Spring 1982

An Evaluation Of The Social Security System With Suggestions For Improvement

Rick Neva
Carroll College

Follow this and additional works at: https://scholars.carroll.edu/business_theses
Part of the Accounting Commons, and the Taxation Commons

Recommended Citation
https://scholars.carroll.edu/business_theses/31

This Thesis is brought to you for free and open access by the Business, Accounting and Economics at Carroll Scholars. It has been accepted for inclusion in Business, Accounting and Economics Undergraduate Theses by an authorized administrator of Carroll Scholars. For more information, please contact tkratz@carroll.edu.
AN EVALUATION OF THE SOCIAL SECURITY SYSTEM
WITH SUGGESTIONS FOR IMPROVEMENT

Submitted in Partial Fulfillment of the Requirements for Graduation with Honors to the Department of Business and Economics at Carroll College, Helena, Montana

Rick L. Neva
March 23, 1982
This thesis for honors recognition has been approved for the Department of Business and Economics.

Mr. Michael Robinson, Director

Mr. Charles Mandeville, Reader

Dr. Joseph Ward, Reader

Date 3/22/82
TABLE OF CONTENTS

ACKNOWLEDGEMENTS. ........................................... i

INTRODUCTION. ................................................... 1

THE HISTORY BEHIND THE SOCIAL SECURITY ACT. ............. 1

THE SYSTEM IN OPERATION ...................................... 7

THE PROBLEMS FACING SOCIAL SECURITY .......................... 14

SOLUTIONS TO THE PROBLEMS .................................. 24

REFERENCES. ..................................................... 36

Acknowledgements

I dedicate this thesis to my parents, whose constant encouragement helped make college and this thesis possible. I would also like to thank Dianne for lifting my spirits when I needed it the most.
The future of Social Security, a law designed to provide individuals with a minimum standard of living, is now highly questionable. Overspending by government, inflation, and a host of other factors have led to the crippling of this program. Today, citizens wonder if they will ever receive the benefits they purchased through years of contributions into the system. The question on many peoples' minds remains, "Is Social Security actually secure?" In the opinion of many experts, the system is headed for destruction within the next few years unless some drastic measures are taken to correct the system's many problems.

To understand the program and the problems of the system, one must understand the circumstances under which the Social Security Act was passed. One should also be aware of how the system operates, including a discussion of the methods of funding and benefit payments. Finally, one should recognize the factors that have caused the system's current woes and some of the proposed suggestions to get the system back on its feet again.

The History Behind the Social Security Act

In years prior to 1929, America was a growing and prosperous country. The stock market was very active and the American people were very confident with our economic system. At this time, there was little emphasis placed on
retirement and pension plans. This is not to suggest that there were no pension plans in existence at the time. There were various pension systems for civil service employees, for men in the military, and for other special groups, such as the clergy, but by and large, the individual and his family were supposed to provide for their own future needs.

The shortage of pension plans, public or private, before 1929 did not reflect a neglectful attitude on the part of Americans. Rather, it reflected the American belief that one's needs should be a matter of personal responsibility. It was the individual's responsibility to work, provide for a family, and save for future events. This concept of self-reliance was one of the foundations of the American system of government and was one of the reasons for our unprecedented economic growth. This economic growth allowed Americans to put money away for future retirement or other unforeseen circumstances. This excess money was usually placed into savings accounts, life insurance policies, or stocks and bonds.

Even though self-reliance was always stressed, there were those times when a family faced undue hardships which exhausted the family savings. In this situation, friends, neighbors, or a local relief bureau were to offer assistance, but not the federal government.

In 1931, however, the views of many Americans began to shy away from the individualistic approach to future security. The change in attitude was due to mounting
unemployment and a decline in the confidence level for the American economic system. As a result, citizens began to call for the federal government to take part in relief programs. At this time, Herbert Hoover was the President of the United States. He was a strong believer in self-reliance and therefore resisted the pleas of the people. In a message to the press in February of 1931, Hoover replied to the problem in the following manner:

This is not an issue as to whether people shall go hungry or cold in the United States. It is solely a question as to the best method by which hunger and cold shall be prevented. It is a question as to whether the American people, on the one hand, will maintain the spirit of charity and mutual self-help through voluntary giving and the responsibility of local government as distinguished, on the other hand, from appropriations out of the Federal Treasury for such purposes. My own conviction is strongly that...if we start appropriations of this character we have not only impaired something infinitely valuable in the life of the American people, but we have struck at the roots of self-government.¹

Perhaps Hoover's views of "charity and mutual self-help" may have been accepted by Americans if the economic picture had improved. Unfortunately, it did not improve. The Depression went on, getting worse and worse. Men and women who had faithfully saved for the future saw their entire savings vanish in a very short time in an effort to cope with the effects of the Depression. Citizens began feeling

frustrated. Americans who once believed that hard work would be rewarded in the later years found this to no longer be a valid assumption. Even die-hard Hoover supporters found that "the spirit of charity and mutual self-help" in each community no longer existed due to the severity of the Depression.

Americans of both political parties felt betrayed by Hoover. He was living in comfortable surroundings in Washington while they faced the devastation of the Depression virtually forgotten by the government paid for by these very people. As a result of the poor economic conditions and other political factors, Hoover was defeated in the election of 1932 by Franklin D. Roosevelt.

Roosevelt entered the White House with several progressive programs for recovery and reform. Programs such as the Agriculture Adjustment Act, the Tennessee Valley Authority Act, the National Industrial Recovery Act, and the Works Progress Administration, were devised to decrease unemployment and regain the confidence of the American people. These programs were quite successful in achieving their goals, but the American people wanted more. Americans wanted protection against possible future depressions and they realized that only the federal government had the means to accomplish such a task. As a result, two new political principles were adopted to deal with the situation.

One principle is that the fortunes of individual Americans are inextricably interlocked; that we
are 'all in the same boat;' and that if any of us fall into deep trouble it is the job of the rest of us—not simply family and friends and neighbors, or even the local community, but the federal government if need be to help them.²

The second principle dealt with government's role in dealing with future depressions.

The other principle is that it is the job of the federal government, through whatever means, to see that there shall not be another Great Depression. Most people want to keep as much economic liberty as possible and most people hate to see the powers of the federal government extended, but we must realize that it is the only instrument on which we can rely in a severe economic crisis, to provide us with a measure of security.³

In accordance with these principles, a series of federal guarantees and insurance programs were implemented to protect Americans from future economic instabilities. One of the programs passed by Congress was known as the Social Security Act of 1935. This program, based on studies by the Roosevelt appointed Committee on Economic Security, provided for a nationally administered compulsory system of old-age insurance, a system of unemployment insurance which was to be supervised by the states in compliance with federally dictated standards and with federal aid, and a system of federal grants to the states to help them look after various other kinds of needy people.⁴


³Ibid., p. 16.

⁴Ibid., p. 16.
The Social Security Act of 1935 was a monumental undertaking to assure Americans of at least a minimum standard of living. Indeed Roosevelt's intentions were good, but as will be shown in the third section of this thesis, the system is now facing problems that may spell an early end to Roosevelt's dreams of social security for virtually every American.

The second section will review the system to give a basic understanding of the mechanics involved in the operation of the system.
The System in Operation

How is the system funded?

The old-age, survivors, and disability insurance system, and the hospital insurance benefits for the aged, are financed out of taxes paid by employers, employees, and the self-employed under the provisions of the Federal Insurance Contributions Act (FICA) and the Self-Employment Contributions Act. Under the Federal Insurance Contributions Act, the old-age, survivors, and disability taxes are paid at the same rate by both the employer and the employee. The hospital insurance taxes, provided for under 1965 amendments, are also paid at the same rate by the employer and the employee. The following table indicates what rates have applied in past years and projected rates for the future based on information gathered in 1965:5

<table>
<thead>
<tr>
<th>Calendar Year</th>
<th>Social Security Rate</th>
<th>Hospital Insurance Rate</th>
<th>Combined Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1937-1949</td>
<td>1.0%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1950-1953</td>
<td>1.5%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1954-1956</td>
<td>2.0%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1957-1958</td>
<td>2.25%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1959</td>
<td>2.5%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1960-1961</td>
<td>3.0%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1962</td>
<td>3.125%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1963-1965</td>
<td>3.625%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Calendar Year</th>
<th>Social Security Rate</th>
<th>Hospital Insurance Rate</th>
<th>Combined Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1966</td>
<td>3.85%</td>
<td>.35%</td>
<td>4.2%</td>
</tr>
<tr>
<td>1967-1968</td>
<td>3.9%</td>
<td>.5%</td>
<td>4.4%</td>
</tr>
<tr>
<td>1969-1972</td>
<td>4.4%</td>
<td>.5%</td>
<td>4.9%</td>
</tr>
<tr>
<td>1973-1975</td>
<td>4.85%</td>
<td>.55%</td>
<td>5.4%</td>
</tr>
<tr>
<td>1976-1979</td>
<td>4.85%</td>
<td>.6%</td>
<td>5.45%</td>
</tr>
<tr>
<td>1980-1986</td>
<td>4.85%</td>
<td>.7%</td>
<td>5.55%</td>
</tr>
</tbody>
</table>

As will be shown in a later table, these projections are far below those now being paid by employees and employers. The employee taxes are computed by applying the rates in effect at the time to the wages received by the employee. The employer taxes are computed by applying the rates in effect at the time to the wages paid by the employer.

It should be noted that the projected tax rates for the later years are far below the percentages now being paid. For example, in 1981 the combined tax paid by the employer and employee amounted to 13.3% compared to the projected combined tax of only 11%. From this example, we can see that the proposed solutions to the social security problems have been based primarily on increasing the amount of revenues generated by the system. As will be demonstrated later, this may not have been the best approach.

For self-employed persons, the old-age, survivors and disability insurance tax is levied at a rate approximately one and one-half times the rate applicable to employers and employees. However, the hospital insurance tax rate is the same as the employer-employee rate. Again, an abbreviated
table is provided to emphasize the dramatic increases in tax rates from those proposed in 1965.\(^6\)

**Social Security and Hospital Insurance Rates for the Self-Employed**

<table>
<thead>
<tr>
<th>Calendar Year</th>
<th>Social Security Rate</th>
<th>Hospital Insurance Rate</th>
<th>Combined Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1951-1953</td>
<td>2.25%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1957-1958</td>
<td>3.75%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1963-1965</td>
<td>5.4%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1967-1968</td>
<td>5.9%</td>
<td>.5%</td>
<td>6.4%</td>
</tr>
<tr>
<td>1969-1972</td>
<td>6.6%</td>
<td>.5%</td>
<td>7.1%</td>
</tr>
<tr>
<td>1973-1975</td>
<td>7.0%</td>
<td>.55%</td>
<td>7.55%</td>
</tr>
<tr>
<td>1976-1979</td>
<td>7.0%</td>
<td>.6%</td>
<td>7.6%</td>
</tr>
<tr>
<td>1980-1986</td>
<td>7.0%</td>
<td>.7%</td>
<td>7.7%</td>
</tr>
</tbody>
</table>

As was the case in the first table, the rates being paid now are much higher than the past projections of what future rates would be. For example, in 1981, the amount of tax paid by a self-employed person amounted to 9.3% compared to a projected figure of only 7.7%.

Further, it must be noted that the wages subject to social security taxes have also steadily increased for all types of employees and employers. Below is a table showing increases in taxes, wage bases and maximum employee contributions for various years.

**Table of Tax Rates and Wage Bases for Various Years**

<table>
<thead>
<tr>
<th>Year</th>
<th>Applicable Tax Rate</th>
<th>Applicable Wage Base</th>
<th>Maximum Employee Yearly Contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>1937-1949</td>
<td>1.0%</td>
<td>$3,000.00</td>
<td>$30.00</td>
</tr>
<tr>
<td>1978</td>
<td>6.05%</td>
<td>17,700.00</td>
<td>1,070.85</td>
</tr>
<tr>
<td>1980</td>
<td>6.13%</td>
<td>25,900.00</td>
<td>1,587.67</td>
</tr>
<tr>
<td>1981</td>
<td>6.65%</td>
<td>29,700.00</td>
<td>1,975.05</td>
</tr>
<tr>
<td>1982</td>
<td>6.70%</td>
<td>32,100.00</td>
<td>2,150.70</td>
</tr>
</tbody>
</table>

\(^6\)Ibid., p. 16.
In future years this base will keep increasing on the basis of the annual increase in average earnings in covered employment. It appears certain that the workers of today will continue to pay for the past mistakes of others.

Who collects these taxes?

All social security taxes are collected by the Internal Revenue Service and paid into the United States Treasury as internal revenue collections.

At one time, the entire amount collected was appropriated to the Federal Old-Age and Survivors Insurance Trust Fund. Then, beginning with the fiscal year ending June 30, 1957, certain percentages of taxable wages and self-employment income were appropriated to the Federal Disability Insurance Trust Fund, and beginning with the fiscal year ending June 30, 1966, amounts equal to the amount of hospital insurance taxes collected will be appropriated to the Federal Hospital Insurance Trust Fund.7

In the case of each of these funds, portions of the funds not needed for current withdrawals are invested in interest-bearing obligations of the United States or in investments guaranteed as to both principal and interest by the United States.

How are Social Security contributions recorded?

Every employee and every self-employed individual covered by the Social Security Act must have a social security account number. The earnings credited to a person's

7Ibid., p. 13.
account are then used to determine the amount of benefits payable when one becomes eligible for social security benefits, becomes disabled, or dies, and the earnings credited to one's account are also used in determining entitlement to hospital insurance benefits. To insure that one's account has been properly credited for the correct amount of contributions, a person can request a statement of the total wages and self-employment income credited to his or her earnings record. If an error exists, that person can request a social security district or branch office to help clear up the error.

How does a person qualify for benefits?

There are literally hundreds of provisions under which a person may be fully or partially entitled to specific benefits. Clearly this is beyond the scope of this thesis, so a general statement concerning benefit entitlement must suffice. In general, a person must have a certain insured status before retirement, survivors, or disability insurance benefits can be paid to him or to his family. A person is insured if he has a sufficient number of quarters of coverage credited to his social security earnings record. A quarter of coverage is a calendar quarter in which a person has been paid $310 or more in wages for employment covered under the law. For self-employed people, a quarter of coverage is a quarter in which a person has been credited $100 or more of self-employment income. A self-employed
person must have at least $400 in net earnings from self-employment in a taxable year beginning after 1950 before any quarters in the taxable year can be credited with self-employment income. The term "calendar quarter," as used above, means a period of three calendar months ending March 31, June 30, September 30, or December 31 of any year.

How are benefits calculated?

Except where the minimum benefit rules applied, retirement benefits were previously based on the computation of an average monthly taxable wage usually covering only the nineteen highest years of taxable wages earned since 1951. Beginning in 1979, however, the number of years included will increase each year. Once the average monthly taxable wage is determined, it is stratified into three predetermined layers to which the specified benefit percentages are then applied in calculating the primary insurance amount. For years after 1978, the benefit percentages are as follows:

<table>
<thead>
<tr>
<th>Average Indexed Monthly Earnings</th>
<th>Benefit Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>First $180</td>
<td>90</td>
</tr>
<tr>
<td>Next $965</td>
<td>32</td>
</tr>
<tr>
<td>Excess over $1,145</td>
<td>15</td>
</tr>
</tbody>
</table>

---

Under the three tier approach, benefits will be based on a person's average indexed monthly earnings. To index, each prior year's taxable wage is multiplied by the ratio of the average covered wages of all workers for the year (two years before the worker reached age 62) to the average covered wages of all workers in the year being indexed. For example,

If the average covered wages were $6,000 in 1960 and were $18,000 two years before the retiring worker reached age 62, and if he had covered wages of $5,000 in 1960 (the year being indexed), the $5,000 would be increased to $15,000 for purposes of calculating the average indexed monthly earnings. Thus, as wages rise each year, the average indexed monthly earnings for each past year will also rise. In addition, as covered wages rise, the amounts in the three strata will also increase. For example, if covered wages increase ten percent, the three strata for the following year would be increased by ten percent. This was done so that persons would not be pushed into higher strata where the benefit percentages are lower.9

Again, it must be emphasized that this section of the thesis deals only with the fundamental mechanics of the system. For a more complete discussion of benefit entitlement and other facets of the Social Security system, see Social Security Handbook, located in the Carroll College library. The next section will review several of the major problems that have led to our present social security system crisis.

Over the past few decades there has been a growing disenchantedment with the social security system. The system has been experiencing numerous financial problems and lost the confidence of many Americans that social security would be there when they retired. There are many problems that have led to the present system's woes, but I will examine five areas which I consider to be of major importance.

One of the problems facing the social security system is that the scope of the program is much larger than Roosevelt had originally intended. Social security was intended to pay only minimum benefits to older workers who had been devastated by the Great Depression.

In the beginning, social security appeared to be a wonder program. Since there were a large number of active workers and a small group of people drawing benefits, the system began to attain a cash surplus. As a result, Congress was pleased and decided to expand the program. Not long after the enactment of social security, benefits were given to a pensioner's dependents and survivors. In 1956, Congress again extended coverage by including disabled workers who had not reached age 65. Nine years later they provided hospital insurance to the elderly under the
medicare program and finally, in 1972, Congress voted to increase benefits based on the consumer price index. With each benefit increase the system moved farther and farther away from its original purpose and costs began to climb.

Unfortunately, someone has to pay for the increasing benefits and that burden was cast onto the shoulders of the active worker. As was shown in an earlier table, the amount of social security taxes paid by employers and employees have increased dramatically. As a result, many workers have become disillusioned with the inequity of the system and are justified in so doing. To illustrate this inequity, take the case of a man who began work in 1937. At that time, FICA taxes were only one percent of the first $3,000 earned, or a total of $30 per year. Compare this to the amount of FICA taxes paid by a worker in 1981. His tax would be 6.65% of the first $29,700, or a total of $1,975. Clearly there appears to be a great inequity in the amount of contributions. To further illustrate, if the 1937 worker were to retire in 1981, he could be eligible for a maximum benefit of about $9,000 per year if he met specific qualifications. The $9,000 per year may seem like a small amount in relation to other 1981 wages, but it becomes a very large figure when you consider the maximum amount he could have paid into social security from 1937 to 1981 was only $14,766. If the man were to live only ten years after retirement he could possibly receive $90,000 of benefits
that cost him only $14,766. It is clear from this example that benefits must be reduced or put on some actuarial basis so that inequities of this magnitude can be avoided in the future. However, the cutting of current benefits would be politically disastrous. Since the elderly, more of whom vote than any other age group, would be affected, politicians fear reprisals from the elderly when it comes time to vote and as a result they fail to act.

A second closely-related problem area deals with the change in demographics. With fewer babies being born over the past few decades, the number of active workers to pay FICA taxes and thus support the pay-as-you-go social security system has declined. "In 1950, for example, each retiree was supported by 16.5 payroll taxpayers. By 1965, that ratio had declined to 4 to 1. Last year each increasingly long-lived pensioner was supported by only 3.2 taxpayers." Again the active worker is forced to pay a larger FICA tax due to changing ratios in order to pay current retirement benefits. But what caused this ratio to change? One factor is that people can now begin collecting some benefits as early as age 62. Currently, fewer than half of all workers wait until 65 to begin collecting benefits. Full benefits may be collected when

---

a person turns age 65. The question is now being asked, should the retirement age arbitrarily be set at 65 or should it be higher? I believe the evidence shows that the retirement age should be raised. "Between 1968 and 1977 life expectancy at 65 jumped from 12.8 to 13.9 years for men and from 16.3 to 18.3 years for women." This may seem like an insignificant figure but when multiplied by the millions collecting social security, the figures are quite staggering. The fact remains, if we are going to live longer, then we should expect to work longer. If, for example, the retirement age were raised to 68 and the benefit formula changed, economists at the National Bureau of Economic Research claim that $885 billion of the long-term deficit in the Old-Age and Survivors portion of social security could be eliminated. This measure is probably more desirable politically than increasing payroll taxes or decreasing benefits although reductions of both are needed. This is not to assume that raising the retirement age to 68 would have no political consequences. Retirees and potential retirees have been raised with the assumption that they would be able to retire at 65 and receive full benefits. If the retirement age were arbitrarily raised to 68, it would be another example of the government reneging on a

13Ibid., p. 17.
fifty-year promise to the American people. With American confidence in the government already quite shaky, it would appear that a change of this nature that affects several million people will be avoided for fear of political disaster.

Another area that has caused problems is the hidden welfare element within social security. The welfare element within the system can best be illustrated with an example. Years ago, Congress enacted a provision known as the "earned income credit," to relieve low-wage earners of the heavy burden of FICA taxes. This provision is desirable to some extent, but it also has an undesirable and inequitable result; individuals may in some instances contribute no money into the system and still receive retirement benefits. For example,

In 1978, a male taxpayer with dependent children has a salary of $4,000 per year. The amount of FICA taxes paid would amount to $242 (6.05 x $4,000). Since this man qualifies for the refundable 'earned income credit,' he, in effect, is relieved of paying the $242 FICA tax and also $158 of income tax. In 1978, he will have contributed nothing toward his retirement, but still be eligible for the heavily weighted benefits paid to low-income earners.15

Clearly it is undesirable that some workers receive benefits without paying for them. As will be shown later, it would be more desirable to base a person's benefits on the amount of contributions made to the system. Welfare is a cost to society that should be paid for by the entire population

15AICPA Federal Tax Division, op. cit., p. 30.
from general revenues and not from a regressive payroll tax. It has been approximated that one-third of the long-range costs are attributable to benefits received but not paid for by beneficiaries. It becomes evident that if the system is to regain the confidence of the American people it must be returned to an actuarially sound basis with benefits received based on one's contributions.

A fourth area that is somewhat indirectly responsible for the system's present situation is the failure of Americans to accumulate private savings to help them finance their retirement. One factor that has caused this non-saving attitude is the mistaken belief held by many Americans that social security was designed to be the only pension a person would need and thus the emphasis on private savings diminished. What appears to be happening is that an attitude of "let the government do it for me" has pervaded the American mind. Back in the 1920's, people had pride in knowing they should provide for their own retirement. The past few decades, however, have shown a decline in this pride. We are a people who are no longer willing to take the time and effort to make plans for providing for retirement. I realize there are those poor people who don't earn enough money to save for retirement and realize they must be taken care of through some form of

a supplemental income program. But those people who have the means should take responsibility for their own future to accumulate savings for their retirement years and not rely on a government system to do it for them.

One factor that may be responsible for the lack of personal savings is the non-deductibility of FICA taxes on a personal tax return. In order to stimulate private savings, and thus remove some of the pressure to pay higher benefits, personal FICA contributions should be afforded the same tax treatment as are the contributions of employers. That is, they should be deductible on the tax return. As the law now stands, a person is taxed on his gross wages without regard to any deduction for FICA taxes paid. What this amounts to is double taxation. The worker is hit with the FICA tax and also an income tax on the amount of FICA taxes paid. An example will illustrate this procedure. In 1981, a worker earns $10,000 and pays $665 in FICA taxes. The worker never receives $665 of his wages and yet he must pay an income tax on this amount. Common sense should show that this is not a logical view. But this view has nevertheless been defended on the basis that social security benefits are not taxable when received. Some may think it's great to get tax-free benefits, but a close look at the mechanics of the process show that in the end the government again comes out on top in regard to tax collections.

When a person is working he is usually in a higher marginal tax bracket than he will be at retirement. As a
result, he pays high marginal taxes on his FICA contributions that will either be not offset at all or offset in an inequitable fashion by the exclusion of social security benefits from taxation. Furthermore, with the existence of the zero bracket amount and personal exemptions the exclusion is meaningless to a person with retirement income from only social security. Social security contributions should be treated in the same manner as those made into private pensions. That is to say, the contributions should be deductible when paid and benefits taxed when they are received.

If FICA contributions were currently deductible the amount of money saved from not paying income tax on them could be invested into a fund to provide for future retirement. If people have more private savings, then there will be less pressure on the system to pay higher benefits in order to insure a minimum standard of living in these inflationary times.

A fifth area that has affected the system's ability to meet short-term financing problems has been the high level of unemployment in recent years. The recession of 1974-75 and the present recession have severely cut into the contributions flowing into the system. With unemployment rates in excess of 8% there are fewer people paying into the system and yet the number of benefit recipients increases daily. This leads to a short-term financing problem which

---

in past years has been paid for through increased FICA taxes. However, increasing taxes only increases the problem. Since the employer pays FICA taxes, too, he is affected by any increase in the tax rates. The employer views these taxes as an expense of doing business. At some point, the employer is no longer able to pay the increased taxes and as a result must further reduce his work force to a level where he can earn a profit. This action adds to the number of unemployed and further adds pressure to other working people and employers to take up the slack. As can be seen, further tax increases are not an acceptable solution because of the resulting increase in unemployment. Perhaps a reduction of FICA taxes might reduce the number of unemployed and thus increase the number of social security contributors, though I doubt this idea would ever be adopted. To summarize, there are a large number of major and minor problems that have in some form contributed to the system's financial woes. I have reviewed five of the major problems that many experts agree have caused the majority of the system's problems. These problems are: a program whose size has grown far beyond original expectations which places an increasing burden on active workers which leads to dissatisfaction with the system, a change in demographics, an increasing amount of welfare being incorporated into the system, American citizens failing to take responsibility for providing for their own retirement,
and finally unemployment.

The final section of this thesis will contain my own feelings as to what should be done with the social security system based upon thoughts developed in the course of researching this thesis.
Solutions to the Problems

At the present time, virtually everyone is searching for answers to cure the ailing social security system. Some of the remedies include: increasing payroll taxes, decreasing benefits, including federal employees in the system, raising the retirement age, and putting the system on an actuarially sound basis.

It is my belief that most of the system's problems could have been avoided if the system had been based on actuarial assumptions. Rather than adopting the pay-as-you-go philosophy, a process similar to setting up a private annuity for each social security contributor should have been established. Under this assumption, a person would receive at retirement the amount of contributions plus the interest that would have accrued over time. In this situation, a person who contributes nothing to the system (as in the case of the refundable earned income credit example) would not be eligible for any social security benefits. It may seem harsh to exclude low-wage earners from receiving benefits, but in order to be equitable to those who paid into the system, this position must be taken. If the low-wage earner has no savings for retirement, then he should receive federal assistance from general revenues in the form of welfare or a supplemental income payment.
It is the obligation of all the population to support the welfare system and not the obligation of a payroll tax levied upon active workers. If we are to make the Old-Age segment of social security a true retirement system then we must eliminate all forms of welfare.

There are those who would argue that it would not be fair to force a man to ask for welfare after working for forty years. They may insist that since he worked those forty years, he deserves to receive retirement benefits. This is an emotional issue, but I would still maintain that if he contributes nothing he should receive nothing. One proposal would pay low-wage earners FICA contributions from the general revenues. If this measure were adopted, the man who paid no FICA taxes from his pocket could still collect social security benefits. Again, this is merely a welfare payment, but it may be psychologically beneficial for a person to believe that he is receiving paid-for benefits rather than welfare.

A second solution that many experts claim could eliminate much of the retirement system's long-term deficit is to increase the age at which a person becomes eligible for full benefits. With increasing medical advances, people have been living longer and longer. In 1940, men who reached age 65 were expected to live 12.1 more years. Today, their life expectancy is fourteen years after 65.\footnote{\textquotedblright{Social Isn't Security Anymore,\textquotedblright{} op. cit., p. 1, Section G.} It has also
been estimated by Robert Myers, a former chief actuary of social security that a man who is 68.9 years old in the year 2000 will have the same life expectancy as a 65-year-old had when social security was started in 1935. For women, life expectancy at age 72.5 will be the same as it was at age 65 in 1935. From these facts, it can be seen that in raising the retirement age to 68, people could still expect to live as many years after retirement as their counterparts who retired twenty or thirty years ago. A subcommittee of Congressman J.J. Pickle of Texas, "figures that gradually raising the retirement age, over ten years starting in 1990, would wipe out $15 billion of the long term debt."20

One proposal, by Stanford University professor Victor R. Fuchs, would begin in 1983 and raise the eligibility age for early retirement by two months each year for the following seventeen years. The same is true for eligibility for full retirement benefits. Beginning in 1983, the eligibility age will rise two months each year for the next seventeen years. By the year 2000 the key eligibility ages would be 65 and 68. By increasing the retirement age, the ratio of workers to retired persons will increase. This will mean more people paying into social security and less taking from it.21

---

19Ehrbar, op. cit., p. 36.
20"Social Isn't Security Anymore," op. cit., p. 1, Section G.
21Fuchs, op. cit., p. 17.
Another factor to consider is the increasing proportion of people taking part in higher education. Since many people go to college for four years, they enter the job market much later than people did in the 1930's and 1940's. As a result, those people should be able to continue working another three or four years in order to equate their total working years to those who entered the labor market four years earlier.

Another proposal to discourage early retirement would be to stiffen the penalty for retiring before age 65. At the present time, a person who retires at 62 receives 80% of the full benefit amount. To discourage early retirement, it has been proposed that the percentage be reduced to 64%. Based upon life expectancy tables it would appear fair to penalize early retirement, but since this amounts to a benefit reduction (a sensitive political issue), it would seem that there is little chance of it being enacted.

A third solution that has been followed in the past is to steadily increase payroll taxes. As can be seen from the tables presented earlier, this is not a very responsible solution. Already workers are being forced to pay outrageously high FICA taxes with taxes scheduled to keep increasing for many years hence. Today, more than half of all American families pay more FICA taxes than income taxes. The following table is presented to illustrate the increases in FICA taxes paid in dollar amounts and percentages
paid:  

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>$5,000</td>
<td>$302.50</td>
<td>$306.50</td>
<td>$306.50</td>
<td>$322.50</td>
<td>9.9%</td>
</tr>
<tr>
<td>$10,000</td>
<td>605.00</td>
<td>613.00</td>
<td>613.00</td>
<td>665.00</td>
<td>9.9%</td>
</tr>
<tr>
<td>$15,000</td>
<td>907.50</td>
<td>919.50</td>
<td>919.50</td>
<td>997.50</td>
<td>9.9%</td>
</tr>
<tr>
<td>$20,000</td>
<td>1070.85</td>
<td>1226.00</td>
<td>1226.00</td>
<td>1330.00</td>
<td>24.2%</td>
</tr>
<tr>
<td>$25,000</td>
<td>1070.85</td>
<td>1403.77</td>
<td>1532.50</td>
<td>1662.50</td>
<td>55.3%</td>
</tr>
<tr>
<td>$29,700</td>
<td>1070.85</td>
<td>1403.77</td>
<td>1587.67</td>
<td>1975.05</td>
<td>84.4%</td>
</tr>
</tbody>
</table>

Notice the 84.4% increase in FICA taxes paid by those in the highest wage bracket. Most would agree that this is too dramatic of an increase for only a four-year period. And this is only the tip of the iceberg. In 1980, the FICA tax rate (including both employer's and employee's contributions) is 12.26% of taxable payroll. Under the intermediate assumptions proposed by the Social Security Administration in 1980, the percentages would rise to 16.6% in 2010, 25.4% in 2030, and 25% in 2050. Under pessimistic projections, the tax rate could climb to an incredible 45.3% of taxable payroll by 2050.  

Based on the above estimates it becomes clear that we must relieve the active worker of the tremendous burden of FICA taxes. If tax rates are not stabilized soon, workers may revolt and totally destroy the system. The alternatives are to cut benefits or put the system on a sound actuarial basis.

---

23 Ehrbar, op. cit., p. 34-39.
A solution proposed by economist Milton Friedman would gradually eliminate social security. He sees social security as an infringement of individual freedom in that it forces people to provide for retirement in a manner that is beyond their control. Under Friedman's proposal, retirement benefits already accumulated would be paid, but no further benefits would accumulate. People already retired would continue to receive their full pensions. However, others would face benefit cuts.

People near retirement would receive a sizable pension because they had already accumulated benefits implicitly owed them as a result of paying taxes over many years. Their pension, however, would be smaller than if the social security system continued on its present course. At the other extreme, young people just entering the labor force would receive no retirement benefits under social security because they would not have accumulated benefits as a result of paying taxes. Thus, there would be a gradual reduction in the level of retirement benefits, and after fifty or sixty years social security benefits would have fallen to zero.24

With benefits decreasing gradually, there is implied a reduction of social security taxes. During perhaps the next fifteen to twenty years taxes will decline very little. This is due to the fixed nature of the benefit levels for those already retired. As these retirees die, however, and are replaced by new retirees who will receive lower benefits, the amount of taxes collected from active workers to finance

---

these benefits will also decrease. On its face the declining tax rates may seem very appealing to active workers. However, there is a great inequity within the proposal as it relates to active workers.

The taxes paid after the adoption of Friedman's proposal, however, would not entitle one to added benefits on retirement; only taxes paid before that time would be accompanied by promises of future benefits.25

Friedman's proposal to eliminate social security will probably never be adopted. My opinion is that it is too discriminatory towards today's active worker. Imagine telling an employee that he must contribute into a system and yet receive no future benefits. I do not believe he would find many workers who would cooperate.

The proposal has one strong point in that it would force people to take responsibility for providing for their own retirement. However, by forcing active workers to contribute into social security and at the same time require them to accumulate savings, an unfair burden is placed on these workers. Perhaps it might be more feasible to pay current benefits out of the general fund. This would give active workers more money to invest in private retirement plans and relieve them of the heavy burden of funding both plans.

A proposal by Martin Feldstein would call for a substantial increase in the social security tax rate. Unlike

25 Ibid., p. 181.
the third solution of raising taxes just to make ends meet, Feldstein would raise taxes in an attempt to create a large reserve fund. Unlike past years when benefits increased with each tax increase, this proposal would not increase benefits beyond the levels already proposed.\textsuperscript{26}

Under this plan, taxes paid in the future would decline because part of the current benefits payable would be paid from interest that accumulated in the reserve fund.

The group that would benefit most under this proposal are those who are just entering the job market. The reason being that they would pay substantially higher taxes for perhaps the first ten to fifteen years, but for the last thirty years of employment they would pay a much lower tax due to interest accumulating in the reserve fund.

The group who would suffer most is that group of workers nearing retirement. Take, for example, a worker who is 55 years old. He would be forced to pay the higher tax until he retired and never be able to take advantage of declining future tax rates.\textsuperscript{27}

Future generations would receive the most favorable treatment as a result of paying the reduced taxes throughout their lifetimes. These generations will be entitled to the same benefits as past generations.

How would the public react to this proposal? I believe there are very few workers who would accept a substantial

\textsuperscript{26}Ibid., p. 181.

\textsuperscript{27}Ibid., pp. 179-180.
tax increase. As shown in an earlier table, taxes have already risen dramatically in past years so I do not believe another tax increase would be acceptable to the majority of people. Granted that an accumulated reserve would allow taxes in the future to decline, but when considering the time value of money, the worker loses out in both cases. The only group that may accept this proposal are those who have been in the labor market a very short time or those who will enter it in later years. Further, it should be emphasized that every time the government collects extra tax revenue, they find ways to spend it. As a result, the reserve fund would never accumulate and we would be in the same position as we are now.

Another possible solution that has been adopted in an attempt to reduce the strain on the system is the new tax law that will expand retirement opportunity. Beginning in January of 1982, all working Americans will be allowed to open up their own Individual Retirement Account (IRA). This is a tax deferred account that allows a person to set aside for retirement a maximum of $2,000 a year if single, $2,250 a year for a couple with one working spouse, or $4,000 per year if both spouses work.\(^{28}\) These contributions are deductible for current tax purposes and are not taxed until they are withdrawn upon retirement.

Under previous law, only people without group pension plans could open up an IRA. Now, virtually every working

---

American is eligible for either an IRA or a similar Keogh plan for self-employed individuals. The underlying political thought being that if Americans have more than one source of retirement income to draw from, there will be less demand for increased social security benefits. Perhaps at some future point in time the responsibility of providing for retirement will be returned to the individual where it rightfully belongs and this new law is a step in the right direction. It should be noted that this new law is not really a solution to the present financial problems of the system. It is merely an attempt to reduce the burden on the social security system that resulted from poor planning on the part of past government officials.

The best aspect of IRAs is that people receive only an amount equal to his or her contributions, plus accrued interest. If social security had been founded on this assumption, the present crisis would never have materialized.

So the question remains, will social security be there when we retire? Probably not because of poor planning on the part of our elected officials. Roosevelt's plan to provide a "minimum standard of living" is a good idea, but the term implies a social adequacy concept which is only another name for welfare. Therefore, if he wanted to protect hardship cases, he should have done so out of general funds since welfare is a cost to society of taking care of the needy. Likewise, if he wanted to protect the future of
workers entering the job market for the first time and also those already in the market by setting up a retirement fund he should have set up a true retirement system that was actuarially sound. If the retirement system were founded on this assumption, there would be no need for benefit increases. A person would realize that when he retires he would receive benefits in the amount of his contributions plus the interest accrued on the principal and nothing more. By having a general estimate of the amount of retirement benefits he will receive, he can form a plan of personal savings to supplement his social security retirement benefits. In this manner, we begin to take responsibility for our own future and this is how it should be. Let government assist low-income groups to attain a socially acceptable "minimum standard of living" through the use of general funds, but certainly not out of a payroll tax designed to provide income for retired workers who have contributed into the system.

To summarize, there is a small ray of hope that the system can be saved, but drastic changes must be initiated now. First, the system must be put on a sound actuarial basis. Perhaps general revenues could be used to pay retirement benefits while this change is being implemented. Income tax rates would probably have to be temporarily increased to pay for the benefits, but this seems more acceptable than continually increasing FICA taxes. Secondly, the retirement age should be increased to 68 until the
actuarial balance is restored. Once the system is put back on a sound actuarial basis there would be no need for a retirement age. If a person wanted to retire at age 60, he would receive benefits based on his contributions plus the interest that would accrue over time. The system would always be on sound financial ground because a person receives benefits of only his contributions plus interest. Even if taxes were increased, a worker would be more apt to accept them since he would realize that the extra money was being deposited in his own "pseudo-annuity" fund.

Third, the welfare element must be eliminated and this would be accomplished by establishment of the actuarial relationship. Those who retire with no source of income will be afforded a minimum standard of living from appropriations out of the general fund.

If the system were to change to an actuarially sound basis in the computation of benefits, then the social security system may once again become financially secure. If it continues on its present course of fiscal irresponsibility, however, the only destiny is bankruptcy.
BIBLIOGRAPHY SOURCES

Books


Documents

Magazines


Newspapers

Porter, Sylvia, "SS Brainwashing" Great Falls Tribune, July 26, 1981, p. 5-E.

Porter, Sylvia, "Unpredictable Pensions" Great Falls Tribune, June 3, 1981, p. 6-E.
