroll, while also increasing the benefits, has a modest effect on its own on the funding of the program. Such a reform would extend the trust fund anywhere between a few years up to an entire decade, depending on the specific features of the reform proposal. It is a reform option that improves the progressivity of the program, which has been reduced due to income inequality and differences in life expectancy.

Other options to raise revenue include expanding the payroll tax base to include income that is currently not taxed (e.g. employer pre-tax benefits such as health insurance), adding a tax on investment income, or using general revenue to fund the difference between payroll contributions and benefit payments. These reforms would also improve the progressivity of the OASDI program, assuming higher income individuals tend to receive employer benefits and investment income. These alternatives raise questions about the best funding model for the program and whether we should continue to rely on the payroll tax as the main source of revenue given the significant changes in income and wealth distribution. In the context of social insurance, it is important to establish floors that protect individuals from poverty and hardship, and the value of these protections may not be directly proportional to individual contributions to the system. Like any insurance product, the benefit from the risk protection adds value for individuals and their families, above and beyond the specific benefits that are guaranteed through these programs.

The narrative that the demographic impact of the Baby Boom combined with increasing lifespans renders Social Security unsustainable is both false and disempowering; it implies there is nothing to be done. As we have shown, however, many reform proposals are viable, and there is real room for democratic decision-making. In multiple surveys and studies focused on Social Security reform, Americans have consistently expressed preferences to maintain at least the current levels of benefits and to find resources to pay for those benefits. Reform proposals that focus exclusively on balancing the trust fund without examining the distributional effects of these changes and their impact on the retirement security of the most vulnerable groups do not reflect responsible policymaking. Rather, any reform should take account of the importance of Social Security benefits in ensuring that Americans of all classes can lead dignified lives in retirement.

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