The tax treatment of different demographic groups varies considerably under Social Security, also called Old Age and Survivors Insurance (OASI). The lifetime net tax rates (LNTR), rates of return (RR), and age-65 net payment (NP-65) charted above are based on the assumption that current tax and benefit rules will prevail throughout the lifetimes of postwar generations—those born after 1945. The calculations draw on a large-scale simulation of the U.S. economy and a sophisticated Social Security benefit calculator.

LNTRs show the number of cents paid per dollar of lifetime earnings through participation in OASI. Generations with the lowest lifetime earnings receive more benefits in present value than they contribute in payroll taxes. Those in the middle quintile face LNTRs of almost 6 cents in present value, while those in the highest quintile surrender just over 5 cents per dollar of their lifetime earnings.

Women have smaller LNTRs than men because of Social Security’s progressive benefit structure (on average, women receive lower paychecks). They also are the majority recipients of dependent and survivor benefits because of their lower earnings and greater longevity. These benefits are Social Security’s insurance against dependency, widowhood, and poverty at very old ages.

In some instances, Social Security is kinder to better-off groups: Whites and the college-educated, for example, face lower LNTRs than do nonwhites and those without a college education. Despite the fact that better-off groups earn more, they collect more benefits because they live longer.

If we view payroll contributions as “investments” that generate a return in the form of future OASI benefits, we can evaluate the rate of (continued on next page)
return (RR) that is implicit in this transaction. Under current rules, all postwar generations receive RRs of just under 2%. These rates are risky because participants do not know how or when taxes or benefits will be altered to correct OASI's long-term insolvency. These RRs compare unfavorably with returns on 10-year Treasury inflation-protection securities (TIPS), which yield much higher returns (greater than 3.5%) and are considered to be almost perfectly safe. OASI participants forgo investment in much safer and higher-yielding assets.

By one estimate, restoring OASI to long-term solvency would require an immediate, permanent hike of about four percentage points in the payroll tax rate (currently at 10.6%). Alternatively, OASI benefit levels would have to be reduced 25% immediately and permanently. Under the payroll-tax-hike option, generations born earlier would see only slight drops in RR, but those born later would suffer larger declines because most of their tax-paying years would occur after the tax hike. Cutting OASI benefits would impose a uniform reduction in the RRs of postwar generations. This option, however, would be likely to impose significant burdens on today's retirees and pre-retirees—those born before 1945.

For those born soon after World War II, participating in OASI means having $200,000 less, on average, at age 65 than they would have gained from contributions placed in private capital markets and earning a 5% rate of return. For those born in the late 1970s and early 1980s, the sacrifice amounts to $270,000. These burdens would be even higher under the tax-hike and benefit-cut options for restoring OASI's long-term financial health.