“Social Security:

An Austrian View of the Problem and Proposed Solutions”

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One of the greatest myths in the United States is the concept of the “American Dream.” Children are faithfully instructed to land a good job, get married, buy a home, raise a family and retire somewhere warm, all safely enclosed inside a white picket fence. Among these life events, retirement has become a prominent thread in the tapestry of the classic American dream. When the Social Security Act was passed in 1935, the government became closely entwined with retirement and old age provisions. The program proved to have poor foresight, which was exacerbated by the events of World War II and following. The ambitious goals of the Social Security have financially entrapped the United States Federal Government.

The industrialization process changed the employment dynamic of older workers. This transition sparked policy makers to explore options to provide for their retirement. The FDR administration formed the Committee on Economic Security, which presented the Social Security Act. On April 19,1935, the House of Representatives adopted the Social Security Act by a vote of 371 to 33. President Roosevelt signed the Social Security Act on August 14th, 1935. After going through numerous amendments and additions, the act began to pose serious problems in the 21st century. The joint factors of increased life expectancy, the baby boom, decreased birth rate, and the trust fund deficit have heavily increased the cost of Social Security and led current policy makers to question the future of the legislation. Countless reform proposals have been suggested. This paper seeks to examine three prominent suggestions and analyze their viability.

**I. HISTORY OF SOCIAL SECURITY**

The Social Security Act was passed during one of the most volatile eras of America’s history. The political impetus of the act was driven by the changing labor dynamic brought on by industrialization. To address these concerns, The FDR administration formed the Committee on Economic Security that ultimately led to the initial Social Security bill presented to Congress. After its passage, the act underwent a litany of reforms and amendments from 1935-1983.

In the late 19th and early 20th centuries, the number older workers increased significantly. Census data show that in 1870, directly following the Civil, 3 percent of the total population was over the age of 65. By 1900, this number rose to 4.1 percent, and by 1930 it was up to 5.4 percent.[[1]](#footnote-1) Sylvester J. Schieber and John B. Shoven, authors of *The Real Deal: The History and Future of Social Security* also note*,* “According to actuarial estimates in 1935, the portion of the population over 65 would roughly double, to make up 11.3 percent of the total by 1980. 45 years later, this projection proved to be almost precisely correct.” [[2]](#footnote-2) In addition to the growing number of elderly workers, their position in the workforce became increasing vulnerable. Because of industrialization, the nature and distribution of labor changed. Companies were concerned that older workers operating new machinery posed a risk. As a result, some organizations began to develop retirement programs. One of the first industries to consistently offer retirement packages was railroad business. Companies found that older workers posed risks to public safety and accidents led to significant losses of capital on account of lawsuits. Moving into the 20th century, more industries adopted the practice of offering retirement packages, including academia, banking, and insurance. According to Murray W. Latimer, author of *Industrial Pension Systems in the United States and Canada,*

“From 1875, when the first plan was established in the United States by the American Express Company, to 1929, 421 companies had established formal pension plans. Of these 28 had already been discontinued. Of the plans in operation, 807 were of the non-contributory type and 90 were of the contributory type. The total number of workers employed by companies with pension plans amounted to 8,745,000, or about one seventh of our industrial workers.” [[3]](#footnote-3)

While the number of retirement programs increased, large business firms almost exclusively provided them. As a result, many aging Americans were still vulnerable to dismissal by their employers. This threat was exacerbated by the economic downturn and crisis during the Great Depression.

The effect of the Great Depression on older workers was devastating. The economic crisis had a threefold effect on the financial security of men and women over 65: increased unemployment, failure of financial institutions, and unfulfilled pension promises. In 1930, 54% of men aged 54 and older were permanently laid off from their jobs. Additionally, 23.3% of men 54-59 were temporary laid off from their jobs, without any steady income. [[4]](#footnote-4) The failure of financial institutions added further financial instability. Any money invested in the stock market was lost in the crash. Because of bank failure, much of the savings of men and women over 65 practically vanished. Finally, even the employees of companies that offered pension plans were not longer given the financial assistance they expected. Organizations were not able to pay the benefits they promised workers. These problems compounded to deliver the hardest blow of the Great Depression to aging Americans.[[5]](#footnote-5)

The FDR administration was not blind to the disproportional impact of the Great Depression on workers over 65. On June 8th, 1934 when addressing the Congress, President Roosevelt stated, “I am looking for a sound means which I can recommend to provide at once security against several of the great disturbing factors in life--especially those which relate to unemployment and old age.”[[6]](#footnote-6) In his address, he goes on to commend a program of social insurance, contributed to by citizens, to be implemented at the federal level. On June 29th, 1934, FDR issued executive order 6757 in order to form the Committee on Economic Security. In this order, he specifies that members of the committee should be qualified representatives able to do the analytical work, working toward a plan for legislative action.[[7]](#footnote-7) Members of the committee came to the conclusion that both employers and employees should make contributions to a trust fund. The committee also made provision for those with inadequate means to contribute to the trust fund. This measure was believed to be especially necessary during the Great Depression when many people were unemployed and unable to pay social security taxes from a paycheck.[[8]](#footnote-8)

On April 19,1935, the House of Representatives adopted the Social Security Act by a vote of 371 to 33. Franklin Delano Roosevelt, signed the Social Security Act on August 14th, 1935. Upon signing the act, FDR noted that the legislation fundamental changed the role of the federal government in providing for citizens. Tax contributions to the trust funds began in 1937 and would be payable in 1942. Generally, the benefits were intended to be proportional to the contributions. Exceptions were made for low wage earners and some of the first to draw benefits because they hadn’t been able to contribute as much to the trust funds as those who worked longer before retiring or had higher wages. Payroll taxes began at 1% out of the first $3,000 earned. Both the employer and employee were responsibility to make this contribution. The taxes were scheduled to increase incrementally until they reached 3% in 1949. Based on this projection, the Committee of Economic Security believed there would be adequate funds to begin paying benefits in 1942, as intended.[[9]](#footnote-9)

As the years progressed, the government expanded the program. In 1956, early retirement became an option for women aged 62-65, though they would receive reduced benefits. Men were given the same option 5 years later in 1961. As attitudes toward Social Security changed, the program began to cover more than just retirees. In 1939, widows over 65 and dependents under 18 received benefits if their main breadwinner passed away. This was extended to dependent widowers in 1950, divorced women who had been married over 10 years in 1965, and divorced men in 1983. In 1960, Social Security was extended beyond retirement programs and provided benefits for all disabled workers. In 1972, congress decided to increase the amount of benefits paid. They established an automatic increase that corresponded to increases in the consumer price index and increased the benefit formula to account for inflation. This proved to be a problem that over indexed benefits. Legislation in 1977 continued the index-based adjustment after a recipient retired. This amendment also formulated benefits based on average indexed monthly earning during the highest 35 years of a retirees career. By 1983, all of these increases had caused serious cost issues. In attempt to reduce the amount of money spent on Social Security, the government made three reforms: lessened early retirement benefits, taxes placed on benefits themselves, and the incentive of increased benefits for men and women who worked beyond the retirement age.[[10]](#footnote-10)

**II. FACTORS CONTRIBUTING TO THE PRICE OF SOCIAL SECURITY**

In fiscal year 2015, spending on Social Security consumed 12.1 billion dollars.[[11]](#footnote-11) This spending far surpasses any other area of the budget consuming tax dollars and contributing to massive debt. The continued employment of the Social Security Act has become such a costly policy because of four developments: increased life expectancy, the baby boom, declining birth rate and lack of money in the trust fund. While some of the following determinants may demonstrate economic progress, they have nonetheless, increased the cost of the program.

The first factor is increased life expectancy. Social Security initially provided financial assistance to men and women 65 or older. But, the program was only expected to benefit a small percentage of the population. In 1930, the average life expectancy was only 58 for men and 62 for women.[[12]](#footnote-12) Social Security was originally designed to assist a select handful of the nation, those with above average life spans. Happily, the average life expectancy in the United States has been on a steady incline. In 2013 the average life expectancy was 76 years for men and 81 for women.[[13]](#footnote-13) When Social Security was enacted, the average life expectancy did not even reach retirement age, but now the average age exceeds the retirement age by almost 14 years. Because people are living longer, retirees are relying on Social Security for financial support long that the program had been designed to account for.

The Baby Boom is the second factor that has and will continue to increase the cost of Social Security. After World War II, veterans returned to their families or came back and began new families of their own. The result was an unusually large influx in the amount of children born in the first 18 years following the war. From 1946-1964, 72.5 million children were born.[[14]](#footnote-14) In 2016, men and women born during the Baby Boom are now between 52 and 70 years old, making many of them eligible for benefits while the rest will become eligible in 13 years or less. The burden of taxation that is applied to Social Security benefits shifts from generation to generation. While members of the Baby Boom generation once bore the weight of this taxation, they now need to be provided for by younger generations.

The third factor affecting Social Security is the declining birth rate in the United States. In the past children have served as “security” for aging Americans. Grown children are able to help parents with financial needs, as they are no longer able to work. However, according to the *CIA World Fact Book*, in 2011 the average American woman has 1.87 children.[[15]](#footnote-15) Not only are there fewer children to take care of their own parents, but also there are fewer workers per retiree to fund Social Security. In 1945, there were about 41.9 workers per each retiree, while in 2012; there were just 2.9 workers per retiree. This number is expected to drop to a ratio of 2 to 1 by 2030.[[16]](#footnote-16) David Wise and Jonathan Gruber also track the ratio of working Americans and retirees and offer a similarly dismal projection, “the ratio of persons over age sixty-five to those aged twenty to sixty-four has risen from 0.14 in 1950 to 0.21 today and is projected to rise to 0.36 by 2030 and to 0.41 by 2070.”[[17]](#footnote-17) The program has been thrown into a serious state of fiscal imbalance.

The fourth key factor affecting the Social Security problem is probably the most significant of them all. The Social Security trust fund is running out of money. According to the *2011 Social Security Trustees Report*, the Social Security trust fund will be exhausted by 2036.[[18]](#footnote-18) The government will be forced to raise taxes, change the benefit structure, or a combination of all of these in order to continue the program.

**III. PROPOSED SOLUTIONS**

Many 21st century presidential administrations and policy makers have noted the impending collapse of the Social Security Act. Countless reforms have been proposed and presented before congress. The following evaluates the validity of three distinct policy suggestions: George W. Bush’s Social Security Initiative, Paul Ryan’s Roadmap for America’s Future, and the Social Security 2100 Act. Each of these proposals represents a unique view on the nature of Social Security.

In George W. Bush’s second term, he proposed The Social Security Initiative. The Initiative focused on a plan for privatizing Social Security. The Initiative suggested that employers and employees would still pay taxes that would be set aside for retirement benefits. However, the proposal specifically targeted problems inherent to the trust fund structure. As such, the Initiative does away with the trust fund and redirects taxes toward a secure combination of bonds and stock funds. The Bush administration cites several benefits of this program. By investing Social Security taxes into stocks and bonds, the money can generate interest in a market setting rather than being added to the federal governments money holdings. According to the former Bush Administration, “A young person who earns an average of $35,000 a year over his or her career would have nearly a quarter million dollars saved in his or her own account upon retirement.”[[19]](#footnote-19) The Initiative also gives workers the ability to pass along their Social Security retirement savings to dependents after passing away.

The Social Security Initiative succeeds in recognizing a key principle of economics: there is entrepreneurial benefit to be gained from private investment. Austrian economics prioritizes the role of the investor. Investors receive financial gain for their relatively low time preference by funding entrepreneurs by charging interest for the money they invest. Beyond providing monetary benefit to investors through interest, stocks and bonds play an important role in financing the innovation and enterprise of entrepreneurs, who, in turn, develop products and services that better fulfill the desires of consumers. Investments are necessary in a chain of production that will ultimately increasing satisfaction and wellbeing of consumers. The Social Security Initiative falters by placing funds for investment in the hands of government officials. While free market investment allows investors to determine the value of various enterprises and choose investments according to their preferences, government investment cannot assess the subjective value of enterprises. In addition, government driven allocation of funds to business function as subsidizes that leads to artificial monopolies.

The second proposal to examine is Paul Ryan’s Roadmap to America’s Future. In 2012, the current Speaker of the House of Representatives, Paul Ryan, recognized the dominance of social security and welfare spending in the United States Federal Government’s budget and spending. In this proposal, Paul Ryan suggests that workers already 55 or older should be given the same benefits they are afforded in the current system. In contrast, for workers under 55, Ryan introduces the option of investing a third of Social Security payments into personal investment, such as stocks and bonds. Similar to Bush’s proposal, these investments are the private property of the taxpayer and are at their disposal to be incorporated into their final will and testament. Noting the increased risk of market investment, the program also makes the ambitious promise that future retirees would not be given fewer benefits than they would otherwise receive in the current system. In addition to this partial privatization of Social Security, Ryan proposes a gradually modernization of the retirement age to account for increased life expectancy. By gently increasing the retirement age, the program would attempt to achieve full solvency within the trust fund.[[20]](#footnote-20)

The Roadmap to America’s Future presents a seemingly very pragmatic approach to the problem to Social Security. However, the proposal faces a similar problem to that of Bush’s Social Security Initiative. Allowing workers to invest money in the stock market is the step in the right direction, but it intervenes with free market operations by through functional subsidies through government based investment choices. Paul Ryan’s plan also nominally recognizes Social Security payments as the property of the individual by giving workers the ability to leave their funds to a beneficiary. However, this is only a partial recognition of the right to personal property. While the taxpayer controls who would receive the money as an inheritance, they have no real autonomy in choosing how to use the money. The modernization of the retirement age may lead to greater solvency within the trust fund, but it does not address the foundational issues within the Social Security program.

The final proposal to examine is the Social Security 2100 Act. John Larson, representative of Connecticut’s first district, presents an overhaul of the Social Security Act with a focus on increased benefits and trust fund solvency. On the side of increasing benefits, Larson proposes an increase in benefits of approximately 2% for every retiree to account for the increased medical costs. The bill also proposes a cost of living adjustment, increasing benefits gradually to account for inflation. Furthering the agenda of increased benefits for retirees, Social Security 2100 suggests a tax cut for beneficiaries. The bill contrasts current taxes with a proposed new taxation program, “Presently, your Social Security benefits are taxed if you have non-Social Security income exceeding $25,000 for an individual or $32,000 for couples. This would raise that threshold to $50,000 and $100,000 respectively.”[[21]](#footnote-21) Finally, the bill increases the amount of money paid in benefits to ensure that every retiree has sufficient funds to live 25% above the poverty line. All of these increases in benefits have to be accounted for. Larson’s legislation attempts to increase the solvency of the trust fund in three ways. First, by gradually increasing the amount workers contribute over 20 years to the final destination of a 1% increase in taxation by 2037. Social Security 2100 also increases taxes for high wage earners. According to Larson, “Presently, payroll taxes are not collected on wages over $117,000. This legislation would apply the payroll tax to wages above $400,000. In order to maintain the link between contributions and benefits a 2% benefit credit would be applied.”[[22]](#footnote-22) Finally, if the trust fund continued to be insolvent after these measure, Larson proposes that up to 25% of the trust fund be invested in the market in order to increase the revenue of the fund to cover costs.

Larson’s proposal in Social Security 2100 is a complete departure from free market principles. This policy would not allow the market to operate freely – with people using their choices to receive either gains or losses from economic decisions. Economies progress when free market decisions are made in consumption, investment, and production. Larson’s suggestions increase the very factors that make Social Security such a damaging – it takes decision-making power away from individuals and gives it to the government.

**IV. CONCLUSION**

Social Security has a long and complicated history. In the wake of the Great Depression, policies that had been put in place to alleviate financial distress for workers of all ages forever changed the perceived role of government in the United States of America. Social Security has become more than just a policy based on a poor understanding of free market principles. It places a serious threat on the financial wellbeing of the nation. In response, countless proposals have been drafted. Each of the proposals examined in this paper recognize, at least in part, the benefit to be gained from free market investment by suggesting a reallocation of trust funds toward stocks and bonds. This type of investment should not be viewed as a last resort, but as one of the first means of workers to position themselves for retirement. At their core, these suggestions violate an individual’s right to personal property. Policy makers almost universally identify Social Security contributions as property of the worker, but they do not allow taxpayers to have free access over their savings. The only reform that would provide a truly viable solution to the problems with the Social Security Act is one that would return the power of saving and investment decisions to the individual.

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