THE PROGRESS REPORT

Socialized Insecurity

By Fred E. Foldvary

The social security system is an economic disaster. Ever more retired workers have been collecting from the system relative to the number of current workers, requiring ever increasing social security taxes. Splitting the payroll tax between employer and employee may fool workers into thinking they don't pay as much, but it all adds to the cost of labor, and it is all a tax on wages. The funds taken in are not invested, but are spent on current recipients, and the current social security surplus is spent as part of the government budget. The money collected from workers costs the economy the lost opportunity of investing the funds, reducing the rate of growth of the economy. Higher-income recipients have to pay income taxes on their social security income, a double taxation of their past wages.

When the baby boomers have retired, doubling the number of retired folks, there will be only two workers for each social security recipient. The system will require a massive change, either an increase in the retirement age for receiving the funds, a stiff increase in social security taxes, or a reduction in the real value of social security income by lower cost-of-living increases. The retirement age is already scheduled to increase to 66 in 2009 and 67 by 2027, but that's not enough to keep the system solvent.

Payroll taxes, including social security, disability, and medicare, now total 15.3 percent of worker income up to $65,400 of income. In the article "Please, Not Another Payroll Tax Hike" (Investor's Business Daily, Feb. 19, p. A34), Timothy Penny notes that about 7 out of 10 of all Americans pay more in payroll taxes than they do in income taxes. For those who want a flat tax, we have one: the payroll tax. It's flat up to the maximum amount of wages taxed, with no deductions or tax credits. It's flat, it's simple, but it's still a burden, not just for individuals but for the economy.

Other countries have faced similar problems with their social security system. A few countries have partially privatized their systems, and there are various proposals for doing this in the U.S. One idea is for the government to invest some of the social security funds in the stock market, a bad idea that could lead to more government controls on industry and to placing retirement funds at risks beyond the control of the recipients.

The best reform would be to recognize that the whole concept of social security has been a big mistake, and eliminate it completely. Those who have paid into it are owed their benefits, but new workers and new income could be made exempt from the payroll taxes. Some reforms would require workers to put funds into private pensions, and that might be a politically feasible alternative. But ultimately, the ideal policy would be to get government out of the pension business entirely.

Let's ask the fundamental question: what is the source of worker insecurity? There are two origins, personal and political. The personal source is that some workers, even if employed all

their life, will fail to save enough money for their retirement, and then there they are, old and broke. Most workers will, in fact, save enough, including equity in their homes. For those who do not, they will need some assistance. But why imprison the whole economy with an unsound system for the sake of the few slackers?

The greater problem is the political one. Workers feel insecure because they fear losing their jobs and not being able to easily find new jobs that pay on the same scale. When the economy turns down, many will be laid off. Even during prosperous times, some workers have difficulty finding or creating new jobs. Many workers have wages so low they can barely pay their bills, let alone save money. But why the low wages and difficulty finding work, when human desires remain unfilled? There must be some barrier between workers and resources, keeping some workers out of jobs while cutting the pay of those working.

Economists call the barriers the "tax wedge" and "intervention." Taxes, including payroll taxes, make labor expensive to hire while leaving much less for workers to take home. Regulations cost the economy $6800 per American household and reduce enterprise and investment. Without these barriers, a strong market for labor would raise wages and eliminate the uncertainty of employment. It would be much easier and less costly to hire workers or start your own business. Real security consists of there always being a ready market for your services. What we have instead is socialized insecurity, where the fate of the elderly is in the hands of politicians who dole out favors today and create ever more insecurity for the future, when the bills come due.