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Social Security: A Finger In The Dike

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In January of 1940, Ida Fuller of Ludlow, Vermont, became the first American to receive social security benefits. She had paid $22.00 in social security taxes. From that time in 1940, until her death in 1975, she received $20,940.85 in social security benefits. That's a 95,085 percent return on a twenty-two dollar investment, folks. Ida had a real good deal.

But as good a deal as Ida had, it points out the fatal flaw in social security. The flaw is this: Everyone takes out more than they put in. In reality, the pure economic analysis of social security is that it is a massive, massive Ponzi scheme, whereby people receive benefits not from the income off their investment, but income is received from the money put in from new investors.

Jane Bryant Quinn described it recently in a November, 1982 article in *Newsweek*, "Any good Ponzi scheme can be maintained as long as enough new people come into the game. Their fresh money pays off the older participants, while they themselves wait patiently for their own reward. Over the years, social security has expanded to include farmers, domestic workers, the military, the self-employed and many others not originally covered. The only major group still outside the system is the federal work force. If they join the game, their contributions will reduce the deficit until they themselves begin to retire. But once you have got everybody playing, the pyramid has got to fall — especially when the operator keeps raising the stakes."

It is obvious that social security has been a good deal for those who are currently retired. It will even be a good deal for those retiring in 1983. But consider the following chart:

Average Wage Earner

Year Attaining 65	Total Social Security Tax Paid	Expected Benefits	Ratio of Benefits to Taxes
1940	$ 63	$ 4,867	77 to 1
1960	1,972	25,995	13 to 1
1980	24,206	125,125	5 to 1
2000	174,860*	404,204*	2.3 to 1

*Estimated

Harding's Ellen Reid Is 1983-84 National PBL President

Ellen Reid, an Economics and Management Major at Harding University, has been elected the 1983-84 National President of Phi Beta Lambda (PBL), a national collegiate business organization. Participating in the PBL National Leadership convention at the San Francisco Hilton Hotel in California July 5-9, Miss Reid, whose home is Sugar Land, Texas, was elected on the second ballot. This followed a week of campaigning, caucusing, and interviewing with delegates who represented the 561 PBL chapters with a national membership of 17,600.

Miss Reid, co-captain of the 1981-82 National Champion Students in Free Enterprise Economics Team, was accompanied to the National Leadership Convention by Dr. Don Diffine, her PBL Advisor and Director of the Belden Center for Private Enterprise Education, along with Karen Koonce, also from Harding, who is the current Arkansas State PBL Secretary.

Additionally, all three Harding University competitors who placed First in their respective events at the state level PBL competition in April, 1983, placed in the top ten at the National Competition in San Francisco. Tonya Newell, a senior Accounting Major from Oak Grove, LA, placed third in the nation in Accounting II. Mary Linda Thurman, a senior Business Systems Major from Byhalia, MS, placed ninth in the nation in Data Processing II. Brian Tucker, a senior Economics Major from Millington, MI, placed tenth in the nation in Economics.

Although the Harding University Phi Beta Lambda chapter is barely a year old, she has achieved an impressive list of awards and honors. We commend these young people to all in our constituency. Our PBL members are strengthening their confidence in themselves and their work, while developing competent, assertive business leadership by growing professionally toward successful careers as business people.

The good deal is getting worse, and the average American entering the work force in 1983 must face the fact that he is on the losing end of a very dangerous Ponzi scheme. This Ponzi scheme is crashing because of three very real socio-economic factors: (1) The aging of America, (2) the explosion of benefits paid by social security, and (3) the enormous tax burden of social security.

AGING

In 1935, when the social security legislation was passed, the average American male was expected to live to be 62. With the retirement age set at 65, it seemed that social security was on a sound financial base. However, in the past decades, Americans have been living longer. The average American now lives to be 72, and as a result there are more and more people drawing social security.

The share of the U.S. population 65 and older has leaped from 6.8 percent in 1940 to 11.4 percent today. Some analysts state that by the year 2025, the percentage could be as high as 20 percent. Therefore, the number of people drawing social security has increased. In 1940, the ratio to workers to retirees was 300 to 1; in 1950, it was 16 to 1; in 1960, 5 to 1; in 1980, 3 to 1; and by 2025 there will be only two workers for each retired person. The aging of America is fast becoming a major demographic phenomenon. This does not bode well for social security.

BENEFIT GROWTH

The social security system, as originally designed, was only a base layer of protection for the elderly. It was never intended to be the comprehensive retirement and welfare program that it now is. In fact, the single largest contributor to the present social security fiasco is the explosion of benefit growth. The following chart is a summary:

MAJOR EXPANSIONS OF SOCIAL SECURITY

1939: Spouse and survivor benefits.

1952: benefits increased by 13 percent.

1956: Disability insurance benefits; early retirement for women.

1958: Dependent benefits for disabled workers.

1960: Disability insurance eligibility liberalized.

1961: Early retirement benefits for men.

1965: Medicare benefits; benefits increased by 7 percent.

1968: Benefits increased by 13 percent.

1970: Benefits increased by 15 percent.

1971: Benefits increased by 10 percent.

1972: Benefits increased by 20 percent; automatic cost of living adjustments to benefits and benefit formula.

The problem with expanding benefits is that insufficient consideration was given to the future funding of these benefit liberalizations. The primary culprit being the cost of living adjustment (COLA) passed at the end of Nixon's first term. The COLA took effect in 1975 and that is also the first year of serious trouble for social security. High inflation increased benefit checks and a deep recession decreased employment and revenues. The system was beginning to fail due to mismanagement for the first time.

TAXES

It should now come as no surprise that accompanying the massive growth in benefits there has been an equally massive growth in taxation. The following chart provides a history of social security taxes:

Year	Taxable Earnings Base	Combined Employer, Employee Rate	Maximum Tax (½ Paid by Employee, ½ by Employer)	% Incr. in Tax
1940	$ 3,000	2.0%	$ 60.00	—
1945	3,000	2.0	60.00	—
1950	3,000	3.0	90.00	50%
1955	4,200	4.0	168.00	87%
1960	4,800	6.0	288.00	71%
1965	4,800	7.25	348.00	21%
1970	7,800	9.6	748.80	115%
1975	14,100	11.7	1,649.70	120%
1980	25,900	12.26	3,175.34	92%
1985	35,700	14.10	5,033.70	58%
1990	57,000	15.30	8,721.00	73%

From 1950 to 1980, the Social Security tax paid by the average worker increased over 2,000 percent while that same worker's wages increased only 490 percent. Most workers today pay more social security taxes than Federal income taxes.

Because social security taxes are based on income, because they are regressive, they have the effect of decreasing employment. An estimate by the Congressional Budget Office stated that the increases in social security taxes in 1977 reduced employment by 500,000 jobs. It is a vicious circle. Higher taxes, fewer jobs. Fewer jobs, larger deficits. To cover the larger deficits, higher taxes, etc., etc., etc., etc., ad nauseum.

Because of the aging American population, because of the explosion of benefit growth and in spite of very large tax increases, the social security system is in serious trouble. In 1977, an attempt was made to resolve the fiscal crisis of social security. The attempt involved massive increases in payroll taxes and did not address the fundamental problems of each worker receiving more than he pays in. However, President Carter was more optimistic when he stated that the legislation was "the guarantee that from 1980 to 2030 social security funds will be sound."

He was wrong. The problems remained. By the end of 1982, the main social security trust fund was losing $20,000 *per minute.* Something had to be done. Hopefully, something to address the fundamental problems with the system.

In the summer of 1982, the Reagan administration produced a plan which would meet these problems. It would have reduced benefits and brought the system fairly close to solid financial footing. However, the outcry against the plan was enormous. So much so that Reagan abandoned the plan and appointed a bipartisan commission to study and make recommendations regarding social security. In January of 1983, the commission made its report and in March of 1983 the slightly modified report was passed by both the House and the Senate and was signed by the President on April 20, 1983.

It would be nice to say that the commission's report addresses the fundamental problems of social security by removing the Ponzi-like nature of the system and brings each person's benefits in line with his contributions. However, to say such would be false. The commission relies heavily on new taxes, lightly on benefit growth reductions and not at all on anything else. These type of solutions were tried in 1977. They did not work then, it would be foolish to believe they will work now.

This paper has tried to give an overview of social security, its history and its problems. Now, we will discuss the specific aspects of the 1938 social security package so that you may use this information in your business planning. However, do not be surprised that in the next few years that Congress must once again address the social security funding problem. Remember, you heard it here first.

THE SOCIAL SECURITY AMENDMENTS OF 1983

The Social Security Amendments of 1983 bring an estimated $164 billion in taxes and benefit growth reductions into the social security system. Of this amount, 91 percent is increased taxes. Nine percent is benefit growth reductions. The plan is very lopsided.

TAX INCREASES

The new employee-employer rates are as follows:

Year	Maximum Wage Base	OASDI	(Medicare) HI	Total	Maximum Employee Tax
1983	$35,700			6.70%	$2,391.90
1984	37,500	5.70	1.30	7.00	2,625.00
1985	40,500	5.70	1.35	7.05	2,855.25
1986	43,800	5.70	1.45	7.15	3,131.70
1987	46,800	5.70	1.45	7.15	3,346.20
1988	50,100	6.06	1.45	7.51	3,762.51
1989	53,400	6.06	1.45	7.51	4,010.34
1990	57,000	6.20	1.45	7.65	4,360.50

It is obvious that what once was a small, 1 percent bite out of the first $3,000 of earnings has grown to be a healthy hunk of every paycheck.

In order to somewhat soften the blow of increasing rates, in 1984 employees will be allowed a tax credit of 0.3 percent of wages. However, to receive the credit, they must, of course, file a 1984 tax return. This does two things. One, it allows the system the use of that money for 1984 and part of 1985; and two, it provides a back-door infusion of general revenues into social security. What once was advertised as a self-financing system is now dipping into the already deficit ridden general budget of the United States.

Previously, self-employed individuals paid a rate equal to 75 percent of the combined employer-employee rate for OASDI and 50 percent of HI. Beginning in 1984, the rates for self-employed persons will be equal to 100 percent of the combined rates for employers-employees shown above. This is obviously a large increase, and again, in order to somewhat soften the blow, a credit will be allowed for the increased taxes paid. In 1984, the credit will be 2.7 percent of net earnings; in 1985, the credit will be 2.3 percent of net earnings, and in 1986 through 1989, the credit will be 2 percent. After 1989 a new system will be dreamed up to try to achieve parity between the self-employed and other workers, but no one really has any idea what that system will be.

FEDERAL WORKERS

All new federal workers hired after January 1, 1984, will be required to join the system. This includes the President, Cabinet officers, members of Congress and federal judges. Employees of non-profit organizations as well as state and local government workers will be brought into the system.

RETIREMENT AGE

As a partial attempt to solve the aging of America problem, Congress raised the retirement age in two bursts. Persons born from 1943 through 1959 must wait until age 66 to receive full benefits, and persons born in 1960 or later must wait until age 67.

TAXING BENEFITS

Beginning in 1984, social security benefits will be taxed for certain individuals. The formula is complicated, perverse and utterly without any economic foundation. It is an attempt to tax wealthy people who do not necessarily need social security benefits to live; however, the end result will be to penalize those who save for retirement.

Let me quote from an article which recently appeared in the **Wall Street Journal** entitled "Marginal-Rate Madness as Social Security Reform" by Paul Craig Roberts. "The perversity of the formula results from phasing-in the taxation of Social Security benefits. Take the case of the single retiree currently in the 30 percent bracket. Since his private income is above the allowable threshold, his Social Security income is subject to tax. For every dollar in private income above the threshold, he has to pay tax on 50 cents of Social Security income until he is paying tax on one-half his Social Security benefits.

"This approach to the taxation of Social Security benefits makes no sense at all — especially in the context of President Reagan's policies designed to lower marginal tax rates and to increase incentives to save and invest. Once people planning their retirement realize that the penalty for providing a private retirement income in excess of the threshold is to be hit with 50 percent to 77 percent increases in marginal tax rates, their saving rate is going to drop. The result will be to make people more dependent on Social Security, thereby worsening the long-run problem."

BENEFIT GROWTH REDUCTION

In spite of intensive lobbying by the elderly the COLA for 1983 was postponed for six months — from July, 1983, to January, 1984. January then becomes the permanent date for COLA adjustments thereafter.

OTHER PROVISIONS

At present, social security benefits are reduced $1 for every $2 of income above $6,600 earned by recipients aged 65 through 69. Beginning in 1990, the reduction will be $1 for every $3 of income earned above whatever is the base in 1990.

The new legislation will make it more attractive to postpone retirement. Currently, a 3 percent bonus is added for each year retirement is delayed between ages 65 through 71. The new law boosts this premium by one quarter of a percent in 1990 and continues the boosting until the year 2009.

Due to the expanding cost of Medicare, certain ill-defined provisions were passed in an attempt to hold down hospital costs. These cost containment provisions are not believed to be strong enough, however, to keep the Medicare trust fund from going bankrupt before 1990.

Finally, another interesting provision allows the social security budget to be separated from the general budget in 1992.

CONCLUSION

While social security has been a real good deal for Ida Fuller and millions like her, it is rapidly becoming and has become a burden on the working class of America. While signing the 1983 legislation on April 20, 1983, President Reagan declared "The changes in this legislation will allow Social Security to age as gracefully as all of us hope to do ourselves — without becoming an undue burden on generations to come." I would hope that these words were true. However, history is not on his side.

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