THE CONTINUED FINANCIAL STABILITY

OF SOCIAL SECURITY

THESIS

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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 receipients, 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 under-
taking 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
D_1, D_2	–	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
M^d	–	Money demand
M^d_t	–	Transactions demand for money
M^d_w	–	Wealth demand for money
MPC	–	Marginal propensity to consume
MPS	–	Marginal propensity to save
M^s	–	Money supply
M^{sx}	–	Excess supplies of money
NT	–	Increase in taxation
OASDHI	–	Old Age, Survivors, Disability and Health Insuracne
OASDI	–	Old Age, Survivors, and Disability Insurance
OASI	–	Old Age and Survivors Insurance
P_1, P_2	–	Price
Q_1, Q_2	–	Quantity
S	–	Savings
S_1, S_2	–	Supply
SLF	–	Supply of loanable funds
t	–	Tax rate
T	–	t times Y
T^i	–	Increase in taxation rate
$T_t + 1$	–	$t + T^i$ times Y
Y	–	Gross National Product
$Y_t + 1$	–	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 pre-scribed 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 estab-lishment 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 de-
veloped 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 news-
paper 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 Wisonsin 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 sta-
> bility 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 con-
gressional 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.

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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 pro-
gressively 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*

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

*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)

| | Income | | | | |
Calendar Year	OASI	DI	OASDI	HI	OASDHI
1979	$ 90.1	$15.6	$105.8	$22.7	$128.5
1980	101.8	17.9	119.8	26.2	145.9
1981	115.4	21.6	137.0	34.8	171.8
1982	130.7	24.8	155.4	40.0	195.5
1983	146.6	28.3	174.9	45.6	220.5
1984	163.9	32.0	195.9	51.4	247.3
1985	188.2	40.7	228.9	59.2	288.2

| | Outgo | | | | |
Calendar Year	OASI	DI	OASDI	HI	OASDHI
1979	$ 93.2	$14.3	$107.4	$21.3	$128.7
1980	108.3	15.9	124.2	24.0	148.2
1981	125.2	17.8	143.0	27.3	170.3
1982	141.5	19.8	161.3	31.2	192.5
1983	157.5	21.8	179.3	35.6	214.8
1984	173.9	24.0	197.9	40.6	238.5
1985	190.4	26.4	216.8	46.2	262.9

| | Net Change | | | | |
Calendar Year	OASI	DI	OASDI	HI	OASDHI
1979	$- 3.1	$ 1.4	$- 1.7	$ 1.4	$- 0.3
1980	- 6.5	2.0	- 4.5	2.2	- 2.3
1981	- 9.8	3.8	- 6.0	7.5	1.5
1982	-10.9	5.0	- 5.8	8.8	3.0
1983	-10.9	6.5	- 4.4	10.0	5.6
1984	-10.0	8.0	- 2.0	10.9	8.9
1985	- 2.1	14.3	12.2	13.1	25.2

| | End of Year Balance | | | | |
Calendar Year	OASI	DI	OASDI	HI	OASDHI
1979	$ 24.5	$ 5.6	$ 30.9	$12.9	$ 42.9
1980	18.0	7.7	25.6	15.0	40.7
1981	8.1	11.4	19.6	22.5	42.1
1982	- 2.7	16.5	13.7	31.3	45.1
1983	-13.6	23.0	9.4	41.3	50.7
1984	-23.6	31.0	7.4	52.2	59.6
1985	-25.7	45.3	19.6	65.3	84.8

*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 Admin-
istration'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 appro-
> priate 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 III

CBO PROJECTIONS OF SOCIAL SECURITY TRUST FUND BALANCES
AT THE START OF THE FISCAL YEAR*
(AMOUNTS IN BILLIONS)

Individual and Combined Trust Funds	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
OASI	22.9	12.7	2.1	- 7.8	-17.0	-20.2	-19.4	- 19.3	- 17.9	- 18.8	- 5.0
DI	7.4	9.9	13.5	17.8	23.8	34.8	50.3	67.3	86.2	105.3	131.6
HI	15.6	21.1	28.8	37.1	45.3	54.8	67.6	80.6	92.4	100.9	104.8
OASDI	30.3	22.6	15.6	10.0	6.5	14.6	30.9	48.0	68.3	86.8	126.7
OASDHI	45.9	43.8	44.4	47.1	51.8	69.4	98.5	128.6	160.7	187.4	231.5

*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*

Calendar Years	Present Law			Reallocation		
	OASDI	OASI	DI	OASDI	OASI	DI
Employees and Employers, Each						
1979-80	5.08	4.330	0.750	5.08	4.330	0.750
1981	5.35	4.525	.825	5.35	4.875	.475
1982	5.40	4.575	.825	5.40	4.750	.650
1983	5.40	4.575	.825	5.40	4.725	.675
1984	5.40	4.575	.825	5.40	4.750	.650
1985-89	5.70	4.750	.950	5.70	5.000	.700
1990 and later	6.20	5.100	1.100	6.20	5.310	.890
Self-employed Persons						
1979-80	7.05	6.0100	1.0400	7.05	6.0100	1.0400
1981	8.00	6.7625	1.2375	8.00	7.2875	.7125
1982	8.05	6.8125	1.2375	8.05	7.0750	.9750
1983	8.05	6.8125	1.2375	8.05	7.0375	1.0125
1984	8.05	6.8125	1.2375	8.05	7.0750	.9750
1985-89	8.55	7.1250	1.4250	8.55	7.5000	1.0500
1990 and later	9.30	7.6500	1.6500	9.30	7.9650	1.3350

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

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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 BILLIONS)***

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

*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.

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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 expendi-
tures, 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 unemploy-
ment 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 expectency 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 un-popular 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 organi-
zations 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 pro-
posal 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 Retire-
ment System and Social Security; some employees
only qualify for benefits under one system so
that their benefits are not based on their life-
time 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 (investged 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 lonable 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 con-

sumption (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.

$$M^d_t = .1(Y-T)$$
$$M^d_t = .1(1000-140)$$
$$M^d_t = .1(860)$$
$$M^d_t = 86$$

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

demand is 286-10(i).

$$M^d_w = 200-10(i)$$

$$M^d = M^d_t + M^d_w$$
$$M^d = 86+(200-10i)$$
$$M^d = 86+200-10i$$
$$M^d = 286-10i$$

Excess supply of money is 114+10i.

$$M^s = 400$$

$$M^{sx} = M^s - M^d$$
$$M^{sx} = 400-(286-10i)$$
$$M^{sx} = 400-286+10i$$
$$M^{sx} = 114+10i$$

The MPS is .05.

$$MPS = 1-MPC$$
$$MPS = 1-.95$$
$$MPS = .05$$

Savings is 43.

$$S = MPS(Y-T)$$
$$S = .05(1000-140)$$
$$S = .05(860)$$
$$S = 43$$

Supply of loanable funds is 157+10i.

$$SLF = S+M^{SX}$$
$$SLF = 43+114+10i$$
$$SLF = 157+10i$$

Demand for loanable funds is 400-10i.

$$I = 400-10i$$
$$DLF = I$$
$$DLF = 400-10i$$

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

$$DLF = SLF$$
$$400-10i = 157+10i$$
$$400-157 = 10i+10i$$
$$243 = 20i$$
$$12.15 = i$$

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.

$$GNP(T^i) = NT$$
$$1000(.01) = NT$$
$$10 = NT$$

$$1000+NT = Y_t+1$$
$$1000+10 = Y_t+1$$
$$1010 = Y_t+1$$

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.

$$T_t+1 = .15(Y)$$
$$T_t+1 = .15(1010)$$
$$T_t+1 = 151.5$$

$$C = MPC(Y-T)$$
$$C = .95(1010-151.5)$$
$$C = .95(858.5)$$
$$C = 815.515$$

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.

$$M^d{}_t = .1(Y-T)$$
$$M^d{}_t = .1(1010-151.51)$$
$$M^d{}_t = .1(858.5)$$
$$M^d{}_t = 85.85$$

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.

$$MPS = 1-(MPC)$$
$$MPS = 1-.96$$
$$MPS = .04$$

$$S = MPS(Y-T)$$
$$S = .04(1010-151.51)$$
$$S = .04(853.5)$$
$$S = 34.34$$

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 equilabrating 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.
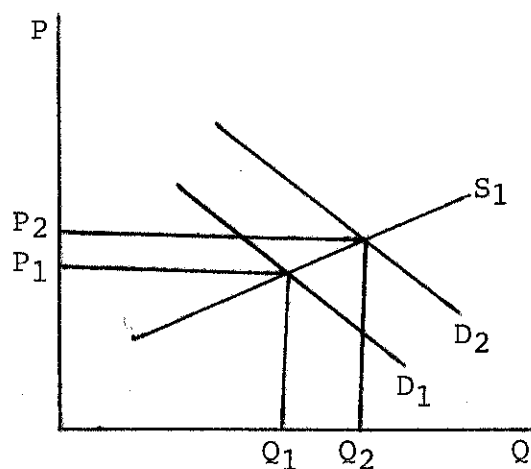

Fig. 1--Increase in Demand with an elastic Supply curve.

Q_2 will symbolize the quantity produced and sold after any changes in taxation and income. The supply curve will be deonted 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 con-

sumption 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 in-

crease 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 infla-

tionary.

Figure 2 represents the case where the supply curve is
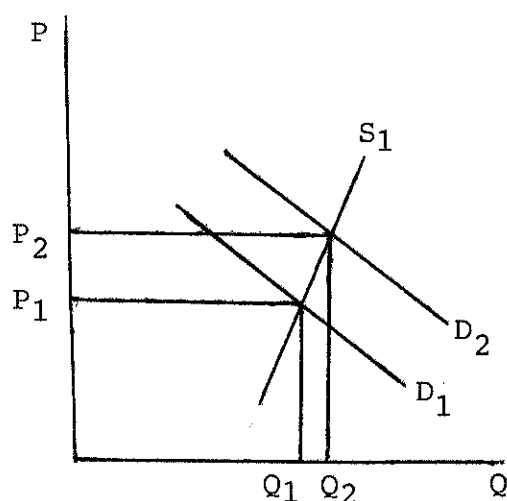
inelastic and there is an increase in demand. Before the

Fig. 2--Increase in Demand with an inelastic Supply Curve.

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 conse-

quences 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

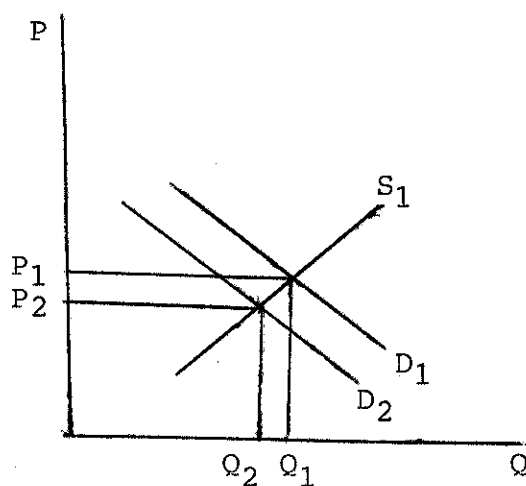production and prices will decrease as is shown in Figure 3.

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.
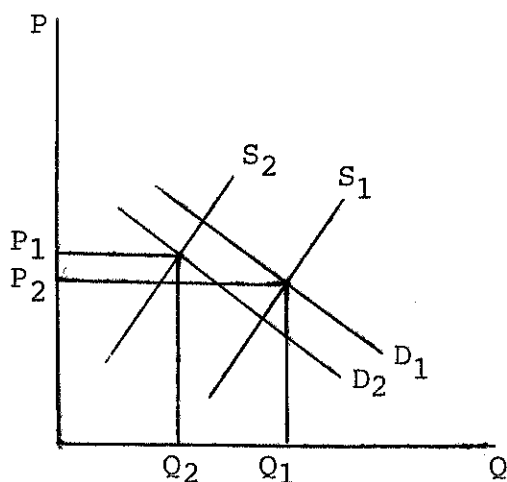

Fig. 4--Decrease in Demand and Supply in the Durables Markets.

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. There-fore, 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 VI

REGRESSIVITY OF THE SOCIAL SECURITY TAX
1981 TAX RATE*

Wage Rate	Tax Percentage	Taxable Wage Base	Tax Paid	Tax Paid as Percentage of Income
$ 5,000	6.65	$29,700	$ 332.5	6.65
10,000	6.65	29,700	665.0	6.65
20,000	6.65	29,700	1330.0	6.65
29,700	6.65	29,700	1975.05	6.65
30,000	6.65	29,700	1975.05	6.5835
40,000	6.65	29,700	1975.05	4.9376
50,000	6.65	29,700	1975.05	3.9501
75,000	6.65	29,700	1975.05	2.6334
100,000	6.65	29,700	1975.05	1.975

*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 manditory 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 in-
creasing 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 reqarranged. 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 propogated 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,

> [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 (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 free-
loaders 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. Con-
> vinced that Social Security was going bankrupt
> soon, these employees voice strong oppostion 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 obligaions (4, pp. 18-20). For now, Social Security's
financial soundness is politically assured. Its con-
tinuing solvency, will be decided through future national
policy.

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