

## CHAPTER 1

# What Is Social Security and How Does It Work?

**F**or many years, Social Security has been considered the foundation of economic security for many millions of Americans. This program uses public funds as a means of providing a certain amount of economic security for those individuals who qualify for benefits.

Social Security is a federally mandated program operated by the Social Security Administration and is supported by tax dollars. The overall intent of the Social Security program is to ensure a minimum financial “threshold” below which any qualified individual who has paid into the system cannot fall.

## Why Social Security Was Created

Originally, Social Security was created as part of President Franklin D. Roosevelt’s New Deal program. It was initially meant to assist the United States out of the Great Depression and, along with that, provide some financial security to those who were retired, as well as to other qualifying beneficiaries.

Regardless of the safety net provided by Social Security, however, it was never intended to replace 100 percent of one’s pre-retirement or pre-disability earnings. In fact, it is estimated the income received from Social Security retirement benefits replaces approximately 40 percent of an average wage-earner’s income.<sup>1</sup>

Upon the creation of the Social Security program, Franklin D. Roosevelt was quoted as saying:

*“We can never insure one hundred percent of the population against one hundred percent of the hazards of life, but we’ve tried to frame a law which will give some measure of protection to the average citizen and to his family against poverty and old age.”*

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<sup>1</sup> Social Security Administration. 2020. “Understanding the Benefits.” <https://www.ssa.gov/pubs/EN-05-10024.pdf>

## How Is Social Security Funded?

The Social Security system is financed primarily via payroll taxes charged on workers' earnings. A worker and his or her employer are each responsible for paying half of the required tax amount. Self-employed individuals pay the entire amount.

In 2020, workers are required to pay Social Security tax on wages earned below \$137,700. Medicare taxes, however, are paid on all of a worker's income, regardless of the annual amount. Starting in 2013, individuals who earned more than \$200,000 per year (or \$250,000 for married couples who file their taxes jointly) were required to pay an additional 0.9 percent in Medicare tax.

**Social Security and Medicare Payroll Tax Rates—2020**

	<b>Social Security Tax Rate</b>	<b>Medicare Tax Rate</b>
<b>Employees</b>	6.2% (on income under \$137,700)	1.45% (on all earned income)
<b>Employers</b>	6.2%	1.45%
<b>Self-Employed Individuals</b>	12.4% (on income under \$137,700)	2.9%

Source: Social Security Administration

In addition to taxes on earnings, there are two funding sources for Social Security: interest from the Social Security Trust Fund assets and the taxation of Social Security benefits themselves.

Those who earn less than \$400 in a given year are not required to pay into the Social Security program, although they may if they choose to do so. In addition, some income is not required to be counted toward Social Security and, therefore, is not required to be included in figuring an individual's net earnings in a given year.

These non-included income sources include:

- Income received from a limited partnership
- Interest income received from loans (unless the individual operates a business that loans money as a part of its regular operations)
- Income received from rental real estate (unless the individual is a real estate dealer or regularly provides real estate-related services to tenants)
- Dividend income received via stocks (unless the individual is a dealer in stocks or securities)
- Interest income received from bonds

Both the income and the expenses of Social Security are accounted for via the program's Old-Age and Survivor's Insurance (OASI) Trust Fund and the Disability Insurance Trust Fund. Each trust fund is

credited by the Social Security Administration for the revenues received and debited for expenses paid out.

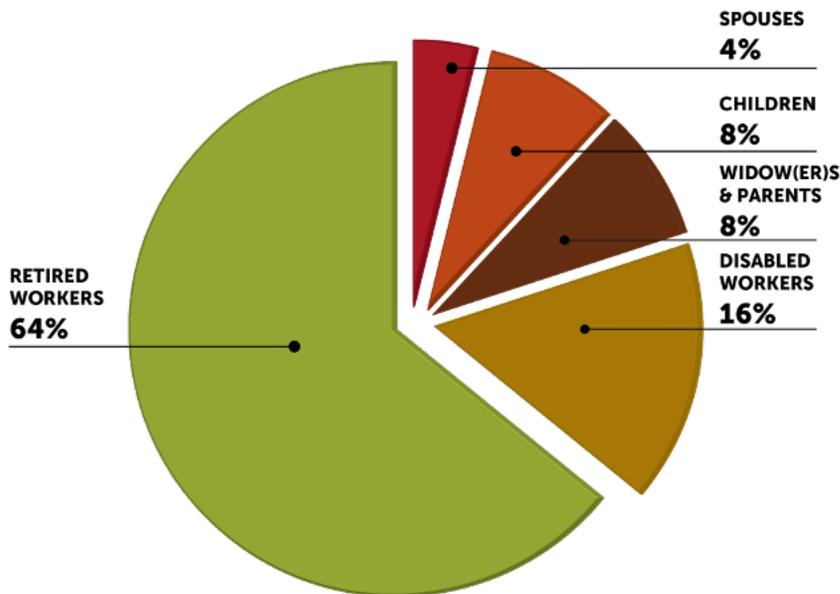
## The Components of Social Security

While many may believe Social Security is a provider of only retirement income, the truth is this program offers several different types of benefits. Those who have worked, paid taxes, and accumulated enough eligibility credits may be entitled to receive any or all of the following:

- Retirement income
- Disability income
- Spouse's benefits
- Survivors benefits
- Dependent's benefits

Social Security pays out benefits in a variety of ways. Therefore, although most Social Security benefit recipients are receiving retirement income, there are others who receive funds if they have a qualifying disability or if they are the qualifying spouse or dependent child of someone who is receiving benefits.

### *Who Benefits From Social Security?*



Source: Social Security Administration

Benefits may also be paid out to the qualifying spouse or dependent child of someone who has passed away or the dependent parent of an eligible Social Security recipient who has passed away.

## Social Security Retirement Benefits

When the Social Security system was created, those individuals who had reached the age of sixty-five were considered to have reached what Social Security deems “full retirement age.” This is one reason why today many people still regard sixty-five as being the “normal” age at which to retire.

Individuals don’t have to wait until they turn sixty-five, however, to begin receiving Social Security retirement benefits. Eligible participants may actually start their Social Security retirement benefits as early as age sixty-two.

However, anyone who begins receiving these benefits prior to their full retirement age receives a reduced amount of monthly income—and this reduction will remain in place throughout the rest of the individual’s life. For example, if a person is born between 1943 and 1954 and he or she begins taking Social Security retirement benefits at age sixty-two, his or her monthly benefit amount will be reduced by 25 percent. The chart below outlines approximately how much this person’s benefits would be reduced if he or she began receiving benefits at other ages:

<b>Age when benefits begin:</b>	<b>Approximate reduction in benefit amount:</b>
62	25%
63	20%
64	13.3%
65	6.7%
66	0%

Source: Social Security Administration

People may also opt to delay receipt of their Social Security retirement benefits beyond their full retirement age. In doing so, they will be eligible for permanently increased benefits at a later time.

This increase in benefits will be added to each month from the time the individual reaches his or her full retirement age until beginning to take their income benefits or reaching age seventy—whichever occurs first. This means the benefit increase will no longer apply when a person reaches age seventy—even if he or she continues to delay the receipt of benefits.

### Increase for Delayed Retirement Benefits

<b>Year of Birth</b>	<b>Annual Rate of Increase</b>	<b>Monthly Rate of Increase</b>
1933-1934	5.5%	11/24 of 1%
1935-1936	6.0%	1/2 of 1%
1937-1938	6.5%	13/24 of 1%
1939-1940	7.0%	7/12 of 1%
1941-1942	7.5%	5/8 of 1%
1943 or later	8.0%	2/3 of 1%

Source: Social Security Administration

Throughout the years, there has been a real strain placed on the Social Security program. This is due in large part to the sheer number of people who are now becoming eligible to receive Social Security retirement benefits.

In order to help ease some of the strain on the system, in 1983, changes were initiated as to when a person is deemed to be at his or her full retirement age. This reform gradually increased full retirement age to sixty-seven.

Today, even though limited benefits are still available once an individual reaches age sixty-two, a person is deemed to have reached full retirement age—and therefore, allowed to receive his or her full amount of Social Security retirement benefits based on the year of birth.<sup>2</sup>

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<sup>2</sup> Social Security Administration. 2020. "Benefits Planner: Retirement." <https://www.ssa.gov/planners/retire/agereduction.html>

### Social Security Full Retirement Age

Year of Birth	Minimum Retirement Age for Full Benefits
1937 or Before	65
1938	65 + 2 months
1939	65 + 4 months
1940	65 + 6 months
1941	65 + 8 months
1942	65 + 10 months
1943 to 1954	66
1955	66 + 2 months
1956	66 + 4 months
1957	66 + 6 months
1958	66 + 8 months
1959	66 + 10 months
1960 or later	67

### *Social Security Disability Benefits*

In addition to retirement income, Social Security provides an income “safety net” to those who are unable to work due to a qualifying illness or disability. Similar to the program’s retirement benefits, in order to receive Social Security disability income, a person must qualify based on work history. The number of work credits is dependent on the person’s age when he or she acquires the disabling injury or illness.

Approximately 14.5 percent of Social Security recipients are disabled workers, and more than half of these individuals are male. As of 2018, the average age of a disabled workers receiving Social Security disability income was age fifty-five.<sup>3</sup>

If an individual is receiving Social Security disability income benefits, it is possible that his or her spouse and/or dependents may also qualify. If a person is receiving these benefits, his or her spouse is also entitled to monthly benefits beginning either at age sixty-two or at any age if caring for a child who is younger than age sixteen.

In addition, unmarried children younger than age eighteen (or age nineteen if they are full-time elementary or high school students), may be eligible for benefits. Children who become disabled before age twenty-two can also be eligible for benefits, provided they are not married and continue to be disabled.

The amount of Social Security disability benefits a person will receive is based upon his or her lifetime average earnings covered by Social Security. In order to qualify for these benefits, the individual must

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<sup>3</sup> Social Security. 2019. “Fast Facts & Figures About Social Security, 2019.” [https://www.ssa.gov/policy/docs/chartbooks/fast\\_facts/2019/fast\\_facts19.pdf](https://www.ssa.gov/policy/docs/chartbooks/fast_facts/2019/fast_facts19.pdf)

provide an official medical report from a doctor, clinic, or hospital that offers information about the disability, as well as about the estimated time the disability is expected to last.

## *Social Security Spouse's Benefits*

Even if the spouse of a qualified individual has never worked (and thus never earned Social Security credits), he or she may be eligible to receive Social Security Spouse's benefits provided he or she is at least age sixty-two and the spouse (or ex-spouse) is either currently receiving or is eligible to receive Social Security retirement or disability income benefits.

As with Social Security retirement benefits, spouses who start receiving Social Security Spouse's benefits between age sixty-two and their own full retirement age (based on their year of birth) will have their monthly benefit permanently reduced. If they wait to receive benefits until their own full retirement age, the benefit amount will be equal to one-half of their worker spouse's full benefit amount.

## *Social Security Survivors Benefits*

If a person who is receiving Social Security income passes away, his or her surviving dependents may also be eligible to receive benefits.

As long as the original benefit recipient possesses at least the minimum amount of work credits, dependents may be able to receive Social Security survivors benefits. These benefits may be obtained regardless of how old the original recipient was at the time of death.

One's eligible survivors may include the initial benefit recipient's:

- Spouse
- Ex-Spouse
- Child(ren)
- Parent(s)

It is estimated that about 12 percent of Social Security income recipients are survivors, with the vast majority being widows or widowers. Most of the children who qualify for such benefits do so either as survivors or as children of disabled workers.<sup>4</sup>

The amount that can be received as survivors benefits is based upon the amount of retirement benefits the deceased individual would have obtained if he or she had reached full retirement age.

If the person passes away prior to that time, their survivors benefit amount will be determined by considering the individual's lifetime earnings, as well as a factor that corresponds to the number of years they would have been expected to participate in the workforce.

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<sup>4</sup> Social Security Administration. 2019. Fact Sheet.  
<https://www.ssa.gov/news/press/factsheets/basicfact-alt.pdf>

# Medicare

In addition to the payroll taxes paid into the Social Security program, there is an additional amount of tax that goes toward funding the Medicare program. Medicare is considered to be the basic health insurance program for those in the U.S. who are age sixty-five or over, as well as for certain qualifying individuals who possess specific types of disability.

The Medicare program consists of the following components:

- **Part A** - Hospitalization Coverage
- **Part B** - Doctors' Services
- **Part C** - Medicare Advantage
- **Part D** - Prescription Drugs

People who are eligible to receive Medicare benefits include those who are age sixty-five and who are also eligible to receive Social Security benefits based either on their own work record or the work record of a spouse.

Persons who are younger than age sixty-five and who have certain adverse health conditions, such as chronic kidney disease that requires either dialysis or a kidney transplant, may also qualify for Medicare. These individuals will automatically get Medicare coverage after they have received Social Security disability benefits for two years.

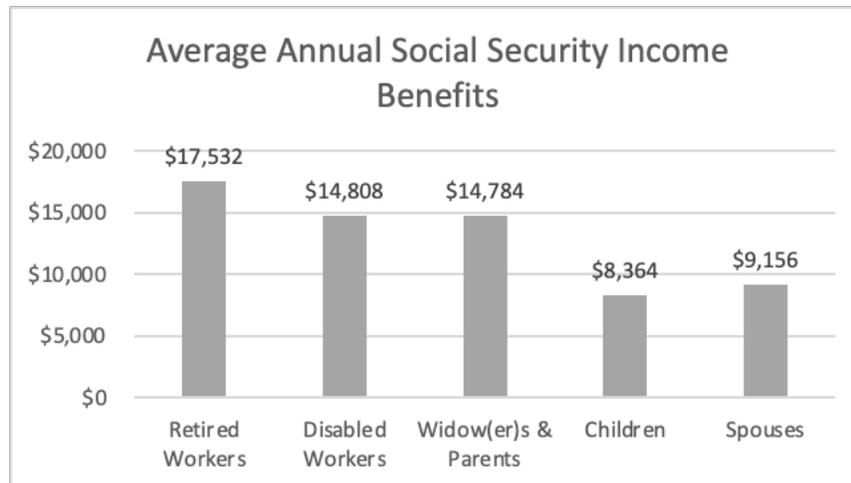
## How Much Are Social Security Benefits?

The amount received in Social Security benefits is dependent upon a number of different factors. These include age, amount of time worked, and the type of benefits. The amount of benefits also depends on whether the applicant is the worker themselves or the spouse or other dependent of the qualified worker/recipient.

Overall, the average annual Social Security benefit amount is typically the largest for those who are receiving retirement benefits. Below are the average amounts of annual Social Security income in 2018, based on the type of benefit that was received.<sup>5</sup>

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<sup>5</sup> Social Security. 2019. "Fast Facts & Figures About Social Security, 2019."  
[https://www.ssa.gov/policy/docs/chartbooks/fast\\_facts/2019/fast\\_facts19.pdf](https://www.ssa.gov/policy/docs/chartbooks/fast_facts/2019/fast_facts19.pdf)



## How Does One Qualify for Social Security Benefits?

In order to qualify for Social Security benefits, individuals must meet the program’s eligibility requirements. They must also fill out and file an application. Eligibility for retirement benefits is based upon age, how much was earned in Social Security covered jobs, and how long the person worked.

Eligible individuals must have accumulated at least forty working “credits” in order to be entitled to full Social Security retirement benefits, with a maximum of four earned credits per year. In order to earn one credit, a person must also make a certain amount of money.

In 2020, one credit would be attained for each \$1,410 that an individual earned via qualified employment. Many people earn four credits per year. Once a person has accumulated a total of forty credits, he or she will be considered “fully insured” by Social Security.

People who do not have forty credits will be unable to obtain any Social Security retirement benefits based upon their own work record. In that case, they may need to continue working on either a full-time or part-time basis in order to accumulate any remaining credits that they need.

It is important to note that people who are the spouse, ex-spouse, or dependent of an individual who has forty credits will not be required to have forty credits of their own in order to receive spouse’s, survivors, or dependent disability benefits from Social Security.

In order to qualify for Social Security disability benefits, an individual must be deemed as being unable to work for at least one year or possess a disabling condition expected to result in death.

Similar to Social Security retirement benefit qualification, a person must have a certain amount of work-related credits to qualify for disability income. The amount of these credits-changes from year to year.

The number of work credits needed to qualify will also depend upon the individual’s age when he or she becomes disabled. In most cases, a person will be required to have forty credits—with twenty of those credits being earned in the immediately previous ten years, and ending with the year in which the person became disabled. There are certain circumstances, however, where a younger worker can qualify for these benefits with fewer than forty credits.

Qualification criteria for Social Security disability benefits also include the extent of the actual disability itself. The individual must not only be unable to do his or her specific type of work—work that they have been trained for and have previously participated in—but they must also be unable to engage in any other type of substantial work that exists in the market (relative to their age, work experience, and education).

What this means is that if a person is trained as a surgeon and is no longer able to perform surgery due to a disabling illness or injury—but is able to work at an office position—then it is not likely that he or she will qualify for Social Security disability income benefits.

In addition, when determining the inability to perform certain work-related tasks, it is immaterial to Social Security whether or not such work actually exists in the applicant's immediate area, or whether or not a particular job vacancy even exists.

Social Security disability benefits will typically continue until the recipient is able to work again on a regular basis. In addition, the program also provides certain “work incentives” geared toward helping individuals make their transition back to work.

If a person is receiving Social Security disability income benefits when he or she reaches full retirement age, then these benefits will automatically convert to Social Security retirement benefits. However, the amount of the income will remain the same.

As with retirement and income benefits, qualifying for Social Security survivors benefits will depend upon the number of credits a person has as well as the age of death. The younger persons are when they die, the fewer credits they are required to have in order for their dependent survivors to receive income benefits from Social Security. For example, a dependent spouse who is caring for the dependent children of the worker can typically obtain benefits if the deceased worker had obtained at least one and one-half years of work (or six total credits) within the three years just prior to his or her death.

Today, it is estimated by Social Security that there are approximately six million widows and widowers who are receiving survivors benefits based on their deceased husband or wife's earnings record.

## **Strength of the Social Security System**

Over the past several years, the Social Security program has faced some potential solvency issues. This is due in large part to the fact that funds paid out as benefits are collected from current workers from a shrinking workforce.

During the past few decades, the number of individuals who are receiving Social Security retirement benefits has grown much faster than the tax-paying workforce paying into the system to fund it.

Because of declining birth rates, increased life expectancies, and the compounding effects of the cost-of-living adjustments, the Social Security system is now facing some serious challenges. In addition, it is anticipated that the number of workers per Social Security retirement income recipient will continue to decrease over time.

### Number of Workers Contributing to One Social Security Recipient's Benefits

Year	Tax-Paying Workers Per 1 Recipient
1945	41.9
1995	3.3
2013	2.8

Source: Social Security Administration ([www.ssa.gov/history/ratios.html](http://www.ssa.gov/history/ratios.html))

Since the preceding chart was published in 2013, the ratio of workers to recipients has remained steady, but the program expects that, by 2035, it will again downgrade to 2.3 workers to cover each beneficiary.<sup>6</sup> In order to help keep the Social Security program solvent, there have been numerous discussions and amendments over the past several years. These have included making various changes to the tax law and proposing privatization of the Social Security system.

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<sup>6</sup> Social Security Administration. 2019. Fact Sheet.  
<https://www.ssa.gov/news/press/factsheets/basicfact-alt.pdf>

## Key Chapter Points

- For many years, Social Security has been considered the foundation of economic security for many millions of Americans.
- Originally, Social Security was created as part of President Franklin D. Roosevelt's New Deal program. It was initially meant to assist the United States out of the Great Depression, and also provide some financial security to those who were retired and to other qualifying beneficiaries.
- The Social Security system is financed primarily via payroll taxes charged on workers' earnings.
- Social Security provides retirement income, as well as disability income, spouse's benefits, dependent's benefits, and survivors benefits.
- Eligible participants may actually start their Social Security retirement benefits as early as age sixty-two.
- Likewise, people may opt to delay receipt of their Social Security retirement benefits beyond their full retirement age.
- Similar to the program's retirement benefits, to receive Social Security disability income, a person must qualify based on his or her work history.
- Even if the spouse of a qualified individual has never worked (and thus never earned Social Security credits), he or she may be eligible to receive Social Security Spouse's benefits.
- In addition to the payroll taxes paid into Social Security, there is another amount of tax that goes toward funding the Medicare program.
- The amount that one receives in Social Security benefits is dependent upon a number of different factors. These include age, the amount of time worked, and the type of benefit.
- Eligible individuals must have accumulated at least forty working "credits" in order to be entitled to full Social Security retirement benefits, with a maximum of four earned credits per year.
- Qualification criteria for Social Security disability benefits also include the extent of the disability.

- Over the past several years, the Social Security program has faced some potential solvency issues. This is due, in large part, to the fact that funds being paid out as benefits are collected from current workers from a shrinking workforce.
- In order to help keep the Social Security program solvent, there have been numerous discussions and amendments over the past several years. These have included making various changes to the tax law, as well as other suggestions such as privatization of the Social Security system.