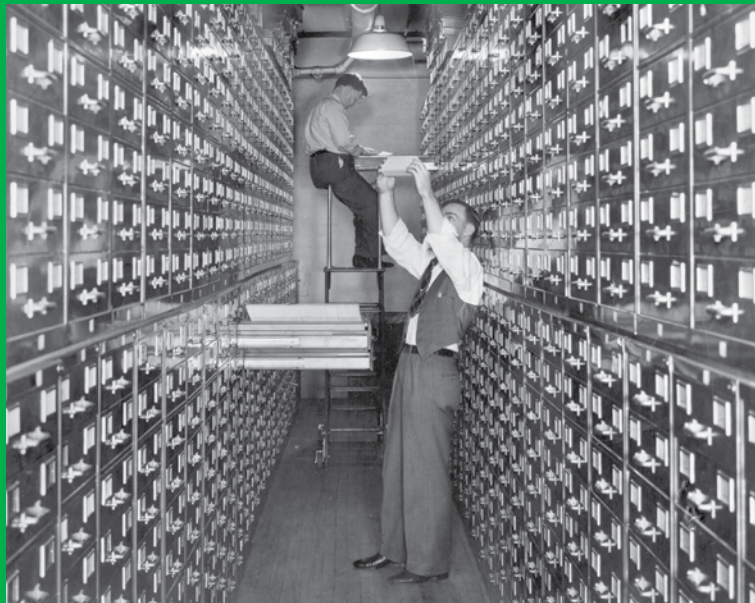




SOCIAL SECURITY RISK MACHINE



**A USER'S GUIDE TO SOCIAL SECURITY
THE CENTER FOR URBAN PEDAGOGY / 2006**

INTRODUCTION

How can we work together to manage our risks? The pamphlet you hold in your hands describes one ingenious answer to this question: the Social Security Risk Machine.

Once upon a time, most old people were supported by their families. When too old to work, they hung around the farm, did what they could, and were fed and housed by the younger generation. So long as there was enough food and living space, the risk of becoming too old to support yourself was managed on a family-wide basis.

As living arrangements and the economy changed, this traditional system of caring for the elderly broke down. By the 1930s, most Americans lived in cities and fewer lived with or directly supported older family members.

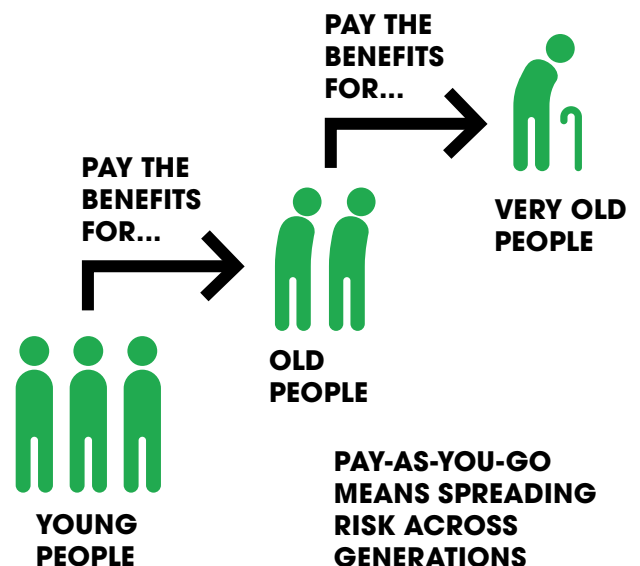
The economic catastrophe of the Great Depression revealed a problem with this new arrangement: roughly half of older Americans were living in poverty. Not only was this unpleasant for individual old people, but it posed a general social problem. It was clear that we needed a way to protect ourselves against the increased risk of becoming old and destitute.

Implemented in 1935, Social Security manages this risk by distributing it across generations. Through Social Security, an entire generation of Americans pays to support the generation that came before it. Money paid into Social Security by current workers goes to current retirees, with the surplus set aside in a trust fund in case of a temporary revenue shortage. This system is called pay-as-you-go.

The social aspect of Social Security—managing risk on the scale of a society—makes it different from individual retirement plans based on personal savings or investments. These other plans help individuals save their own money for their personal use; but if for whatever reason someone doesn't have money to retire, she is out of luck. Social Security is also different from programs that provide economic security based on need, such as welfare. Only Social Security is specially designed to help everyone manage financial risk by spreading it across generations.

Social Security can be thought of as a gigantic risk management machine. The input to this machine is payroll taxes. The output is monthly benefits paid to eligible Social Security recipients. Like any great machine, this one is completely adjustable to suit changing conditions or needs.

In this user's guide to the Social Security machine, possible adjustments are shown in green type.



1. INPUT

Social Security gets nearly all of its revenue from payroll taxes. Everyone who is covered by Social Security has to pay Social Security payroll tax. However, not everyone is covered by Social Security. For example, undocumented workers are not covered, and some government employees are covered by a different program.

What would happen if we increased the number of people covered by Social Security? This would bring more money into the machine in the short term, but would eventually require more going out when they retire.

Unlike income tax, which takes into account other sources of income and expenses, payroll tax comes directly out of people's paychecks. Workers each pay 6.2% of their wages, and employers match it one-for-one. One important exception: payroll tax only applies to the first \$90,000 of your wages. If you make more than that, none of your wages above that maximum taxable amount go into Social Security. This cap on taxable income changes each year to reflect inflation.

What would happen if we raised taxes by one percent, with each worker and each employer paying 0.5 percent more? It would bring much more revenue into the program. Another way to raise more taxes would be to raise the maximum taxable income to \$250,000, or abolish the cap altogether. This would bring additional money into the program by taking more from rich people.

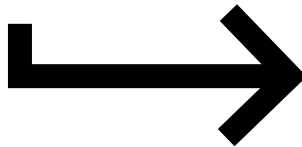
**WAGES ABOVE
\$90,000 / YEAR
ARE NOT TAXED**



**WAGES BELOW
\$90,000 / YEAR
ARE TAXED @ 6.2%**



**WORKER'S
CONTRIBUTION**



**EMPLOYER'S
CONTRIBUTION**

**EMPLOYERS MATCH
WORKERS CONTRIBUTION
ONE-FOR-ONE**

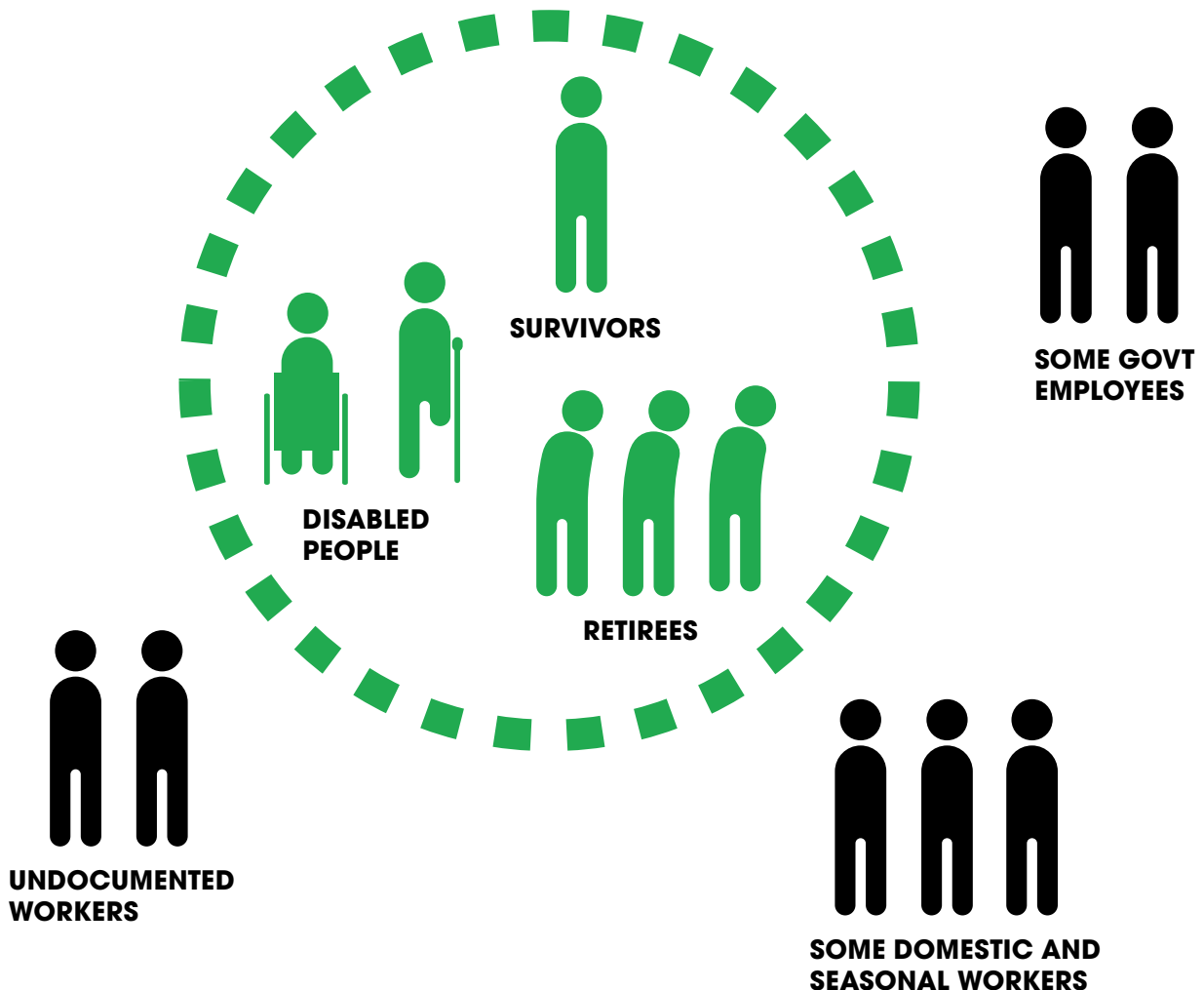


**REVENUE OF THE
SOCIAL SECURITY
ADMINISTRATION**

2. ELIGIBILITY

To be eligible for Social Security benefits, you have to pay into the program for at least ten years. After that, you can apply to receive benefits once you reach legal retirement age or if you become unable to work due to a disability. If you die, then your surviving family members can apply to receive benefits. Most people on Social Security are retirees. Disabled people and survivors make up a smaller group. The current retirement age is 67. You can retire as early as 62, but if you retire early you will not receive your full benefit.

What would happen if we raised the retirement age to 70? This would mean more people paying taxes and fewer people receiving benefits; the total amount that Social Security takes in would increase, and the amount that it pays out in benefits would decrease.

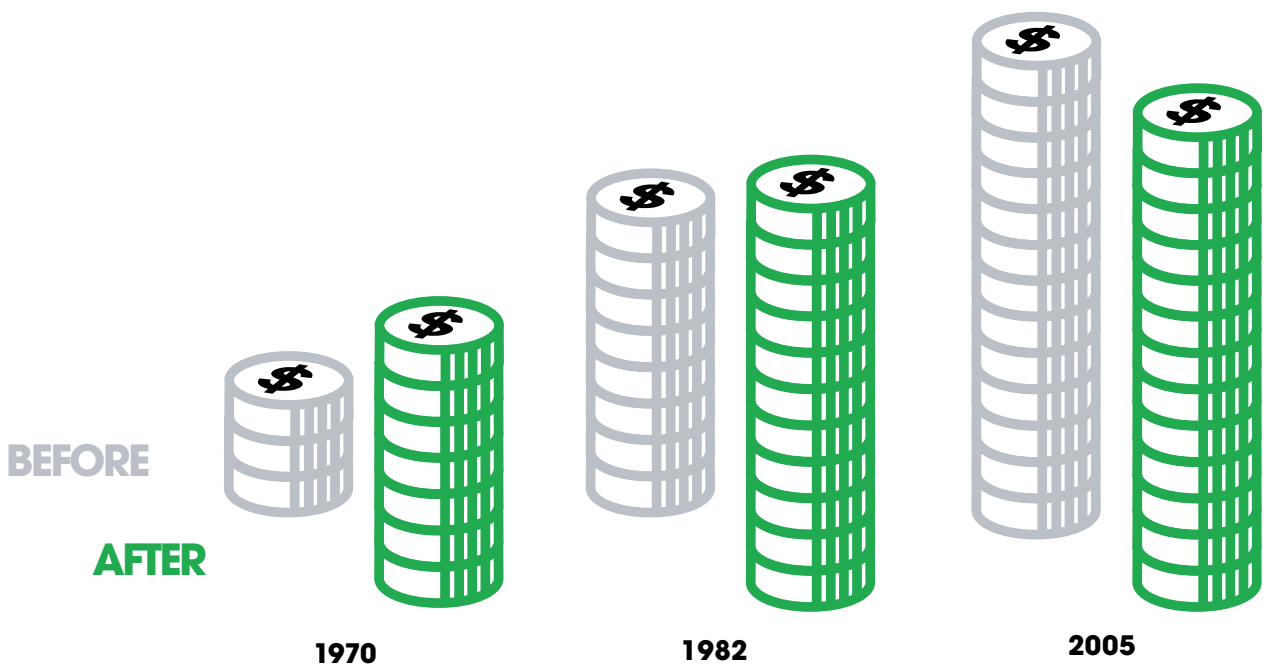


3. INDEXING

How much money should someone receive from Social Security? These next three parts of the machine are designed to calculate the amount of monthly benefits due to an eligible person. The machine is designed so that the more money you have made over your lifetime, the more you get from Social Security.

This step, called indexing, helps calculate a fair total of your lifetime earnings by adjusting your past earnings for inflation, counting wages from the past as the equivalent wages today. For example, average annual wages from 1960 (about \$4,000) or 1970 (about \$6,200) are both counted as the 2005 average (about \$34,000).

What would happen if we indexed wages in a different way? One suggestion is to index Social Security to prices rather than wages. Because prices usually go up more slowly than wages, this would mean that eventually Social Security would pay less in benefits.

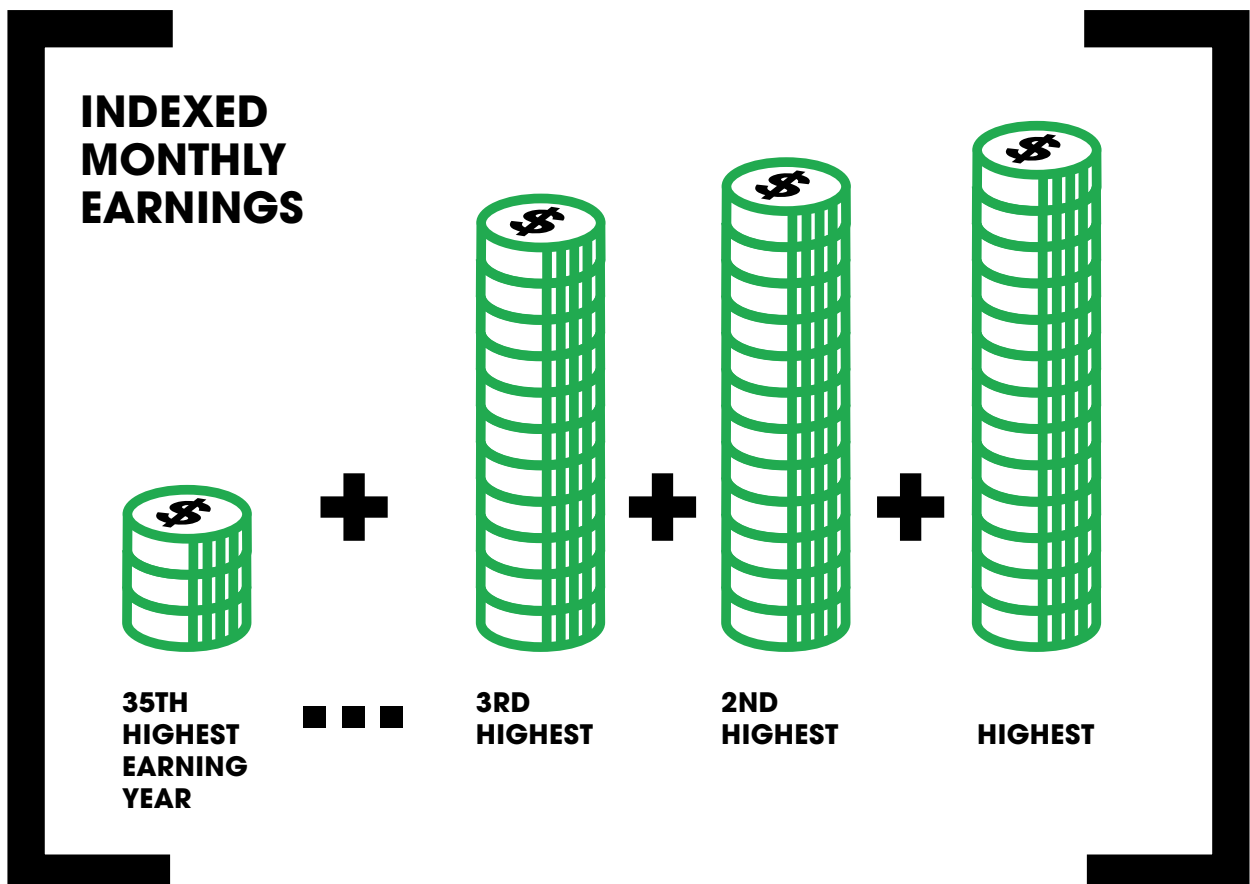


4. AVERAGING

AIME

The next step in calculating your benefit is to find your average monthly salary—the machine is designed so that the higher your average earnings, the more money you receive. The machine averages your indexed monthly wages, but only counts your thirty-five highest-earning years—other years are left out of the calculation. The resulting number is called your AIME, or average indexed monthly earnings.

What would happen if we took the average over some longer period? For example, taking the average over your forty highest-earning years would have the effect of including five lower-earning years, bringing your average down and translating into a smaller benefit. People who have been unemployed or who took time off to raise children would suffer the greatest reduction in benefits.



CONCLUSION

Right now Social Security operates with a surplus, and has more than \$1.7 trillion (\$1,700,000,000,000) in its trust fund. But what will happen ten, thirty, or seventy-five years from now? It seems clear that advances in health care will mean people living longer, resulting in more retirees collecting more benefits. We could use the trust fund—that's what it's for—but eventually we might need to make some adjustments to the Social Security machine to keep it working.

In this pamphlet, we have looked at different adjustments we could make: increasing payroll taxes, decreasing benefits, or distributing benefits in different ways. We can also imagine other, more extreme options, such as getting rid of the program altogether. We could go back to the way risk was managed in the 1930s, when the elderly, the poor, and the disabled depended mainly on charity to survive. Without Social Security, each of us would be responsible for saving enough money to support ourselves in old age. It is up to us to determine how much risk we want to manage together and how much we will bear alone.

This pamphlet is part of CUP's project on Risk Management, a public examination of social strategies for dealing with unexpected events from earthquakes to currency crashes. CUP makes educational projects about places and how they change, using art and design to make policy public. Find out more at www.anothercupdevelopment.org.

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THANK YOU.



“The civilization of the past hundred years, with its startling industrial changes, has tended more and more to make life insecure. We can never insure one hundred percent of the population against one hundred percent of the hazards and vicissitudes of life, but we have tried to frame a law which will give some measure of protection to the average citizen and to his family against the loss of a job and against poverty-ridden old age. The law will flatten out the peaks and valleys of deflation and of inflation.

It is, in short, a law that will take care of human needs and at the same time provide the United States an economic structure of vastly greater soundness.”

