Social Security was created in 1935 with the goal of providing economic security to the nation’s elderly; it was expanded in the 1950s to include support for the disabled. The program is established largely on a “pay-as-you-go” basis: current employed workers contribute taxes that fund benefits to retired workers and survivors in the Old-Age and Survivors Insurance (OASI) program as well as disabled workers and their families under the Disability Insurance (DI) program.

Today, Social Security is the largest program in the federal budget and makes up approximately one-quarter of total federal spending. The program provides benefits to about 63 million beneficiaries, or 19 percent of the American population. Nearly nine out of 10 individuals over the age of 65 receive benefits, and those benefits represent about 33 percent of total income to older Americans.

**Who gets Social Security?**

Retired workers account for 70 percent of the program’s beneficiaries. Disabled workers make up another 14 percent of beneficiaries. The remainder are the survivors of deceased workers as well as spouses and children of retired workers.
Social Security is a major source of post-retirement income for low-income seniors. For seniors at the bottom of the income distribution, benefits make up over 80 percent of their total yearly income. However, the benefits received by low-income retirees are modest. Workers who earned $20,000 on average before retirement would receive only $12,600 per year in Social Security benefits (in 2018 dollars) if they retired this year at the full retirement age.
Workers become eligible for Social Security benefits for themselves and their family members by working and paying Social Security taxes. Generally, a worker must have 10 years of employment to be eligible for retirement benefits. Disability benefits depend on the worker’s earnings before disability and the worker’s age at disability.

A worker’s initial monthly benefit under the OASI program is based on their average indexed monthly earnings during the 35 years in which their earnings were highest. Benefits are calculated using a progressive formula that provides a higher replacement rate for workers with lower earnings. In 2018, a worker who retired at age 66 with $20,000 in career-average earnings would receive Social Security benefits that replaced 63 percent of her pre-retirement earnings. By contrast, Social Security benefits to workers earning $50,000 would replace only 44 percent of their career-average earnings.
Full benefits are payable at the normal retirement age, which is between 65 and 67, depending on one’s birth year. Early retirement is possible at the age of 62, but benefits would be subject to a permanent reduction. Similarly, if retirement is delayed, benefits would be higher when they go into effect. However, nearly half of retirees claim their benefits as early as possible, and about 90 percent of them claim benefits before their full retirement age.

Disability benefits, on the other hand, are paid to people who cannot work due to a medical condition that is expected to persist for at least one year or result in death; Social Security does not grant benefits to individuals with partial or short-term disabilities. The Social Security Administration also pays benefits to disabled adults and children with limited income and resources under the Supplemental Security Income program; that program is reported separately in the budget.

**How is Social Security Funded?**

Social Security is mainly funded through a dedicated payroll tax created by the Federal Insurance Contributions Act. Employers and employees each pay 6.2 percent of wages, with a cap on the amount of wages subject to the tax ($132,900 for 2019, adjusted annually for growth in economy-wide wages).3 Those who are self-employed pay both the employee and the employer share of the tax. Those revenues are credited to the OASI and DI trust...
funds, which keep track of the programs’ receipts and expenses.

The programs receive income from two other sources: a tax on Social Security benefits paid by higher-income beneficiaries and income generated by the investment of the trust fund reserves in non-marketable U.S. Treasury securities. However, from the perspective of the government’s overall budget, the interest income paid to the trust funds by the Treasury has no effect. Although it is a receipt to the trust funds, it is an equal dollar expense to the Treasury.

Mechanics of Social Security’s Trust Funds

Income is credited to the funds and disbursements for benefits and administration are counted against the funds’ balances. The Social Security Administration has the legal authority to spend any accumulated balances plus any incoming revenues. However, once a trust fund balance reaches zero, spending cannot exceed incoming revenues.

As with other trust funds, Social Security’s surpluses are credited with securities issued by the Treasury; that excess income is used to reduce the amount of new federal borrowing necessary to finance governmental activities. The reverse happens when revenues for the trust funds fall short of their expenses.
The balance of the trust funds is a measure of the historical relationship between receipts dedicated to the programs and their expenditures. Therefore, it is important to understand that securities held by the funds are essentially bookkeeping mechanisms to track cash flows in and out of the accounts. However, trust funds have an important legal meaning in that a balance is required to permit spending from a fund.

Between 1984 and 2009, Social Security ran significant cash surpluses (excluding interest). Such surpluses were primarily the result of program reforms enacted in 1983. Those reforms slowly raised the retirement age and increased payroll taxes, which produced substantial trust fund reserves (or balances) during the 1990s and early 2000s.

In 2010, Social Security began running cash deficits (excluding interest). Without reforms, the trustees project that cash-flow deficits will grow rapidly. Between now and 2035, annual cash deficits will total $2.9 trillion dollars. As Social Security runs those cash deficits, the trust funds will “redeem” their Treasury securities and the Treasury will have to borrow funds from the public to cover the shortfalls.

By 2035, the Social Security Trustees project that the combined Social Security trust funds will be fully depleted. Separately, the the OASI fund is projected to have its reserves depleted in 2034; the DI trust fund would have a balance until 2052. Once the trust funds are exhausted, the Social Security Administration will be
limited to spending only as much as incoming revenues. Retirees could face an immediate 23 percent cut in their scheduled benefits upon depletion of the OASI fund. At that point, 73 million beneficiaries would be affected; the average retiree would incur an immediate benefit cut of around $5,500 in today’s dollars. Upon depletion, the DI trust fund would only be able to pay 91 percent of its obligations (a nine percent reduction) to the projected 13 million beneficiaries in the program at that time. If the funds of the two programs were combined, the reduction in benefits upon depletion of both funds would be 20 percent in 2035.

Demographics and Social Security

The transition from annual Social Security surpluses to annual Social Security deficits is the result of the changing demographic composition of the United States. The program is financed largely on a pay-as-you-go basis, which means that today’s workers pay Social Security taxes into the program and money immediately flows back out as monthly income to beneficiaries. A pay-as-you-go system works well as long as there are enough workers contributing to the system to cover its costs. However, as baby boomers retire and life expectancy continues to increase, the number of Social Security beneficiaries is projected to climb sharply.
The aging of the Baby Boom Generation will boost the number of Americans age 65 and older.

**Number of People Age 65 and Older (Millions)**


NOTE: The highlighted period represents the time span between the years when the oldest and when the youngest of the Baby Boom Generation turn age 65.

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In 2010, the ratio of workers paying taxes to support each Social Security beneficiary was 3:1; by 2030, that ratio is expected to decline to 2:1. As the population of beneficiaries grows faster than the population of workers, expenses will grow faster than income, and the finances of the system will become increasingly strained.
Because the Social Security system provides a form of social insurance against the risk of extreme poverty in old age, it redistributes income from higher earners to lower earners.

The lifetime benefit/tax ratio is one way to assess the degree of redistribution among people with different levels of career-average incomes and from different birth cohorts. If the ratio is less than one, people are expected to receive lifetime benefits that are less than their lifetime taxes; if it is greater than one, lifetime benefits are expected to exceed lifetime taxes.
For people in the 1960s birth cohort with income in the middle quintile, the benefit/tax ratio is projected to be 1.10, based on calculations using data from the Congressional Budget Office. For them, the expected value of their lifetime benefits roughly matches their expected contributions. This measure accounts not only for their projected path of earnings, but also the expected length of their life.

By contrast, people who are in the lowest income quintile of the 1960s birth cohort are projected to have a benefit/tax ratio of 2.25. That means that their lifetime benefits are expected to be twice the amount that they contributed into the system, even after accounting for their shorter-than-average life expectancies.

At the same time, those in the highest income quintile in the 1960s birth cohort are projected to have a benefit/tax ratio of only 0.72, which means that their lifetime benefits are expected to be only 70 percent of the taxes that they paid. These results illustrate how Social Security provides social insurance: it redistributes income from retirees who have higher earnings to those with lower earnings.

**Conclusion**

The Social Security system faces major financial challenges. If reforms are not enacted, beneficiaries could face an across-the-board benefit cut of 20 percent in 2035 (on average) when the combined trust fund reserves are depleted. Because of the critical importance of this program for ensuring financial security for many retired and
disabled people — especially those with low incomes — reforms are needed to ensure that the program can continue to provide benefits.

Any viable reform package will need to balance two priorities: adequacy of benefits for recipients and financial sustainability for the federal government. It should also be announced well in advance and phased in gradually to give people time to prepare and adjust their saving and retirement plans. There are many possible solutions which can be found on our Solutions webpage.

Finding Solutions: Social Security

Latest Social Security Report

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1 Career-average earnings are measured by average indexed monthly earnings (AIME). Earnings before age 60 are adjusted by the growth of economy-wide wages, then the highest 35-years of indexed earnings are averaged.

2 In 2018, the first-year monthly benefits to workers claiming benefits at the normal retirement age are 90% of the first $895 of the AIME, 32% of the AIME between $895 and $5,397, and 15% of the AIME above $5,397.

3 In 2011 and 2012, the worker share was temporarily reduced from 6.2% to 4.2% under the “payroll tax holiday” in order to provide a fiscal stimulus to the economy.

4 The benefit/tax ratio is the expected present value of lifetime benefits divided by the present value of payroll taxes. Present value converts a stream of future benefits or taxes into an equivalent lump-sum amount received or paid today.

5 The estimates in the section are based on numbers from CBO’s 2017 Long-Term Projections for Social Security: Additional Information (October 2017). The benefit-tax ratios are based on payable benefits.