FROM THE DESK OF

DICK DINGMAN

10/13

Morton -

Per your
request.

Dick

THE COMMISSIONER OF SOCIAL SECURITY
BALTIMORE, MARYLAND 21235

SEP 30 1983

Mr. Richard B. Dingman
Legislative Director
The Moral Majority, Inc.
Suite 101
499 South Capitol Street
Washington, D.C. 20003

Dear Mr. Dingman:

I am responding further to your letter of June 21, 1983 to Secretary Heckler concerning the Social Security Amendments of 1983. Please accept my apology for the delay in responding.

By way of background, the Social Security Amendments of 1983 (Public Law 98-21) provide that all employees of religious and other nonprofit organizations will be mandatorily covered under Social Security beginning January 1, 1984. For Social Security purposes, ministers are not employees of religious organizations they serve as long as they are performing services in the exercise of their ministry. A minister is considered, rather, to be a self-employed person and is required to pay self-employment taxes unless exempted by the proper filing of Internal Revenue Service Form 4361. This is an application for exemption from payment of self-employment taxes upon income earned from services performed in the exercise of the ministry. By filing the form, the minister certifies opposition by reason of conscience or religious principles to the acceptance of public insurance based on income from the ministry. Once an exemption is approved, it cannot be revoked. The 1983 amendments did not change these rules.

The word "minister" encompasses "ordained, commissioned or licensed" ministers, and these terms describe the procedure followed by recognized churches or church denominations to vest ministerial status upon individuals who meet the requirements of the church. Services performed "in the exercise of the ministry" include performing sacerdotal functions and conducting religious worship. It also includes the control, conduct and maintenance of religious organizations, and religious boards, societies and other integral agencies of these organizations that are under the authority of a religious body constituting a church or church denomination.

The control, conduct and maintenance of a religious organization relates to directing, managing, or promoting the activities of the organization. A religious organization is considered under the authority of a religious body constituting a church or church denomination if it is organized and dedicated to carrying out the tenets and principles of a faith according to the requirements or sanctions governing the creation of institutions of the faith.

Services performed by a minister for an organization that is neither a religious organization nor operated as an integral agency of a religious organization are not considered in the exercise of the ministry unless the services are performed according to an assignment or designation by his or her own church.

With regard to the specified situations you posed, the answers are as follows:

A. Would ministers who are employed full-time by a church be exempted from paying Social Security taxes?

We assume that the services performed would be in the exercise of the ministry. As with previous law, ministers are considered to be self-employed and must pay self-employment tax unless an exemption has been approved by the Internal Revenue Service.

B. Would ministers who are employed full-time by a religious organization (e.g., Mission board) be exempted from paying Social Security taxes?

Same as A. above.

C. Would a minister who is working part-time outside the church, while simultaneously pastoring a church that is financially unable to support him fully, be exempted from paying Social Security taxes on his church income?

Same as A. above.

D. Would missionaries, foreign or domestic, who are employed in the secular work force to financially assist their ministry be exempted from paying Social Security taxes?

Probably not, at least with respect to services performed within the United States. The income derived by a minister from services not in the exercise of the ministry is subject to the usual rules of taxation. There are no special rules for lay missionaries.

With regard to services performed outside the U.S., it is unlikely that the income would be subject to U.S. Social Security taxation. Earnings from work performed outside the U.S. (except in countries which have social security totalization agreements with the U.S.) are subject to U.S. Social Security tax only when the employee is a U.S. citizen and the employer is an American employer or, under certain conditions, an affiliate of such. Earnings from work performed in countries which have totalization agreements with the U.S. may be subject to social security taxation by the U.S. or the other country, depending on the details of the agreement. We cannot comment on whether social security taxes would be imposed by a foreign country which does not have a totalization agreement with the U.S.

E. Would church secretaries and other church administrative support staff be exempted from paying Social Security taxes?

All employees of nonprofit organizations are mandatorily covered effective January 1, 1984.

I hope this information is helpful to you. Please let me know if I can be of further assistance.

Sincerely,

for Martha A. McSteen
Acting Commissioner

"ETERNAL VIGILANCE IS THE PRICE OF LIBERTY"

December 2, 1983

Honorable Morton Blackwell
Office of Public Liaison
The White House
Washington, D.C. 20500

Dear Morton:

I am writing to seek your help in arranging a meeting between Ed Meese and a small group of Christian leaders to discuss the Social Security Amendments of 1983 and their impact on churches and Christian schools.

As you know, a large number of pastors have voiced their intention to not comply with the law when it takes effect in January. Their objection is two-fold:

1. They feel it is unconstitutional to levy a tax on the church;

2. They feel they would be violating a biblical injunction to "render to Caesar that which is God's".

If these pastors do not comply with the law, it could create a definite embarrassment to the Reagan Adminiatration. Your Justice Department and your Treasury Department will be in the position of taking pastors and lay church treasurers to court. These people were a vital part, I believe, of the wonderful 1980 victory of Ronald Reagan.

To avoid the conflict which is near certain to come, our organization is working with other sympathetic groups to secure a two-year delay in the implementation of section of the law dealing with religious organizations. We believe that during those two years we can resolve the problem with permanent legislation that either (1) accommodates those churches with theological objections or, (2) answers the constitutional questions.

Senator Dole has agreed to address these questions in a Finance Committee hearing scheduled for December 14 at 2:00pm. Part of the hearing will focus on the merits of S.2099 (the Jepsen Bill) providing the two-year delay. We feel that the Jepsen Bill has a good chance of passing the Congress soon after it reconvenes; but it will only pass if it has the support of the President.

National Christian Action Coalition
Box 1745, Washington, D.C. 20013 (703) 941-8962

Therefore we respectfully ask an audience with Mr. Meese to brief him on our predicament and solicit the Administration's support.

Sincerely,

William Billings

p.s. If I may suggest a date: most of the interested parties will be in town December 14 for the hearing. A meeting on the 13th or 15th would be very convenient.

ATTACHED: list of possible participants

Dr. Paul Kienel- President ACSI
William Ball- Attorney
Dr. William Billings- President NCAC
Dr. Greg Dixon- President Coalition Unregistered Churches
Rev. Robert McCurry- Calvary Temple
David Gibbs- Attorney
Hon. Ed Whitcomb- Accelerated Christian Education
Mr. Richard Dingman- Moral Majority

JAMES M. WOOTTON

file

421 4th Street, S.E.
Washington, D.C.
November 18, 1982

Mr. Morton Blackwell
The White House
Washington, D.C. 20500

Dear Morton:

I hope ~~the enclosed~~ list of persons interested in genuine Social Security reform is helpful.

Please, let me know if there is anything I can do.

Sincerely,

J.

Enclosure

List of persons interested in Social Security:

Curt Clinkscales	National Alliance for Senior Citizens	241-1533
Stuart Butler	Heritage Foundation	546-4400
Ed Feulner	Heritage Foundation	546-4400
Phil Trulack	Heritage Foundation	546-4400
Richard Halwell	Heritage Foundation	546-4400
Ed Crane	Cato Institute	546-0200
Jewell Herbert	National Taxpayers Legal Fund	546-5190
Mike Burch	National Taxpayers Legal Fund	546-5190
Jim Davidson	National Taxpayers Union	
Connie Marshner	CFSFC	546-3004
Joe Peccione	CFSFC	546-3004
Norman Ture	Former Under-Secretary of the Treasury	466-5866
Martin Anderson	Former Domestic Policy Advisor	
Howard Phillips		
Bob Walker	Joseph Coors, Co.	626-4810
Stan Evans	Columnist	
James J. Kilpatrick	Columnist	
Fred Smith	Council for a Competitive Economy	549-3786
Bill Brubaker	STEP Foundation	556-9775
Charles Jarvis	Sen. Grasley's Legislative Director	
Mrs. Constance Armitage	President's Task Force on Aging	

Betty Brake	Action	
Grover Norquist	Americans for Reagan Agenda	835-0819
Dr. Balitzer	Foundation for Private Sector Innovation	835-0819
Mark Frazier	Sabre Foundation	546-8320
Haeworth Robertson	Former Chief Social Security Actuary--William M. Mercer, Inc.	686-5860

ELS PROPOSAL FOR

YOUTH OUTREACH PROGRAM

The External Liaison Staff plans to significantly strengthen its youth outreach program to inform students and young workers of Social Security's program goals, structure, benefits, and current issues of public concern. We propose to develop contacts with various organizations and agencies that deal with young people and to establish relations with youth groups that express interest in Social Security.

This population has been neglected by ELS in the past; our service has been primarily directed to beneficiary groups, organized labor and business, women, and State and local government organizations. Until recently, young people expressed little immediate concern with issues related to retirement, disability, or the contributions they are making in preparation for these eventualities. However, as young people enter the work force today, they face much higher Social Security taxes than workers first entering the work force only ten years or even five year ago. This fact, coupled with the ongoing debate over Social Security financing issues, has created negative public perceptions and lowered the confidence of young workers in the system. We badly need to counteract this growing lack of confidence.

Recent public opinion polls show the magnitude of this public perception problem. A study just completed by Peter Hart ranks Social

Security second only to unemployment as the most severe problem facing the United States today. World peace ranked third. A Washington Post-ABC News survey taken in late January 1982 found that confidence in the Social Security system corresponds inversely to age. Sixty-six percent of the respondents under age 45 believe Social Security won't be there by the time they retire. Among those age 18 to 30, 74 percent are skeptical of the program's integrity. (Although a majority of respondents over age 45 expect to receive benefits, the confidence level dwindles among those furthest from retirement age.) Clearly, there is a need to inform and invite the participation of younger people in the discussion of a program to which they will contribute substantially over a life time.

In addition to this severe skepticism, there is evidence that people do not believe they can communicate their concerns about Social Security through the right channels. A February 13 Washington Post article cites various young people, all expressing cynicism and disaffection toward Social Security. Ronda Hobbs of Houston is quoted: "I don't think it will exist (when she retires), but I think we'll pay in for 10 or 15 years and then it won't be there. You don't feel like you have any control over it at all."

In the face of particularly low levels of confidence in the system among young people, with the prospect of possible legislation later this year, and with the report of the National Commission on Social Security Reform due this year, early implementation of this outreach program is critical. The plan we propose is outlined in the following pages.

YOUTH OUTREACH SCHEDULE OF ACTIVITIES

March	Develop proposal and materials for kit
	Make initial contacts with groups and national organization representatives
	Make appointments and preparations for program presentations to groups and representatives
	Begin search for celebrity or personality to promote youth awareness of Social Security issues
April	Continue development of kit materials and search for promo personality
	Begin presentation visits
	Prepare student/leader training kits
	Obtain cooperation statements at the Departments of Education and Labor and HHS-ACYF
	Obtain speaking appointments for SSA Commissioner at conventions of national organizations
May	Continue presentation visits, production of kit materials and personality search
	Arrange for training of students, teachers and youth leaders at summer conventions, institutes and seminars
June	Begin training sessions
	Publicize Commissioner appearances
	Contact publishers, press and textbook people with items regarding Social Security and the youth outreach effort

Schedule of Activities (cont'd)

July	Continue training sessions and speech publicity
	Train celebrity and possibly film with Commissioner
	Prepare radio spots
	Begin distribution of discussion kits to trained discussion leaders
August	Continue above activities and tie up loose ends
	Step up distribution of discussion kits and training efforts
September	Continue training sessions and material distribution
	Step up publicity efforts and begin discussion sessions at local level
	Monitor and encourage use of kits by schools, groups, field reps, military, etc.
	Make speaking engagements for youth leaders at adult service, fraternal and religious groups
October	Continue above activities and begin preparation of report for forensics societies
November	Continue above activities
	Update materials as necessary (pending report of NCSSR and possible lame duck session of Congress)
December	Present proposal to National Forensics League for a 1983-84 high school debate topic dealing with Social Security

YOUTH OUTREACH PROGRAM PLAN

Item	Project	Time Frame
National Youth-Serving Groups Collaboration (13) DECA, FFA, Debate Clinics Religious Groups Leadership Programs	—Make initial contacts with national organizations —Make presentations to leaders —Develop projects suited to individual organizations —Distribute kits and train leaders and youth —Secure speech appearances for SSA Commissioner —Monitor projects and advise on use of kits	Mar-Apr Apr-May May → Jul Jun → Aug Apr → Dec
High School/Vo-Tech Dept. of Education Teacher Summer Institutes Youth Summer Institutes NEA Pre-school workshops	—Request support of Dept. of Education for High School and Vo-Tech participation —Make presentation to State Executive Officers' national meeting to gain state support —Contact NEA to get support and state contacts —Distribute training kits and make summer institute presentations to teachers/students —Secure appearances for SSA officials before major education conventions —Monitor use of kits by schools, NEA, trained teachers/students	Mar Apr Apr-May Jun → Aug Jun → Dec Sep → Dec

Item	Project	Time Frame
College/Vo-Tech Fraternities Sororities SGA/SA Newspaper Staffs Clubs Leadership Programs Speech & Debate Clinics	—Make initial contacts —Make presentations to organization leadership —Recruit and train speakers (leaders and celebrities) —Secure speech appearances for Commissioner or SSA officials —Develop individualized projects and distribute kits —Monitor and encourage use of kits and projects —Publicize major events	Mar–Apr Apr–May May → Aug May → Dec May → Dec Sep → Dec May → Dec
Youth Employment Programs Dept. of Labor Dept. of HHS (ACYF)	—Request cooperation of Dept. of Labor and HHS (ACYF) for distribution of literature thru CETA agencies and ACYF grantees —Inform agencies/grantees of program by letter —Distribute cartoon booklets with Soc. Sec. leaflets thru CETA and State/county youth agencies	Mar Apr–May Jun → Dec
Military	—Make initial contacts —Make program presentations —Develop projects/adapt program —Distribute kits and literature	Mar–Apr May–Jun Jul–Aug Sep → Dec

Item	Project	Time Frame
Debate Societies National Forensics League American Forensice Associatio	—Make initial contacts --Prepare presentation and background research —Make presentation to win adoption of Soc. Sec. debate topic 1983-84	Mar-Apr Sep → Dec Dec
Publishers/Press	With advice and assistance of OPA and the Press Office place fact sheets, graphs, cartoons, articles, speeches in: —Teen magazines —School newspapers —Textbooks —Weekly Reader/Nat'l Scholastic —Organization newsletters —General press	Jun → Dec
OGA	--Develop materials for initial presentations to groups --Develop training kits for students/teachers/speakers --Arrange training sessions and assemble kits for distribution --Begin training of students, teachers and youth speakers —Recruit and train celebrity(ies) for possible filming or taping --Continue training distribution of kits and monitoring of kit use —Prepare NFL/AFA debate topic research and make presentation	Mar-Apr Apr-May Apr-May May Jun → Aug Jun → Aug Sep → Dec Sep → Dec

SOCIAL SECURITY YOUTH OUTREACH

RESOURCE KIT

This kit contains materials to help you present to a young audience an introduction to the workings of the Social Security system. It includes:

1. "Social Security 1982"

   A 30-minute videotape of students questioning the Commissioner of Social Security at the White House during the summer of 1982.

2. "Big Money"

   A comic book which outlines the basic goals and provisions of the Social Security program.

3. Vocabulary List

   A list of terms that will be necessary to a discussion of Social Security with definitions and descriptions.

4. Program Description Outlines

   A series of five camera-ready summaries which trace the history of Social Security legislation; descirbe the program's current provisions; state present benefit eligibility requirements; give current and past wage base and tax rates schedules; list important program statistics.

5. Discussion Guide

   A list of questions to direct student's thoughts to the role of Social Security in American society and in their own personal future. Also a "how-to-use" the resource guide materials suggestion sheet.

6. Talking Points

   Outline of major points that can be used by speakers, debaters and discussants of Social Security topics.

7. Issue Papers

One-page summaries of arguments for and against various proposals to remedy the short- and long-term financing problem.

8. Resource Bibliography

A list of books, articles and research papers that will serve as sources for speakers and discussants of Social Security topics.

9. Incnetive Program Information

A description of the contest which and list of sponsoring organizations which will disburse awards for speakers and essayists contributing most to an increase in public awareness of Social Security.

10. Sample Publicity

Camera-ready samples of flyers to announce discussions, films, debates, contest speakers, etc.

THE WHITE HOUSE
WASHINGTON

Norton, file Social Security

Here's a copy of my proposal and Soc. Sec. comic book draft.

Dick Beall is looking it over - when I hear from him I'll ask you to send it to Dave Swope. Thanks,

- Eileen

BIG MONEY
or
Your Money $

MR. K.

This is Bennetti.
Joe Bennetti.
The teachers think he's a loser.
But he's so smart he doesn't need to go to school.
(He thinks)

Move to right

Susie is awful cute. Cuter than Bennetti. Mr. K. thinks she's sweet, too.

Jackson makes it to class most of the time. But he makes it to games all the time.

Buzzo here is pretty smart. Sometimes though he's really dumb. But he knows how to get a good grade

Sonny is kind of a pain, but he's always good for some laughs.

Profile
(shoot rubber band)

turn head to face reader

GRAFFITI OF THE DAY

CAN YOU RELATE

Let's talk about money

Sure, you handing it out?

I'll take some

I mean Big Money- all the money you're going to earn in your life.

A million

Ten million

A zillion

$

if you're Mr. Average Taxpayer.

And what are you going to have to live on when you get old?

Who's gettin' old, man?

Mr. K

!

Pension

Stocks

Horses

Real estate

You forgot about Social Security (use logo)

Yeah that's right Soc. Sec will take care of you Mr. K.

But Social Security is going broke.

Not as long as you keep paying your FICA payroll tax

So we keep payin' so you can retire- but we ever going to see any of that money?

Sure, Congress isn't going to let Social Security checks stop.

But we don't know what those boys in Washington be doing.

You read the paper, Jackson

Sure, the sports page

Anybody here know anything about Social Security?

Sure - it's a government program that pays checks to retired people.

And who pays for the checks?

Everybody. The government takes the tax out of everybody's paycheck

And who collects Social Security?

Old people

My grandma

Teachers that are too old to teach

Sonny

I wish Mr Clappo would start collecting his

Yeah, I'd contribute to that

Well, you're all contributing about 7% of your wages this year.

That's about $465 for Bill cooking hamburgers 40 hrs/week

Hey Buzzo, that's enough for a stereo or car insurance

So, what do I get for my $465 a year?

About $___ month if you earn minimum wage until you retire.

50 years of cooking hamburgers!

Well, let's say you graduate and get a job at $20,000.

You think I'll graduate?

Your tax would be $1340 a year + your retirement $___ month.

Hey, but what if I die? I'll never see any of that money!

Tommy

No, but your wife and kids would.

Wife! kids?

Well, it happens, you know accidents happen, too. You could get hurt. You'd be unable to work

Like Jack on here he broke his leg and he's on the bench for 2 mos.

He don't have no wife

No, he does'nt but you get the picture.

SOCIAL SECURITY

You're paying in so just in case something happens there's still money coming in

It's like the care insurance- you got to pay just in case.

That's right- good old Last Ditch Auto Insurance be paying for my leg and the old man's car.

(crashed car)

Is Jackson getting Social Security?

Yeah, he's disabled

No, he isn't permanently disabled

But Sonny and Susie are getting Soc Sec

How come, they aren't disabled

Except mentally

Mr Siropolis got hurt last spring and he still can't work

So the government is paying Sonny + Susie?

And Mr. S. and Mrs. S.

All right, how much you two getting?

Because Mr. S. paid Soc Sec. taxes he's qualified for disability protection for his family and Medicare for his hospital bills.

Okay - but what about the Big Money you wanted to talk about

Big Money

All right - how much do you think Uncle Sam is paying for Social Security this year?

a billion? $10 billion

a zillion!

A zillion is close. $176 billion is going out in Social Security and Medicare

$176 BILLION
000,000,000

$1/6 billion! How much is that?

Enough for a good time on Saturday night

$176 BILLION
000,000,000

If you spent $1 million every week from the birth of Christ until now, you'd spend about $1 billion.

Wow

But, we're spending it in one year - that's $500,000,000 a day

What I could do with that much

So we're spending $500 mill a day to take care of old people and their families?

And disabled people + their families

Sonny! Say you're the average Taxpayer.

TAXES & BENEFITS

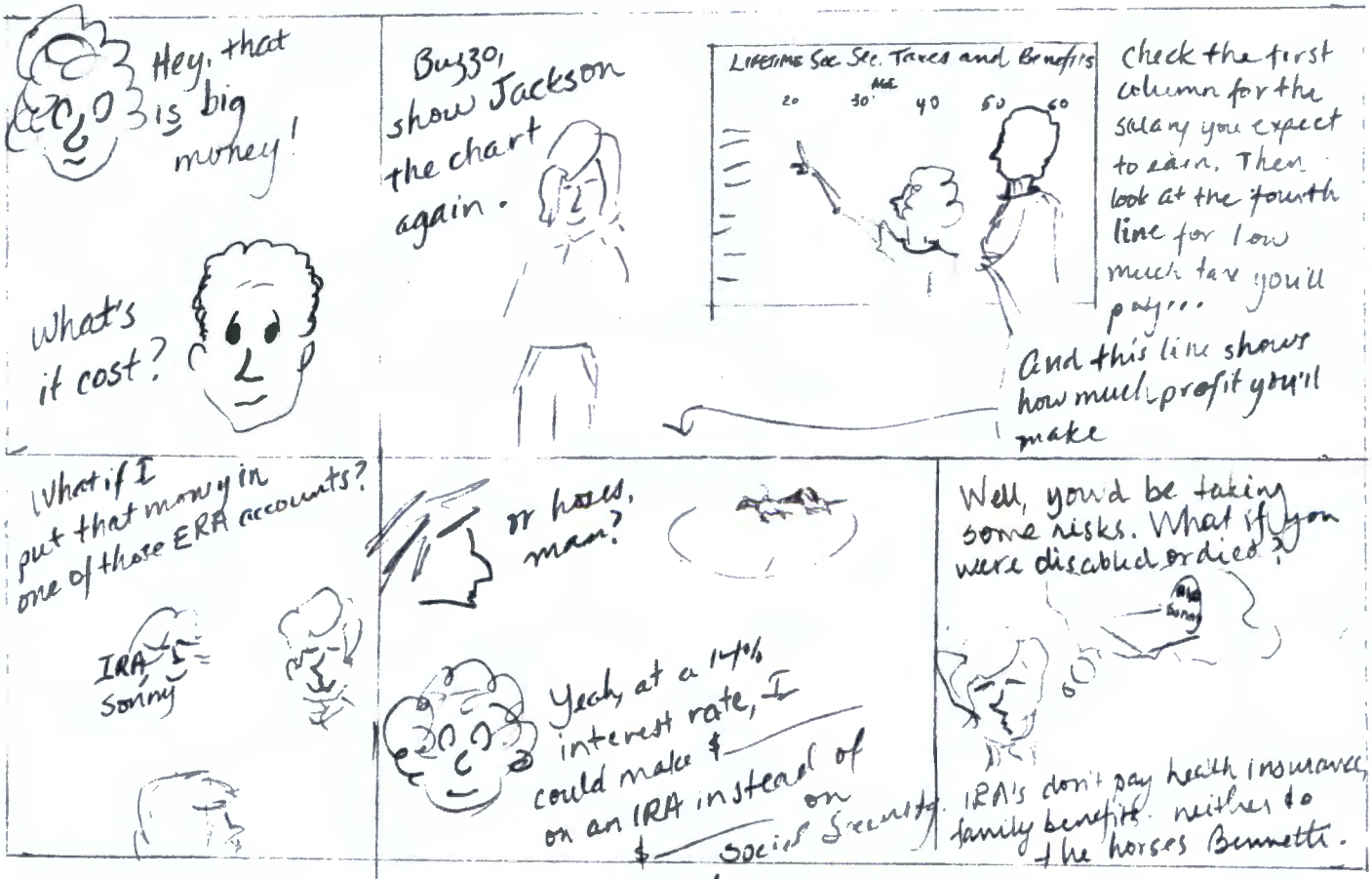
When you reach 65, you can expect to get $___ from Soc Security

What about me?

And me?

Turn the page to find your lifetime taxes and benefits...

LIFETIME SOCIAL SECURITY TAXES AND BENEFITS



So, what's the scoop, Mr. K? What about all that big money?

Yeah, how much are we paying for Soc. Sec?

Well Buzzo, you're going to be a doctor – so we're talking about $250,000 of your money

And Jackson when you make the big league, you'll be paying in the same amount

We could get ourselves a real nice house in a real nice neighborhood for that money

You wanna be neighbors?

But how do we know we're going to get any back?

Are they doing anything to save Social Security?

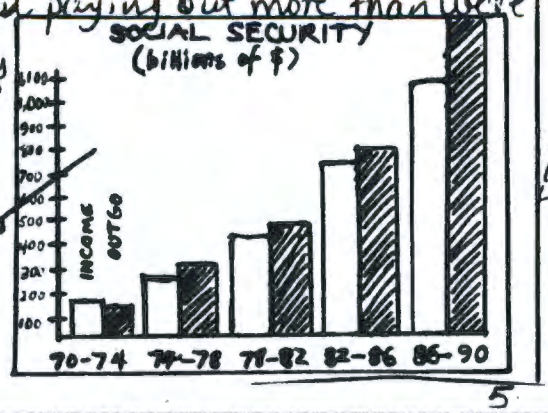
As a matter of fact there's a lot of concern about Social Security in Washington right now. Let's take a look at this special report to the President.

Special Report

from the Commissioner of Social Security to the President of the United States

Jack, let's hear the report on Social Security's Trust Funds

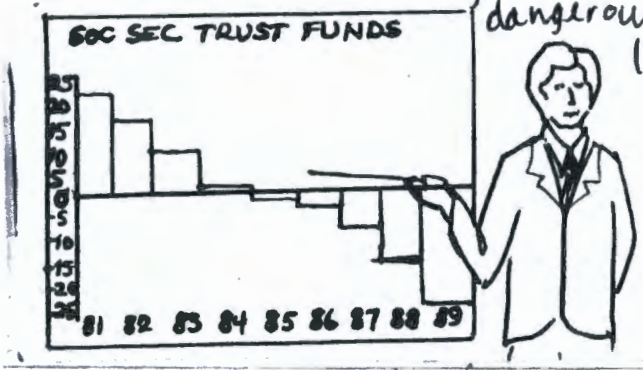
Sir, as you know today's tax dollars pay today's benefits – and since 1974 we've been paying out more than we're collecting in taxes



You mean my $400 this year goes straight to Jackson's grandmother in Peoria?

That's right, man

Our reserves have been paying the shortfall and now they're running dangerously low.



So, Social security is running out of money?

Right again.

At the current tax and benefits rates, we project that benefits will stop in July 1983.

What about my $250,000

And what about my $470?

Congress has given Social Security permission to borrow from Medicare; but unless something is done, both funds will be used up by 1987 - or even sooner.

What happens after 1987? I don't start collecting til 2025?

Man, this sounds bad!

What are they going to do?

Obviously, Mr. President, something must be done —

and done soon.

Why don't they just borrow from the government?

Yeah, Uncle Sam runs the printing presses.

You ever heard of inflation?

Any more inflation and I can't buy Buzzo's burgers

This is serious, Jack. We've got 36 million Americans out there depending on Soc Sec.

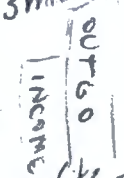
What do you propose we do?

We have two choices to save the system sir:

1. Increase Taxes
2. Decrease benefits

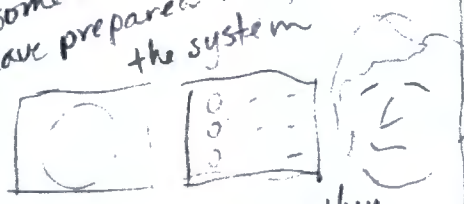
And Congressmen don't like to vote for either

Until the Congress and the voters realize that it's a choice between smaller benefits



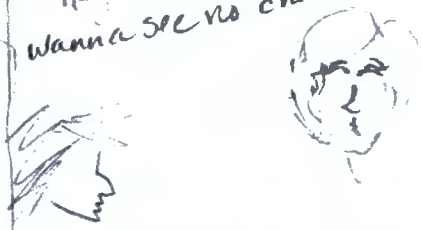
or no benefits - we're not going to get anywhere.

Here are some charts we have prepared to explain the system

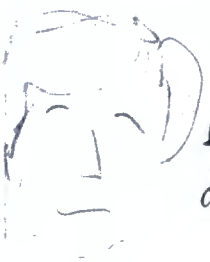


to the taxpayers so they can make some difficult decisions

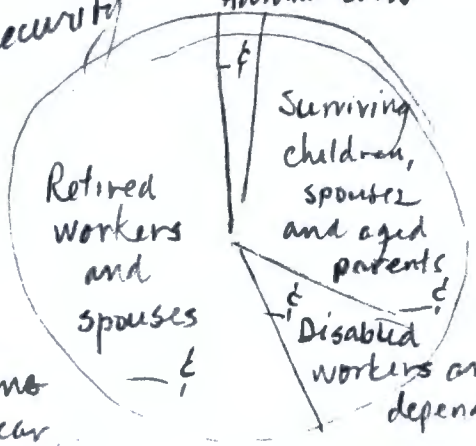
Hey! I don't wanna see no charts



You want to just keep paying your dough and never see nothing comin back?

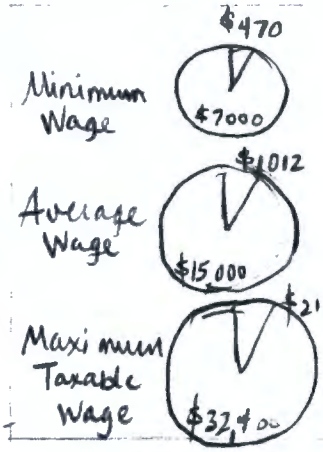


Here's how every Social Security dollar is spent



As you can see, Social Security is more than a retirement plan.

$176 billion is sent to 36 million Americans this year



This is how Social Security taxes affect American workers.

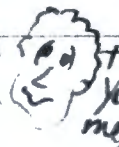
Notice that the employer pays ½ the worker's total FICA tax, and the lifetime totals are based on a 40-yr working career

Yearly Tax	Lifetime Tax *Constant $
$940	$48,000
$2024	$86,000
$4340	$263,000

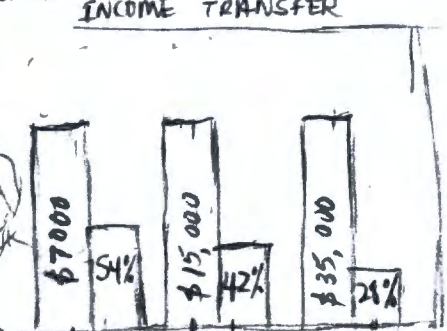
40 years! Wow, I'll be as old as Mr. K!

he' he'

But Social Security is also less than an adequate retirement plan. We replace only *28% - 54% of a worker's income at retirement....



that's you and me, Buzzo.



... we transfer money to the lower earners and pay a little less to high earners

* The benefit formula for 1982 was 90% of the first $230 of average indexed monthly earnings, 32% of the next $1,159, and 15% of the remainder

* Constant dollars

So, you mean Buzzo and me, we got less back than bums like Bennetti here?

That's cool, man.

No. you get more than Bennetti – you just get to subsidize him a little bit

Like I said, that's cool.

So. what's the problem – we got a little Robin Hood here – take from the rich, give to the poor – the rich ain't goin broke.

Yeah, how come Social Security's goin' broke?

Lets take a look at the film again

Commissioner, what has caused this crisis?

Well, sir, there are a combination of factors.

Benefit Increases
Inflation
Unemployment
Health Care Costs
Declining birth rate

In the past 10 years Congress has increased the benefit amounts to 4 times their value in 1970!

Boy, could I go for raises like that!

I could!

I'd be making $12/hour!

Inflation has forced the payments up 15% each year,

Medicare costs have tripled since ___

And unemployment – for every ___ worker out of worker, we lose $1 billion in taxes not paid

This sounds just like Mom explaining our budget to Dad – I don't understand it.

Yeah, this sounds like so much talk.

Take a look at this chart – it shows what has happened to Social Security taxes between 1950 and 1980.

TAX DEMANDS ON AVERAGE WORKER

UP SOCIAL SECURITY 2011%

4x WAGES

3x TAXES

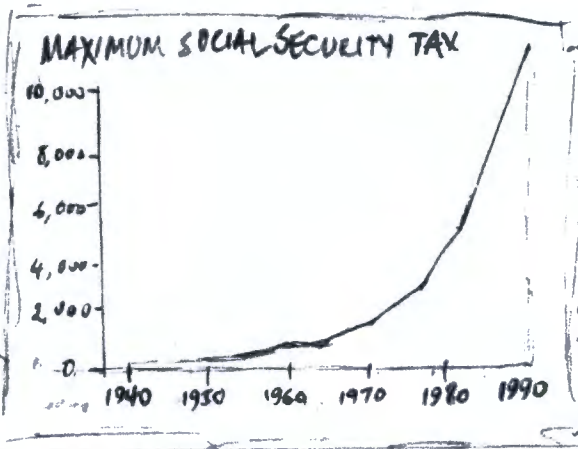
UP WAGES 490%

UP INCOME TAX 594%

Are we paying more because there are more old people?

...And because there are less young people being born.

Look at the growth of the Social Security tax from 1940...



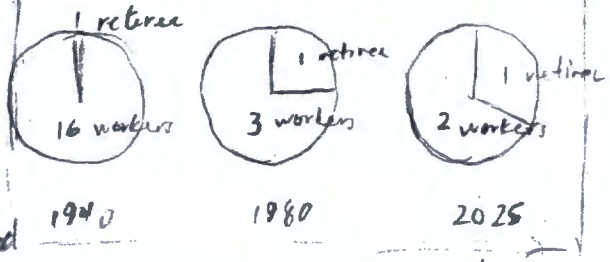
...to 1990. We expect taxes to go from 13.4% currently to 24% by 20__.

You mean they want to double my taxes?

That's what the man said

And, we're not certain that even those increases will keep the system going

When the program started in 1940, there were — workers supporting every retiree. Today the ratio is 3 to 1, and in 2020, it will be 2 to 1. So each worker will be paying for a retirement pension



Hey, Mr K. here, he's one of those "baby boom" babies. Which one of you is gonna pay his Social Security?

I will

You give me and A for the semester?

Bennette, you know it doesn't work like that

Yeah, Joe, all the money goes into one big fund and the government sends it right out to all the people who are getting S.S.C. see now

That's right, Bill. I appreciate your overwhelming generosity, Jackson

Susie, you get an A for the day.

Since we're fighting taxes, inflation and unemployment, Commissioner

What can be done to save the Social Security system?

Raise retirement age
Limit COLA's
Cover federal workers
Lower benefits
Borrow from Medicare
Raise taxes
Reform the system

Mr. President, the Congress is discussing several ideas...

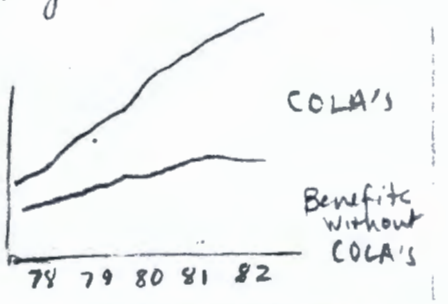
What does Coca-Cola have to do with Social Security?

That's an acronym, Sonny, like SWAT. It stands for cost of living adjustment

It's an automatic increase that raises Social Security benefits each year to keep up with inflation.

Automatic raises!

COLA's have totalled about 15% each year recently. They cost the government a lot.



What's that one about govt workers. Don't they get taxed already?

Some do, but most federal employees have a separate pension plan + pay no Soc Sec at all

That sounds pretty good - the horses do better for me than any old Social Security.

Yeah, what's wrong with ERA's?

IRA, Sonny

Well shouldn't everybody have to pay?

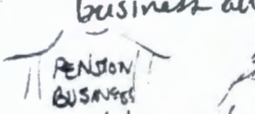
Most people think so but some think nobody should have to contribute to social security

Nothing's wrong with it as long as people end up with enough money to retire on.

What if they don't?

Or what if they get hurt?

For example, some Congressmen are proposing that government get out of the pension business all together.



They say, let everybody invest the best way he can, and the government will only pay welfare to the needy.

Then the government would have to help them out...

Which means you'd pay and I'd pay thru our taxes.

I don't want to pay more taxes.

And I don't want lower retirement checks

How about borrowing from Medicare?

Or general revenues

What's that?

Borrowing from Medicare would last about 5 years - then it would go broke, too.

$ $ $ $ -

And general revenues is just income tax - we'd all still pay more taxes.

So what are we going to do?

What do you mean we? What can we do anyway?

You can vote.

and write letters — my Dad loves to write letters to his Congressman

He's your Congressman, too, Bill.

You can get information, too.

Yeah, like read this comic book.

And the newspapers.

You can do what our class is doing.

We're calling up the local Soc Sec office

The Social Security representative will come out and answer our questions

and give us help with the speeches we're writing. Cool

Buzzo and Jackson are going to argue for taxing government employees.

And Joe is going to make a case for reforming the system to pay only the needy

Like the guys who lose at the track

I think they ought to just stop COLA's

Since when did you start thinking?

BIG M

What do you think? It's your money.

Assignment:

1. Look at fact sheets
2. Fill out survey
3. Write your solution for Social Security

MR. K

GRAFFITI OF THE DAY

IT'S UP TO YOU

The Heritage Foundation Backgrounder

No. 159

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December 14, 1981

File

Rx FOR SOCIAL SECURITY: THE FIRST STEPS

INTRODUCTION

The Social Security system has enjoyed overwhelming public support since its inception and is frequently called the single most successful income security program in American history. However, as the system's deficiencies become more apparent, public confidence in it is being rapidly eroded. A recent nationwide poll conducted by Sindlinger and Company, Inc., for The Heritage Foundation revealed that 84 percent of those surveyed expressed little or no confidence in the financial soundness of Social Security. Several members of the Administration have testified that unless immediate action is taken the most devastating bankruptcy in history could occur on or about November 3, 1982. This could be a disaster for the many people dependent on current or expected future benefits. The program currently covers 90 percent of the labor force and provides income support to 36 million elderly or disabled Americans and their dependents. Although Congress has repeatedly insisted that it would never allow the Social Security system to fail, it is becoming increasingly clear that unless the practice of providing excessively generous benefits is reversed, the resulting financial burden may lead to the system's collapse.

Social Security's underlying problems result from its conflicting objectives -- to be both an insurance program and a welfare program. Even though constant constituent pressure to raise benefits, whether earned or unearned, has effectively destroyed the link between contributions and benefits, there are still many who complain that their benefits are inadequate. The fact is that most current retirees are earning an extremely high return on their "investment," but economic realities and demographic shifts will make this all but impossible in years to come. Stanford University economist Michael Boskin predicts that "if we wait until the baby-boom generation retires before we begin to

deal with the tremendous long-term deficit in Social Security, we will see the greatest tax revolt and age warfare in the history of the United States."[1] In short, the government has promised benefits that will be difficult to provide under projected conditions. The only way to avoid the cataclysm described by Boskin is to examine the system thoroughly and then to reform it. President Reagan's appeal for immediate action in dealing with the problems facing the economy is equally applicable to Social Security:

> Can anyone here say that if we can't do it, someone down the road can do it? And if no one does it, what happens to the country? All of us here know the economy would face an eventual collapse. I know it's a hell of a challenge, but ask yourselves: If not us, who? If not now, when?[2]

BACKGROUND

The Social Security Act was signed into law on August 14, 1935, and established a federal Old Age Insurance (OAI) system designed to provide workers with monthly benefits upon retirement at age 65. Social Security originally was intended as an insurance program to replace a portion of workers' earnings lost as a result of retirement. Participants were urged not to rely solely on Social Security for old age support, but to supplement their retirement incomes from other sources. President Roosevelt alluded to this point in his message to Congress on June 8, 1934:

> Ample scope is left for the exercise of private initiative. In fact, in the process of recovery, I am greatly hoping that repeated promises of private investment and private initiative to relieve the government in the immediate future of much of the burden it has assumed, will be fulfilled.[3]

Similar sentiments were expressed by members of Congress. The report of the House Ways and Means Committee on April 5, 1935 described the purpose of Social Security:

> While humanely providing for those in distress... [Social Security] does not proceed upon the destructive theory that the citizens should look to the government for everything. On the contrary, it seeks to reduce dependency and to encourage thrift and self-support.[4]

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1 "The Crisis in Social Security," Newsweek, June 1, 1981, p. 25.
2 Charles Alexander, "Making it Work," Time, September 21, 1981, p. 38.
3 Cited in Peter J. Ferrara, Social Security: The Inherent Contradiction (San Francisco, California: CATO Institute, 1980), p. 18.
4 Cited Ibid., p. 19.

In sum, the basic goal of Social Security was to provide safeguards against the worst misfortunes and vicissitudes of life, but not to provide the sole means of support for the elderly.

The program has been financed through a special Social Security payroll tax, which is assessed against a portion of earned income. This tax was to be shared equally by employee and employer alike, although economists generally agree that the employee bears the full burden of the tax.[5] The self-employed pay a flat tax rate that has ranged from two-thirds to three-fourths of the combined employer-employee tax. In 1937, the combined tax rate for employers and employees was 2 percent levied against the first $3,000 of earned income.

A payroll tax is the appropriate mechanism for financing such benefits because it captures the quid pro quo nature of an insurance program. As a result, people have come to view their contributions to Social Security as premiums on insurance, giving them title to annuities from the government in their old age. Over the years, the program has extended protection to cover its participants and their dependents from costs associated with disability, hospitalization, and death.[6]

At the same time, Social Security taxes have soared. (See Table 1.) The inexorable growth of Social Security taxes has imposed an increasingly severe burden on workers. In the early years, these taxes grew relatively slowly. In 1937, the maximum tax payable was only $60, which remained constant until 1950, when it was raised to $90. Since then, the maximum has grown at a steady and ever more rapid rate, increasing an astounding 900 percent between 1965 and 1981. Inclusion of hospital insurance raises the total to $3,950.10 today. This extraordinary increase can be attributed primarily to the program's departure from strict insurance principles and the inclusion of a sizable unearned component in the payment of benefits.

The future costs of financing Social Security appear even more disturbing. Table 2 projects tax rates of the Social Security system if benefit payments and financing methods are not altered. By the year 2030, Social Security payroll taxes approach one quarter of taxable payroll. This number could surpass 40 percent if more pessimistic but actuarially possible assumptions are accurate.

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5 This point will be discussed in more detail later. Also, see John A. Brittain, "The Incidence of Social Security Payroll Taxes," American Economic Review LXI (March 1971), pp. 110-125 and Ferrara, op. cit., pp. 405-412.

6 Benefits were added for survivors of deceased workers in 1939, at which time the program became known as the Old-Age Survivors Insurance (OASI) program. Disability insurance (DI) was added in 1957; hospital insurance (HI) in 1966. Each has its own trust fund and is financed by its own tax, although all three are assessed together as if one tax: the OASDHI tax.

Table 1

Years	Maximum Taxable Income	Tax Rates (percent of taxable payroll) Employee and Employer Combined	Self-employed	Maximum Tax for employees and employers combined
1937-49	$ 3,000	2.00		$ 60.00
1950	3,000	3.00		90.00
1951-53	3,600	3.00	2.25	108.00
1954	4,200	4.00	3.00	144.00
1955-56	4,200	4.00	3.00	168.00
1957-58	4,200	4.50	3.375	189.00
1959	4,800	5.00	3.75	240.00
1960-61	4,800	6.00	4.50	288.00
1962	4,800	6.25	4.70	300.00
1963-65	4,800	7.25	5.40	348.00
1966	6,600	8.40	6.15	554.40
1967	6,600	8.80	6.40	580.80
1968	7,800	8.80	6.40	686.40
1969-70	7,800	9.60	6.90	748.80
1971	7,800	10.40	7.50	811.20
1972	9,000	10.40	7.50	936.00
1973	10,800	11.70	8.00	1,263.60
1974	13,200	11.70	7.90	1,544.40
1975	14,100	11.70	7.90	1,649.70
1976	15,300	11.70	7.90	1,790.10
1977	16,500	11.70	7.90	1,930.50
1978	17,700	12.10	8.10	2,141.70
1979	22,900	12.26	8.10	2,807.54
1980	25,900	12.26	8.10	3,175.34
1981	29,700	13.30	9.30	3,950.10

Since its inception, Social Security has also fulfilled a social adequacy function, paying some individuals benefits solely on the basis of need, whether or not they have paid for these benefits through their taxes. In fact, many of the benefits provided by Social Security are completely unrelated to a worker's contributions and are largely responsible for the emasculated condition of the Social Security trust funds. The Social Security system is an inappropriate vehicle for achieving these putative welfare objectives because it is financed by a regressive payroll tax.[7] While such a tax is suitable for the insurance goal of Social Security, there can be no reasonable justification for providing welfare benefits by a tax that places its heaviest burden on the very group it is designed to help. In short, the increasing instability of the Social Security system is linked to

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[7] This tax is considered regressive because it is levied proportionately up to the ceiling, at which point the tax rate becomes zero and thus takes a greater proportion of income at the lower end. The regressivity is increased when unearned income is included as part of total income.

Table 2

Projected Tax Rates Necessary to Finance
Present Social Security Program

Calendar Year	Tax Rates (percent of taxable payroll) Employee and Employer Combined	Self-employed
1982-84	13.40	9.35
1985	14.10	9.90
1986-89	14.30	10.00
1990	15.30	10.75
2000	15.60	10.75
2010	17.20	11.50
2020	21.10	14.10
2030	24.60	16.40
2040	24.70	16.40
2050	24.40	16.20

NOTE: Figures from 1980 through 1990 are the tax rates scheduled in present law. The figures for the year 2000 and later represent the tax rates necessary, based on the intermediate assumptions in the the 1979 Trustees Reports, to finance benefits and administrative expenses assuming no change is made in present law. This does not include the taxes necessary to support the Supplementary Medical Insurance program, which is not financed by payroll taxes.

SOURCE: Adapted from A. Haeworth Robertson, The Coming Revolution in Social Security (McLean, Virginia: Security Press, Inc., 1981), p. 63.

its two conflicting goals: individual equity and social adequacy. The key to reforming Social Security thus is to separate the transfer and annuity functions and finance them through general revenues and payroll taxes respectively. The transfer component then could be completely needs-oriented. Only after crossing this Rubicon will Social Security resemble the retirement program it was intended to be.

THE PROBLEM OF INEQUITY

Social Security suffers from serious inequities, which occur between people within the same generation as well as between those of different generations. These inequities result from Social Security's quixotic social adequacy function, which often pays benefits regardless of whether or not they are earned. These transfers are advocated in the belief that recipients need financial assistance. However, no proof of need is ever required because it is determined by surrogate measures supposedly reflecting need, such as age, family size, and earnings in employment covered by Social Security. Distributing benefits in such a

manner is very inefficient and often leads to payment of considerable unearned benefits to people who would not qualify as needy under most definitions. Social Security's contradictory goals make it both a poor tool of income redistribution and an unsound insurance program.

Benefit Formula

A worker's benefit is determined on the basis of his earnings record in covered employment. Once a worker's average indexed monthly earnings (AIME) are computed, a primary insurance amount (PIA), which is the worker's benefit, is found by applying the AIME to a special formula. In 1981, this formula was:

90 percent of the first $211 of AIME, plus
32 percent of the next $1,063 of AIME, plus
15 percent of all AIME over $1,274.[8]

This formula is adjusted annually by the rate of increase in wages. A person's PIA is reduced by five-ninths of 1 percent for each month benefits are received before the age of 65 and is raised by one-fourth of 1 percent for each month receipt is delayed.

The benefit schedule is clearly weighted to favor lower income classes. This bias is evident in in Table 3, which compares benefits of two workers with differing earnings, one with an AIME of $1,100 and the other with an AIME of $220. Although the former worker paid about five times as much in taxes, his benefit is only about two-and-a-half times as large. The benefit-to-taxes ratio falls still further as a recipient's AIME crosses the $1,274 threshold and is pushed from the 32 percent benefit bracket to the 15 percent bracket.

Other factors, however, tend to work against the poor. They are more likely to pay payroll taxes over a longer period than the rich, who can delay their entry into the labor force by extending their schooling. The typically shorter life span of lower-income groups, moreover, means that they do not collect benefits for as long as the rich do. Finally, the tax-exempt status of Social Security benefits is a more valuable feature to wealthy beneficiaries in higher marginal tax brackets.

To ensure individual equity, benefit payments should be closely related to past contributions. Adopting a strictly proportional benefit structure would be a more equitable approach to disbursing benefits.

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[8] This formula is used for those reaching the age of 62 after 1978. For those attaining age 62 prior to 1979, a more munificent benefit structure is used to determine benefits. In addition, those becoming 62 at any time from 1979 through 1983 have a choice of either formula for calculating retirement benefits.

Table 3

Comparison of the Primary Insurance Amount of Workers With Different AIMEs[9]

	AIME of $220	AIME of $1,100
90 percent of $211	$189.90	$189.90
32 percent of $ 9	2.88	---
32 percent of $889	---	284.48
Primary Insurance Amount	$192.78	$474.38

Retirement Test

There is much controversy regarding Social Security's so-called earnings, or retirement, test, which limits benefit payments to otherwise eligible Social Security recipients earning more than a specified amount. In 1981, those aged 65 to 71 will lose $1 for every $2 earned in excess of $5,500. (The amount exempt for beneficiaries under 65 is $4,080.) This limitation was perceived as unfair by more than 65 percent of those surveyed in the Heritage Foundation poll. However, the penalty is justified by proponents of the test for several reasons. First, because Social Security was originally intended to partially replace earnings lost as a result of retirement, individuals continuing to work have earnings that remove the need for Social Security benefits. Second, by inducing the elderly to retire, problems with unemployment are relieved somewhat by making more jobs available for younger workers. Finally, members of the National Commission on Social Security argue in a recent report that repealing the earnings test would cause intergenerational inequities by allowing higher-earning workers to remain employed while receiving full benefits and compelling their younger, lower-paid co-workers to finance these benefits through their contributions to Social Security.[10] The real motivation for hanging onto the retirement test, however, is the cost of paying increased benefits. These may be difficult to finance in light of the impending crisis in Social Security.[11]

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9 This is an updated version of an example in J. W. Van Gorkom, Social Security Revisited (Washington, D.C.: American Enterprise Institute, 1979), p. 14.

10 National Commission on Social Security, Social Security in America's Future, Washington, D.C., March 1981, p. 150.

11 The first-year cost would be about 6 to 7 billion dollars and more in later years. For those aged 65 and older, however, the cost in the first year is only about 2 billion dollars.

Though there are reasons for the earnings test, it is one of the more inefficient and inequitable provisions of Social Security. Supporters of the earnings test contend that by continuing to work beyond the age of 65, the elderly restrict the job market for younger workers. This view is an example of the "lump of labor fallacy," which falsely holds that there are only a given number of jobs available in the economy and that one person's gain is another person's loss.

The 50 percent benefit reduction rate on earnings above a set limit effectively raises marginal tax rates for older workers. When this reduction is combined with the income and Social Security payroll taxes, which they also pay, these workers become one of the nation's most heavily taxed groups. As a result, many of the elderly who otherwise would have continued working are involuntarily forced into retirement. Rather than encouraging older people to provide more for themselves, the earnings test makes it difficult, if not impossible, for them to supplement their income; in many cases, it may actually lower their standard of living. Alicia Munnell, vice president and economist of the Federal Reserve Bank of Boston, has accurately described some of the pernicious effects of the retirement test:

> In sum, there is good reason to be concerned about the provision of Social Security law that discourages labor force participation of people over sixty-two who prefer to continue working. By limiting available income sources, such a deterrent reduces the welfare of the elderly. The burden falls particularly heavily on low-income people, who seldom have other sources of retirement income such as private insurance, pension benefits, or savings. In addition, any provision that encourages a smaller labor force in future years will force a significantly higher tax rate in the long run.[12]

Moreover, this constraint on earnings misallocates resources and lowers potential output by distorting the labor-leisure decision of older people. This loss is particularly egregious given the experience and knowledge the elderly have to offer.

The greatest inequity of the earnings test is that it denies the elderly benefits they have paid for during their working years. This problem again arises from a confusion of insurance and welfare objectives. Paul H. Douglas, an economist who helped draft the amendments to the Social Security Act and who later became a U.S. senator from Illinois, elaborated on this problem:

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12 Alicia Munnell, The Future of Social Security (Washington, D.C.: The Brookings Institution, 1977), p. 82.

> This provision, however, is in part a confusion of the idea of relief with that of insurance. The workers will have made direct contributions for half of their annuities and indirectly will have paid for most of the employers' contributions as well. When the system is thoroughly established, they will therefore have earned their annuities. To require them to give up gainful employment is, in reality, attaching a condition upon insurance which they have themselves bought.[13]

Peter Ferrara compares this to a bank withholding cash from a customer because it felt that the customer did not need the money.[14] Is it fair for the government to coerce people into Social Security and then deny them benefits if they choose to work beyond a certain age? In addition, full benefits are received after age 72 regardless of whether the recipient has substantial earnings or not. This inconsistency is a direct antithesis to the rationale advanced by advocates of the retirement test.

The earnings test limits benefits on the basis of earned income, yet allows full benefits even if there is enormous income from other sources such as dividends, interest, capital gains, or rents. This also discriminates against low-income workers since they rely primarily on wage income, while the wealthy are able to supplement their retirement incomes through various investments. What justification is there, moreover, for a distinction between earned and unearned income? Both can be viewed as a return on an investment. Marshall Colberg, professor of economics at Florida State University, writes:

> Investment in the individual is now seen to be similar in many ways to investment in material resources. Formal education, vocational training, on-the-job training, and even expenditures on health, on migration, and on searching for information about prices and incomes have been viewed as investments in human capital....Interest earnings on material and human capital are consequently not inherently unlike....
>
> For many persons and under many conditions during their lifetime, material resources and human resources are practical alternatives for investment. Yet interest from following the former course is considered by law to be "unearned income" while equivalent interest derived from the latter course is called "earned income".... Interest on this form of capital encounters the problem of the Social Security earnings test while interest on material capital escapes the test.[15]

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13 Marshall Colberg, The Social Security Retirement Test: Right or Wrong (Washington, D.C.: American Enterprise Institute, 1978), pp. 2-3.

14 Ferrara, op. cit., p. 244.

15 Colberg, op. cit., pp. 23-25.

A more productive economy could be achieved by eliminating this restraint on the elderly.

Two further inequities associated with the retirement test should be mentioned. First, distortions arise from differences in the cost of living across the nation. Because the limitation is in current, rather than real dollars, beneficiaries in some areas are unfairly more restricted than in others. Second, Social Security's treatment of earned income differs from that of many other retirement plans, which allow workers to take other employment without sacrificing their annuities.

Finally, there are several immediate benefits from expunging the earnings test: increased labor force participation would add to income and Social Security payroll tax collections; costs to the Social Security Administration would decline by reducing the administrative burden of enforcing the test; and perhaps most compelling of all, an unfair and costly onus would be lifted from the aged.

Spouse's Benefit[16]

The spouse's benefit, added to Social Security in 1939, consists of two parts: a retirement benefit, which awards the wife of a retired worker 50 percent of her husband's benefit; and a survivor's benefit, which grants a widow 100 percent of her husband's benefit. These annuities become available in full after participants reach age 65, although reduced benefits are provided under each part for women who are 62 and 60 years of age respectively. In essence, this measure is an unearned benefit awarded on the premise that a worker with a wife is more needy than a single worker. This provision distorts the nexus between benefits and contributions while adding considerably to the system's cost.

As a result, the spouse's benefit creates a number of inequities. First, married workers receive greater protection than single workers under Social Security. A married worker is entitled to receive 50 percent more in benefits than a single worker contributing an equal amount in taxes. Forcing single workers to subsidize their married counterparts is clearly a violation of determining payments based on insurance principles.

Second, there are inequities associated with the unequal treatment of working and non-working wives. Married women may find that the protection they receive based on their earnings record adds little or nothing to the coverage they already have

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16 Similar benefits are available for children, grandchildren, parents and divorced wives. The size of the benefit depends on the worker's PIA. For simplicity, the discussion here is restricted only to the spouse's benefit.

from the spouse's benefit. If a wife's earnings record entitles her to a benefit that is equal to or less than one-half of her husband's, she will get no return on her contributions at all. If she qualifies for more than the amount available from the spouse's benefit, her net gain is only the difference between her benefit and the benefit she could have received based on her husband's earnings record. It is unfair, moreover, to have working wives, who tend to come from lower-income households, subsidize benefit payments for non-working wives, who are more likely to come from higher-income households.

Finally, a family with two earners may receive less in benefits than a one-earner family with the same total family earnings. For example: in Family A both husband and wife earn an equal share of the family income, while in Family B the husband is the sole supporter. Assume that the two families have had equivalent yearly earnings and that all four individuals reach age 65 at the beginning of 1981. With AIMEs of $400, both husband and wife in Family A receive an annual benefit of $250.30 for a combined payment of $500.76. In family B, where only the husband has worked, both husband and wife receive a greater benefit -- his AIME entitles them to $378.38 per month plus 50 percent, or $189.19, for his spouse, for a total monthly retirement benefit of $567.57. Family B will receive an annual benefit $801.72 greater than Family A even though both families have presumably paid an equivalent amount in taxes.

Eliminating the spouse's benefit would reduce some of the anomalies in the current benefit structure. This benefit was created on the basis of the traditional family model of the 1930s when it appeared that most women would marry and that few would then participate actively in the labor force. This no longer holds today. Family structures and women's work patterns have changed tremendously since 1939, dramatically reducing women's dependence on their husbands. The number of married women working, for instance, has nearly tripled since 1940, yet the spouse's benefit remains and continues to discriminate against them.

One possible remedy is to treat each household as a single economic unit. For a married couple, the benefit earned by either would be divided equally among both. This would remove a large welfare element from Social Security.

Intergenerational Transfers

An inequity often overlooked in Social Security is the inherent subsidization of an older generation by a younger one. This has been defended on the grounds that elderly recipients are generally in need. Indeed, a common justification for Social Security is that it transfers money from a younger, wealthier generation of workers to an older and poorer generation of retirees. As a consequence, young, unskilled workers, struggling to make ends meet may be compelled to subsidize retired doctors, lawyers, and others who may be far better off than the workers themselves.

Just how this transfer works is clear from the case of an individual with average earnings, 62 years old in 1937, who retired at age 65 in 1940.[17] If he invested his Social Security contributions at the interest rates then prevailing, he would have accumulated a retirement fund of $68.36 by 1940, yielding him $6.59 per year. From the standpoint of social adequacy, however, such benefits were considered too meager. The average annual Social Security benefit actually awarded in 1940 to a 65-year-old male was $270.60 -- yielding the beneficiary a $264.01 windfall. But since these benefits were subject to periodic changes, it is more useful to compare capitalized savings and benefits. The present value of lifetime Social Security benefits for this individual would have been $2,962.09, resulting in a pure transfer of $2,893.73 or 97.7 percent of benefits received. However, the relative size of this unearned component has been falling over time as the system has been maturing.

A factor contributing to a significant reduction in the welfare component is the longer period over which more recent retirees have paid taxes. A retiree in 1960, for instance, could only have contributed to Social Security for a maximum of twenty-three years, whereas a retiree in 1981 may have participated for as many as forty-four years. Now that the system is nearly mature, these windfalls from short earnings histories in covered employment will be smaller. Moreover, the percentage of payroll taxes has steadily grown, lowering the return on Social Security still further.

These transfers were initially accepted because a large pool of workers supported a relatively small recipient group. In 1940, for example, the ratio of covered workers to retirees was 300:1. This ratio radically declined in subsequent years: 16:1 in 1950; 4:1 in 1965; and 3.2:1 today. By the year 2030, this ratio may fall to 2:1, or still lower if the projected demographic trends prove to be too optimistic. As the worker to retiree ratio continues to fall, the burden on future generations will become increasingly greater.

Michael Boskin calculated the return on Social Security contributions that workers of various age groups in 1977 can expect to receive under current law, including tax increases already legislated but not yet implemented (see Table 4). He computed the amount each age cohort has paid (or will pay) into the OASI system, and then compounded each year's contributions by an interest rate. He then estimated the benefits each age group will collect over a lifetime. The return on contributions for most workers appears to be quite good. The average current

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17 This example is taken from D. Parsons and D. Munro, "Intergenerational Transfers in Social Security," in Michael Boskin, ed., The Crisis in Social Security: Problems and Prospects, (San Francisco: Institute for Contemporary Studies, 1977).

Table 4

Old Age and Survivors Insurance: Relationship of Taxes Paid to Benefits Received (1977 Dollars)

	65+	64-55	54-45	44-35	34-25	Under 25
Average Tax/ Family	7,058	18,345	33,883	53,326	73,843	
Average Benefit/ Family	49,400	47,639	55,600	66,321	73,577	
Avg. Net Benefit/ Family	42,343	29,294	22,718	12,994	-267	large, negative
Avg. Net Benefit as % Tax/Family	600.0	160.0	67.0	24.4	-.36	
Total Taxes pd. by Cohort (billions)	172	235	349	389	540	552+
Total Benefits pd. to Cohort (billions)	1,282	629	570	473	503	
Transfers as % of Total Benefits	86.2	62.7	38.8	19.4	-7.39	large, negative

SOURCE: Michael J. Boskin, John B. Shoven, Marcy Avrin, and Kenneth Cone, "Separating the Transfer and Annuity Functions of Social Security," Department of Economics, Stanford University and National Bureau of Economic Research, p. 28.

retiree receives a net transfer of about $42,000 per family, an amount six times larger than what he paid in plus interest. The size of this return, however, will steadily decline for those retiring in the future. An average family of the 55-64 age cohort, for example, will receive a transfer amounting to only 1.6 times what it paid in plus interest. Workers in the 25-34 age cohort will be the first group as a whole to get a negative return on its Social Security contributions, albeit a relatively small loss. Indeed, the average tax paid by this group is ten times as high as that paid by those currently retired, yet their benefits are only one-and-a-half times as great. For those under the age of 25, the loss will be so great that Boskin simply lists it as "large" and "negative."

The threat of the Social Security system going bankrupt because of changing economic conditions and demographic shifts could have been avoided by a fully-funded system. Providing overly generous benefits during the start-up phase of Social

Security, however, resulted in a pay-as-you-go system. Contributions to the program are not saved and invested, but used to pay benefits to today's recipients. The consequences of this policy are now becoming apparent as the tax burden worsens and many more people begin getting lower returns on Social Security contributions than they otherwise would have been able to obtain in the market. It would have been far more efficient and equitable if the first generation of retirees had been taxed more than 2 percent of their earnings during their working years, and their benefit payments reduced to more accurately reflect their past contributions. Though this may have resulted in very low benefit payments in the program's early years, it would have equalized the return across generations. Those deemed to be in need could have been more appropriately cared for through means-tested welfare programs. Nevertheless, the first cohorts of retirees were allowed to collect benefits that were far in excess of anything "justified by their brief taxpaying experience."[18]

EFFICIENCY CONSIDERATIONS

Savings and Capital Formation

One harmful side effect of Social Security is the reduction in savings that results from the pay-as-you-go nature of its financing. As a result, funds available for capital formation are reduced, thereby depressing economic growth and national output.[19]

Social Security reduces private savings in two ways. First, Social Security payroll taxes lower disposable income, leaving individuals with less money to allocate for other purposes,

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18 John A. Brittain, The Payroll Tax for Social Security (Washington, D.C.: The Brookings Institution, 1972), p. 9.

19 There is still considerable debate on the nature and extent of the effect of Social Security on private saving and its corresponding impact on capital formation. For a more complete review see Robert J. Barro, The Impact of Social Security on Private Saving: Evidence from U.S. Time Series, with a reply by Martin Feldstein (Washington, D.C.: American Enterprise Institute, 1978); Michael Darby, The Effects of Social Security on Income and Capital Stock (Washington, D.C.: American Enterprise Institute, 1979); Martin Feldstein, "Social Security, Induced Retirement, and Aggregate Capital Accumulation," Journal of Political Economy, Vol. 82 (Sept.-Oct. 1974), pp. 905-926; Martin Feldstein, "Social Security, Induced Retirement, and Capital Accumulation: A Correction and Update," National Bureau of Economic Research, Working Paper 579, November 1980; and Alicia H. Munnell, The Effect of Social Security on Personal Saving (Cambridge, Massachusetts: Ballinger, 1975). The evidence that Social Security does not substantially retard saving remains weak. For an excellent critique of these alternative theories see Ferrara, op. cit., pp. 76-104.

including saving. The magnitude of this reduction depends on the marginal propensity to save.

More important, many individuals view their contributions to Social Security as a form of forced savings for retirement and are therefore likely to reduce the savings they otherwise would have accumulated for retirement. Savings may be depressed by the full amount of Social Security taxes. For example, consider an individual with an income of $10,000 a year who, without Social Security, might save 10 percent of his earnings for retirement.[20] With Social Security, he is forced to save more than the $1,000 he originally intended to save because he is required to pay a greater amount in Social Security payroll taxes. In this case, the net impact is likely to be a reduction on savings equal to the full $1,000. Because the government uses the contributions to pay current beneficiaries, there is no corresponding increase in savings to balance the resulting decline in savings. On the aggregate level, pay-as-you-go financing may lower savings on a dollar-for-dollar basis with Social Security contributions.

In an empirical study, Martin Feldstein estimated that Social Security had reduced personal savings by $55 billion in 1976.[21] With $95 billion in total private savings that year, this loss amounts to 58 percent of total actual private saving and a 37 percent reduction of the potential total private saving of $150 billion. That same year, employee and employer contributions to Social Security (OASI) amounted to $63 billion. Thus, the estimated $55 billion decline corresponds to 87 percent of private saving and supports the hypothesis that Social Security lowers private savings almost by the full amount of the tax.

Covered workers may think of their contributions to Social Security as part of their overall personal wealth. "Social Security wealth" can be defined as the present value of the annuity stream that an individual expects to receive in the future. It is fungible with ordinary wealth and allows one to reduce his own accumulation or personal wealth by an equal amount. Unlike ordinary wealth, however, Social Security wealth is not a tangible form of wealth. Rather, it is simply an implicit promise that the next generation will tax itself to pay the benefits that were promised by an earlier generation. Because Social Security wealth is not real, the amount of Social Security wealth represents the stock of personal wealth lost because of the program. Feldstein estimates the value of Social Security wealth in 1976 to have been $3,238 billion (in 1976 dollars). By inducing people to substitute Social Security wealth for real wealth, the Social

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20 This example is taken from Martin Feldstein, "Social Security," in Boskin, op. cit., p. 22.

21 Martin Feldstein, "Social Security, Induced Retirement, and Capital Accumulation: A Correction and Update," National Bureau of Economic Research, Working Paper 579, November 1980.

Security system has had an enormous adverse impact on the size of the nation's capital stock.

By decreasing saving, Social Security lowers the amount of money available for capital formation. In essence, this redistributes income from labor to owners of capital, as the relative scarcity of capital drives up its price, and the smaller capital stock leads to a decline in worker productivity -- which reduces per capita output and the real wage rate. This redistribution is particularly harmful to low-income workers, who rely heavily on wage income for support, whereas the wealthy typically receive a much larger share of their income through capital investment. Lower wages are also likely to contract the supply of labor by lowering the price of leisure relative to labor. Taken together, lower productivity and less employment lead to slower economic growth and a lower gross national product.

Labor Supply

The Social Security payroll tax also has a pronounced negative impact on labor supply because it drives a wedge between what an employer pays and what an employee receives as compensation. This wedge includes both the employee's and the employer's share of the tax since the burden of the tax is shifted completely to labor. According to a basic law of economics, employment is inversely related to the real wage rate, which is equal to the marginal productivity of labor. If one component of the real wage rises, another must fall if existing levels of employment are to be preserved. In other words, an employer is able to pass the burden of the payroll tax onto an employee by lowering his observed wage, thereby maintaining a constant real wage.

Even if employers cannot prevent the real wage from rising somewhat, labor still cannot evade the consequences of the tax. A rising real wage increases labor costs, thereby lowering employment opportunities. This simply shifts the burden to those either losing their jobs or those unable to find work. Moreover, by reducing a worker's disposable income, this wedge discourages employment. Consider an employee whose productive value enables him to command $10 an hour in the marketplace. Today, with a combined OASDHI tax rate of 13.3 percent, this individual will receive only $8:67 after deducting both the employer and employee portions of the tax.[22] By lowering compensation, the Social Security payroll tax precludes workers from receiving their full worth and induces some of them to drop out of the labor force as the price of leisure falls. New York attorney Peter Ferrara accurately characterized the consequences of the tax: "The payroll tax is essentially a tax on employment and as always the result of taxing something is that there is less of it."[23] This

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22 The size of this wedge may be somewhat smaller after taking into account the tax deductibility of the employer's share. This mitigates, but does not eliminate, the adverse effect on labor supply.

23 Ferrara, op. cit., p. 105.

employment effect would largely be negated if individuals could receive actuarially sound returns on Social Security, but the return on Social Security is uncertain and only tenuously linked to past contributions. Moreover, as the system fully matures, the rate of return for an increasing number of people will fall below the market rate of return, which will further exacerbate the distortion of the wedge effect on labor supply.

When considered along with the labor supply effects of the earnings test, which reduces employment among those over 65, it is apparent that Social Security depresses employment, creates economic inefficiency by misallocating resources, and reduces total output. These problems of Social Security arise once again from Social Security's conflicting objectives of trying to be both an insurance and a welfare program.

AVENUES FOR REFORM

Indexing

One commonly discussed proposal to improve efficiency and equity within the Social Security system is to modify benefit indexation. Benefits are currently adjusted for inflation by indexing them to the Consumer Price Index (CPI). Use of the CPI, however, may improperly lead to excessive Social Security benefits if, as many economists assert, it overstates the true rate of inflation. One of the major flaws in the CPI is its treatment of homeownership. The CPI overstates housing costs by ignoring the investment value of the home. Other criticisms of the CPI include outdated buying patterns (determined in 1972-73), failure to account for consumer substitution when faced with higher prices, and limited applicability to certain subgroups, such as the elderly. In this connection, it should be noted that only a very small proportion of the elderly are in the housing market, a category heavily weighted in calculating the CPI. By exaggerating the inflation rate, the CPI may lead to the substantial overcompensation of Social Security recipients.

A "rental equivalence" (CPI X-1) index, now being developed by the Bureau of Labor Statistics, endeavors to circumvent some of the more serious problems connected with the housing component. This approach attempts to separate the consumption and investment motives in purchasing a home by using market rents as a proxy for the shelter services of a similar owner-occupied home.

Other economists have suggested using the Personal Consumption Expenditure (PCE) chain index on the National Income and Product Accounts. This index would be preferable to the CPI for several reasons: 1) its coverage is somewhat broader as it includes all goods and services currently produced for consumption; 2) it employs the rental equivalency approach used in computing the CPI X-1; and 3) it uses current consumption patterns rather than those determined in the 1972-73 survey period.

In lieu of changing the CPI or replacing it with a new index, President Reagan and other policymakers are considering a three-month deferral of cost-of-living increases for Social Security beneficiaries. Although this would result in large savings, it ignores the basic flaws of the CPI as an escalator.[24]

Raising the Retirement Age

Increasing longevity among the elderly and the trend toward early retirement have contributed greatly to the actuarial imbalance of Social Security by lengthening the period over which benefits are received and reducing the number of years during which taxes are paid into the system. When Social Security was originally conceived in 1935, the average retiree spent 12.8 years in retirement; now it is 16 years.[25] Moreover, this expected increase in longevity will extend the retirement period still further, thereby increasing the threat of insolvency. As a result, one of the most frequently discussed proposals under consideration is delaying retirement by raising the age at which full Social Security benefits are paid. This would help offset the projected reduction in the ratio of workers to beneficiaries. To allow those nearing retirement age sufficient time to adjust, this reform could be phased in gradually.[26].

Raising the retirement age for Social Security recipients can be justified for several reasons. First, medical advances not only have increased life expectancy, but also have enabled people to work longer. Second, a shift in employment from mining and manufacturing to trade and service jobs has reduced the proportion of the labor force in physically demanding and dangerous employment. Finally, the demand for higher education has effectively shortened the working years for many people by delaying their entrance into the labor force.

The primary disadvantage of raising the retirement age, however, is that it does not consider the special needs of the elderly who may not be able to postpone retirement for health reasons or other circumstances. This disadvantage can be avoided by allowing workers to retire at any age they choose and to receive actuarially fair benefits. Unfortunately, this may not be possible unless the transfer and annuity portions of Social

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24 For a detailed discussion of the CPI and indexing, see: Peter Germanis, "Adjusting the Consumer Price Index," Heritage Foundation Backgrounder No. 152, October 15, 1981.

25 President's Commission on Pension Policy, Coming of Age: Toward a National Retirement Income Policy, Washington, D.C., February 26, 1981, p. 23.

26 Representative J. J. Pickle (D-Tex.), Chairman of the Ways and Means Subcommittee on Social Security, and Senator Lawton Chiles (D-Fla.) have both introduced bills raising the retirement age gradually from 65 to 68. Rep. Pickle would implement this change from 1990 to 1999, while Sen. Chiles recommends that this be done from 2000 to 2012.

Security are separated because the cost of maintaining this flexibility would be more than the system could support. Reducing the number of years individuals can collect benefits may be a more politically feasible alternative than cutting benefits by eliminating the current welfare component.

Taxation of Benefits

Employees now pay income taxes on the part of their earnings also subject to the Social Security payroll tax; employer's contributions, however, are considered business expenses and thus escape taxation. Including half of all Social Security benefits in taxable income would approximate the current tax treatment of private pensions and benefits from other government programs. This measure would have few, if any, ramifications on the low income group since the tax code already has several provisions that take into account an individual's ability to pay, e.g., progressive tax rates, a zero-bracket amount, and a personal exemption that is doubled for those over 65. Excluding Social Security benefits from taxation simply helps those recipients with relatively high incomes. Although including half of Social Security benefits in taxable income would reduce the after-tax benefits for some recipients, it also could be viewed as a tax cut because it would reduce the need to raise payroll taxes in the future.

Universal Coverage

Universal coverage requires the extension of Social Security protection to all workers. At present some seven million workers are not covered -- primarily those permanent civilian employees of the federal government, employees of a number of state and local governments, and non-profit organizations choosing not to participate.

Making coverage compulsory for all workers would eliminate gaps in protection experienced by workers moving between covered and uncovered employment. These gaps arise because Social Security and most pension plans require a minimal period of employment before eligibility is established.

Universal coverage also would largely eliminate windfalls that accrue to individuals with short work periods in covered employment or those with low earnings histories arising from time spent in non-covered employment. Many of these people have qualified for benefits under other retirement plans and, despite being relatively well-off, receive unearned benefits designed to provide a subsistence income for workers with low lifetime wages. The following examples illustrate the present inadequacy.

Mr. Jones worked his entire life as an unskilled laborer and at age 65 retired with an AIME of $211, which entitled him to a monthly benefit of $189.90. Mr. Jones is the type of worker the weighted benefit formula was designed to assist.

Mr. Smith, on the other hand, spent all his life as an employee of the federal government and earned a civil service pension of $1,500 per month. In addition, Mr. Smith qualified for Social Security benefits by working in covered employment in his spare time. With an AIME of $211, Mr. Smith also received a monthly annuity of $189.90 for Social Security. The progressive benefit structure was not intended to yield him such a generous award, yet he was allowed to take advantage of it.

This type of abuse of Social Security is not uncommon: approximately 45 percent of those receiving a civil service pension also get benefits under Social Security.[27] Universal coverage would greatly increase contributions by expanding the tax base while only gradually increasing disbursements. If mandatory coverage were to become effective January 1, 1982, for example, incremental revenues of over $100 billion could be realized by 1987, thereby providing immediate relief for the short-run financing problems.[28] This is possible in the short run because it would be many years before a sizable number of newly-covered workers would reach retirement. Although the long-term effects are not as significant, the Social Security Administration estimates that universal coverage could lead to a reduction in payroll taxes of 0.5 percentage points during the next seventy-five years.[29] The only way this proposal could improve the actuarial balance of Social Security, however, is by giving the newly-covered workers a "bad deal," and it is therefore sure to be resisted.

Spreading the burden to uncovered workers thus is not a solution to Social Security's problems. Its main advantage is that it points out the great need to separate the welfare component from the program so that no group is unfairly penalized by participating in the program. This would then make universal coverage a moot question.

Accounting Changes

Accounting adjustments may provide relief in the short run without altering either benefit payments or already scheduled tax rates.

Interfund borrowing would allow the three trust funds to borrow from one another whenever any runs short of funds. This

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27 Colberg, op. cit., p. 16.

28 Lowell Jones and Michael Romig, "Social Security Financing and Options for the Future," Statement of the Chamber of Commerce of the United States of America, July 10, 1981, p. 9.

29 U.S. Department of Health and Human Services, The Desirability and Feasibility of Social Security Coverage for State and Local Government and Private Non-profit Organizations, Report of the Universal Social Security Coverage Study Group (Washington, D.C., 1980), p. 47.

change is aimed at augmenting the projected shortfall in the OASI fund, the largest of the three trusts, and would enable it to receive temporary transfers from the more solvent disability insurance (DI) and hospital insurance (HI) funds. Another alternative is to realign the proportion of the payroll tax going to each of the three trust funds. These reallocations may resolve the short-run financing problems, but fail to address the more serious and imminent underlying problems facing Social Security.

General Revenue Financing

One of the many nostrums advocated for curing the Social Security system of its financial ills is financing part or all of the program through general revenues. Through general revenues, goes the argument, part (or all) of the burden of the payroll tax would be shifted from the low wage worker, who can least afford a reduction in disposable income, to those in society better able to absorb the loss. This proposal, however, would further weaken the already tenuous connection between payments made into the system and benefits paid out, while substantially advancing its conversion to a pure welfare program. If the objective of this reform is to aid the poor, moreover, then this can be more efficiently achieved through other needs-related programs financed by general revenues such as the Supplemental Security Income (SSI) program, food stamps, and the Aid to Families with Dependent Children (AFDC) program. In particular, SSI provides a guaranteed level of income for the aged, blind, and disabled because it recognizes that Social Security alone may not be sufficient.

CONCLUSION

The key to establishing a fair and efficient retirement program is to eliminate the transfer function of Social Security altogether and pay benefits that are directly related to an individual's total contributions plus interest. This would require dropping the redistributive benefit structure, the spouse's benefit, the earnings test, and other features based on welfare principles. These often have led to paying substantial unearned benefits to those generally not considered needy. Continuing transfers without regard to need raises serious questions of equity, while further financially emasculating the Social Security system.

The destitute elderly would not be ignored. Instead, they would more appropriately be helped through needs-oriented programs, such as SSI and food stamps, which are financed from general revenues. Funding for these programs would have to be expanded, of course, but there could be enormous savings running probably into the tens of billions of dollars by precluding retirees who are not poor from receiving undeserved welfare benefits. A major objection to this reform, however, is that many of the elderly poor would be subject to "degrading" needs-related tests. Even though some of these people may feel embarrassed to accept finan-

cial assistance from welfare programs, they are, nevertheless, now receiving an implicit welfare subsidy through Social Security. There need be no stigma attached to receiving welfare. In any event, if the rest of the nation's needy citizens receiving assistance are obliged to recognize their plight, why should the elderly be exempted?

The final step in bringing about a comprehensive reform of Social Security is to make it voluntary and partially, if not completely, privatized. Some 60 percent of those surveyed in the Heritage poll feel that Social Security should be made voluntary; an even greater number believe that private pension alternatives could provide for retirement more efficiently. Though extensive analysis of such reform is beyond the scope of this paper, there are a few advantages to this option that are readily apparent.[30] There is no reason that government-approved private insurance alternatives cannot adequately provide for retirement or any of the other contingencies covered by Social Security. People could be given a choice of either continuing their participation in Social Security (without the welfare subsidy) or investing a portion of their income in private plans. This would greatly expand individual liberty by allowing people to choose from a variety of plans and to purchase the one best suited to their needs and desires. In addition, fully funded private plans would stimulate economic growth by reducing the adverse incentives for capital formation of the pay-as-you-go nature of the current system.

Although some of the reforms outlined in the preceding section of this paper might strengthen the financial soundness of Social Security, they do not address the main flaw of the program: its schizoid attempt to pursue both insurance and welfare objectives. Yet many ignore this flaw and oppose genuine reform. The National Commission on Social Security, for example, contends that Social Security is "sound in principle" and that any substantial changes would violate the implicit compact made between generations:

> Social Security is based upon a social compact between generations. Those who are retired depend for their benefits on those who are working, just as their taxes paid the benefits to those who came before them. For the younger generation, the deduction from their earnings for Social Security is justified by the understanding that the system will support them when they retire.[31]

This so-called compact, however, was made by a generation that is now reaping a tremendous windfall at the expense of the

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30 For a compendium of proposals to achieve these goals, see Ferrara, op. cit., pp. 311-397.

31 National Commission on Social Security, op. cit., p. 131.

up-and-coming generations. The obvious question is: Why should a younger generation be bound by a compact made without their consent and one that will yield them an unjustifiably low return in their retirement? Basing benefit payments on past contributions plus interest is the key to achieving a fair and efficient retirement program.

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