A Different Slant on Social Security Reform

A fairly straightforward examination of our present Social Security system, as well as the reform versions presently offered by the experts, shows them all to be giant rip-offs for future retirees, examples of the poor and middle-class seriously subsidizing the rich. In planning for Social Security, Roosevelt envisioned a fairly standard retirement program in which one pays in money during one's working life, the money is conservatively invested, say in U.S. Treasury bonds, and on reaching retirement age the accumulated payments plus return on investment is used to purchase an annuity which provides a pension for the remainder of one's life, an arrangement routinely available to the financially well off. The sources of one's pension payments are the accumulated money one paid in and return on investment from interest on Treasury bonds, that is, from income and corporate profit taxes, the latter accounting for more than 30% of pension payments.

Pensions for recent retirees are at levels that return on investment would provide and were more generous in the early period of Social Security but these pensions have been almost entirely paid for from payroll tax receipts, no return on investment, no community at large contribution. A good share of the experts' efforts have been devoted to transforming the rocky history of Social Security into imaginative ideologies justifying this payroll tax only funding. Up until now, funding this way was made possible by large increases in the number of people entering the system paying payroll taxes and by steady increases in the payroll tax rates, now much too high for actuarially sound pensions arrangements, continual increases that cannot continue: hence the present crisis. (Note the issue is not the difference between Treasury bonds and the stock market, it's the presence of any return on investment.)

For most of Social Security's history the money that should have gone to purchasing bonds has gone into various welfare benefit additions: in the early years, higher pensions for retirees who had paid in for only a few years, higher pensions for low-paid workers and benefits for workers families, all of which made good social sense but were funded out of payroll taxes (3% on a income up to $3,000 until 1950) instead of from income and corporate profit taxes.

It may be time to confront a major question of social justice: Should these social benevolences provided by our community be funded out of payroll taxes or out of general revenues? In keeping with present political thinking, only a radical conservative would propose funding welfare by a flat tax on annual income up to $97,500, the present payroll tax arrangement.

What effect would funding the social benevolences from general revenues, combined with Roosevelt's vision, have on payroll and income taxes? A rough estimate is that the combined employer, employee payroll tax rate would be reduced from the present 12.4% to about 6.8% and the payroll tax plus income tax would be lowered on annual incomes less than $350,000, with the largest percentage reduction going to the lowest paid workers. A gradual transition to this arrangement would be much simplified by an affirmation of "out of general revenues" strong enough to justify correcting the past. Where would we be now if the Roosevelt model had been used and the additional benefits had been paid out of general revenues, assume no change in past payroll taxes and pension payments. At end of each year the total amount of pension payments above what the Roosevelt model provided would have been an expense in the general revenue budget, which would have been exactly canceled out by receipts from the sale of the Treasury bonds going into the trust fund, producing a trust fund today that one can reasonably conjecture would be close to meeting present liabilities, that is, an estimate on what would be needed now - invested in Treasury bonds - to pay future pensions based on payroll taxes paid in up to the present day, that is, pensions presently bought and paid for by all workers, calculating pensions from wage histories to the present.

With the revised Trust Fund, the interest on the bonds in the Trust Fund could be raised to cover the societal benevolences of the system. This would have the community at large paying for the benevolences and each worker paying his own way for his or her pension. Return Social Security to its former autonomy by taking its expenses and receipts out of the federal government's annual budget, eliminating the "entitlement" nonsense. Although the federal debt would be increased, the Trust Fund holdings are significantly different from Treasury bonds owned outside the federal government. Congress could modify tax rates and pension levels to maintain solvency but would be restrained by the clear relationship between the trust fund and money paid in by workers. Basically, the trust fund is a device by which the cost of pensions is divided between the recipient's payroll tax payments and the community at large like private pension plans. With the present weakness of employer provided pensions, a bold move would be to allow workers to increase their payroll tax payments for actuarially sound increases in their Social Security pensions.

The bottom line on any reform proposal is how benefits are changed and how funding of benefits is divided between payroll taxes and general revenues (or from return on stocks and bonds, if moving that way could be justified.)

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