



The United States Social Security System

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What is Social Security?

- Formal name: "Old Age, Survivors, and Disability Insurance" Program (OASDI)
- Provides income to:
 - Retirees ← *our focus today*
 - Disabled Workers
 - Spouses of Beneficiaries
 - Widows & Dependants of Beneficiaries



Today's Objective

- By the end of today, you should be able to:
 - Explain the basic tax and benefit structure of the Social Security retirement program
 - Explain why Social Security faces long-run financial problems



Why Should You Care?

- Of every \$1000 you earn in your lifetime, you will pay *at least* \$124 in taxes to support it
- Your parents / grandparents may be depending on it during retirement
- In 2001 the federal government spent *more* on Social Security than on the following programs *combined*:
 - national defense
 - education, training, employment, social services
 - energy, natural resources, environment
 - international affairs
 - general science, space, and technology



Who Participates?

- 90%+ of all workers in the United States pay into Social Security
- Some state/local workers are exempt (including U of I employees)
- Must work minimum number of years to be eligible for benefits (approx. 10)
- Spouses also eligible



How Is It Paid For?

- While working, you and your employer each pay 6.2% of wages (=12.4% total) to the government
- Only taxed on first \$84,900 of earnings
- Look at your paycheck – FICA
 - Federal Insurance Contribution Act
 - Covers SS (12.4%) and Medicare (2.9%)
 - 2/3 of US households pay more in FICA than in income tax!



What Benefits Does It Pay?

- If you pay into SS "long enough" (approximately 10 years), you can receive a benefit at retirement
- Can claim as early as 62
- Monthly income is paid to you for *as long as you live* (i.e., as an annuity)
- Payments are increased annually with inflation
- Spouse can also receive benefit



Does Social Security Redistribute?

- Program is designed to redistribute "progressively" from rich to poor
 - Higher "replacement rate" (ratio of benefits to pre-retirement income) for lower earners
- But recent research shows that it is not very progressive on a lifetime, household basis
 - "The rich live longer"
 - Low income individuals are often spouses of high income individuals



Is Social Security Like a Pension?

- Both have contributions
- Both have retirement benefits based on contributions
- What is the key difference?
 - Where do the contributions go?
 - How are they invested?

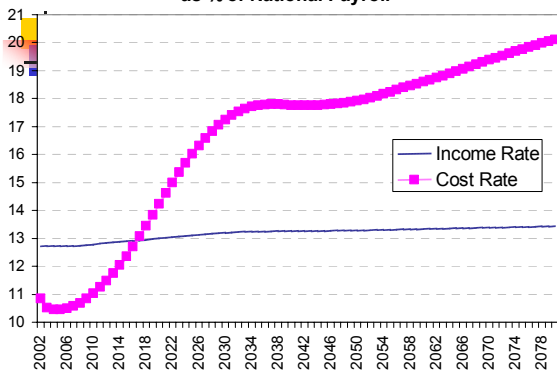
Social Security Finances

- "Pay-As-You-Go": Taxes paid by today's workers are used to finance today's retirees
- Today, we are running surpluses: taxes exceed benefits by \$76 billion in 2001
- So what is the problem? Why does Social Security need "saved?"

What Do You Believe?

- 1994 survey of those 18 to 34 years old
 - 46% (___% of class) think UFOs exist
 - 28% (___% of class) feel Social Security will exist by the time they retire
- Source: Analysis of [Third Millennium Survey](#) by Frank Luntz and Mark Siegel, Sept. 1994

Social Security Income and Cost as % of National Payroll





Sources of the Problem

- Demographics
 - Rising Life Expectancies
 - Declining Birthrates
 - Declining ratio of workers to retirees
- Structure of the Current System
 - Inability to "grow our way out"



People Are Living Longer

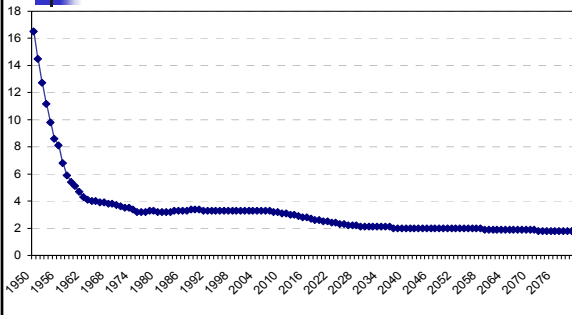
- Generation born in 1875
 - Only 40% of males reached age 65 in 1940
 - Those that did lived another 12.7 years
- Generation born in 1935
 - 69% of males reached age 65 in 2000
 - Those that did expected to live 16.2 years
- Generation born in 1985
 - 84% of males will reach age 65 in 2050
 - Those that do can expect to live 19.1 years



And Having Fewer Children

- Total U.S. fertility rate
 - 2.2 children per woman in 1940
 - 3.2 in 1947
 - 3.7 in 1957
 - 1.8 in mid-1970s
 - Now approximately 2.0

So There are Fewer Workers to Support Each Beneficiary (Ratio of Workers to Beneficiaries)



Options for "Saving" Social Security

- Two solutions
 - Put more money in
 - Payroll tax increase
 - Transfer money from rest of government (cut other spending or raise other taxes)
 - Borrow
 - Take less money out
 - Cut benefits (or at least reduce the rate at which benefits are growing)

What About a "Third Way?"

- "Increase the rate of return" on the Social Security contributions through:
 - Direct investment of the Trust Fund in equities
 - Personal accounts
- This is the "Great Debate"
 - 2000 Presidential Election
 - 2002 Congressional Elections



The "Pros" of Personal Accounts

- Benefit levels: On average, personal accounts will result in higher benefits
- Choice, Ownership & Control
- Inheritability: Can leave money to kids
- Provide stock market access to all
- A good case can be made that it will contribute to national savings (and thus economic growth)



The "Cons" of Personal Accounts

- By themselves, they do not "save" Social Security – other steps required
- Requires more money in the short-run to fund the accounts and pay benefits
- Increases financial market risk



To Learn More

- www.csss.gov (President's Commission to Strengthen Social Security)
- www.ssa.gov (Social Security Admin.)
- www.access.gpo.gov/eop/index.html (Economic Report of the President, Chapter 2)
