
A widely circulated booklet, Your Social Security, put out by the U.S. Department of Health, Education and Welfare, begins its section on “Financing”:

The basic idea of social security is a simple one: during working years employees, their employers, and self-employed people pay social security contributions into special trust funds. When earnings stop or are reduced because the worker retires, dies, or becomes disabled, monthly cash benefits are paid to replace part of the earnings the family has lost.¹

It would be hard to pack a greater number of false and misleading statements into a single paragraph. “Contributions” implies a voluntary payment; but what “employees, their employers, and self-employed people” pay are taxes levied on payrolls. Moreover, “employers” do not pay them in any sense other than that in which retail stores may be said to “pay” sales taxes. The tax, whether nominally paid by the worker or the employer, is borne by the worker. His employer simply transmits the amount.

“Into special trust funds” implies that the taxes paid in are accumulated to pay later benefits. This is, of course, not true. The “special trust funds” are small, currently about $56 billion, and consist simply of promises by one branch of government to pay another branch. The present value of pensions already promised to persons covered by social security (both those who have retired and those who have not yet done so) is estimated as totaling several trillions of dollars. That is the size of the trust fund that would justify the words of the booklet.

The paragraph gives the impression—though it does not literally say so—that a worker’s “benefits” are financed by his own “contributions” out of the pooled “trust funds.” That impression is wholly false. Current benefits to persons already retired are being paid from current taxes being
collected from persons at work. The so-called “trust fund” could more accurately be termed a “petty cash” fund.

What assurance do current workers have that they will receive the benefits promised? Solely the confidence that our children will be willing to impose taxes on themselves to pay benefits being promised by us to ourselves. This one-sided “compact between the generations,” foisted on generations that literally cannot give their consent, may be sufficient assurance, but it is a very different thing from a “trust fund”—a “chain letter” would be a more accurate designation.

The booklet goes on: “Nine out of ten working people in the United States are now building protection for themselves and their families under the social security program.”

More doublethink.

What nine out of ten working people are now doing is paying taxes to finance benefits to persons who are not working. An individual working person is in no sense building his own protection—as a person who contributes to a private vested pension system is building his own protection. Persons now receiving benefits are receiving much more than the actuarial value of the taxes that were paid on their behalf. Young persons are now being promised much less than the actuarial value of the taxes that are being paid on their behalf.

More fundamentally yet, the relationship between taxes paid and benefits received is extremely loose. Millions of people will never receive any benefits attributable to their taxes because they have not paid for enough quarters to qualify, or because they receive benefits as spouses rather than on their own account. Two persons may receive the same benefit, yet may have very different taxes over their working lives because they worked different numbers of years. Conversely, two persons may have paid precisely the same taxes at the same times, yet may receive very different benefits.
because one is married and the other is single. A man who continues working after age 65 will be required to pay additional taxes, yet may receive no benefits at all.

Social security is not in any meaningful sense an insurance program in which individual payments purchase equivalent actuarial benefits. It is a combination of a tax—a flat-rate tax on wage income up to a maximum—and a program of transfer payments, in which all sorts of considerations other than the amount paid determine the amount received.

Taken by itself, the payroll tax is almost surely the most regressive element in our tax system. For most families of low or modest income, it is by far the heaviest tax they bear. Its inequity is compounded by its disincentive effects: simultaneously discouraging employers from hiring workers and potential workers from accepting jobs by driving a substantial wedge between the wage cost to the employer and the net return to the worker.

Taken by itself, the benefits are capricious and inequitable. Surely a sensible benefit system would try to relate the benefits to some criteria of “need” and the availability of other resources. It would not make benefits depend on whether the recipient worked in a covered or non-covered industry, or how long he had worked and at what wages, etc. It would not completely disregard the wealth of the recipient or his income—if that income does not come from work. (There are millionaires who regularly receive social security; and it is entirely legal for them to do so, so long as their ample annual income derives from returns on investments and not from current employment.)

Hardly any student of social security—or, more broadly, hardly anyone, whatever his social and political views—would approve of either the tax separately, or the benefit system separately; yet the two, combined, have become a sacred cow. I know of no greater triumph of imaginative packaging and Madison Avenue advertising.
The imaginative packaging has served a very important political function: it has made the public at large willing to pay much heavier taxes than they otherwise would have been willing to bear; it has made them willing to accept a capricious system of benefits and to support a mammoth bureaucracy that could never have arisen separately. The ultimate effect has been to foster the growth of government and, above all, of central government.

Perhaps the most striking example of the potency of the imaginative packaging is the success it has had in converting self-styled “fiscal conservatives” into willing allies of those whom they would term “big spenders.” The obvious financial problems of social security led President Ford to propose a further increase in the payroll tax, and this proposal was hailed by many “fiscal conservatives” as courageous fiscal procedure.

In my opinion it was precisely the reverse. True fiscal conservatism calls for holding down government spending, not cooperating in its growth. Yet by accepting the myth that social security is an insurance program in which there is a valid connection between taxes and spending, President Ford’s approach simply enhances the willingness of the public to pay taxes and, in this way encourages the growth of government.

The point at issue is part of a much broader problem—the tendency for fiscal conservatives to stress the deficit rather than government spending. I believe, along with Parkinson, that government will spend whatever the explicit tax system will raise—plus a good deal more. The historical process has been that government spending has raced ahead of explicit taxes, producing a deficit. Fiscal conservatives, alarmed by the deficit, proceeded to cooperate in enacting taxes to close the deficit. The result: a further burst of spending, and a repetition of the process.

The true cost of government is not measured by explicit taxes, but by total spending. If the federal government spends $450 billion and takes in $380 billion in explicit taxes, who pays the
difference? Not Santa Claus but the U.S. citizen. The deficit must be financed by creating money or by borrowing from the public. In either case, a hidden tax is imposed—in the form either of inflation or of the present value of the higher taxes that will be required in the future.

This line of reasoning has led me to favor tax reduction under any and all circumstances, and to oppose tax increases under any and all circumstances, as the only way to bring effective pressure on holding down government spending.

To return to social security, this line of reasoning is reinforced by my conviction that the social security system is an undesirable and inequitable system. It cannot be abolished outright—on both moral and political grounds. Morally, we have entered into commitments to millions of persons who have shaped their lives in accordance with those commitments. We should discharge those commitments, so far as we can do so without imposing still greater inequities on others. Politically, the “chain letter” character of social security has not yet become clearly apparent. Anything that promotes a public understanding of the true character of social security will hasten the day when real reform will be possible.

On these grounds, I oppose any increase in the employment taxes and, indeed, favor any decrease. If revenue from the payroll tax is inadequate to finance current benefits, the difference should be financed from the general Treasury. This will have two advantages: first, it will help to dissolve the public belief, so carefully and dishonestly fostered by the social security bureaucracy, that social security is an insurance system; second, it will absorb funds that would otherwise be available for even more undesirable government programs, such as national health insurance.

This is, of course, only a temporary expedient. For the longer run, we should press for a fundamental reform of our whole set of welfare measures, including social security. I have elsewhere outlined in some detail the direction which I believe such a reform should take.
Notes

* In writing this, I have used large parts of my column. "Truth in Advertising," *Newsweek*. 14 June 1971.