Today’s Lecture #23
Social Security
What Goes In and What Goes Out?

Financing
Historical Development
Benefits
What You Can Expect

The Cost of Current Social Security Benefits

Current (2003) payroll tax is 7.65% of first $87,000 in earnings plus 1.45% of any additional earnings.

Example
You earn $30,000 this year. You pay $2295 in Social Security taxes (.0765 x 30,000) and your employer pays the same amount. The total Social Security tax is $4590 (15.3% of your salary).
Of this 15.3%, 12.4% is for OASDI and 2.9% is for Medicare.

Example - 2
You earn $187,000 this year. Your Social Security taxes are $8,105.50 (.0765 x 87,000 + .0145 x 100,000) and your employer pays the same amount. The total Social Security tax is $16,211.

Historical Development

1935 Social Security Established
Benefits to Retired Workers of $10-85/month, starting in 1939
Tax = 1% of First $3000 of Earnings
1939 Added Dependents and Survivors
1956 Added Disabled
1961 Retirement at 62
1965 Incorporated Medicare
1972 Indexed benefits (Double Indexing Error)

1977 Corrected Double Indexing Error
Raised Future Taxes
“Financially sound through the end of the century”
1983 Raised taxes
Expanded coverage
Taxed some benefits
Changed index
Increased retirement age
**Coverage**

Universal with exceptions
Major exceptions:
  - Federal workers hired before 1984
  - Railroad workers
  - State and local government workers if employer elected, prior to 1984, not to have Social Security

**Eligibility**

Earn one “Quarter” of coverage for each $x of annual earnings, subject to maximum of 4 quarters per year:

- 1978: \( x = 250 \)
- 2000: \( x = 780 \)
- 2001: \( x = 830 \)
- 2002: \( x = 870 \)
- 2003: \( x = 900 \)

Fully Insured Status
- 40 quarters of coverage
  - less if born before 1929
Currently Insured Status
- Six quarters out of last 13
  - Applies to survivor benefits

**Types of Benefits**

- Retirement
- Survivors’
- Disability
- Medicare
  - Part A - Hospital Benefits
  - Part B - Medical Benefits

**Amount of Benefits**

(http://www.ssa.gov/OACT/COLA/BenForm.html)

The Primary Insurance Amount (PIA) is a function of covered earnings. First, actual earnings are adjusted for inflation. Then average earnings during a selected period of time is calculated (Average Indexed Monthly Earnings, or AIME). For 2002, the PIA is based on the AIME:

- 90% of the first $592
- 32% of the AIME from 592 to 3567
- 15% of the AIME over 3567

**Replacement Rates**

At Normal Retirement Age
Based on Intermediate Assumptions

<table>
<thead>
<tr>
<th>Wage Level</th>
<th>Year</th>
<th>Low</th>
<th>Average</th>
<th>Max</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>2000</td>
<td>52.8%</td>
<td>39.2%</td>
<td>31.7%</td>
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<tr>
<td></td>
<td>2050</td>
<td>56.2%</td>
<td>41.9%</td>
<td>34.4%</td>
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</table>

Earnings Levels Under Intermediate Assumptions

<table>
<thead>
<tr>
<th></th>
<th>1998</th>
<th>2045</th>
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</thead>
<tbody>
<tr>
<td>Low</td>
<td>$12,164</td>
<td>$95,661</td>
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<tr>
<td>Average</td>
<td>27,026</td>
<td>212,169</td>
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<tr>
<td>Maximum</td>
<td>68,400</td>
<td>514,072</td>
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</table>

**Amount of Benefits**

Retired Worker at Normal Retirement Age - 65 (for those born in or before 1937) – increases monthly to age 67, the age for those born in 1960 and later

- Eligible for PIA each month
  - Less if under 65
  - More if over 65

Spouse of Retired Worker

- If 65 or older
  - 1/2 PIA
  - Less if under 65

If spouse is eligible for own retirement benefit, receives only the larger benefit
**Example**

PIA is $800
- 65 year old retired worker
- 65 year old spouse who never worked

Monthly benefit for couple is $1200
- Retiree 800
- Spouse 400

If spouse had worked and had a PIA of $500
Monthly benefit for couple would be $1300
- Retiree 1 800
- Retiree 2 500

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**Future Cost of Social Security**

Cost of current OASDI benefits for 25 year periods as % of taxable payroll

<table>
<thead>
<tr>
<th>Assumptions</th>
<th>I</th>
<th>II</th>
<th>III</th>
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</thead>
<tbody>
<tr>
<td>2002-2026</td>
<td>11.39</td>
<td>12.42</td>
<td>13.71</td>
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<tr>
<td>2027-2051</td>
<td>14.69</td>
<td>17.60</td>
<td>21.21</td>
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<tr>
<td>2052-2076</td>
<td>14.20</td>
<td>18.85</td>
<td>25.59</td>
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**What Will Happen to Social Security**

Three choices by the time you retire:
- Raise payroll taxes by 50-100%
- Lower benefits by 1/3 to 1/2
- Reduce the number of beneficiaries
  - Increase the Normal Retirement Age to around 75

Which would you choose?

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**One Proposal to Save Social Security**

Reduce the annual Cost-of-Living Adjustments (COLAs) by 1%.
If this is done now, the Social Security system will remain solvent indefinitely.
Why don’t we do this?