Payroll Taxes for U.S. Retirement, Health, and Disability Programs

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Since 1937, American workers and their employers have paid a percentage of wages to help finance social welfare programs for the elderly and disabled. Over the past eight decades, the share of the economy devoted to those benefits and the number of programs have generally increased, as have the tax rates required to maintain their solvency. Social Security began paying annuities to the elderly in 1940. In 1956 Disability Insurance was enacted. The Medicare Hospital Insurance (HI) program was created in 1966. Other programs for the elderly and disabled are financed by non-payroll tax receipts: Supplemental Security Income and Medicare coverage for physician services and prescription drugs are financed chiefly from general revenues and premiums from enrollees.

As benefits and enrollment in these programs have grown, so have the tax rates required to finance them. Between 1960 and 1990, the combined payroll tax rate (employer and employee portions) for Old Age, Survivors, Disability, and Hospital Insurance (OASDHI) increased about 3 percentage points each decade until it reached its current rate of 15.3 percent for most workers. The Affordable Care Act introduced a 0.9 percent HI "surtax" for workers earning more than $200,000 ($250,000 for couples) beginning in 2013. Congressional Budget Office data show that roughly 80 percent of households paying payroll taxes owed more in payroll taxes than in individual income taxes in 2011. Those payroll taxes become increasingly inadequate to support the programs in future years.

Over a career, payroll taxes add up. Having paid 10.4 percent of wages at the start of their careers and 15.3 percent in their last year of work, workers reaching age 65 in 2015 earning about an "average" wage each year (about $49,000 in 2015) paid about $254,000 in OASDHI taxes in inflation-adjusted terms. If those funds had been invested at a 2 percent interest rate above inflation, the workers could have saved about $388,000. Of course, this calculation does not count income or other taxes paid to support those programs.

Payroll Tax History for Workers With Steady 'Average' Wages (About $49,000 in 2015 dollars)

Worker Retires at Age 65 in Year:	Combined OASDHI Tax Rates		Career Taxes Paid, 2% Real Rate of Return (2015 dollars)			
	Career Start	Career End	OASI	DI	HI	Total
1950	0%	2%	$6,000	—	—	$6,000
1970	0%	9.6%	$47,000	$3,000	$2,000	$52,000
1990	2%	15.02%	$146,000	$15,000	$22,000	$183,000
2015	10.4%	15.3%	$277,000	$40,000	$72,000	$388,000

Source: Authors' calculations from Social Security 2014 Trustees report and Social Security Annual Statistical Supplement.
Notes: Career taxes paid are total employer and employee FICA contributions adjusted to present values at age 65. Workers are assumed to earn the Social Security Administration's Average Wage Index each year from age 22 until they retire on their 65th birthdays.