The Poor Man's Welfare Payment to the Middle Class

by Milton Friedman

A widely distributed, unsigned booklet from the Department of Health, Education and Welfare (HEW) entitled "Your Social Security" begins:

> The basic idea of social security is a simple one: During working years employees, their employers, and self-employed people pay social security contributions which are pooled in 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.

Milton Friedman teaches economics at the University of Chicago. This article is adapted from Social Security: Universal or Selective?, *a debate between Milton Friedman and Wilbur J. Cohen, published this month by American Enterprise Institute.*

This is Orwellian doublethink.

- Payroll taxes are labeled "contributions" (or, as the Party might have put it in the book, *1984*, "Compulsory is Voluntary").

- Trust funds are conjured with as if they played an important role when, in fact, they are extremely small ($32.5 billion as of December, 1970) and consist simply of promises by one branch of the government to pay another branch. Over a decade ago the Social Security Administration estimated that the present value of the old age pensions already promised to persons covered by social security (both those who had retired and those who had not) was over $300 billion. The corresponding sum must be far larger today. That is the size of the trust fund that would be required to justify the words of the booklet. ("Little is Much.")

- The impression is given that a worker's "benefits" are financed by his "contributions." The fact is that taxes currently being collected from current workers are being used to pay benefits to persons who have retired or to their dependents and survivors. No trust fund in any meaningful sense is being accumulated. ("I am You.")

A worker paying taxes today can derive no assurance from trust funds that he will receive benefits when he retires. Any assurance derives solely from the willingness of future taxpayers to impose taxes on themselves to finance benefits being promised by present taxpayers to ourselves. This one-sided "compact between the generations," foisted on generations that literally cannot give their consent, may be sufficient assurance, but it certainly is a very different thing from a "trust fund." A chain letter would be a more accurate designation.

The HEW booklet goes on to say, "Nine out of 10 working people in the United States are now building protection for themselves and their families under the social security system."

More doublethink. What nine out of 10 working people are now doing is paying taxes to finance payments to persons who are not working. The individual worker is in no sense building protection for himself and his family—as a person who contributes to a private vested pension system is building his own protection. Persons now receiving payments are receiving much more than the actuarial value of the taxes that they paid and that were paid on their behalf. Young persons who are now paying social security taxes are being promised much less than the actuarial value of the taxes that they pay and that are paid on their behalf.

More fundamentally yet, the relationship between individual contributions (that is, payroll taxes) and benefits received is extremely tenuous. Millions of people who pay taxes will never receive any benefits attributable to those taxes because they will not have paid for enough quarters to qualify, or because they receive payments in their capacity as spouse. Persons who pay vastly different sums over their working lives may receive identically the same benefits. Two men or two women who pay precisely the same taxes at the same time may end up receiving 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, and yet may receive no benefits at all. This list can be extended indefinitely.

Social security programs involve annual expenditures of roughly $43 billion. These programs appear on balance to transfer income from relatively low-income classes to middle- and upper-income classes. They are flourishing, are widely regarded as highly successful, and seem destined to expand.

Welfare programs involve annual expenditures of $15 billion. These programs appear on balance to transfer income from middle- and upper-income classes to lower-income classes. They are in a state of crisis, are widely regarded as intolerable, and

Answers to April puzzle:

C	A	M	P	A	I	G	N	S		S	O	P	U	P
I		E		R		O		E		P		R		O
N	O	D	A	T		G	O	V	E	R	N	O	R	S
E		I		I		E		E		U		R		I
M	E	A	N	S	I	T		R	E	C	O	U	N	T
A				A		T				E		S		E
S	E	V	E	N	T	E	E	N		D	O	S	E	D
		I				R		E				I		
T	A	C	K	S		S	E	C	R	E	T	A	R	Y
I		T		N				E		X				E
M	O	O	D	I	E	R		S	I	T	S	O	N	A
P		R		P		A		S		O		W		R
A	N	I	C	E	D	T	E	A		P	Y	L	O	N
N		E		A		E		R		E		E		E
I	N	S	E	T		S	K	Y	W	R	I	T	E	R

seem destined to be transformed.

My own attitude toward the two programs is almost the reverse. Bad as the welfare mess is, at least public assistance does go mainly to needy persons who are at lower income levels than the persons paying the taxes to finance the payments. The system badly needs reform, but at the moment it serves an essential social function. It seems impossible to eliminate it promptly, even though its elimination should be our long-term objective. On the other hand, social security combines a highly regressive tax with largely indiscriminate benefits, and I believe that it serves no essential social function. Existing commitments make it impossible to eliminate it overnight, but it should be unwound and terminated as soon as possible.

As I have gone through the literature, I have been shocked at the level of the arguments that have been used to sell social security, not only by politicians or special-interest groups, but more especially by self-righteous academics. People who would not lie to their children, friends, or colleagues, whom I would trust implicitly in personal dealings, have propagated a false view of social security—and their intelligence and their exposure to contrary views make it hard to believe that they have done so unintentionally and innocently. The very name—old age and survivors insurance—is a blatant attempt to mislead the public into identifying a compulsory tax and benefit system with private, voluntary, and individual purchase of individually assured benefits. What am I to make of professors at leading institutions, of high-level bureaucrats, of cabinet and sub-cabinet officials who compare the future benefits promised to young workers solely with the tax nominally levied on employees, often not even mentioning the equivalent tax levied on employers? They know very well that common sense, economic theory, and empirical evidence all support the view that the distinction between the social security tax paid directly by the employee and the tax paid by the employer is primarily the label attached to components of the employers' cost of labor. Both are proportional to wage rates; both enter labor costs; both are borne equally by the employee.

Or what am I to make of high-minded gentlemen protesting in one breath the accuracy of the insurance terminology and objecting in the next to full payment of benefits to persons between 65 and 72 who continue to work on the ground that the "need" of these elders is less than that of other persons to whom the money could be paid. If, indeed, the benefits are linked to "contributions," the need argument is irrelevant. If the criterion of need is relevant, then the talk about "insurance," about benefits linked to "contributions," is simply hogwash.

Taxing Security

The social security tax is a flat-rate tax on covered earnings up to a maximum. As of early 1971, the rate of Old Age and Survivors Insurance (OASI) alone is 8.1 per cent, split between employers and employees, and 6.075 per cent on the earnings of the self-employed, in both cases up to the maximum earnings of $7,800. The rate for OASDHI (Old Age, Survivors, Disability, and Hospital Insurance) is 10.4 per cent on wages and 7.5 per cent on the earnings of the self-employed, and there is an additional tax for unemployment insurance. Coverage is by now nearly universal.

What can we say about this tax viewed solely as a tax?

1. This is a very heavy tax on very low incomes. For most persons with incomes less than the maximum covered, the social security tax is many times larger than the personal income tax.

2. The tax is regressive because of the maximum limit and the absence of exemptions.

3. It is hard to see any excuse for the differential between the rates on

Nicholas von Hoffman on Social Security

Social security is so rooted in people's minds as an unmitigated good that few will listen to anything that sounds like criticism of it. Eight years ago in a rollicking and more lighthearted presidential campaign, Barry Goldwater made the mistake of bringing the subject up. Everybody thought he was a nut–myself included–but now I'm beginning to wonder if I wasn't crazy to heed the voice of my preconceptions instead of listening to what the man was saying.

The government collects an unbelievably large amount of money from social security taxes. Something like $42 billion dollars last year, and you know that whenever they're raking in that kind of money, there's bound to be something fishy. The first fish is how heavily this tax comes down on the poor. Last year a person making $7,800 paid five per cent of his income to social security while someone making $30,000 paid slightly more than one per cent.

Nor do the benefits in favor of the well-to-do end there. A rich, retired person living on annuities, stock dividends, or any other form of unearned income can get full social security benefits without paying any taxes on it. A poor person trying to supplement his social security pension by earning money will find himself penalized up to and beyond 100 per cent of his pension, depending on how much he makes. The longer you look at the social security system, the less sense it makes. The poor pay larger proportions of their incomes into it, but get less out of it than the rich, who draw more benefits from it because they live longer; but single people and women also get the short end of the stick. An unmarried person is entitled to only two-thirds the benefits of a married couple, although he may have paid in as much or more.

A married woman worker can't receive the money which ought to be owed her as both a wife and a worker. The rules are so illogical that a working couple can wind up with lower benefits than a couple in which only one partner worked.

When you look over the whole system and you see who's paying how much and who is getting how much and when, it might be a good idea to abolish social security entirely. In place of it, the government could guarantee everybody . . . under a certain income a large, fat, full pension, a pension that would be paid for by a graduated income tax.

–*from* the Washington Post

wages and salaries and on earnings from self-employment.

4. Several categories of employment are excluded from the program altogether. This is unjustifiable from the tax point of view, but it is now trivial.

5. No allowance at all is made for family size.

6. The tax is solely on realized income from personal services. All property income is excluded, along, of course, with imputed income from services.

7. The tax rate is raised drastically for persons between 65 and 72 who are eligible for benefits, choose to work, and earn more than $140 a month. The marginal social security tax rate on earnings from $140 a month to $240 a month is 60.4 per cent, and from $240 a month until benefits are reduced to zero, 110.4 per cent. When the unemployment taxes and federal, state, and local taxes are included, the overall marginal rates are still higher.

8. The tax has risen very rapidly. Tax receipts for OASI alone have risen more than 11-fold from 1950 to 1970, and the average tax paid per covered person, by over 7.5-fold.

The payroll tax is almost surely far and away the most regressive element in our tax system and a significant disincentive to work. Over 10 per cent of any worker's wage cost, at the low levels, which means up to $7,800 now and it will be $9,000 soon, is taken out and sent to social security. Indeed, one of the great problems of providing sufficient incentive for a person to get off welfare is that, if he takes a job, then besides any reduction in his welfare benefits, he has to start paying social security taxes. He has to pay 10.8 per cent of his wage cost in taxes, and that raises the marginal rate.

I was astounded when I went through these figures. I had always thought that disincentive to work was associated with the high rates of the personal income tax. I am now persuaded that the social security tax is a greater disincentive to work than the personal income tax, because it hits people lower down; it hits people who have the alternative of relief and it hits them hard.

Special Interest Rag Bag

I have long believed that the major defect of our present arrangements is the proliferation of special programs either for special groups or special commodities: OASDHI for some retired or disabled, Old Age Assistance for others, unemployment insurance, aid to the blind, Aid to Families with Dependent Children, food stamp plans, public housing, urban renewal, medicaid, farm subsidies, etc. Whatever the good intentions of the initial proponents of these programs, the programs tend to become the preserve of special vested interests and come to serve purposes very different from those that they were initially designed to serve.

The total amount of money spent on these and similar programs, federal, state, and local, exceeded $75 billion in 1969-70. If this were divided among the 24.3 million persons classified as "poor" in 1969 under the arbitrary social security definition (4,950,000 families plus 4,851,000 unattached individuals), it would come to over $3,000 per person, a sum that nearly equals the average income of all persons in the United States. The problem is not that the government is spending too little on redistributive programs, but that most of the money spent is not going to the poor.

The correct direction in which to move, I believe, is to replace all these programs by a single program designed to give assistance to persons with low incomes, regardless of the reason why their incomes are low—whether because they are old or unemployed, unskilled or ill, physically or mentally handicapped, or whatever. Such a comprehensive program would cost far less each year than the present ragbag of programs. Yet it would come far closer to alleviating true distress.

How can the existing program be wound down without doing injustice to persons now covered? My agenda is as follows:

1. Repeal the payroll tax.
2. Terminate any further accumulation of benefits.
3. Enact a negative income tax, treating benefit payments under social security as income for purposes of determining eligibility for benefits.
4. Continue to pay all existing beneficiaries the amounts that they are entitled to under current law, except that these amounts should automatically be escalated over time by any changes in the cost of living. This will meet our commitments in real, not nominal, terms. Give such beneficiaries an option to accept a capital sum equal to the present value of the payments instead of continuing payments.
5. Give every worker who has earned coverage under present law a commitment to the retirement and survivors' benefits that he would be entitled to under present law, given his present tax payments and earnings record. This commitment would be in the form of *either* a promise to pay the specified annual sum at the future date when under present law he would be entitled to the sum *or* government bonds equal in market value to the present value of those benefits, calculated at the market interest rate on government obligations of corresponding maturity, at the option of the worker.
6. Give every worker who has had taxes paid on his behalf but has not yet earned coverage a capital sum equal to the accumulated value of the taxes that have been paid on his behalf.
7. Finance payments under 4, 5, and 6 out of general tax funds plus the issuance of government bonds.

Note that in the main these items simply recognize explicitly and fund obligations that now exist in an unfunded form. They do not add in any way to the true debt of the government, but simply terminate the accumulation of any further obligations. These steps would enable the bulk of the present social security administrative apparatus to be dismantled at once. It would be necessary to keep only a declining staff to administer item 4.

Reforming a Sacred Cow

Social security is in no meaningful sense an insurance program in which individual payments purchase equivalent actuarial benefits. It is a combination of a particular tax—a flat-rate tax on wages up to a maximum—and a particular program of transfer pay ments, in which all sorts of considerations other than the amount paid determine the amount received. Hardly anyone approves of either part separately. Yet the two combined have become a sacred cow. What a triumph of imaginative packaging and Madison Avenue advertising!

The argument against reform seems to be that social security's disproportionate benefits to the middle class are the political price of getting the program enacted, and that any program designed explicitly for the poor "will most likely be a poor program." What puzzles me is this. Are we really helping poor people by saying to them, "Here is a program under which we will take two dollars from you and give you one back, and we can get that program passed, but we can't get a program passed which will take a dollar from you and give you a dollar back"?

If that is the case, it seems to me that if I were one of those poor people—if I were one of the people to whom we are saying, "Don't worry, we'll take care of you, we promise that for every two dollars we take from you, you will get one back"—I would repeat Thoreau's comment: "If I knew for a certainty that a man was coming to my house with the conscious design of doing me good, I should run for my life." □

If you're growing tired of being "such a good listener"...

Of course, it would be a lot more fun to be a "great conversationalist" instead. But how would you go about it? How could you become the kind of fascinating person you usually admire — full of ideas, information, with an air of enviable authority on half a dozen subjects . . .

If you had all the time in the world, you could plow through dozens and dozens of magazines and books every month. But if your time is limited, you can let the editors of *Intellectual Digest* do all that heavy reading and sifting for you. And bring you the best of the lot — the not-to-be-missed discussable articles that really interest you.

Intellectual Digest gives you the opportunity to sample the most fascinating magazines published today — from the well-known quality magazines such as *The New Yorker, Foreign Affairs* and *Commentary* . . . to professional magazines (usually unavailable to the layman) such as *Physics Today, Annals of Internal Medicine,* and *The New Scientist* . . . to the "little magazines" and literary quarterlies such as *Paris Review, Daedalus,* and *Antioch Review*. Over 300 magazines in all.

You'll be absorbing facts, theories, discoveries, revelations, even backstage rumors, about everything important on the current scene . . . in science, literature, sociology, art, medicine, history, politics. Most articles are published in full — but when space considerations make cuts necessary, it's always with the approval and collaboration of the author.

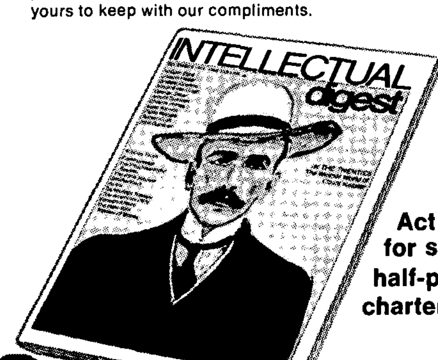
In addition, at least six excerpts from major books are in every issue—often brought to you before publication. Recent examples: John Gardner's *Grendel, The "Diary" of Van Gogh,* Kate Millett's *Sexual Politics,* Julian Huxley's *Memories,* and R. D. Laing's *Knots.* And newsletters in every issue keep you abreast of the latest developments in the arts and sciences.

Why shouldn't you be the one to bring fascinating subjects like these into the conversation?

- **Gore Vidal attacks the fallacy of the male imperative and asks why the male ego can't accept the female challenge to its dominance.** *(N. Y. Review of Books)*
- **A geologist discovers that the South Pole was once in the Sahara Desert.** *(Natural History)*
- **Was Ho Chi Minh a bad poet? Read the arguments, pro and con, and decide for yourself as Intellectual Digest presents the Chinese original and two clashing translations.**
- **"Is Religion Superfluous?". . . noted British historian Arnold Toynbee tells why science cannot solve human insecurity, fear of failure and death.** (Excerpt from *Surviving the Future)*
- **"The Liberal Schism". . . a venomous ideological confrontation among warring factions of New York's literary-political fraternity.** *(Commonweal)*

Act now for the half-price Charter offer

Doesn't this sound like the kind of magazine that could make even talking to *yourself* more interesting? Why not take advantage of the special $5 Charter Rate while it's still in effect. Just mail the coupon and after your first issue arrives, decide for yourself if you wish to continue. In any case, the first issue is yours to keep with our compliments.



Act now for special half-price charter rate

INTELLECTUAL DIGEST
P.O. Box 2986
Boulder, Colorado 80302

Please send my complimentary issue and enter my charter half-price subscription for 11 additional issues at only $5 (a total savings of 50% on the regular $10 price). I may cancel within 14 days after receiving it if not fully satisfied.

☐ **Bill me** ☐ **$5 enclosed**

Name..

Address..

City..

State..........................Zip............

Add 50¢ for Canada and $2 for Foreign. 6364

MEMO of the Month

UNITED STATES DEPARTMENT OF JUSTICE

LAW ENFORCEMENT ASSISTANCE ADMINISTRATION

WASHINGTON, D. C. 20530

DATE: March 31, 1972

REPLY TO ATTN OF: OGC

SUBJECT: Office of General Counsel

TO: All Employees

Efffective today, the name change of the Office of General Counsel to the Office of Legal Counsel is rescinded and the current Office of Legal Counsel is redesignated Office of General Counsel.

JERRIS LEONARD
Administrator