Social Security: From then to now, 70 years of growth

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Today, just as in 1935, there appears to be a fundamental belief in American society that those who have worked and made contributions into a retirement system should have some assurance that they will not be left unprotected by our government once they have reached an age where they cannot work. The problem we are facing as a society is one of determining how to offer retirees income protection while not taxing our shrinking working population too heavily. There are many proposals being debated on how to “fix” the system, but before decisions are made on how to restructure our social security system we need to look at its history. Perhaps in this way we can maintain the basic principles of the social security program that our society still professes to believe in.

Background and History
(Passage of the First OASI)

The idea of the U.S. Government ensuring elderly, retired citizens some financial protection in their last days was a result of massive numbers of Americans, who after devoting years of service to their employers, were left with no means of financial subsistence. During the early 1930’s many companies went out of business without providing any type of old age assistance or pensions for their employees. With few jobs to be had after the 1929 stock market crash, and the ones which were available typically going to younger, stronger workers, many older hard-working Americans found themselves with no means of support.

In 1920, the Federal Government started providing retirement assistance to protect elderly Federal workers through a civil service retirement program. Retired railroad workers had also been provided retirement coverage under the 1934 Railroad Retirement Act. So in 1935 it was not too much of a leap for Congress to pass legislation mandating financial protection for all retired American workers. Congress, as well as most American, found it unthinkable that someone could work their entire adult life and then, through no fault of their own, be unable to find work and be forced to live at a substandard level. The Social Security Act of 1935 was signed into law by President Franklin Roosevelt on August 14 and provided that both employers and employees would contribute equally to a fund to provide benefits to assist retirees. The program was referred to as an old age insurance program designed only to provide “meager payments” to workers in the fields of commerce and industry.

David M. Alvin, then assistant director of the Bureau of Social Security Administration, identified several basic principles of the social security system. (David, 1960) First, and perhaps most basic, was the idea that this was not to be a welfare system but rather a way to ensure that older workers would have a continuing income guaranteed by law with the benefits received a direct result of the worker’s own labor. The original Social Security Act provided that payments to

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retirees would be based on their total lifetime earnings, as well as, the contributions into the system from both workers and their employers. Therefore, since the retiree would be receiving their own contributions back these benefits should be received without a means test. (David, 1960).

Second, David (1960) stated that this was to be a supplementary income program. At no time did the Government intend for retirees to live entirely on their Social Security benefits. This intention is illustrated by the fact that social security payments have never been based on need but rather on a mathematical formula created by Congress reflecting the retiree’s and employer’s contribution into the system.

Third, in order for the program to protect those who would probably need it the most, the program was mandatory. No worker or employer would be allowed to opt out of the system. Congress realized that some lower paid employees (those who would need the system the most) might, if given a choice, choose not to participate and some employers might try to dissuade employees from participation (David, 1960).

A fourth principle identified by David (1960) aimed at preventing Social Security eligibility from being determined subjectively. The 1935 Act required Congress to clearly define the retiree’s eligibility and benefits through legislation. Once again benefits were to be determined based on a predetermined mathematical calculation.

The final principle was that it was to be self-funded. Each employee and employer would contribute 1% on the first $3000 of each employee’s earnings. As a means to ensure self-sufficiency, payroll contributions were to be withheld beginning in 1937, but the first payments to retirees were not scheduled to begin until 1942. The system was not originally intended to be a “pay-as-you-go” system. (David, 1960)

Congress Makes Changes to the Original Act

It did not take long for Congress to begin tinkering with Social Security. As planned, after passage of the 1935 Social Security Act, collection of the first payroll taxes began in 1937. The taxes began with a maximum of $300 collected from the employee matched with $300 from the employer.

The first changes occurred in 1939 with Congress broadening the program and accelerating payments to beneficiaries. These changes were accomplished through three substantial amendments to the Social Security Act. First, it was decided to accelerate the program and begin disbursements to the beneficiaries two years earlier than had been originally agreed upon. Social Security payments began being distributed in 1940 instead of waiting until 1942 thus preventing the accumulation of funds necessary to provide for self-funding.

Second, the method of calculating a retiree’s benefits was changed. Originally benefits were to be based on a retiree’s total earnings throughout their lifetime. The 1939 amendments changed the benefit calculation to one basing the retiree’s monthly social security on their average earnings over their work life. This change allowed the system to pay out benefits immediately but in smaller amounts without violating the concept of self-funding.

The third and perhaps one of the most significant changes was that
benefits would not be restricted to the retiree. The program was expanded to allow the government to make payments to other members of the retiree’s family such as a wife, young children, widows, orphans, and dependent parents of deceased workers. This was a fundamental change in the concept of the social security program. The program had been changed and expanded from one based on providing benefits to an individual worker, to providing financial assistance to an entire family.

With these changes America had a social insurance program designed to provide financial protection for the retiree and their family against loss of earnings instead of a program to assist workers in saving for retirement. To reflect these changes the social security program now became known as the Old-Age and Survivors Program.

The 1950’s Open the Program to Significant Changes

The next period of major changes came during the 1950’s. The program was expanded in 1950 to extend coverage to public employees, farm workers, and domestic workers. This increased the social security rolls by nearly 9 million people (David, 1960). In that same year the annual benefit amounts for retirees were also increased. It was determined that the benefits as originally established were not adequate to ensure a “decent” standard of living. This marked a major shift away from the program being supplementary to one of reliance.

In an effort to maintain the concept of a self-supporting social security program while providing expanded coverage and increased benefits to retirees and their families, in 1950 Congress implemented a plan to incrementally increase the original contribution rate. The 1% rate would increase to 1.5% on the first $3,000 of earnings (for both employees and employers) in 1950 up to 2.5% of maximum earnings of $4,800 by 1959. These rate increases were scheduled to go into effect at 5 year intervals. By 1958 this 5 year phase-in had been shortened to a 3 year interval (David, 1960).

In 1954 Congress expanded coverage of the Social Security program. All self-employed individuals, other than lawyers and medical professionals, were brought into the Social Security program. The “disability freeze” provision was added to protect retiree benefits from being reduced if one was to become totally or permanently disabled before retirement.

By 1956 legislation had been passed to extend disability insurance benefits (still based on earnings) to disabled workers between the ages of 50 and 65. This created the need for a name change to the Old-Age, Survivors, and Disability Insurance program (OASDI). Not only were disabled workers to receive disability payments but now disabled children 18 or over, who had been continuously disabled since before the age of 18, would be eligible to receive social security benefits. The same year Congress added a provision that would allow women to retire early and begin receiving reduced benefits at the age of 62 versus 65.

So by 1957 the government program born out of a desire to provide “basic subsistence for individuals who had worked and paid into the system” had grown and morphed into a social insurance policy. Over one-half (55%) of elderly Americans were using Social Security as their sole means of retire-

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One of the most significant changes to the social security program occurred on July 30, 1965 with the creation of the Medicare program administered by the Health Care Financing Administration. This program was fully implemented by July 1, 1966. From its inception the Medicare program consisted of two separate but coordinated programs - hospital insurance (Part A) and supplemental medical insurance (Part B). The Medicare program was established to provide healthcare benefits to persons 65 and over who were entitled to receive social security benefits. That year, 1965, Congress passed legislation to begin deducting $3 from monthly social security checks to cover the new Medicare hospital benefits (Part B).

By the end of 1969 the Social Security and Medicare calculation had increased in amount and complexity. The maximum earnings and self-employment income subject to OADSI in 1969 was $7,800. The tax rate for the OADSI was increased to 4.8% with 3.725% allocated to social security and 0.475% for the Medicare portion. Self-employed individuals were assessed a rate of 6.9%. President Nixon also signed the Tax Reform Act of 1969, providing for a 15% increase in Social Security benefit payments.

The 1970’s and Cost of Living Increases

The 1970’s were a time of rapidly rising prices and high rates of inflation. In an effort to ensure Social Security payments would keep pace with inflation legislation was passed in 1972 to automatically adjust Social Security benefits to reflect cost of living increases.
During the 1970’s there was a rapid increase in both the maximum earnings and self-employment income subject to Social Security and Medicare taxation. The rate to be applied to earnings rose from 4.8% (4.2% for Social Security and .6% for Medicare) on maximum earnings of $7,800 in 1970 to 6.13% (5.08% for Social Security and 1.05% for Medicare) on maximum earnings of $22,900 in 1979. These rates were applied equally to both employees and employers.

The 1980’s Bring About ‘Age and Income-Creep’

During the 1980’s measures were put in place to help ensure the viability of the OASDI program. Payroll taxes were increased from 6.13% on maximum earnings and self-employment income of $25,900 for both employees and employers to 7.51% (6.06% for Social Security and 1.45% for Medicare) on maximum earnings and self-employment income of $48,000.

In 1983 Congress again made significant changes to the Social Security and Medicare program in an effort to curb its growth and to ensure its solvency. The age at which full Social Security benefits could be received was increased from 65 to 67 to be phased in over several years. Tax reform measures were passed taxing Social Security benefits paid to higher income taxpayers. Retirees were required to start including up to 50% of their Social Security benefits in taxable income if their modified adjusted gross plus half of their Social Security Benefits exceeded $25,000 or $32,000 depending on their filing status. Congress removed the Social Security trust funds from Federal budget restrictions by converting it to “off budget” status.

The 1990’s See Significant Changes and Rate Increases

Many of the changes of the 1990’s focused on social security rate increases, additional taxation of Social Security benefits, and removal of certain classifications of individuals from the disability roles. By 1990 the Social Security Payroll tax had increased to 15.3% on maximum earnings of $51,300 shared equally by the employee and employer. Each party had to pay 6.2% for Social Security and 1.45% for Medicare.

1993 saw more significant changes to the OASDI program. Two major changes in the tax laws were implemented. First, Congress repealed the dollar limit on earnings subject to Medicare taxes. Second, a two tiered approach for calculating the portion of one’s taxable Social Security benefits was implemented. The new rules required the inclusion of up to 50% of a retiree’s Social Security benefits in taxable income once their modified adjusted gross income equaled $25,000 or $32,000 and then inclusion of up to 85% of their benefits if their modified AGI equaled or exceeded $34,000 or $44,000 depending on filing status.

By 1994 the maximum earnings subject to Social Security tax had increased to $60,600 with no cap on Medicare taxes. Legislation was passed to automatically update the ceiling for calculating taxable social security earnings based on nationwide average wage and salary earnings.

On January 1, 1997, another important change was instituted. President Clinton signed legislation that removed from the SSI program approximately 207,000 recipients whose dis-
ability was materially the result of a
drug or alcohol dependency.
By the end of 1999 the maximum
earnings and self employment income
subject to Social Security tax had in-
creased to $72,600. The rates were still
15.3% split equally between employee
and employer.

The New Millennium Ushers In
Medicare “Modernization”

Since the turn of the century maxi-
mum earnings subject to OASDI has
increased from $76,200 to $90,000 in
2005. Earnings subject to Medicare
taxes are still uncapped. According to
2000 labor statistics released by the
Congressional Budget Office, 41% of
households pay more in payroll taxes
than in income tax.

The two most significant items re-
lated to Social Security and Medicare
in the new millennium have been the
introduction of the new Medicare Part
D drug coverage enactment and the
many proposals set forth to “save” the
system. The new coverage, described
as “Medicare Modernization” is called
Medicare Part D and is a voluntary
program for seniors on Medicare. The
program became operational in Janu-
ary 2006 and for the first time repre-
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turn to the fundamental principles of the system is what will save it. A return to the concept that Social Security is or should be part of a “three legged stool” approach to financing retirement is necessary. The three legged approach assumes one leg is the retiree’s pension or 401(k), the second leg being personal savings, and the third leg being social security. (Jennings, 2004).

Unfortunately, many retirees consider it appropriate for Social Security to constitute a majority portion of their “nest egg” for the future. Realistically this government program has become ingrained as a basic component of our retirement planning but it can not survive without some compromises and some sound financial principles being applied by all parties involved.

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Vangermeersch Receives 2006 Burns Biographical Research Award

Edward Coffman of Virginia Commonwealth University (right) presents the 2006 Thomas J. Burns Biographical Research Award to Richard Vangermeersch, Professor Emeritus at the University of Rhode Island. The presentation was made on August 7, 2006, at the Accounting Hall of Fame Induction in Washington D.C.

Professor Vanger-

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