The growth and budgetary impact of Social Security: The swelling of the modern welfare state

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PLSC 4333

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December 8th, 2025

Introduction

The largest federal program is social security and it is one of the most consequential components of the modern welfare state. Since its creation in 1935, it has been repeatedly amended to modify the structure in response to unintended flaws in benefit design, demographic change and economic pressure. Some amendments attempt to correct the financing logistics that threaten the programs solvency while others expand coverage or increase benefits. Despite repeated reforms, most notably 1977 and 1983. Social security continues to face long-term fiscal imbalance.

This paper explores the history of the program and focus on major episodes where financing challenges emerged. This paper proceeds in fourt parts. First it outlines the original 1935 Social Security amendment and the subsequent changes that inadvertently raised long-term costs. Second it examines the 1977's attempt at fixing the program and why it only partially addressed the underlying problem. Third it evaluates the 1983 Social security reform which solved the short term fiscal imbalances but still lacked to address the core issues of the social security program. Fourth, it breaks down the modern demographic issues and financing solutions and how policy makers can solve the long-term imbalance

By examining these periods of policy responses to fiscal imbalance the paper argues that the program's recurring solvency issue is a not an anomaly, but is structural feature of a pay-as-you-go system facing rising benefits and an aging society.

Social Security Act of 1935: Pay-as-you-go Problem

The Social Security Act of 1935 created a federal system of retirement benefits and authorized states to administer financial assistance programs for aged individuals, the blind, dependent and disabled children, maternal and child welfare, public health services, and unemployment compensation. However according to the social security administration the original act had limitations “The original Act was far from complete, however; it excluded many classes of workers and established only a modest system of old-age benefits.”[1] These limitations were later addressed in subsequent amendments.

Act also required states to appropriate sufficient funds for these programs, submit their plans for approval by the Social Security Board, and establish a single statewide administrative agency with fair hearings for denied claims, standardized reporting, and procedures approved by the Board. States were also required to follow federal eligibility standards, including a minimum age requirement above sixty-five (with age seventy temporarily permitted until 1940), residency rules of five years within the prior nine plus one continuous year, and non-discriminatory citizenship requirements.

The Act’s titles outlined the program’s structure: Title I reimbursed state cash assistance for the elderly; Title II created federal old-age insurance funded by payroll taxes; Title III provided grants to states for unemployment insurance systems; and

[1] Social Security Administration, *The Social Security Act of 1935*, https://www.ssa.gov/history/35act.html

Titles IV through XI funded child welfare, maternal health, public health initiatives, the Social Security Board itself, payroll tax provisions, voluntary unemployment insurance rules, aid to the blind, and definitions of taxable wages. Together, these provisions established the fiscal and administrative foundations for a coordinated federal–state social insurance system.

The 1935 Social Security act was in direct response to the great depression. In Ian Stubbs "Undeterred by Depression" he quotes "By the mid-1930s, economic desperation had become so widespread that federal action was no longer a matter of ideology but of necessity."[2] The social safety net was a necessity but the issue of time made it difficult to plan properly. The issue of the pay-as-you-go financing structure is that benefits could begin without decades of saving to build up a trust fund which left the program sensitive to demographics in the long run. The act also excluded many workers and left the benefit design incomplete. These choices forced future reforms like the 1939 Social Security act to expand eligibility and address the gaps in the original retirement-benefit structure.

The 1939 Expansion: From Retirement Insurance to Family Insurance

The Social Security amendment of 1939 greatly expanded and added new benefits for spouses, widows, children and survivors to address undercovered workers and needy dependents. Social Security evolved into a family based economic security program. Dependents of the retired beneficiaries now received benefits and also received benefits in the event of a premature death of a covered worker. The old age benefit was

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[2] "Undeterred Through Depression," *Denny Center for Democratic Capitalism, Georgetown Law*, 2023, https://www.law.georgetown.edu/denny-center/blog/undeterred-through-depression/.

calculated based on a formula where recipients received "40 percent of average monthly wages, up to the first $50, plus 10 percent of average monthly wages in excess of $50"[3]. The children's insurance benefit was set at "one-half of a primary insurance benefit of the individuals with respect to whose wages the child is entitled to receive such benefit"[4]. For wives, the insurance benefit was "equal to one-half of a primary insurance benefit of her husband"[5], though if she was entitled to receive her own primary insurance benefit for any month, her wife's insurance benefit for that month "shall be reduced by an amount equal to a primary insurance benefit of such wife"[6]. The benefits became disqualified in the event that her spouse died or they divorced.

Table 1 [7]

Social Security Benefits as a Percentage of Total Federal Budget Outlays 1940-2002 [1]

Year	Social Security Benefit Payments	Total Federal Budget Outlays	Social Security as a Percentage of Total Outlays
1940 [2]	28	9,468	.29
1941	91	13,653	.66
1942	137	35,137	.38
1943	177	78,555	.22
1944	217	91,304	.23

[1] Source: Budget of the U.S. Government, Fiscal Year 2004, Historical Tables. U.S. Government Printing Office, 2003.

Table 1 above displays . The number of beneficiaries to workers was extremely small. According to the IRS "The number of individual and taxable fiduciary returns

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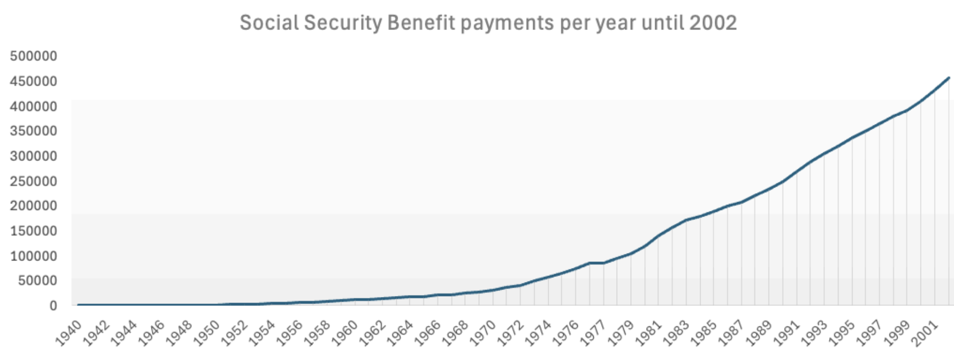
[3] U.S. Social Security Administration. *"Legislative History: 1939 Amendments."* Social Security Administration. https://www.ssa.gov/history/1939amends.html.
[4] Ibid
[5] Ibid
[6] Ibid
[7] Larry DeWitt, "Percentage of Population Aged 65 or Older," *Social Security Administration Historian's Office*, 2003, https://www.ssa.gov/history/percent.html.

filed for 1940 was 14,778,159"[8] not all of these tax payers were paying payroll taxes but a large number of these were federal and corporate employees that goes to show how small the number of actual payments to revenues received the government obtained at the start of the program. One reason why obligations were expanded without the proper proportional revenue increases since the worker to beneficiary ratio was high.

Graph 1 [9]



[1] Source: Budget of the U.S. Government, Fiscal Year 2004, Historical Tables. U.S. Government Printing Office, 2003

The result of the expansions in coverage to dependents, survivors and new workers is the steep upwards slope of the line displaying the increase in Social Security benefit payments . The number of Social Security beneficiaries grew exponentially with expansion of coverage and eligibility liberalization. The Social Security acts of the 1950's and 1960's followed this trend which accelerated growth of the program.

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[8] Internal Revenue Service, Statistics of Income for 1940, Part 1, U.S. Government Printing Office, 1944, https://www.irs.gov/pub/irs-soi/40soireppt1ar.pdf

[9] Larry DeWitt, "Percentage of Population Aged 65 or Older," *Social Security Administration Historian's Office*, 2003, https://www.ssa.gov/history/percent.html.

The 1950's, 1960's and 1970's Amendments: further expansion

The 1950 act expanded coverage by about 10 million workers, which included self-employed, domestic farm workers, certain federal employees, small occupational groups, and offering optional coverage to many State/local government and nonprofit employees. Based off the reports of the Technical Adviser to commissioner for Social Security, Wilbur Cohen and the Chief Actuary of the Social Security Administration Robert Myers "For a retired worker the average benefit is increased from around $26 a month to $46 for persons ...and to around $50-55 a month for those who retire after the new law takes full effect"[10]. This benefit expansion was the single largest in the program's history. It was a politically popular move, doubling the benefit levels to current retirees. Who were still struggling with the loss of wages to the Great Depression and had aging bodies unable to work hard labor jobs. However this shifted the program to a financially vulnerable position, and further benefits were continually added.

The law also eased earning limits and provided lump-sum death payments. "raised the wage base for tax and benefit computation purposes".[11] Payroll taxes applied only to a portion of wages, that taxable portion was raised. More money was collected now to account for the new growth but future benefits were calculated with higher maximum earning levels which meant greater payouts in the future. Additionally it added lump-sum death payments which required greater liquidity of the fund. States could also now extend Social Security coverage even to employees who already had a retirement system.

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[10] Wilbur J. Cohen and Robert J. Myers, *"Social Security Act Amendments of 1950: A Summary and Legislative History,"* Social Security Administration, n.d., https://www.ssa.gov/history/1950.html.
[11] Social Security Administration. *"1950 Amendments."* Social Security https://www.ssa.gov/history/1950amend.html

The 1954 amendment Coverage expanded again by around 10 million additional Americans. The retirement calculations for Old-Age insurance changed to increase benefit calculations. Which was done by eliminating retirees four or five lowest years of earnings from benefit computation. The amendment also increased benefits for individuals "The total annual earnings on which benefits and contributions are based is raised from $3,600 to $4,300"[12]. Benefit categories were again expanded in 1956 further growing the fiscal responsibility of the Social Security Administration.

The massive shift in the 1956 Social Security amendment was the creation of the Social Security Disability Insurance (DI) program for disabled workers aged 50–64. For workers from the ages of 50-65, the benefits are less for this category however still funded by payroll taxes and not funded by a proportional increase in funding. In 1965 the Social Security act framework the programs medicare and medicaid were created which acted as health insurance for which was paid for by payroll taxes. Due to the liberalization of Social Security benefits, the growth of new beneficiary categories took effect.

Congress was politically motivated to expand benefits without further increasing payroll taxes and also while occurring during inflationary periods. Fiscal expansion during inflationary periods can be poorly timed due to cyclical inflation. Cyclical inflation occurs when there is a boom in the economy, like in the 60's when unemployment was low and GDP was high. It leads to an output gap where the economy is producing above its natural, potential level, pushing prices up, as a response the Federal Reserve bank raises interest rates to cool down the economy.

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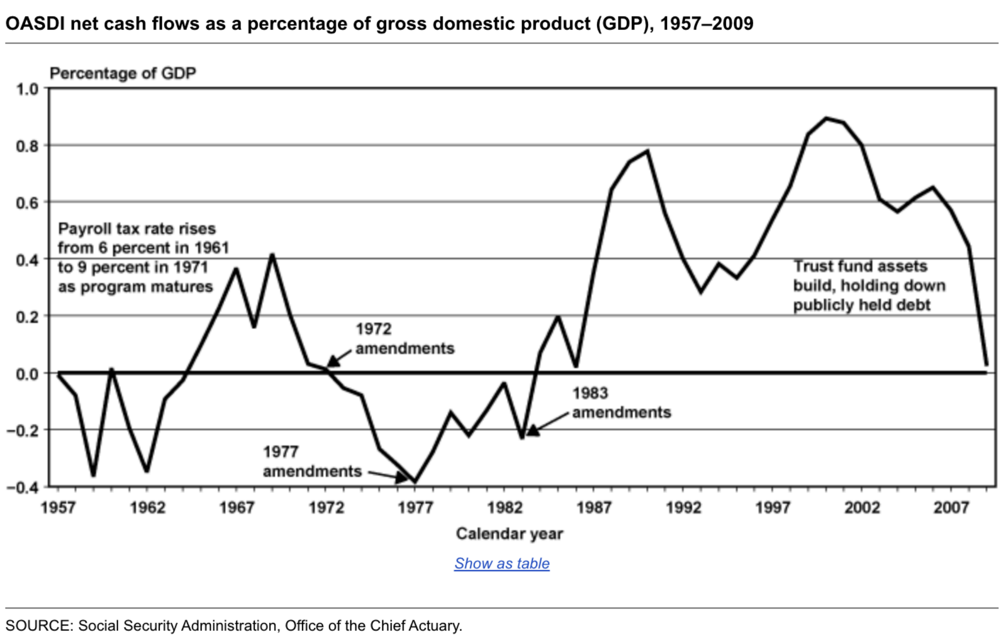
[12] Cohen, Wilbur J., Robert M. Ball, and Robert J. Myers. "Social Security Act Amendments of 1954: A Summary and Legislative History." *Social Security Bulletin*, vol. 17, no. 9 (September 1954): 3–18. https://www.ssa.gov/policy/docs/ssb/v17n9/v17n9p3.pdf

However if the expansionary fiscal policy is expanded without corresponding tax increases then the expanded benefits and higher interest rates counteract each other. Higher interest rates control the economy through monetary tightening which lowers demand putting downward pressure on prices to ultimately decrease inflation. When the expanded benefits are for political motivation and don't take the economic outlook into account there is hard pressure on future administrations to reverse the status quo of benefits received. If the Fed has to employ restrictive monetary policy then the result will be a bipartisan mess to control the fiscal imbalance that Social Security deficits cause. When congress expanded benefits in the late 60’s while inflation was rising and the fed was tightening it created a fiscal-monetary mismatch. The imbalance was clearly shown in the cash flow of the program.

Chart 1 displays the negative cash flow of the Social Security program and why Congress had to intervene and respond to the changes created in previous amendments.

Chart 1 [13]



[13] Social Security Administration. “Is Social Security an Entitlement?” *Social Security Bulletin*, vol. 70, no. 3, 2010, pp. 111–128, https://www.ssa.gov/policy/docs/ssb/v70n3/v70n3p111.html.

The huge turning point in the downward progression of the curve was the indexing issue caused by introduction of COLAs, later expanded upon in the next section. The adjustment for inflation benefit rates increases the importance of the Federal Reserves ability to lower inflation rates so that our government can afford Social Security long-term.

1972 Social Security limit: The Double Indexing Mistake

1972 was a pivotal turning moment for Social Security that created a solvency crisis of the program. Social Security still had a relatively small number of beneficiary payouts to payroll tax payers; however the Social Securities Administration's large consumption of the federal budget was already in strong effect.

In 1971 the program had the largest percent of budget outlays to date at 15.47%[14]. Despite this the 1972 Social Security amendment was passed in Congress where two major shifts in the policy occurred. First through a minor debt ceiling bill, COLAs, Automatic Cost-of-Living Adjustments was attached as a major rider. It went into effect in 1975, increasing benefits automatically to adjust for the cost of living, by accounting for the inflation rate. Secondly, the amendment also raised the payouts to beneficiaries to "an immediate 20% increase "[15]. Additionally it further improved the early retirement benefit for men retiring at 62 and later retirement benefit of men working beyond 65. It

[14] Social Security Administration. *"Historical Percent of Total Outlays."* Social Security Administration. https://www.ssa.gov/history/percent.html
[15] Social Security Administration. "Tally of Major Amendments — 1972." *Social Security Administration Historical Web Page*, https://www.ssa.gov/history/tally1972b.html.

also liberalized the retirement earnings test from “$1,680 to $2,100 the amount a beneficiary can earn without having benefits reduced”[16]

The 1972 Social Security amendment created a solvency crisis due to a policy design flaw. COLAs indexed the benefits retirees received “provided in addition for keeping the amount up to date automatically in the future as average wages rise”[17]. The issue is as wages rose economy-wide due to inflation, new retirees naturally had higher nominal earnings in their work history. Then the wages, that already were adjusted to inflation, were indexed to adjust for inflation greatly improving benefit calculations and giving inequitable payouts to current retirees. The double indexing error dramatically expanded long-term liabilities and caused the Trust Funds projected insolvency. Which became a more prominent issue in 1974 when the total cost of Social Security was greater than total income and proceeded this way for the next eight years with its peak coming in 1982 where costs outweighed income around 16.9 billion[18]. Which led to the 1977 reform as a result of increasing deficits the program was running.

1977 Social Security Act: A Failed Attempt at Reform

By the 1970s, Social Security's financing structure was destabilized by the flawed benefit calculation coupled with high inflation, causing payments to grow faster than intended. The Social Security Administration explains, the benefit formula produced

[16] Presidency of the United States. “Statement on Signing the Social Security Amendments, 1972.” *The American Presidency Project*. https://www.presidency.ucsb.edu/documents/statement-signing-the-social-security-amendments-1972.

[17] Social Security Administration. *“Social Security Amendments of 1972.”* Social Security Administration. https://www.ssa.gov/history/1972amend.html

[18] Social Security Administration, Office of the Chief Actuary. *“Table IV.A1 — Number of Beneficiaries by Type of Beneficiary and Age, December 1940-2023.”* Social Security Administration. https://www.ssa.gov/oact/STATS/table4a1.html

"windfall benefits for some groups and putting the system's long-range financing in jeopardy."[19] To correct these errors, Congress passed the 1977 Amendments , which , "establish[ed] a new formula for computing the primary insurance amount based on the individual's average indexed monthly earnings."[20] The legislation also increased payroll taxes, raised the taxable wage base, and adjusted the minimum benefit in an effort to stabilize trust-fund reserves. These improvements helped correct the technical mistake of double indexing which slowed the growth of new benefits, between 1978 and 1981 the spending deficit decreased but they did not address the core demographic forces that would later push the program into fiscal imbalance despite tax policy reform.

1983 Social Security Act: Short-Term Reform

The 1983 amendment restructured the program's financing and benefit structure to restore long-term solvency. They broadened coverage to remaining uncovered workers which included nonprofit employees and new federal employees, and tightened rules for state plans. The first major reform was Congress adjusted COLAs to a calendar-year basis and added a 'stabilizer'. Before COLAs were calculated on a mid-year schedule, which caused irregular timing where benefit jumps did not align with the federal fiscal year and yearly inflation measurements. The stabilizer was an automatic adjustment based on the health of the trust fund. This was done so that future COLAs would be smaller when trust-fund balances were low and vice versa. The adjustment now matches the strength of the economy. It also trimmed windfall gains, the unexpectedly large benefits some received, for workers who also received

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[19] Social Security Administration. "Notch-Generation: A History." By James W. Kelley and Joseph R. Humphreys, former Congressional staff. https://www.ssa.gov/history/notchfile3.html
[20] Ibid

noncovered pensions. While also improving protections for divorced spouses, disabled workers and certain widows.

Additionally, fifty percent of the benefits became taxable for higher income beneficiaries and scheduled payroll-tax increases were accelerated. This made Social Security payments tax benefits taxable on higher income retirees supporting the fund without reducing benefits for lower and middle income classes.

Thirdly there was a "Gradual increase in the age of eligibility for full benefits to age 66 in 2009 and to age 67 in 2027"[21]. Helping the fund grow alongside earnings tests were strengthened, spousal benefit rules were tightened and abuse was reduced through better verification and use of death records. All together this reform combined targeted benefit cuts, revenue increases and administrative refinement in an effort to help stabilize Social Security but this was only a temporary fix.

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[21] Svahn, John A., and Mary Ross. "Social Security Amendments of 1983: Legislative History and Summary of Provisions " *Social Security Bulletin*, vol. 46, no. 7, 1983, pp. 3–15. https://www.ssa.gov/policy/docs/ssb/v46n7/v46n7p3.pdf

Table 2 [22]

Old-Age and Survivors Insurance Trust Fund, 1937-2024

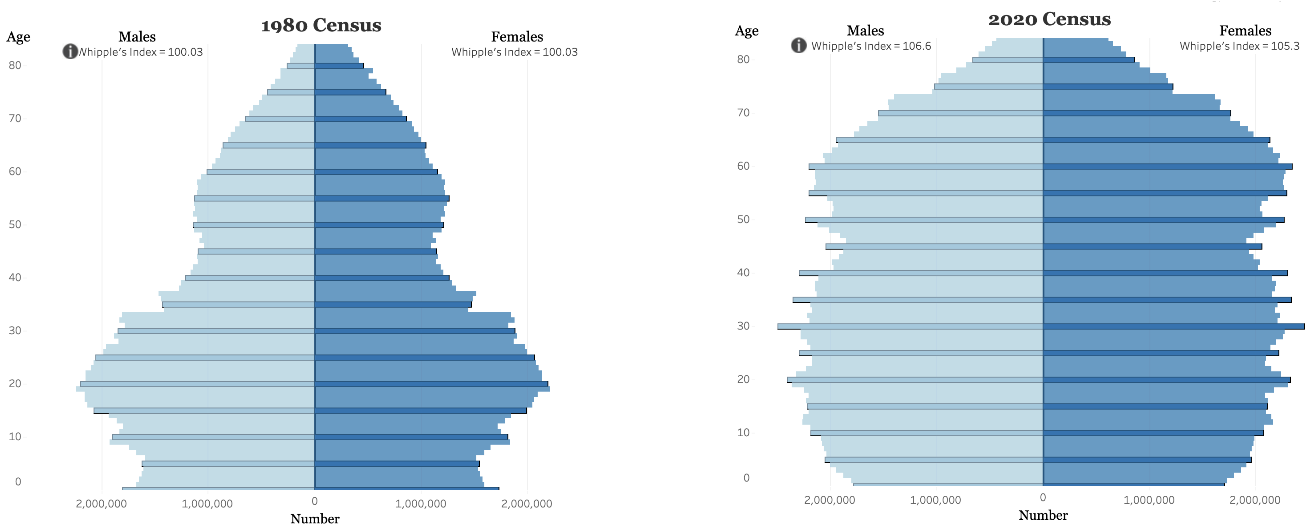
[In millions]

			Asset Reserves [a]	
Calendar year	Total income	Total cost [a]	Net change during year	Asset Reserves at end of year
1983	150,584	152,999	-2,416	19,672
1984	169,328	161,883	7,445	27,117
1985	184,239	171,150	8,725	35,842
1986	197,393	181,000	3,239	39,081
1987	210,736	187,668	23,068	62,149
1988	240,770	200,020	40,750	102,899
1989	264,653	212,489	52,164	155,063
1990	286,653	227,519	59,134	214,197

The effects of the 1983 amendments allowed for a resurgence in the trust fund's health. Table 2 illustrates how the inflow of funds grew faster than benefit outflow with accelerated payroll taxes, alongside the addition of high income tax on Social Security that multiplied the asset reserves at the end of the fiscal year. The Reagan administration tried to make cuts in 1982 to the program but this faced heavy political backlash and now Social Security was excluded from reconciliation which means future changes required bipartisan agreements. Meaning that it's incredibly difficult to change the program due to pressure from both angles but it must be changed due to the demographic change of America.

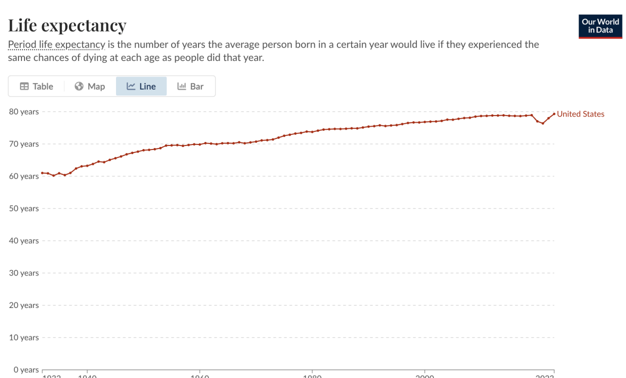
[22] Social Security Administration, Office of the Chief Actuary. "Table IV.A1 — Number of Beneficiaries by Type of Beneficiary and Age, December 1940–2023." Social Security Administration. https://www.ssa.gov/oact/STATS/table4a1.html

Graph 2 [23]

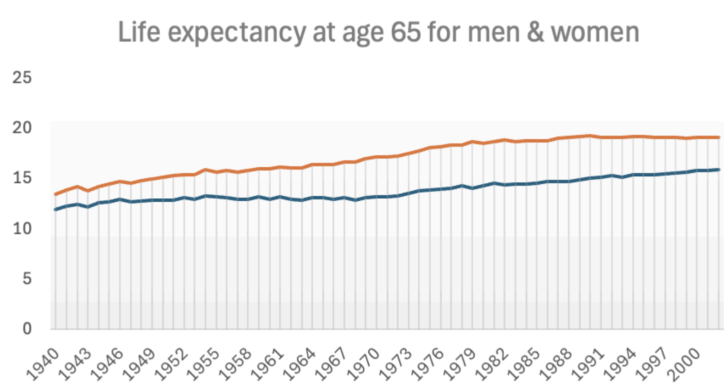


The age distribution shows a greying population that illuminates the aging demographic shift of the United States. There is decreasingly less workers to beneficiaries. The ratio of retirees to people working has weakened.

Graph 3 [24]



Graph 4 [25]



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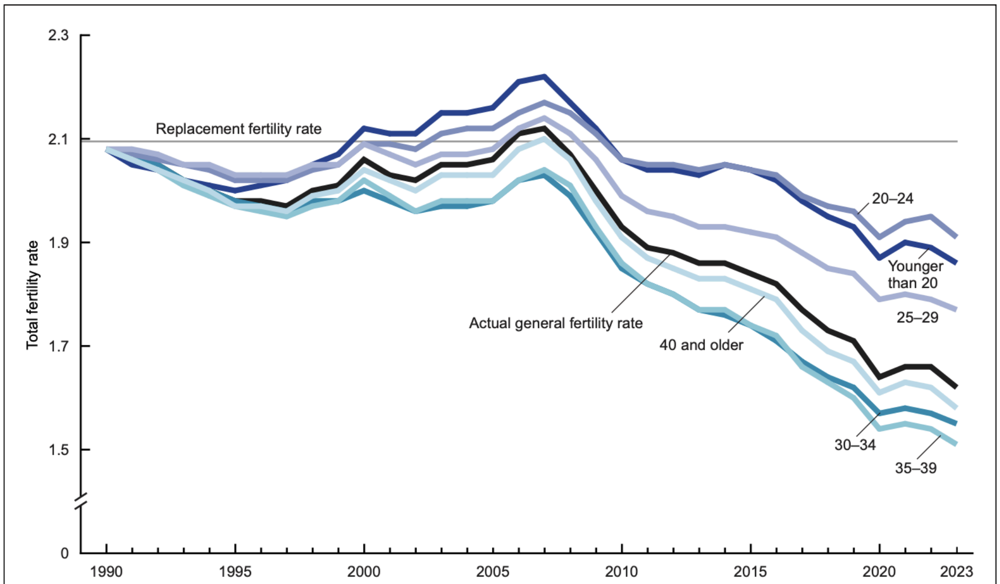
[23] U.S. Census Bureau. "Age-Sex Pyramid for the United States." 2023. https://www.census.gov/library/visualizations/interactive/age-sex-pyramid-for-the-united-states.html
[24] Our World in Data. "Life expectancy — United States." Accessed 2023. https://ourworldindata.org/grapher/life-expectancy?time=1932..latest&country=~USA
[25] Social Security Administration, Office of the Chief Actuary. "Table IV.A3 — Old-Age and Survivors Insurance and Disability Insurance Trust Funds: Asset Amounts, Year-End, 1940–2023." Social Security Administration. https://www.ssa.gov/OACT/TR/TR02/lr5A3-h.html#foot1

The shift is due to two major factors. The first is that life expectancy has increased. The life expectancy in 1980 was 73 , in 2025 it was 79 according to Graph 5 . Graph 3 above shows how lifespans in the United States have grown and Graph 4 above shows that the number of years people are living for after 65 has increased steadily. Increases in medical technology and access have improved human lifespan outlook and have increased Social Security Responsibility. The other major factor is the decline in the fertility replacement observed in Graph 5.

Graph 5 [26]

Figure 4. Actual and adjusted total fertility rates: United States, 1990–2023



NOTE: Adjusted total fertility rates apply 1990 fertility rates for the specified age group to populations in subsequent years.
SOURCE: National Center for Health Statistics, National Vital Statistics System, natality data file.

[26] Driscoll, Anne K. and Brady E. Hamilton. "Effects of Age-specific Fertility Trends on Overall Fertility Trends: United States, 1990–2023." *National Vital Statistics Reports*, vol. 74, no. 3, 2025. https://www.cdc.gov/nchs/data/nvsr/nvsr74/nvsr74-3.pdf

In 2024 there are now 71 million beneficiaries[27], the Social Security Administration spent 1.6 trillion dollars[28] and currently the trust fund is estimated to be depleted by 2034[29]. At that point incoming taxes would cover only about 75–80% of promised benefits.

Conclusion: The Next Policy Steps Moving Forward

The solutions to reforming Social Security are relatively straight forward. Most likely under a Democratic administration, payroll tax rate could be increased this would increase revenue. The wage cap could be raised, so that the top 6% contribute more to the payroll tax. Another option is a tax on other types of income like capital gains, which could be an additional source of revenue for Social Security.

Reform could also address benefits, which is the favored solution of Republicans. A solution could look like a change in the benefit formula to lower replacement rates. This would decrease the percentage of pre retirement earnings that a worker would have replaced by Social Security , meaning they would get smaller future benefit payments, reducing long term impact and payouts. Secondly, the COLAs inflation index could be smaller. Benefits will rise but more gradually which flattens the long rung cost curve. Finally the retirement age could further be increased like previously done, a decision that could be supplemented by the rationale that age after retirement is increasing.

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[27] Social Security Administration. *"Fast Facts & Figures About Social Security, 2024."* Social Security Administration, 2024. https://www.ssa.gov/policy/docs/chartbooks/fast_facts/2024/fast_facts24.html
[28] Social Security Administration. *Annual Report of the Supplemental Security Income Program, 2024.* 2024. https://www.ssa.gov/OACT/ssir/SSI24/ssi2024.pdf
[29] Social Security Administration. "*Social Security Board of Trustees: Projection for Combined Trust Funds One Year Sooner than Last Year*." Press Release, June 18, 2025. https://www.ssa.gov/news/en/press/releases/2025-06-18.html

A last measure could be the federal government's transferring of general revenues borrowing from the treasury to fill the gap in 2034, however this increases deficits and puts further upwards pressure on the price level rendering Social Security payments less helpful to the American citizen. Bipartisan agreement over Social Security is at the core of the issue, without it we can not hope to solve the growing fiscal challenge of Social Security.

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U.S. Census Bureau. "Age-Sex Population Pyramid for the United States: 2023." https://www.census.gov/library/visualizations/interactive/age-sex-pyramid-for-the-united-states.html.