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Few understand that Social Security is already means-tested

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"Y*eah, I'll bet they start means-testing Social Security soon. If you make a bunch of money, you won't be able to collect any benefits."*

Lots of people make such comments. Lots of other people listen seriously. "Means-testing" seems to be a quick solution for the inadequate funding of future Social Security benefits. What few understand is that Social Security is already means-tested. In fact, it is means-tested twice.

Confused? Then come with me into the weedy details of Social Security. It's good to remember, right here, that Social Security is the single largest part of our social safety net. It provides about 39 percent of all income received by the elderly and more than 50 percent of all income for many. Without Social Security, we'd be in something worse than chaos.

First, let's look at how benefits are calculated. What most people don't know is that our employment tax dollars don't all buy the same amount of future benefit. Some of our employment tax dollars buy six times as much in benefits as others.

According to the most recent Trustees Report, for instance, the first $767 of "average indexed monthly earnings" (a complex formula that adjusts earnings over time) is credited at a 90 percent rate, assuring the lowest wage workers of a retirement benefit nearly equal to their earned wage.

Wages of more than $767 a month but less than $4,624 a month are credited at a 32 percent rate. This means retirement benefits increase at a much lower rate. The benefit pinching, however, does not end there.

More means less

For wages of more than $4,624 a month up to the wage base maximum ($113,700 for 2013), the crediting rate is only 15 percent. Thus, all the wages earned — and employment taxes paid — over that $55,488-a-year "bend point" gain benefits at only one-sixth the rate of the lowest wage earners.

In effect, the Social Security benefits formula functions as a sharply graduated benefits "tax," reducing the benefits that accrue to higher wages by 85 percent. The higher your means, the lower your benefit.

The result can be seen in the percentage of earnings workers can expect their Social Security retirement benefit to replace.

According to the most recent Trustees Report, while workers at low-wage levels can expect Social Security to replace 57.8 percent of earnings at normal retirement age, workers at a "medium" earnings level can expect 42.9 percent and workers at the maximum level can expect only 28.7 percent.

So high-wage workers get half as much for their employment tax payments as low-wage workers — basically, a form of means-testing.

But means-testing doesn't stop there.

While the original political promise of Social Security was that the benefits would never be subject to taxation, the tax reform of 1983 (during the Reagan administration) initiated taxation of benefits.

A sly tax

A second change during the Clinton administration created another level of tax on benefits. This increased the percentage of benefits subject to taxation from a maximum of 50 percent to 85 percent.

From the start it was a sly tax.

In its first year, it was expected to affect only 3 percent of all retirees. The formula for the taxation of Social Security benefits, however, is one of the few items in our miserable tax code that is not indexed to inflation.

As a consequence, an estimated 30 percent of all retirees now pay some amount of tax on their benefits.

Ultimately, that tax will take back much of the benefits that accrue above the second bend point for higher-income workers. In other words, most of the employment tax paid on wages over about $55,488 a year will bring little benefit to workers because much of it will be taxed away.

All of this is history. It all happened before our slippery friends in Washington started dealing with “entitlement reform.” Soon they will start talking about changing the formula for future benefits and other sneaky ways to reduce — or further “means-test” — benefits.

When you translate “change the formula for future benefits” from politicalspeak to what will really happen, what you get is yet another way to have workers pay in the same amount of taxes for less in future benefits.

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