WRONG RX FOR SOCIAL SECURITY

The National Commission on Social Security Reform seems to be convinced that the treatment for anemia is bloodletting. Instead of finding a way to revitalize the Social Security system, the Commission is prescribing a bigger dose of what has afflicted and weakened the system for decades. The Commission's $169 billion bail-out plan fails to address Social Security's underlying structural problem--Congress's attempt to make it function as both insurance and welfare. This unnatural and unworkable hybrid is unfair to retirees, workers, and especially to the young, who are forced to participate in a program that is inferior to private sector alternatives. Ignoring the root ills of the system, the Commission instead is trying to solve the problem by raising taxes, cutting benefits, forcing those now outside the system to climb aboard the Titanic as it heads for the iceberg.

The $40 billion payroll tax hike would raise employment costs. The result: longer unemployment lines, lower capital investment, and slower economic recovery. Rather than easing Social Security's financing problems, the Commission's proposals could merely cause the economy to deteriorate--weakening Social Security revenues and forcing more extreme corrective action in the future. Raising payroll taxes was supposed to solve Social Security's problems in 1977, when Congress passed one of the largest tax increases in the U.S. history. It didn't then, and it won't now, because payroll tax increases do not attack the system's basic problems and perpetuate the structure that has brought the system to the edge of bankruptcy. Most of today's younger workers will receive a pitiful return on their tax contributions. Another increase in taxes now simply will reduce their return still further.

The Commission also recommends increasing the tax on self-employed persons to the tune of $18 billion by raising the base from three-fourths of the combined employer-employee rate to the full employer-employee rate. In return, they would be allowed to deduct half of the payroll tax from taxable income. This is little more than a backdoor method of financing Social Security from general revenue; it would redistribute, not reduce, the tax burden. Slowing the growth of benefits or allowing workers to opt out of the program are the only means of lowering this tax burden. Indirect general revenue financing just robs Peter to pay Paul--and increases the burgeoning non-Social Security budget deficit.

Under the Commission's plan, Social Security coverage would be extended to newly hired federal employees and to nonprofit groups now outside the system, and it would end the right of state and local governments to withdraw from Social Security. By forcing new participants into the system, this measure would only postpone the day of reckoning; it would undermine sound private pension plans and torpedo the Civil Service Retirement System. Moreover, it is clear that many Americans want to withdraw from Social Security. In 1982, for example, 172,000 employees from various organizations withdrew from the system primarily because of soaring payroll taxes and the system's suspect solvency. If Americans believe Social Security is not a good insurance program, they should not be compelled to join it. Instead, the government should allow them to select private sector alternatives for Social Security's insurance functions. Forcing more people into the system will merely increase dissatisfaction with the program and increase the scale of the underlying problem. The Commission is simply suggesting that more people should be made to join the chain letter ruse that is Social Security.

The Commission would also reduce benefits by permanently delaying the annual cost-of-living adjustment (COLA) by six months. Although benefit increases in the last fifteen years have been excessive, rising much faster than prices and the average wage, a benefit cut is not the solution. Because millions of people have based their retirement plans on the expectation of receiving inflation adjusted benefits, delaying the annual COLA for those now retired would amount to changing the rules in the middle of the game, and it would impose unfair hardship on the group least able to adjust to sudden changes. Cutting benefits by $40 billion would partially shift costs to general revenues by increasing spending on poverty programs.

Half of their Social Security benefits, recommends the Commission, should be included in taxable income for some middle to upper income retirees. The rationale for this change is that the employer's share of the payroll tax has escaped taxation because it is a business expense. By including half of all Social Security benefits in taxable income, the tax treatment of the system would resemble that of private pensions and other government programs. While this proposal has some merit, taxing benefits would mean, in effect, a reduction in benefits for about three million people, and it would penalize most those who have taken the precaution of saving for their retirement. The change should only be phased in after a reasonable grace period--it is not a short-term option.

True reform of Social Security cannot begin until Americans and their Congress recognize the program for what it really is: part insurance and part welfare. Once this is understood, the problem can be dealt with in a manner fair to both the beneficiaries and taxpayers. The Commission's recommendations are unfair to both groups and would impose substantial costs on the economy. A successful approach to rebuilding Social Security will require division of responsibilities between the government and the private sector, with the government maintaining the welfare aspects of the program (albeit in a more efficient manner) and increased private sector participation fulfilling the program's insurance function. Only in that way can the fears of current beneficiaries be reduced and the younger workers of today anticipate secure retirement years.

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For further reading:

Peter J. Ferrara, Social Security Reform: The Family Plan (Washington, D.C.: The Heritage Foundation, 1982).

Rebuilding Social Security, Heritage Lectures 18 (Washington, D.C.: The Heritage Foundation, 1982).

Peter Germanis, "Rx for Social Security: The First Steps," Heritage Foundation Backgrounder No. 159, December 14, 1981.