A FEASIBLE PLAN FOR SOCIAL SECURITY

Background

Addressing Social Security (SS) at a recent Speakers Forum at Foothill-DeAnza College, guest Robert Reich (D) proposed the following:

> *The first $10K a person earns be exempt from the Social Security(SS) tax
> *Remove the cap(upper limit) so that all SS potentially taxable income is indeed taxed. (In 2005 the cap is at $90K, up from $87.9K in 2004.)

He also stated that there is no problem with Social Security. He said that the bigger problem to address seriously is Health and Medicare. Another guest speaker, retired US Senator Alan Simpson (R), said that removing the cap would not work. He had floated that idea back in his Congressional days and got an earful from angry citizens.

Also in January (05) Representative Peter DeFazio (D-OR), in response to the President's announcement of his plans for Social Security, stated that he had a plan that would keep Social Security solvent. His plan calls for exempting the first *$4K* from Social Security tax and removing the cap.

XY Plan: The DeFazio/Reich Plan with a Simpson Twist

My proposal is based on those ideas. Instead of a 4K or $10K tax free approach, the tax exempt amount would vary from $0K to $10K. I call this tax exempt amount variable Y.

For example, if variable Y is $5K, when the $95K cap is reached ($95K instead of the current 90K because the first 5K will be tax free) then compromise and reduce the tax rate by half to 6.2%. (This appears as 3.1% for FICA on a paycheck). I call this rate X.

Rate X can range anywhere from 0 to 12.4%, so the Social Security tax 6.2% comes down to 3.1% on a paycheck. The overall tax comes down from 12.4% to 6.2% (or up from the current 0 after the cap to 6.2%).

These X and Y values would be adjusted every five years, and would calibrate X and Y so that Social Security would be solvent for the next *50 years* (not 75 years).

Two sources of data would measure Social Security solvency:

- The awesomely cautious Social Security administration and their OASDI (Old Age Survivor Disability Insurance), who currently say the system will be short of funds in 2042.
- CBO (Congressional Budget Office) who currently says that the system will be short of funds in 2052.

Robert Reich also stated that CBO is a rather conservative forecasting outfit, just not as timid as OASDI. I.e., he thinks that 2052 is also too soon. If we average these dates we come up with 2047.

Plan Benefits

Some of the benefits of this plan would be:

- Workers who make over 95K will still see a reduction in their FICA later in the year (or Jan 2nd for Bill Gates!). *This is an important feature of this plan.* Social Security tax deduction will be cut in half (from 6.2% to 3.1% on the paycheck)
- Everyone earning less than $95K will get a tax cut (near 90% of the taxpayers). This would be $310 (6.2% of $5K) for those who earn less than $90K pay. Such a tax cut could help the economy.
- The system will be self-correcting.
- The adjustments aim to make Social Security solvent for 50 years instead of 75. With a checkup every 5 years there will be ample time to make corrections.
- The regressiveness of the current SS tax will be greatly diminished.

Math Review

X = the Social Security tax rate that will be used beyond the current cap. This can be anything from 0 to 12.4%. The initial setting estimate is 6.2%. (3.1% appears on the paycheck instead of 6.2%)

Y = the amount of initial income that will be exempt from the Social Security tax. This can be anything from $0K to $10K. The initial setting estimate is $5K.

Currently X and Y are both zero. In the Reich plan X=12.4% and Y=10K and the tax cut for incomes beneath the cap would be $620.

These absolute dollar amounts ($10K, $90K) would slowly rise due to inflation just as the current cap rose from $87.9K in 2004 to $90K in 2005.

Next Steps

This plan must be investigated by the appropriate statisticians and actuaries in D.C. to validate its soundness… and to calibrate X and Y!

And Another Plan!

The CBO analyzed the comprehensive Diamond-Orszag Social Security Plan in December 2004. Briefly, in this plan Y=0 and X starts at 3% and slowly grows to 4%.

In addition, the basic 12.4% rate would grow gradually from 12.7% in 2023 to 12.7% in 2025, 13.9% in 2050, and 15% in 2075. According to CBO projections, benefits would be estimated to decrease by 2% in 2025, 12% in 2050, 23% in 2105.

We can attain long term solvency! To learn more, read what respected experts Peter Diamond of MIT and Peter Orszag of the Brookings Institution have to say in *Saving Social Security: A Balanced Approach* (Washington: Brookings Institution Press: 2004).

Fran Cochran

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