THE CONTINUED FINANCIAL STABILITY
OF SOCIAL SECURITY

THESIS

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For the Degree of

MASTER OF SCIENCE

By

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The Social Security System is projected to encounter both short-term and long-term financial crises. The economic effectiveness and impacts of alternative solutions to both problems are analyzed.

Government projections show the short-term deficit can be solved through interfund borrowing. Solving the long-term deficit will require the generation of new funds. All four solutions analyzed will increase unemployment, inflation, and interest rates, and decrease growth potential. A combination of increased OASI taxation and mandatory coverage is recommended as the most effective solution with the least adverse economic consequences.
PREFACE

The Social Security System's financial stability has continuously been questioned since 1978, the year after the 1977 Tax Restructuring. The financial stability of the Social Security program is especially pertinent to current recipients, those who are counting on it as a retirement income, and those who believe Social Security is a program which is depriving them of some of their present wealth. The present concern over the solvency of Social Security is centered on whether or not the present financing methods are viable.

The interest in Social Security is almost universal since over ninety-three percent of the United States' population is either paying into the program, are dependents of those covered or are receiving benefits from it. The number of interested parties prompted Congress to initiate a National Committee on Social Security in 1976. This independent group has the job of reassessing the entire Social Security Program each year. The committee is also required to prepare and submit a detailed annual report on the financial condition of the program and make suggestions on how to improve the system. Considering the size of the Social Security System -- which annually spends over 120
billion dollars -- the members of this committee are undertaking a large task.

Although the National Committee on Social Security has the primary task of scrutinizing the entire Social Security Program, it relies heavily on outside sources of analysis, including many actuarial reports from groups such as the Brookings Institute, retirement groups, governmental agencies, and ex-administrators of the Social Security Program. Many reliable sources have independently compiled studies which have fostered the fear that the Social Security System is headed for severe financial trouble. This paper is primarily concerned with the financial solvency of the system.

There are many aspects of Social Security which need complete reexamination. The purpose of this paper, however, is narrowly confined to the study of the financial stability of Social Security today and to an analysis of four of the proposed solutions to projected future financial problems. The paper concludes with some possible solutions which, if implemented, could help solve future financial problems likely to occur in the Social Security System.
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LIST OF ABBREVIATIONS, ACRONYMS
AND VARIABLES

C - Average consumption levels
CBO - Congressional Budget Office
CPI - Consumer Price Index
CSR - Civil Service Retirement System
D1, D2 - Demand
DI - Disability Insurance
DLF - Demand for loanable funds
G - Government expenditure
GNP - Gross National Product
HI - Hospital Insurance
i - Interest rate x 100
I - Investment
Md - Money demand
Md* - Transactions demand for money
Mdw - Wealth demand for money
MPC - Marginal propensity to consume
MPS - Marginal propensity to save
M* - Money supply
Msx - Excess supplies of money
NT - Increase in taxation
OASDHI - Old Age, Survivors, Disability and Health Insurance
OASDI - Old Age, Survivors, and Disability Insurance
OASI - Old Age and Survivors Insurance
P1, P2 - Price
Q1, Q2 - Quantity
S - Savings
S1, S2 - Supply
SLF - Supply of loanable funds
t - Tax rate
T - t times Y
Ti - Increase in taxation rate
Tt + 1 - t + Ti times Y
Y - Gross National Product
Yt + 1 - Gross National Product after the tax change
CHAPTER I

INTRODUCTION

Social Security is a national insurance system designed to help citizens cope with the major financial problems which may occur in their lives. The purpose of Social Security is

... to provide for the general welfare by establishing a system of federal old-age benefits, and by enabling the several states to make more adequate provision for aged persons, blind persons, dependent and crippled children, maternal and child welfare, public health and the administration of their unemployment compensations laws; to raise revenues; and for other purposes (5, p. 1).

This, however, does not mean a guaranteed income at the recipients preretirement level. Social Security is often mistakenly interpreted as a replacement wage for individuals at the level of their last employment (3, p. III). According to President Franklin D. Roosevelt,

We can never insure 100 percent of the population against 100 percent of the hazards and vicissitudes of life, but we have tried to frame a law which will give some measure of protection to the average citizen and to his family against the loss of a job and against poverty-ridden old age (2, p. 4).

Since Roosevelt, Social Security has expanded to include dependents of retired workers, crippled children, disability insurance, and health insurance (Medicare) for Social
Security recipients. It still includes compensation for those who lose employment because of retirement or disability (5, pp. 1-203).

The Social Security System is an insurance system which helps provide enough income to allow an individual to feed, clothe, and house himself, if he or she has paid into the Social Security System, or has been married to someone who has paid into the system, or is a dependent of someone who has paid into the Social Security System. Social Security notably helps provide protection against loss of income, but also includes health insurance for qualified aged and disabled persons, which covers the cost of prescribed medicine, medical treatment, and transportation costs to and from the place at which a beneficiary receives medical treatment (1, pp. 1-17).

The need for this program is so broadly recognized that it is compulsory in over ninety percent of the jobs in the United States.

That is the only sure way to prevent large-scale economic insecurity. Most people just do not save enough on their own to provide a continuing income when they are no longer able to earn. It is not really an issue of whether people ought to save sufficiently on their own, or even whether theoretically they could; demonstrably most have not done so, and did not do so prior to the establishment of social insurance institutions.

The pressure of more immediate needs keeps most people from accumulating the very large sums that are necessary to provide income security. In the absence of a method which provides protection automatically, large numbers of people would be dependent on public charity (1, p. 5).
The part of Social Security which may have engendered the idea that Social Security should replace preretirement income completely is the tying of benefits to preretirement wages, specifically, to the amount paid into the Social Security System. The purpose of tying an individual's benefits to his contributions is two-fold. First, people believe that they should receive as much as their contributions to the system. Second, we become habituated to a certain level of income and it is hard to deviate downward from that level (1, pp. 4-7). According to Robert Ball, "Economic security depends ... on being able to count on a level of living when one can't work that is not too far below that attained while working" (1, p. 7).

As the Social Security System now stands, a greater percentage of preretirement income is replaced at the low end of the income scale than at the high end of the scale. The reason for this is that lower income groups cannot afford to decrease their expenditures after retirement as much as higher income groups can and still allow for expenditures on food, clothing and shelter. The regressiveness of benefits to contributions, therefore, helps additionally to reduce the disparity of living standards for the poor, retired, and disabled (1, pp. 7-9).

The purpose of Social Security is to provide an income for those who at one time were productive members of our
society, but who can no longer provide for themselves, either because they are too old or disabled. This developed in the United States because Americans were not able, in the 1930s, to provide for these people without falling back on the extended family. Since that time we have counted increasingly on Social Security to provide funds for these groups and have reduced the role of the immediate and the extended family. Thus, the financial stability of the Social Security Program is increasingly important to the American public (1, pp. 7-9).

If one is to believe the radio, television and newspaper reports over the past few years, the Social Security System is rapidly headed for bankruptcy (4, p. 937). The media has apparently over-reacted. In fact, the financial future of Social Security is not dramatically endangered. Congress will not allow Social Security to financially falter. Senator Gaylord Nelson of Wisconsin states:

Over the years, the American Public had demanded secure and financially sound Social Security trust funds. Congress had responded by approving numerous measures to safeguard the financial stability and integrity of the trust funds.

In the future, there can be no question that Social Security benefits will remain secure. Those persons who are now retired or who will become eligible for Social Security benefits in the future can depend on Social Security -- not as a matter of welfare or charity, but as an earned right (6, p. 2).

As Senator Nelson seems to echo the prevailing congressional views on Social Security, it is totally unlikely
that Congress will allow the Social Security System to go bankrupt. Congress' concern is great because generations of United States' citizens have depended upon Social Security as a form of present or future retirement income. "Practically every American is either a beneficiary, a contributor building protection for the future, or the dependent of a contributor. Ninety-three percent of people sixty-five and older are eligible for Social Security benefits (1, p. vii)." It is extremely unlikely that a politically sensitive Congress will allow the Social Security System to fail. Rather, the questions are: how shall we continue to finance the Social Security System and what does this imply for the distribution of the tax burden. Two major problem areas have emerged. In the short run, there is concern that Old Age and Survivor's Insurance (OASI) will over spend its revenues in the 1980s. The second, long run concern is that there might not be sufficient funds to cover the Social Security Program when the "Baby Boom" retires in the early twenty-first Century (2, p. 131). The four major possible solutions for these problems are addressed in the following chapters.
CHAPTER BIBLIOGRAPHY


CHAPTER II

FINANCIAL STABILITY IN THE SHORT TERM

In 1976, it became evident to Congress that Social Security was headed for disaster. This crisis was supposed to come to a head in late 1979 because insufficient funds would have been generated for the purpose of paying out promised benefits (1, p. 1). To address this problem, Congress increased both the tax rates and the taxable wage base progressively upwards over time (2, p. 13). In 1977, the tax rate was 11.7 percent split equally between both employee and employer, and for the self-employed, the tax was 7.9 percent (3, p. 3). Public Law 95-216 which was passed in April, 1978, raised the taxable wage base progressively until 1990 (4, pp. v, 805; 6, p. 4) (Table I).

At the same time that the tax rates and taxable wage base were adjusted, the percentages of the tax earmarked for each segment of Social Security -- Old age and Survivors' Insurance (OASI), Disability Insurance (DI) and Hospital Insurance (HI) were also adjusted. This is where the current problem lies. As the segments are now earmarked, OASI will be bankrupt as early as late 1982 (but estimated income will adequately cover estimated expenditures again by 1985) (5, p. 63).
### TABLE I

**SOCIAL SECURITY TAX LEVEL FOR EMPLOYERS AND EMPLOYEES EACH***

<table>
<thead>
<tr>
<th>Year</th>
<th>OASI</th>
<th>DI</th>
<th>OASDI</th>
<th>HI</th>
<th>OASDHI</th>
<th>Maximum Taxable Wage Base</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>4.520</td>
<td>.560</td>
<td>5.08</td>
<td>1.05</td>
<td>6.13</td>
<td>$25,900</td>
</tr>
<tr>
<td>1981</td>
<td>4.700</td>
<td>.650</td>
<td>5.35</td>
<td>1.30</td>
<td>6.65</td>
<td>29,700</td>
</tr>
<tr>
<td>1982</td>
<td>4.575</td>
<td>.825</td>
<td>5.40</td>
<td>1.30</td>
<td>6.70</td>
<td>32,400</td>
</tr>
<tr>
<td>1983</td>
<td>4.575</td>
<td>.825</td>
<td>5.40</td>
<td>1.30</td>
<td>6.70</td>
<td>35,400**</td>
</tr>
<tr>
<td>1984</td>
<td>4.575</td>
<td>.825</td>
<td>5.40</td>
<td>1.30</td>
<td>6.70</td>
<td>39,000**</td>
</tr>
<tr>
<td>1985</td>
<td>4.750</td>
<td>.950</td>
<td>5.70</td>
<td>1.35</td>
<td>7.05</td>
<td>42,900**</td>
</tr>
<tr>
<td>1986-</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1989</td>
<td>4.750</td>
<td>.950</td>
<td>5.70</td>
<td>1.45</td>
<td>7.15</td>
<td>.***</td>
</tr>
<tr>
<td>1990</td>
<td>5.100</td>
<td>1.100</td>
<td>6.20</td>
<td>1.45</td>
<td>7.65</td>
<td>.***</td>
</tr>
</tbody>
</table>

*Source: Senate, Committee on Finance Documents: The Social Security Act and Related Laws (4, pp. v, 805) and Staff Data and Materials Related to Social Security Financing (6, p. 4).

**Estimates from President's 1981 fiscal year budget assumptions.

***Not available, subject to inflation rate and change in rate of average earnings of U. S. citizens.

The irony of this is that the funds in DI and HI will be growing during this time. In fact, the three funds together are projected to raise enough money to more than adequately cover the projected total expenditures of the Social Security System for the period 1982-1985. This makes the answer to this problem really quite simple. All Congress needs to do to keep the entire Social Security Program alive during the 1980s is to redistribute funds so that OASI, DI and HI are all sufficiently covered (5, pp. 14-17, 60-75).
There are two major types of proposals which may accomplish this redistribution of funds. One is to pass a law which allows for interfund borrowing. The second is to readjust the percentages of the Social Security tax which go into each fund.

Two separate yet similar proposals which suggest interfund borrowing between OASI, DI and HI deserve examination. The specific proposals identified are those of William J. Driver (Former Commissioner of Social Security), Lawrence Thompson (present Associate Commissioner for policy of Social Security), and Alice M. Rivlin (Director of the Congressional Budget Office) (5, pp. 8-17, 47-75). These proposals are based on the previously stated assumptions that the OASI fund will not collect enough income to pay for its expenditures in the early 1980s. However, the DI and HI funds will bring in a surplus which will more than adequately cover the projected short term financing problem (5, pp. 14-17, 60-75).

Driver and Thompson's proposal is the plan officially endorsed by the Social Security Administration. This plan suggests that interfund borrowing will offset the projected insufficient funds for OASI. Driver and Thompson presented their findings to the Subcommittee on Social Security of the Committee on Finance, United States Senate, Ninety-sixth Congress, Second Session (5, pp. 8-18) (Table II).
## TABLE II

FINANCIAL STATUS ON THE OASI, DI, AND HI TRUST FUNDS UNDER PRESENT LAW
BASED ON THE ECONOMIC ASSUMPTIONS CONTAINED IN THE PRESIDENT'S 1981
BUDGET**,**,**  CALENDAR YEARS 1979-1985 (AMOUNTS IN BILLIONS)

<table>
<thead>
<tr>
<th>Calendar Year</th>
<th>Income</th>
<th>Outgo</th>
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<tbody>
<tr>
<td></td>
<td>OASI</td>
<td>DI</td>
</tr>
<tr>
<td>1979</td>
<td>$90.1</td>
<td>$15.6</td>
</tr>
<tr>
<td>1980</td>
<td>101.8</td>
<td>17.9</td>
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<tr>
<td>1981</td>
<td>115.4</td>
<td>21.6</td>
</tr>
<tr>
<td>1982</td>
<td>130.7</td>
<td>24.8</td>
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<tr>
<td>1983</td>
<td>146.6</td>
<td>28.3</td>
</tr>
<tr>
<td>1984</td>
<td>163.9</td>
<td>32.0</td>
</tr>
<tr>
<td>1985</td>
<td>188.2</td>
<td>40.7</td>
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<table>
<thead>
<tr>
<th>Calendar Year</th>
<th>Net Change</th>
<th>End of Year Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>OASI</td>
<td>DI</td>
</tr>
<tr>
<td>1979</td>
<td>$-3.1</td>
<td>$1.4</td>
</tr>
<tr>
<td>1980</td>
<td>-6.5</td>
<td>2.0</td>
</tr>
<tr>
<td>1981</td>
<td>-9.8</td>
<td>3.8</td>
</tr>
<tr>
<td>1982</td>
<td>-10.9</td>
<td>5.0</td>
</tr>
<tr>
<td>1983</td>
<td>-10.9</td>
<td>6.5</td>
</tr>
<tr>
<td>1984</td>
<td>-10.0</td>
<td>8.0</td>
</tr>
<tr>
<td>1985</td>
<td>-2.1</td>
<td>14.3</td>
</tr>
</tbody>
</table>

*Source: Senate, Committee on Finance, Social Security Financing (5, p. 17).

**Also assumes present regulations.

***Totals do not necessarily equal the sum of rounded components.
Table II shows the income and outlays for the OASI, DI and HI funds from present tax laws using the President's 1981 budget. The table also contains the net change, end of the year balance, and beginning trust fund as a percentage of projected outgo for the years 1979-1985. According to these projections, OASI will run into a severe problem in 1982 which will not start to correct itself until 1985. This is illustrated in the net change columns of Table II. The projected OASI funds show a deficit for this period of time, while the DI and HI funds are projected to grow beginning in 1980 and to continue to increase through 1985 (5, pp. 14-17, 60-75).

By allowing the DI and HI trust funds to be borrowed by the OASI trust funds and using the Social Security Administration's projections, OASI will remain solvent during the 1980s. This form of financing is advocated by the Social Security Administration over the proposal of restructuring the tax rate, because the Interfund borrowing plan . . . will always prevent cash flow problems from developing in a single fund at a time when overall reserves are adequate while any allocation of tax rates which appears appropriate today may be inappropriate a few years hence, just as the 1977 one has already proved inappropriate (5, p. 11).

William Driver -- acting representative of the Social Security System at the time -- therefore, proposed that an
amendment to the Social Security Act be passed allowing for interfund borrowing until 1990.

The primary purpose of the interfund borrowing authority is to meet a temporary shortfall in the OASI trust fund during the early and middle years of the 1980s. Current projections show that payroll tax increases scheduled in the law for 1985 and 1990 will begin to rebuild the OASI reserves so that after 1990 borrowing authority will no longer be necessary. Also, the 1990 expiration date will allow the Congress to review the efficacy of the interfund borrowing provision and to decide whether it should be extended or allowed to expire (5, p. 16).

This would be an adequate answer to short term financing problems in OASI if the Social Security Administration's projections are correct. Interfund borrowing would also have other advantages over changing the tax rates. According to Ex-Commissioner Driver, it has the advantage of being neutral in its effect on benefits, payroll taxes, and the overall budget. It can however, make a major contribution to public confidence in the Social Security System and help assure the beneficiaries that their benefits will be paid regardless of economic downturns (5, p. 16).

Just such an economic downturn has contributed to the present concern over Social Security's financial health (5, p. 11).

The proposal by Alice Rivlin, Director, Congressional Budget Office is very similar to that of the Social Security Administration. However, it is based on a slightly different set of projections. Therefore, the projections of the Congressional Budget Office warrant examination. Like the
Social Security Administration, the Congressional Budget Office (CBO) suggests that simple borrowing from the DI fund and HI fund will be adequate to cover the short term deficit expected to be encountered by OASI (5, pp. 47-59). The CBO bases its suggestion on data set forth in Table III.

As can be seen in Table III, the OASI trust fund is projected to experience a shortfall in 1982 or 1983. If interfund borrowing is allowed and the CBO projections are correct, no benefit payments should be missed. This is evidenced by the OASDHI trust fund balance in the last row of Table III, which shows a continual rise from 1981 through 1990 (5, pp. 51-56).

Although this plan to allow interfund borrowing seems to more than adequately finance Social Security through 1990, some other plans have been proposed to cure the apparent deficit which OASI may soon be facing. Almost all of the other proposals involve restructuring the Social Security tax rates, i.e., redistributing the percentages of the Social Security Tax which go to OASI, DI and HI.

Only one of the tax restructuring proposals will be shown in this paper, because they are all very similar. The tax restructuring plan to be reviewed is that of the National Commission on Social Security. As in the programs which propose interfund borrowing, the tax restructuring plan is entirely internal and will not cause any overall change in the tax rate or the economy (5, pp. 109-124).
<table>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>OASI</td>
<td>22.9</td>
<td>12.7</td>
<td>2.1</td>
<td>-7.8</td>
<td>-17.0</td>
<td>-20.2</td>
<td>-19.4</td>
<td>-19.3</td>
<td>-17.9</td>
<td>-18.8</td>
<td>-5.0</td>
</tr>
<tr>
<td>DI</td>
<td>7.4</td>
<td>9.9</td>
<td>13.5</td>
<td>17.8</td>
<td>23.8</td>
<td>34.8</td>
<td>50.3</td>
<td>67.3</td>
<td>86.2</td>
<td>105.3</td>
<td>131.6</td>
</tr>
<tr>
<td>HI</td>
<td>15.6</td>
<td>21.1</td>
<td>28.8</td>
<td>37.1</td>
<td>45.3</td>
<td>54.8</td>
<td>67.6</td>
<td>80.6</td>
<td>92.4</td>
<td>100.9</td>
<td>104.8</td>
</tr>
<tr>
<td>OASDI</td>
<td>30.3</td>
<td>22.6</td>
<td>15.6</td>
<td>10.0</td>
<td>6.5</td>
<td>14.6</td>
<td>30.9</td>
<td>48.0</td>
<td>68.3</td>
<td>86.8</td>
<td>126.7</td>
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<tr>
<td>OASDHI</td>
<td>45.9</td>
<td>43.8</td>
<td>44.4</td>
<td>47.1</td>
<td>51.8</td>
<td>69.4</td>
<td>98.5</td>
<td>128.6</td>
<td>160.7</td>
<td>187.4</td>
<td>231.5</td>
</tr>
</tbody>
</table>

*Source: Senate, Committee on Finance, Social Security Financing (5, p. 56)
Based on CBO's January 1980 economic assumptions.

Note -- Details may not add to totals because of rounding.
Under the 1980 proposal of the National Commission on Social Security, "a portion of the DI fund would be permanently allocated to the OASI fund" (4, p. 115). Table IV shows how the program would establish the new tax rates. As can be seen in Table IV, the total tax rates remain unchanged, while the relative percentages going to OASI and to DI change. HI remains unaffected. The purpose for this change is to attempt to correct the improper rates assigned by Congress in 1977 (5, p. 113).

If the new tax rates are adopted, then OASI and DI should both be solvent through the year 1989. This is demonstrated in Table V, which shows the National Committee on Social Security's projections after the tax rate changes proposed in Table IV (2, pp. 109-124).

As shown in Table V, trust funds for OASDI will become very low at the beginning of 1983 and even lower in 1984. Because of this, the National Committee on Social Security also favors an interfund borrowing program, in case the projections used are too optimistic and additional funding from the HI program is needed to insure solvency (2, p. 115).

As in the interfund borrowing proposals, the restructuring of the tax proposals do not call for a change in the overall tax rates. Neither of these programs will directly cause a change in the overall tax rates, nor a change in the overall economy.
TABLE IV
CONTRIBUTION RATES FOR OASI AND DI UNDER PRESENT LAW AND
UNDER A REALLOCATION OF THE COMBINED OASDI TAX RATE
BEGINNING IN 1981*

<table>
<thead>
<tr>
<th>Calendar Years</th>
<th>Present Law</th>
<th>Reallocaton</th>
</tr>
</thead>
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<tr>
<td></td>
<td>OASDI</td>
<td>OASI</td>
</tr>
<tr>
<td>1979-80</td>
<td>5.08</td>
<td>4.330</td>
</tr>
<tr>
<td>1981</td>
<td>5.35</td>
<td>4.525</td>
</tr>
<tr>
<td>1982</td>
<td>5.40</td>
<td>4.575</td>
</tr>
<tr>
<td>1983</td>
<td>5.40</td>
<td>4.575</td>
</tr>
<tr>
<td>1984</td>
<td>5.40</td>
<td>4.575</td>
</tr>
<tr>
<td>1985-89</td>
<td>5.70</td>
<td>4.750</td>
</tr>
<tr>
<td>1990 and later</td>
<td>6.20</td>
<td>5.100</td>
</tr>
</tbody>
</table>

Employees and Employers, Each

Self-employed Persons

<table>
<thead>
<tr>
<th></th>
<th>Present Law</th>
<th>Reallocaton</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>OASDI</td>
<td>OASI</td>
</tr>
<tr>
<td>1979-80</td>
<td>7.05</td>
<td>6.010</td>
</tr>
<tr>
<td>1981</td>
<td>8.00</td>
<td>6.7625</td>
</tr>
<tr>
<td>1982</td>
<td>8.05</td>
<td>6.8125</td>
</tr>
<tr>
<td>1983</td>
<td>8.05</td>
<td>6.8125</td>
</tr>
<tr>
<td>1984</td>
<td>8.05</td>
<td>6.8125</td>
</tr>
<tr>
<td>1985-89</td>
<td>8.55</td>
<td>7.1250</td>
</tr>
<tr>
<td>1990 and later</td>
<td>9.30</td>
<td>7.6500</td>
</tr>
</tbody>
</table>

*Source: Senate, Committee on Financing, Social Security Financing (5, p. 117).
TABLE V

ESTIMATED OPERATIONS OF THE OASI AND DI TRUST FUNDS, COMBINED UNDER A REALLOCATION OF TAX RATES BETWEEN OASI AND DI*,** CALENDAR YEARS 1978-89

(AMOUNTS IN BILLIONNS)***

<table>
<thead>
<tr>
<th>Calendar Year</th>
<th>Income</th>
<th>Outgo</th>
<th>Net Increase In Funds</th>
<th>Funds at End of Year</th>
<th>Funds at Beginning of Year as a Percentage of Outgo During Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1978</td>
<td>$91.9</td>
<td>$96.0</td>
<td>- 4.1</td>
<td>$31.7</td>
<td>37%</td>
</tr>
<tr>
<td>1979</td>
<td>105.8</td>
<td>107.4</td>
<td>- 1.7</td>
<td>30.1</td>
<td>30</td>
</tr>
<tr>
<td>1980</td>
<td>119.8</td>
<td>124.2</td>
<td>- 4.5</td>
<td>25.6</td>
<td>24</td>
</tr>
<tr>
<td>1981</td>
<td>136.9</td>
<td>143.0</td>
<td>- 6.1</td>
<td>19.5</td>
<td>18</td>
</tr>
<tr>
<td>1982</td>
<td>155.4</td>
<td>161.3</td>
<td>- 5.9</td>
<td>13.6</td>
<td>12</td>
</tr>
<tr>
<td>1983</td>
<td>174.9</td>
<td>179.3</td>
<td>- 4.4</td>
<td>9.3</td>
<td>8</td>
</tr>
<tr>
<td>1984</td>
<td>195.8</td>
<td>197.9</td>
<td>- 2.1</td>
<td>7.1</td>
<td>5</td>
</tr>
<tr>
<td>1985</td>
<td>226.8</td>
<td>216.8</td>
<td>10.0</td>
<td>17.2</td>
<td>3</td>
</tr>
<tr>
<td>1986</td>
<td>247.5</td>
<td>234.7</td>
<td>12.8</td>
<td>30.0</td>
<td>7</td>
</tr>
<tr>
<td>1987</td>
<td>267.8</td>
<td>252.6</td>
<td>15.1</td>
<td>45.1</td>
<td>12</td>
</tr>
<tr>
<td>1988</td>
<td>289.0</td>
<td>270.6</td>
<td>18.4</td>
<td>63.5</td>
<td>17</td>
</tr>
<tr>
<td>1989</td>
<td>310.1</td>
<td>288.5</td>
<td>21.6</td>
<td>85.1</td>
<td>22</td>
</tr>
</tbody>
</table>

*Source: Senate, Committee on Finance, Social Security Financing (5, p. 119).

**Based on the President's 1981 budget assumptions, modified in 1984 and 1985 and extended through 1989 as requested by the staff of the Senate Finance Committee.

***Totals do not necessarily equal the sum of rounded components.

If the projections used to derive the figures in Tables II, III and V are not overly optimistic (This is discussed in Chapter III), then Social Security will be financially sound through this century (2, pp. 17, 56, 119). Therefore, Congress need only decide which form of redistribution of Social Security's income is to be chosen.
However, if these projections are overly optimistic as in the past, other forms of refinancing will be necessary.
CHAPTER BIBLIOGRAPHY


CHAPTER III

POSSIBLE SOLUTIONS TO FUTURE FINANCING PROBLEMS

In the second decade of the Twenty-first Century, the World War II "Baby Boom" will begin to retire (18, pp. 5-6). The population distribution at that time is estimated to be two working for every person receiving money from Social Security. Presently, it is three working for each person receiving money from Social Security (16, p. 7).

When making projections for Social Security expenditures, the Social Security Administration has suggested that growth rates in real output will increase from - .4 percent in 1980 to 3.6 percent in 1985. Growth in real output is expected to drop to 2.4 percent in 1995, and then stabilize at about 2.8 percent (2, p. 12). The unemployment rates are projected to drop from the present rates of about 8 percent to 7 percent in 1985 (22, p. 20) and then stabilize at a level of 5 percent starting around 1995 (2, p. 12). With this, the Consumer Price Index (CPI) is expected to drop from its 9.1 percent rate to about 6.5 percent in 1985 (22, p. 20) and then stabilize around the year 2000 between 4 and 5 percent. The fertility rates are expected to grow from their present levels to 1.8 percent by the year 2000 (2, p. 12).
These projections made by the Social Security Administration are being used for the purpose of this paper. It should be noted that some of the Social Security Administration's projections have previously been optimistic. The major concerns about the Administration's projections center on the rates of fertility, immigration, mortality, retirement, labor force participation, and unemployment. If any of these projections are incorrect the need for additional funds may either be postponed or occur more quickly.

It is probable that all of the variables used are slightly incorrect. Immigration, fertility, and labor participation rates could very easily be greater than the Social Security Administration projects. If this is true more people will be able to work and pay into the Social Security program, which would help strengthen the financing of Social Security. The average life expectancy and retirement ages may be too low, which would hurt the financial situation of Social Security more than is presently expected. The rate of unemployment projected by the Social Security Administration may also be too low, which would decrease receipts. Overall, incorrect projections which Social Security may have made may cancel each other out, making their final projections fairly accurate. However, if the Administration's projections are overly optimistic and the financial problem occurs earlier or is more acute than
projected, the programs recommended in this paper will still be the best solutions.

Assuming the above to be true, the Social Security Administration projects that the OASDI tax rates, under present law, will not produce enough funds to cover current expenditures in the year 2015 (22, p. 80). However, in the years prior to 2015, i.e., 1987 to 2014, trust funds will be growing (22, pp. 80-82). Due to the excess funds in these years, Social Security is projected to be solvent through the year 2030. After this time, the trust funds are projected to be exhausted (22, p. 82). These projections by the Social Security Administration's Actuarial Department have caused concern over Social Security's future solvency.

With these forecasts in mind, many members of Congress and several interest groups have suggested ways in which Social Security revenues might be changed to assure solvency through the Twenty-first Century. Four ways to increase revenues are presently being proposed to Congress. These are: 1) General Revenue financing; 2) increasing the amount of tax for OASDI beyond current legislation; 3) eliminating the taxable wage base, i.e., making the Social Security tax applicable to all income; and 4) eliminating the Civil Service exemption, in which employees of non-profit organizations, federal, state and local governments
can vote or have voted not to participate in the Social Security System (10, p. XXXIII).

Each of these four proposals will be addressed individually to analyze whether it would be able to cure the financial problem for Social Security predicted in the Twenty-first Century. Then the proposals which seem politically feasible will be examined for their impacts on the economy as a whole. This examination will concentrate on the impacts on growth, unemployment, inflation and interest rates.

General Revenue financing is the first alternative to be addressed. Two problems immediately appear when looking at General Revenue financing of Social Security. The first is that moving Social Security over to General Revenue financing would necessitate either higher taxes or increased deficit spending. This is because Social Security now spends at least 120 billion dollars a year, which would have to be financed through General Revenues instead of the present OASDHI tax. Since it is forecast that more funds will be needed than are presently legislated, more taxes will be needed to fund Social Security. Simply moving Social Security financing from OASDHI funds to General Revenue funds would not increase revenues. In today's world of tax cuts and demands for balanced budgets, it is
very unlikely that Congress would promote a program which would increase either taxes or deficit spending.

Another argument cited for funding through the payroll tax OASDI alone is that it promotes restraint, since increases in benefits must usually be accompanied by increases in the earmarked payroll tax (4, p. 29).

According to Alicia Munnell, the line between Social Security benefits and contributions must continue so that the Social Security System will be a forced savings plan (15, p. 11). These arguments lack statistical data concerning financing Social Security with General Revenues. The following quote by Senator Altmyer will cast more light on why examination of this issue is so often neglected.

[T]hose taxes were never a problem of economics. They are politics all the way through. We put those payroll contributions there so as to give the contributors a legal, moral, and political right to collect their pensions. . . With those taxes in there, no damn politician can ever scrap my social security program (7, p. 230).

Since the inception of the Social Security Act, the primary form of raising new funds for the Social Security Program has been increasing the OASDHI tax rate and base (7, pp. 244-248). Since the problem in Social Security is not projected to occur until 2030, few people are presently concerned about increasing our tax burden at this time. Even though raising any taxes is politically unpopular at this time, two similar proposals exist on raising the OASDI tax rate.
Robert M. Ball, ex-commissioner of Social Security and advisor to the Social Security Council suggests that the legislated tax rate of 6.2 percent for both employers and employees for the year 2005 (see Table I, page 8) be increased. The increase Mr. Ball suggests is to 7.5 percent for both employer and employee. According to his projections, this should more than adequately cover the deficit projected for Social Security in 2030 (9, p. 317).

The Advisory Council on Social Security has echoed Mr. Ball's suggestion by stating that even a lower tax increase to 7.25 percent for both employer and employee in the year 2005 will secure solvency during the projected deficit period (21, p. 103). Unfortunately, exact projections were not furnished in these reports. However, assuming that these projections are accurate, raising the combined OASDI tax rate for employer and employee from 12.4 percent in 2005 (22, p. 80) to 15 percent should solve Social Security's projected long range deficit.

Another alternative which has recently been proposed is the elimination of the taxable wage base (22, pp. 37-41). This program is unpopular for three reasons. First, if benefits remained tied to contributions at the 41.8 percent replacement level of preretirement income (22, p. 56), it would add more costs than it would bring in new revenues (21, pp. 102-103). The second reason is that even if
benefits are untied from contributions, there would still have to be a tax increase to avoid the projected deficit (22, pp. 37-41). The last argument is that if benefits are untied from contributions, then -- just as in general revenue financing -- the system would no longer be viewed as an insurance program (21, pp. 103-104).

Eliminating the taxable wage base has not been proposed recently without keeping benefits tied to contributions. Therefore, it is rarely mentioned in studies on refinancing Social Security. The few times that elimination of the taxable wage base is addressed, it is a condemnation not a proposal (21, pp. 102-104).

Requiring all United States workers to pay into the Social Security System is the fourth way to increase funds for the Social Security Program. Presently, the federal civil service, the military, members of non-profit organizations and some state and local civil service employees do not pay Social Security taxes (10, pp. 10-11). It is estimated that if mandatory coverage were put into effect, at first, the increased funds for the system would far outweigh the additional costs. In fact, according to the Social Security Administration, if all employees who are not included in Social Security were added to the program in 1985, additional funds for 1985 through 1988 would be 106.4 billion dollars. Additional costs would only be 689
million dollars for the same period of time (10, pp. 49-50). Of course, this gap would start to decrease as time went on. But in the short term, this would be a windfall to Social Security funds. "The effects of extended coverage on the Social Security Program, however, are not sufficient to 'bail out' the system from any long term financial problems it might face" (10, p. 271).

Even though mandatory coverage will not cure the "Baby Boom" deficit projected for 2030, it is an important program for preventive maintenance. If the ability for non-profit organizations and state and local governments to remove themselves from the Social Security Program continues, then even fewer people could be paying into the system than the two for one projection discussed earlier (22, p. 85).

"The long range savings estimated to result from this proposal is roughly 0.5 percent of taxable payroll" (22, p. 49; 10, p. 271). This would not be enough to finance the deficit projected for 2030, but it would reduce the amount needed to finance the predicted deficit.

Economically, this is a very neutral program. "Both Social Security and the Civil Service Retirement System are funded from the same budget" (10, p. 270). Equity is the major concern related to mandatory coverage. Even though a few members of the programs replaced by Social Security would lose some additional income, the majority would have a more secure future (10, p. 271). As an example,
There are gaps in protection of workers who have worked both under the CSR Civil Service Retirement System and Social Security; some employees only qualify for benefits under one system so that their benefits are not based on their lifetime earnings and contributions to both systems, while other employees fail to get benefits under either system. The second problem is that many employees who have worked under both systems are able to qualify for Social Security benefits by working for relatively short periods in jobs covered under Social Security, and to also qualify for substantial CSR benefits.

These Social Security benefits generally are based on substantially less than a full lifetime of covered work and are heavily weighted and represent a very high return on the employee's contribution. This situation is unfair to all workers covered under Social Security and to their employers, who must bear the cost of the windfall benefits payable to Federal Employees (2, pp. 47-48).

In each of the four proposals the economic consequences are relatively similar. Because there will be a need for more funds each proposal will have to increase the tax burden on at least one group of taxpayers to be effective. Any changes caused by an increase in the tax burden will depend on the health of the overall economy; what will be done with the increased tax revenues (invested or doled out to Social Security recipients); the stability of prices in the durable and non-durable markets; and finally the changes will be slightly different if the tax dollars are taken from different income groups.

When analyzing the economic changes caused by increased taxation, five assumptions of the future will be made. First, it is assumed that those individuals who have incomes
above the taxable wage base are willing and able to save a higher percentage of their income than those who earn less than the taxable wage base. (19, p. 65). Second, it is assumed that the income tax actually paid by individuals and corporations will remain progressive (3, p. 339). Third, it is assumed that when disposable income decreases, people would rather decrease savings than decrease consumption (17, p. 66). The fourth assumption is that business will freely raise prices if the opportunity exists, but if demand decreases for a product, producers would rather decrease supply than decrease price (supply is relatively inelastic) (24, p. 82). The last assumption is that most labor is semi-skilled; and when employment opportunities decrease in one trade, the newly unemployed would rather take income from unemployment insurance and wages from layoff funds, than take employment for less money or retrain for other semi-skilled jobs (12, pp. 438-442).

For analysis of changes in the economy, the income level, savings rates and tax rates will be arbitrarily assigned, because the types of economic changes caused by changes in taxation are similar no matter what the rates. For simplicity, the Gross National Product (GNP) or (Y) will be shown at one trillion dollars. The tax rate (t) will be an average of 14 percent. Taxes collected (T) is the tax
rate times \(Y\). Average consumption \(C\) will equal the Marginal Propensity to Consume (MPC) times disposable income \((Y-T)\). The Marginal Propensity to Consume is assumed to be .95 in this model, and \(i\) is 100 times the interest rate. Investment \((I)\) will be 400-10i. Government expenditures \((G)\) will be .14 of GNP, and a balanced budget is assumed. \((6, p. 63)\).

For the money markets, money supply \((M^S)\) is 400. Transactions demand for money \((M^d_t)\) will be 10 percent of disposable income \((Y-T)\). Wealth demand for money \((M^d_w)\) is 200-10(i), and money demand \((M^d)\) is \(M^d_t + M^d_w\) \((6, pp. 123-129)\). The Marginal Propensity to Save (MPS) is 1-MPC \((6, p. 251)\). Savings \((S)\) is Marginal Propensity to save times disposable income or \(MPS(Y-T)\) \((6, p. 251)\). To find the interest rates which gives equilibrium in the money markets, we need to equilibrate DLF with SLF, at a given income \((5, pp. 93-98, 299)\). Supply of loanable funds must equal demand for loanable funds, \(SLF = DLF\). Demand for loanable funds equals investment, \(DLF = I\). Supply of loanable funds equals savings plus excess supplies of money \((M^{sx})\). The excess supply of money is money supply minus money demand, \(M^s - M^d\). Then to find the equilibrium interest rates all that is needed is to equilibrate SLF to DLF \((8, p. 3)\).
Starting with GNP \( (Y) \) at one trillion dollars consumption \( (C) \) will equal 817 billion dollars. (All equations show dollars in billions.)

\[
Y = 1000 \\
T = .14(Y) \\
T = .14(1000) \\
T = 140 \\
MPC = .95 \\
C = MPC(Y-T) \\
C = .95(1000-140) \\
C = .95(860) \\
C = 817
\]

Money demand for transactions will equal 86 billion dollars.

\[
M_{Dt} = .1(Y-T) \\
M_{Dt} = .1(1000-140) \\
M_{Dt} = .1(860) \\
M_{Dt} = 86
\]

Money demand for wealth will equal 200-10\( (i) \). Money demand is 286-10\( (i) \).

\[
M_{dW} = 200-10(i) \\
M_{d} = M_{Dt}+M_{dW} \\
M_{d} = 86+(200-10i) \\
M_{d} = 86+200-10i \\
M_{d} = 286-10i
\]

Excess supply of money is 114+10\( i \).

\[
M_{S} = 400 \\
M_{SX} = M_{S}-M_{d} \\
M_{SX} = 400-(286-10i) \\
M_{SX} = 400-286+10i \\
M_{SX} = 114+10i
\]
The MPS is .05.

\[
\begin{align*}
\text{MPS} &= 1 - \text{MPC} \\
\text{MPS} &= 1 - .95 \\
\text{MPS} &= .05
\end{align*}
\]

Savings is 43.

\[
\begin{align*}
S &= \text{MPS}(Y - T) \\
S &= .05(1000 - 140) \\
S &= .05(860) \\
S &= 43
\end{align*}
\]

Supply of loanable funds is 157 + 10i.

\[
\begin{align*}
\text{SLF} &= S + M^{Sx} \\
\text{SLF} &= 43 + 114 + 10i \\
\text{SLF} &= 157 + 10i
\end{align*}
\]

Demand for loanable funds is 400 - 10i.

\[
\begin{align*}
I &= 400 - 10i \\
\text{DLF} &= I \\
\text{DLF} &= 400 - 10i
\end{align*}
\]

Demand for loanable funds equals supply of loanable funds, and the equilibrium interest rate is 12.15 percent.

\[
\begin{align*}
\text{DLF} &= \text{SLF} \\
400 - 10i &= 157 + 10i \\
400 - 157 &= 10i + 10i \\
243 &= 20i \\
12.15 &= i
\end{align*}
\]

Now, if the tax rate is increased so that more funds will be available for Social Security then there would be an increase in total income and an increase in interest rates. This can be shown by first using the balanced budget taxation multiplier which equals one times the increase in taxation (6, p. 89, 96). This gives a new GNP of one trillion plus the increase in taxation (NT).
1000+NT=Y_{t+1}. If we increase Social Security taxation by one percent making the tax rate increase (T^i), NT equals 10 billion.

\[
\begin{align*}
\text{GNP}(T^i) &= NT \\
1000(.01) &= NT \\
10 &= NT
\end{align*}
\]

\[
\begin{align*}
1000+NT &= Y_{t+1} \\
1000+10 &= Y_{t+1} \\
1010 &= Y_{t+1}
\end{align*}
\]

This would give a new GNP (Y) of one trillion ten billion dollars. Then placing this new GNP along with the new tax rate of 15 percent in the previous equations, the new interest rates can be determined.

Consumption will now be 815.575 billion if the MPC remains 95 percent. $T_{t+1}$ is the tax collected after the tax change.

\[
\begin{align*}
T_{t+1} &= .15(Y) \\
T_{t+1} &= .15(1010) \\
T_{t+1} &= 151.5
\end{align*}
\]

\[
\begin{align*}
C &= \text{MPC}(Y-T) \\
C &= .95(1010-151.5) \\
C &= .95(858.5) \\
C &= 815.515
\end{align*}
\]

However, people would rather decrease savings than decrease consumption, and some growth will be expected. Therefore, consumption should increase, and the MPC must increase. If the MPC increases to .96, consumption would be 824.16 instead of 815.575.
C = MPC(Y-T)
C = .96(1010-151.5)
C = .96(858.5)
C = 824.16

Money demand for transactions will now equal 85.85.

\[ M^d_t = .1(Y-T) \]
\[ M^d_t = .1(1010-151.5) \]
\[ M^d_t = .1(858.5) \]
\[ M^d_t = 85.85 \]

Money demand for wealth will still equal 200-10i.

Money demand now equals 285.5-10i.

\[ M^d_w = 200-10i \]
\[ M^d = M^d_t + M^d_w \]
\[ M^d = 85.85 + 200 - 10i \]
\[ M^d = 285.85 - 10i \]

Excess supply of money is now 114.15 = 10i.

\[ M^{sx} = M_s - M^d \]
\[ M^{sx} = 400 - (285.85 - 10i) \]
\[ M^{sx} = 400 - 285.85 + 10i \]
\[ M^{sx} = 114.15 + 10i \]

Savings changes to 34.34. MPS now equals .04.

\[ MPS = 1 - (MPC) \]
\[ MPS = 1 - .96 \]
\[ MPS = .04 \]

\[ S = MPS(Y-T) \]
\[ S = .04(1010-151.51) \]
\[ S = .04(858.5) \]
\[ S = 34.34 \]

Supply of loanable funds is now 148.49 + 10i.

\[ SLF = S + M^{sx} \]
\[ SLF = 34.34 + 114.15 + 10i \]
\[ SLF = 148.49 + 10i \]
Demand for loanable funds still equals Investment.

Investment still equals 400 - 10i.

\[ I = 400 - 10i \]

\[ DLF = I \]
\[ DLF = 400 - 10i \]

Now, by equilibrating DLF with SLF, we can find out the new interest rate.

\[ DLF = SLF \]
\[ 400 - 10i = 148.49 + 10i \]
\[ 251.51 = 20i \]
\[ 12.5755 = i \]

The new interest rate 12.5755 percent is a small increase over the earlier rate of 12.15 percent.

This increase in GNP, consumption and interest rates shows that little concern is necessary when looking at a small increase in the tax rates. However, the change may need more consideration if inflation and not growth is what accounts for the increase in income. This will depend on the elasticity of supply for non-durable goods; the present growth rate of the economy; who gets the increase in income; and from whom the tax dollars are taken.

If the increase in tax revenues goes to Social Security recipients, the increase in consumption should go to non-durable items. Therefore, the prices and quantities of non-durable goods should increase. If the supply of non-durable goods is elastic as in Figure 1, then most of the increase will be in output -- not in price.
In Figures 1 through 4, $P_1$ will symbolize the average price of goods and services before any changes in income and taxation. When price is denoted by $P_2$, it symbolizes price after any changes in income and taxation. When quantity is denoted by $Q_1$, it will symbolize the quantity produced and sold before any changes in income and taxation.

Fig. 1--Increase in Demand with an elastic Supply curve.

$Q_2$ will symbolize the quantity produced and sold after any changes in taxation and income. The supply curve will be denoted by $S_1$ before any changes in taxation and income, and by $S_2$ after any changes in taxation and income. The demand curve will be denoted by $D_1$ before any changes in taxation and income, and by $D_2$ after any changes in taxation and income.

The elastic supply curve shown in Figure 1 assumes that suppliers are willing and able to increase the quantity of
their good or service a great deal to secure a higher price for that good or service. When demand for non-durable items increases from $D_1$ to $D_2$ because of an increase in income to people who consume mostly non-durable goods and services, the quantity of those goods and services will increase at a greater percentage rate than prices. This can easily be seen by looking at Figure 1 which shows the increase of prices from $P_1$ to $P_2$ and quantity from $Q_1$ to $Q_2$.

However, if the supply curve is relatively inelastic for non-durable goods and services, the increase in consumption and income shown in Figure 1 may be realized as mostly inflationary. This is because when prices increase due to an increase in demand, quantity produced is not able to increase as rapidly. Quantity may not be able to increase because there is a lack of individuals with skills to produce those goods (13, pp. 726-727). There may not be an increase in quantity because the products may be seasonal giving a totally inelastic supply curve. Lastly, holding back an increase in quantity of goods and services may be a way of restricting supply so that prices will increase. The supply curve in Figure 2 is one in which we can see that an increase in demand may be mostly inflationary.

Figure 2 represents the case where the supply curve is inelastic and there is an increase in demand. Before the
increase in taxation, the average market price for non-durable goods would be $P_1$, and the quantity produced of these goods and services would be $Q_1$. However, after the increase in taxation, the demand for these products would increase from $D_1$ to $D_2$ because of the increase in income to Social Security recipients. With this increased demand for non-durables, the price would increase to $P_2$ and quantity demanded would increase to $Q_2$. As Figure 2 shows, the percentage increase in prices would be greater than the percentage increase in quantity of non-durables.

By comparing Figures 1 and 2, we can see that if non-durable goods have an inelastic supply curve, inflation would be greater than if non-durable goods and services have an elastic supply curve. In both cases, the inflation is
demand pull, caused by an increase in income in the hands of people who basically consume necessities. The consequences may be more severe if there has been a restructuring of income which would cause a decrease in consumption in the durables markets.

If the demand in fact does decrease in the durables markets, a reduction in growth and employment would occur. The reduction in demand for the durable goods may cause either a reduction in production and price, or just a reduction in production. This will depend on whether the individuals controlling the production of goods and services in the durables markets are willing to decrease prices. If they are willing to decrease prices, then both production and prices will decrease as is shown in Figure 3.

Fig. 3--Decrease in demand in the Durables Markets.
But if prices are sticky downward and the companies who produce durable goods would rather decrease supply than prices, production would decrease and prices might actually increase as shown in Figure 4.

Figure 3 shows the case where suppliers are willing to increase prices for their goods. In this case, the quantity of goods purchased will decrease from $Q_1$ to $Q_2$ because of a decrease in demand. At the same time, prices would decrease to $P_2$ from $P_1$. This should cause less employment to be needed by those who produce durable goods.

![Figure 4](image)

**Fig. 4**—Decrease in Demand and Supply in the Durables Markets.

However, if producers are reluctant to decrease prices and would rather restrict supply than lower prices, there will be a more drastic decrease in quantity than if they
allow price to decrease. This is obvious when we compare Figures 3 and 4. In Figure 4, there is a reduction in supply accompanied by a decrease in demand, which gives a much greater decrease in quantity from \( Q_1 \) to \( Q_2 \) than in Figure 3 where suppliers are willing to reduce price. In both cases there will be a lower amount of production which in turn will cause producers to lay off employees. The larger reduction in the quantity produced the fewer employees that will be needed to produce durable goods.

The reduction in employment would most likely increase the unemployment rate for some time. This is because most employees in the durables markets are semi-skilled and would not be willing to take less money (11, pp. 338-340). Instead, the people who would be layed off from these durables markets would rather receive lay-off funds built up by unions or take early retirement.

Since people would rather reduce savings than reduce consumption, it is unlikely that there would be a reduction in demand for durable goods. Therefore, if a small increase in taxation is used to fund Social Security when the World War II "Baby Boom" begins to retire, savings would be reduced in order to maintain consumption levels. However, if the marginal propensity to save is low enough that people are not able to decrease savings in order to keep consumption at the current levels, unemployment and reduction in demand
must be considered. The Social Security Administration ignores whether or not savings will be substantial enough to allow for a decrease in past savings in order to keep consumption at its present level. There will, however, still be a decrease in potential growth.

The probable decrease in growth rates can be shown by looking at the change in the dollars saved before the tax change with the dollars saved after the tax change. When using the model previously shown, savings is 43 million dollars before the tax change. Savings drops to 34.34 million after the tax change. This decrease in savings leaves fewer funds available for industry to borrow. Therefore, fewer new businesses can be started and fewer companies can rebuild ailing equipment by using borrowed funds. This will cause a decrease in possible growth rates. This will especially be true if inflation is high, because in a time of inflation, the limited number of goods available will cost more than they would have previously (14, pp. 367-369).

All four proposed solutions will cause some inflation, reduction in output, reduced growth potential, increased interest rates, and decreased employment opportunities. However, General Revenue financing and eliminating the taxable wage base would be more detrimental than requiring mandatory participation in the Social Security Program and
increasing the Social Security tax rate. The reason for this is that by using General Revenue financing or elimination of the taxable wage base, more of the increased funds will come from the population groups who do most of the saving in the United States. This occurs by moving from a relatively regressive tax system to a more proportional or progressive tax system. This would give a larger decrease in savings than if the increase in the tax burden is on individuals who do not save. According to William J. Fitzgerald, Inc. of Bethesda, Maryland, people with incomes below the present taxable wage base do not, in general, save, while those with incomes above the present taxable wage base do most of the savings in the United States (19, p. 65).

Since most people in the United States now pay a higher percentage of taxes as their income increases, a shift to General Revenues would put more of the Social Security tax burden on those who save more (19, p. 65). Presently, Social Security is on a regressive tax system as can be seen in Table VI. When income increases above the taxable wage base, a lower percentage of income goes toward Social Security (1, pp. 421-422).

Table VI shows how the 1981 OASDHI tax rate is regressive above the taxable wage base. Under the 1981 taxable wage base of 29,700, the OASDHI tax rate is
<table>
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<th>Tax Paid</th>
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*Source: Senate Committee on Finance Documents: The Social Security Act and Related Laws (23, pp. v, 805); and Staff Data and Materials Related to Social Security Financing (22, p. 4).

proportional. However, as the income increases above the taxable wage base, the tax paid as a percentage of income decreases.

If the increase in funds needed is raised partially by eliminating the taxable wage base, the regressive nature of the Social Security Tax will be more proportional. This may not decrease savings as much as moving to General Revenue financing, but it would decrease savings by a larger amount than a simple increase in the Social Security tax rate. A decrease in savings occurs because those who earn above the taxable wage base save a larger percentage of their income.
than those who earn less than the taxable wage base (19, p. 65). This would not only decrease funds available for investment which would decrease the potential growth rate, but also have an increased affect on demand-pull inflation.

The more savings is depressed to increase funds for expenditures, the more inflationary pressures increase. (14, pp. 125-126). This occurs when funds which previously would have been used for expansion of production are now used for consumption. This is shown in Figure 1 where demand increases. However, if these new funds came from people who do virtually no savings, the only inflationary pressures are those which come about because of increased GNP.

By increasing the tax rate or making it mandatory to participate in the Social Security Program, there will be an increase in inflation and a decrease in growth potential. William J. Fitzgerald, Inc. of Bethesda, Maryland showed those who earn under the taxable wage base save virtually zero percent of their income (19, p. 65). For this reason, a lower percentage of savings should turn into consumption by simply increasing the OASDI tax rate than by either increasing the taxable wage base or by switching to General Revenue financing. Therefore, the new income of the Social Security recipients would basically be funds that would have previously been used for consumption.
Savings would not be decreased if funds are raised by forcing everyone to participate in the Social Security Program. At present, the majority of those who do not pay Social Security taxes work for state and local government agencies. These individuals primarily earn less than the current taxable wage base (19, p. 65). Therefore, very little savings would be used for new consumption by requiring those groups to participate in the Social Security System.

An increase in the OASDI taxation rate or requiring the entire working populace in the United States to participate in the Social Security System would cause less severe economic consequences than shifting to the use of General Revenue Funds or eliminating the taxable wage base. However, the direction of economic changes by any of the four alternative measures would be the same; only the severity of the consequences would be different. These changes are increased demand-pull inflation, decreased savings, and decreased growth potential.

No matter what form of financing is used to finance the deficit projected for 2030, it will affect someone adversely. When financing such a national policy, all possible solutions must be carefully weighed. Only then can the effective solution that does the least damage to society be chosen. The conclusion of this paper encompasses
some recommendations as to which of the proposed solutions should be implemented now and in the future.
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CHAPTER IV

CONCLUSION

The Social Security Program seems to be financially sound in the immediate future. This does not, however, mean that funds need not be rearranged. If OASI is to remain solvent -- using the projections presented, internal financial adjustments must be made (14, pp. 60-75).

The issue is what plan to use in readjusting Social Security financing. Interfund borrowing seems to be the best choice. With interfund borrowing, no new changes in financing will be necessary as long as overall reserves are sufficient to cover expenditures (14, p. 11). This is also the program presented by the Congressional Budget Office and the Social Security Administration when addressing projected deficient funds in the OASI Program (14, pp. 14-17, 60-75).

Interfund borrowing is advantageous over restructuring the tax rates because "any allocation of tax rates which appears appropriate today may become inappropriate a few years hence, just as the 1977 one has already proven inappropriate (14, p. 11). In this case, new congressional action would become necessary to readjust the newly inappropriate tax rates. The interfund borrowing would
apparently take care of any projected short term financial problems (14, pp. 14-17, 60-75).

The most commonly projected long term financial instability which may occur is that of insufficient availability of funds when the "Baby Boom" generation begins to retire. At this time, forecasts predict that only two people will be working for every one receiving benefits from Social Security (6, p. 7). The increased expenditures and decreased revenues caused by this problem and any other financial problems will need to be solved to keep Social Security solvent.

Four different financing proposals have been discussed. These are elimination of the taxable wage base; general revenue financing; requiring participation by every working United States citizen or alien working in the United States, and raising the OASDI tax rate. These programs will now be recommended in ascending order of desirability. Feasibility of enacting such a program is also addressed.

Elimination of the taxable wage base would undoubtedly increase funds, but it will not increase funds enough to cure the projected deficit in the year 2030. Therefore, an increase in the tax rate would have to accompany the elimination of the taxable wage base to be effective (2, p. 162-163). Eliminating the taxable wage base will also increase taxation on those who do most of the saving
in the United States (11, p. 65). The decrease in savings caused by taxing the wealthy more would also decrease potential growth, and increase demand-pull inflation more than some alternative solutions. A decrease in growth potential would be very devastating if the economy is already in a recessionary period. Perhaps the largest complaint to eliminating the taxable wage base is that benefits would have to be entirely untied from money paid into the system in order not to increase funding deficits (14, p. 37). This has propagated the fear that Social Security would become viewed as a welfare system (1, p. 16).

Switching funds to General Revenue financing, as in eliminating the taxable wage base, would need to be accompanied by increased taxation in order to solve the deficiency in funds projected for 2030. Moving to General Revenue financing would also be moving taxation from a somewhat regressive tax system to a more progressive tax system (1, pp. 121-122; 10, p. 60). This would cause a lower percentage of savings in the United States which would redistribute savings to consumption. The redistribution of income would increase demand-pull inflation and decrease potential growth while increasing interest rates. However, the greatest adverse reaction to General Revenue financing is political.
Moving Social Security to General Revenues would destroy the link of benefits to contributions (14, p xi). This would help Social Security not to be viewed as a forced savings plan, and as Senator Altmyer stated,

[H]ose taxes were never a problem of economics. They are politics all the way through. We put those payroll contributions there so as to give the contributors a legal, moral, and political right to collect their pensions... With those taxes in there, no damn politician can ever scrap my social security program (9, p. 230).

The last two programs, mandatory coverage and raising the tax rate, are both proposed as appropriate measures. By requiring universal participation, every person who works in United States for ten years would be assured of receiving retirement benefits. This will also assure that people are covered for disability which is not covered under most other pension programs (7, p. 271-273). The other advantage of mandatory coverage is that with more people paying into the system, it will be fiscally stronger (15, p. 219).

One of the present complaints which the Social Security System faces is that some military personnel and civil service employees receive Social Security benefits without paying into the program (5, p. i). There are now, also, many city employees across the nation who are electing to be removed from the Social Security System. If this continues, a large decrease in funds is projected to appear
in the Social Security System. If all people are not included in the system, then many individuals will receive benefits which have not been earned (7, pp. XXXIII-XXXVI).

By creating mandatory participation in the system, no freeloaders will continue to live on the system.

Mandatory coverage is strongly opposed by the seven million workers who presently are not covered by the system.

They felt that their current pension funds would be expropriated to 'bail out' Social Security from financial difficulties; . . . To them, coordinate systems could never provide better combined protection than they now receive. Convinced that Social Security was going bankrupt soon, these employees voice strong opposition to the redistributional aspects of Social Security, which they characterized as the 'welfare components' of the program (7, p. 275).

This fear of Social Security going bankrupt in the near future is presently unfounded as shown in Chapter II.

"The effects of extended coverage on the Social Security Program, however, are not sufficient to 'bail out' the system from any long-term financial problems it might face" (7, p. 271). The program of mandatory coverage would need to be accompanied by an increase in the tax rate to assure solvency during the fourth decade of the Twenty-first century, assuming the present projections remain accurate. However, the tax rate increase needed would be less if mandatory coverage were implemented (15, p. 49; 7, p. 271). By increasing the tax rates, a decrease in overall economic activity might cause a further reduction in an already
declining economy. But as long as we are fiscally sound with balanced growth, an OASDHI tax increase will cause some inflation, reduction in growth potential, increased interest rates, fewer employment opportunities and some redistribution of income (12, pp. 12-15). Even though this solution would have the same effects as eliminating the taxable wage base or changing over to General Revenue financing, the economic consequences will be less severe because savings will not be decreased as much (8, pp. 250, 251).

Since the problem is not projected to exist until 2030, Robert Ball advised that no action on raising the tax rate is necessary at this time (7, p. 317). Previously, legislated tax increases should be sufficient to secure Social Security's solvency between now and 2005 (15, pp. 80-82). The need for tax rate increases should be continually monitored as projections of the years in question become more reliable. Mandatory coverage, however, should be implemented as soon as possible to help assure long term stability within the Social Security System.

Analysis of the Social Security System's financial situation will never be complete as long as Social Security exists. "One consequence of a pay as you go system such as Social Security is that the financial status of the system is extremely vulnerable to unforeseen changes in the
population or in the economy" (3, p. IX). The fact that it is a public system also leaves Social Security subject to the feelings of all constituents whom it affects.

Since over 93 percent of the population in the United States is presently affected by the Social Security System, it will always be in the public eye (1, p. vii). This will probably continue to cause over-reaction to its financing situation similar to the present alarm. The President and Congress pledge that Social Security will continue to pay its obligations (4, pp. 18-20). For now, Social Security's financial soundness is politically assured. Its continuing solvency, will be decided through future national policy.


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