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Making America Work: Alfred P. Murrah Professorship Inaugural Lecture

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MAKING AMERICA WORK: ALFRED P. MURRAH PROFESSORSHIP INAUGURAL LECTURE*

JONATHAN BARRY FORMAN**

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It is a privilege to be here today to share my thoughts on Making America Work. It is truly an honor to hold the Alfred P. Murrah Professorship at the University of Oklahoma College of Law. In this position, I follow in the footsteps of my esteemed colleague, Leo H. Whinery, Professor of Law Emeritus, renowned expert on the law of evidence, and horseman

* This article is based on Jonathan Barry Forman's Alfred P. Murrah Professorship Inaugural Lecture, delivered on October 24, 2006, as part of the Coats Hall Endowed Professorship Lecture Series at the University of Oklahoma College of Law. The lecture draws from JONATHAN BARRY FORMAN, *MAKING AMERICA WORK* (2006). Portions are reprinted by permission of the Urban Institute Press, 2100 M Street N.W., Washington, D.C. 20037. This lecture is only sparingly footnoted, and interested readers should look in that book for the detailed citations of authority.

** Alfred P. Murrah Professor of Law, University of Oklahoma; B.A. 1973, Northwestern University; M.A. (Psychology) 1975, University of Iowa; J.D. 1978, University of Michigan; M.A. (Economics) 1983, George Washington University; Vice Chair of the Board of Trustees of the Oklahoma Public Employees Retirement System.

extraordinaire. I also want to thank J. Hugh Roff, Jr., for his generosity in funding the Alfred P. Murrah Professorship. Of note, Mr. Roff started his legal career as a law clerk to Judge Alfred P. Murrah.

It is truly a pleasure to honor the memory of Judge Alfred P. Murrah today. Orphaned as a young boy, by age thirteen, young Alfred was hopping freight trains and traveling across the country.¹ In 1917, a railroad policeman in Tuttle booted him off the train, and the rest is history.²

A kindly farmer gave young Alfred a home in exchange for farm work and gave him the chance to go to school.³ Alfred worked his way through high school, and then he worked his way through college and law school at the University of Oklahoma.⁴ He hung out his shingle in Seminole, built a law practice, and at the ripe old age of thirty-two, Alfred P. Murrah was the youngest man in history to be appointed as a federal judge.⁵ He went on to become Chief Judge of the United States Court of Appeals for the Tenth Circuit.⁶

Is this a great state or what? Indeed, our motto is *labor omnia vincit* — labor conquers all things.

My wife, Lani, and I have been in Oklahoma for more than twenty-one years. We are proud to call it home, and like Alfred P. Murrah and so many of you, we share a belief in the importance of work.

Work. Hard work! And plenty of it. That's what has made the United States into the world's foremost economic superpower. Although the United States has less than 5% of the world's population, our economy accounts for more than 28% of the world's production. There are more than 150 million Americans in the civilian workforce, and our unemployment rate tends to hover around 5%. In fact, our unemployment rate is typically lower than that of most other industrialized nations, and our labor force participation rate — 66% in 2005 — is higher.

To be sure, the United States has been blessed with magnificent and abundant resources. But ultimately, the economic success of America is about the hard work of Americans, and about a government that generally has had the good sense to stay out of their way. In just over two centuries, Americans have built

1. Oklahoma City National Memorial & Museum, From Rail to Robe: Alfred P. Murrah, <http://www.oklahomacitynationalmemorial.org/secondary.php?section=5&catid=146&id=85> (last visited Mar. 23, 2007).

2. *Id.*

3. *Id.*

4. *Id.*

5. *Id.*

6. *Id.*

a great network of cities and states that would make our founding fathers and mothers proud.

Why does America work? In large part the answer is embedded in our cultural values. In particular, we value and respect work. We want to see hard work and creativity rewarded. We love Horatio Alger stories — stories in which our hero triumphs from hard work, honesty, and perseverance. Alfred P. Murrah's life is, of course, one such story.

We truly want to have a nation in which any child can grow up to become the President of the United States or, at least, the president of a Fortune 500 company. At the same time, however, we respect everyone who works, be they doctors or garbage collectors.

While we value and respect work, we are also concerned about economic justice. In our labor markets, we like to see all Americans earn a fair day's pay for a fair day's work, and we like having a safety net to catch those who, despite their best efforts, cannot compete successfully in our labor markets.

In short, America works because it has achieved a balance between our desire to reward work and our concern about economic justice.

But America could work even better.

I. The Role of Government

In a complex society like ours, the economic rewards from work are determined by a combination of market forces and government policies. Markets arise automatically from the economic interactions among people and institutions. Here and there, government intervenes to influence the operations of those markets and to shape the outcomes that result from market transactions.

Needless to say, policymakers can't do much about market forces. Adam Smith's laws of supply and demand are every bit as immutable as Newton's laws of thermodynamics. But policymakers can change how governments influence market operations and outcomes. In that regard, governments influence market outcomes through regulation, spending, and taxation.

Government regulation defines and limits the range of markets and so influences the shape of the initial distribution of economic resources. Taxes and government spending also have a significant impact on the distribution of economic resources. In particular, taxes and spending are the primary tools for redistribution.

A. Measuring the Impact of Government on the Distribution of Economic Resources

It is probably impossible to measure the full impact of government policies on the distribution of economic resources. In particular, it is hard to estimate the

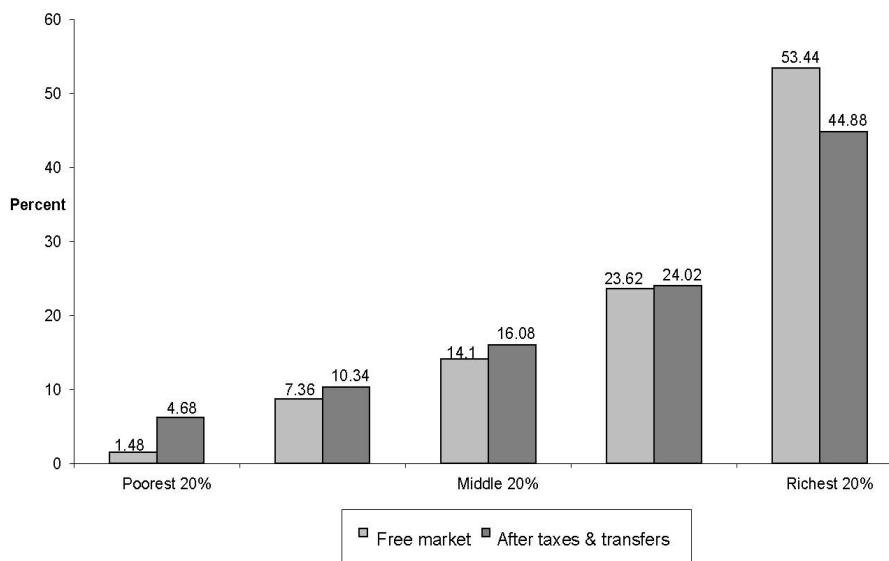
impact of government regulation. We simply do not start from some theoretical Hobbesian state of nature, only to have government add a regulatory framework to it. Rather, governments define and limit the realms of market competition. These activities both enhance the ability of markets to create wealth and influence the ultimate distribution of that wealth.

For example, government grants of patents not only encourage the creation of tradable property rights in new technologies, but also concentrate the resulting wealth in the hands of the patent owners. Governments also grant monopolies to utilities, broadcasters, and liquor stores. All in all, it is clear that government regulation significantly affects the distribution of economic resources, but it is difficult to measure that effect.

On the other hand, we can get a very good idea about the influence of taxes and government spending on the distribution of economic resources.⁷ The light gray bars in Figure 1 show the U.S. Census Bureau's estimate of the free market's initial distribution of household income in 2004. Before taxes and transfers, the richest 20% of American households received 53% of household income, while the poorest 20% got just 1.5% of household income.

Needless to say, that's a rather unequal distribution of income. In fact, the richest 20% of families had thirty-six times as much income as the poorest 20%.

Figure 1. Share of Household Income



Source: Jonathan Barry Forman, *Making America Work* (2006), 30 (figure 2.5)

7. See *infra* fig.1.

The dark gray bars show how government taxes and transfers reduce economic inequality. After taxes and transfers, the richest 20% had 45% of “disposable” income, and the poorest 20% of households saw their income share grow to almost 5% of disposable income. All in all, taxes and transfers reduce household income inequality by about 20%.

But that still leaves us with a pretty unequal distribution of income.

B. Why Is There So Much Inequality?

Why is there so much inequality in the United States?

1. Earnings Inequality

Much of that inequality is attributable to the fact that there is a great deal of inequality in the distribution of individual earnings. Some people just get paid a lot more than others for their forty hours per week of work. For example, Table 1 shows that the average lawyer made \$106,000 in 2004, the average police officer made \$50,000, the average secretary made \$32,000, and the average waitress made \$9,000. Are these the income levels that Plato’s philosopher-king would choose for us?

TABLE 1. ANNUAL EARNINGS, ANNUAL HOURS, AND HOURLY EARNINGS OF FULL-TIME WORKERS, 2004

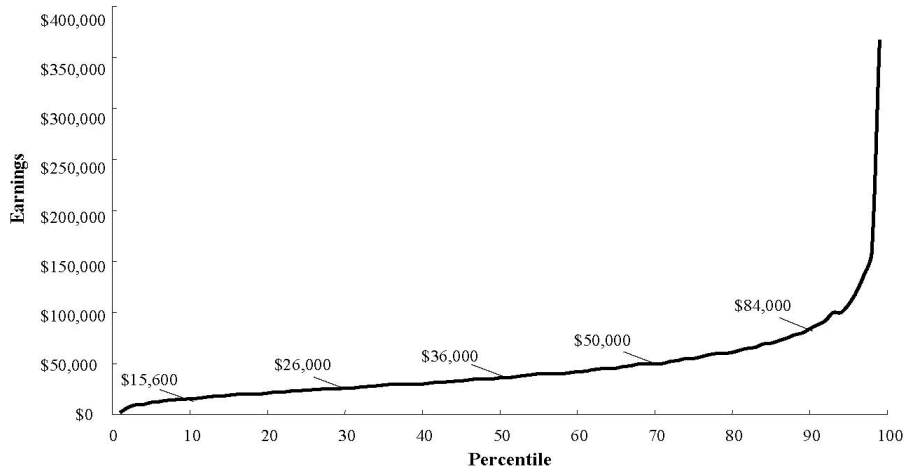
Occupation	Mean annual earnings	Mean annual hours	Mean hourly earnings
Physicians	\$128,689	2,243	\$57.90
Airplane pilots and navigators	128,406	1,083	113.82
Lawyers	105,716	2,174	48.60
Managers, marketing, advertising, and public relations	103,704	2,131	48.65
Economics teachers	99,516	1,555	63.98
Law teachers	89,947	1,526	57.05
Dentists	82,437	2,142	42.91
Actuaries	72,088	2,179	33.09
Economists	71,672	2,171	33.02
Registered nurses	53,289	2,002	26.87
Psychologists	51,508	1,776	28.49
Accountants and auditors	50,761	2,073	24.56
Police and detectives, public service	50,063	2,073	24.10
Secondary school teachers	46,038	1,416	32.53
Elementary school teachers	45,296	1,393	32.46
Machinists	40,736	2,078	19.59
Automobile mechanics	38,967	2,097	18.37

Dispatchers	35,115	2,103	16.53
Prekindergarten and kindergarten teachers	33,487	1,672	19.45
Secretaries	32,349	1,994	16.11
Garbage collectors	31,284	2,172	12.96
Transportation ticket and reservation agents	30,044	2,054	14.78
Bank tellers	22,317	2,049	10.65
Nursery workers	21,671	1,937	9.87
Nursing aides, orderlies and attendants	20,959	2,015	10.20
Cashiers	19,305	2,033	13.23
Hotel clerks	18,255	2,022	8.95
Waiters and waitresses	8,789	1,906	4.44

Source: Jonathan Barry Forman, *Making America Work* (2006), 27 (figure 2.4)

Figure 2 shows the distribution of earnings of full-time workers in 2004 — by percentile. That year, a high-paid worker — one in the ninetieth percentile — earned \$84,000. Meanwhile, a worker in the tenth percentile earned just \$15,600.

Figure 2. Distribution of Earnings, 2004



Source: Jonathan Barry Forman, *Making America Work* (2006), 30 (figure 2.5)

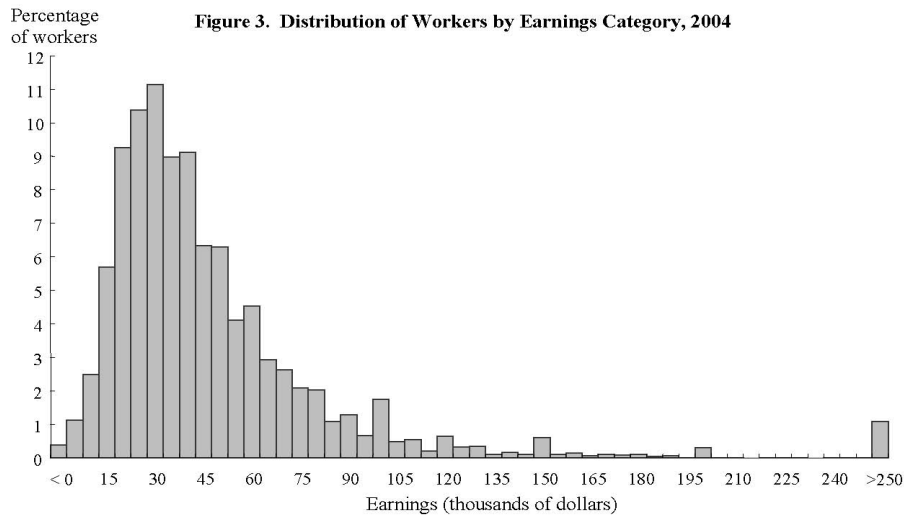
One way to measure inequality is to compare the earnings of workers at various positions in the earnings distribution. For example, dividing \$84,000 by \$15,600 gives us a so-called “90/10 ratio” of more than five to one.

In fact, the remarkable difference between the pay of average workers and the pay of top earners simply cannot be captured in a graph like this. In 2004, for example, the typical chief executive officer of a major U.S. company made

431 times as much as the average production worker. With just 260 days of work a year, that means that a typical chief executive officer earns more in one day than the average worker earns in a whole year.

Of course, CEOs are by no means the only American workers who earn extraordinary compensation. Many movie stars and athletes have seven- or even eight-digit incomes. In 2005, for example, actress Reese Witherspoon made \$30 million, and baseball player Alex Rodriguez made \$25 million.

All in all, most full-time, year-round workers have relatively modest annual earnings, but a few workers earn so much that they fall off the chart.⁸ We live in what Robert Frank and Philip Cook have called a “winner-take-all society” in which the top workers in each field of endeavor earn ridiculously large rewards for their efforts.⁹



Source: Jonathan Barry Forman, *Making America Work* (2006), 50 (figure 3.3)

Note: All civilian noninstitutionalized year-round, full-time workers.

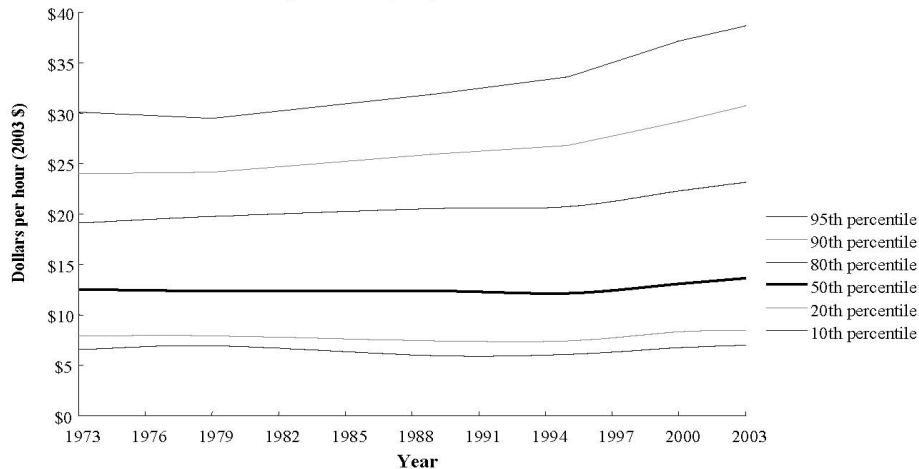
Worse still, earnings inequality has been increasing for decades.¹⁰ For example, from 1979 to 2003, the real wages of top earners — those in the ninety-fifth percentile — increased by more than 30%. On the other hand, workers in the middle saw their wages increase by just 10%, and workers at the bottom saw an increase of less than 1%.

8. See *infra* fig.3.

9. See generally ROBERT H. FRANK & PHILIP J. COOK, *THE WINNER-TAKE ALL SOCIETY* (1995).

10. See *infra* fig.4.

Figure 4. Wages by Percentile, 1973-2003



Source: Jonathan Barry Forman, *Making America Work* (2006), 31 (figure 2.6)

All in all, the United States has significant inequality in the distribution of earned income, and that earnings inequality has increased by about 25% over the past few decades.

2. Inequality in the Distribution of Investment Income

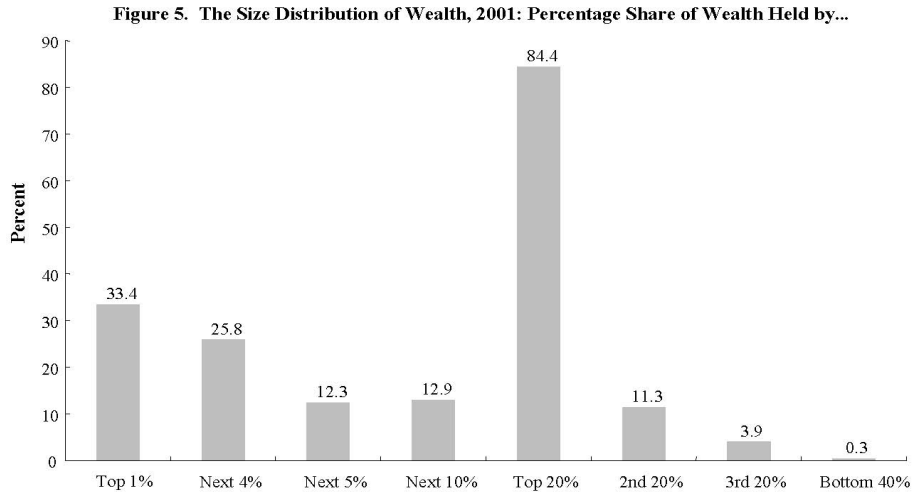
Another reason why the free market's distribution of income is so unequal has to do with the increasingly unequal distribution of investment income. Relatively few well-off households receive the lion's share of this nation's investment income.

For example, Figure 5 shows the distribution of wealth in 2001. The top 1% of households had more than a third of the nation's wealth that year, and the top 20% had more than 84% of wealth. Meanwhile the bottom 40% of Americans had, and has, less than 1% of the nation's wealth.

C. What Should the Government Do?

The basic problem is that free markets generate much more inequality than is needed to ensure the adequate production of goods and services. Some people just get more than they deserve, and some get less than they deserve.

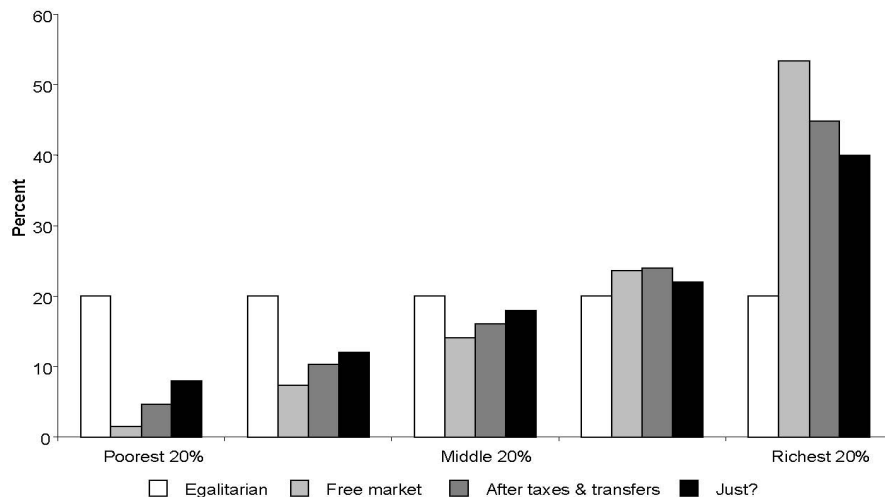
That's where the government comes in. One of the central functions of modern governments is to reduce economic inequality. To be sure, there is considerable debate as to just how much the government should do to reduce economic inequality. It is perhaps easiest to articulate the two most extreme sides of that debate: egalitarianism and libertarianism.



Source: Jonathan Barry Forman, *Making America Work* (2006), 37 (figure 2.9)

Pure egalitarians argue that all people are entitled to share equally in the productive output of their society.¹¹ Consequently, egalitarians favor government tax and transfer policies that would equalize, or at least tend to equalize, the distribution of economic resources. Like latter-day Robin Hoods, egalitarians often favor taking from the rich and giving to the poor. Similarly, egalitarians might argue that everybody who works forty hours a week should be paid about the same.

Figure 6. Share of Household Income



11. See *infra* fig.6 (representing the egalitarians with the white bars).

At the other extreme, libertarians start from the premise that free-market outcomes reflect the free and voluntary trades made by relatively equal market participants.¹² Pure libertarians argue that the free market's distribution of economic resources is inherently just and that the government has no right to interfere with it. Not surprisingly, libertarians generally argue that individuals should be allowed to keep whatever income and wealth they acquire in the marketplace. Moreover, most libertarians doubt that government intervention would actually make society better.

Almost everybody actually falls somewhere in between these two extreme positions. Those with an egalitarian bent usually concede that differential rewards are needed to ensure adequate productivity, and those with a libertarian bent typically concede that some minimal amount of redistribution is needed to help the truly disadvantaged. As already mentioned, government tax and transfer policies currently reduce household income inequality by about 20%.¹³

To be sure, it seems unlikely that a convincing moral argument can be made for any particular level of redistribution. There is simply no magic 90/10 or 80/20 ratio that defines the theoretically and morally "correct" level of inequality.¹⁴

As the current after-tax, after-transfer distribution shows, however, there is a fairly strong consensus in favor of at least some government policies to reduce economic inequality. Moreover, we are always debating government policies that would achieve additional redistribution.

We are especially interested in government policies that can both improve the rewards from work *and* promote greater economic justice. Improving the rewards from work would encourage more people to work, and their added productivity would increase the size of the economic pie. We could then achieve greater economic justice by making the shares of that larger pie more equal.

The key here is to design government policies that encourage work and work effort, and we have already begun to do so.

12. *See supra* fig.6 (representing the libertarians with the light gray bars).

13. *See id.* Compare the free market distribution (light gray bars) with the after-tax, after-transfer distribution (dark gray bars).

14. *See id.* (representing a hypothetically just distribution with the black bars).

II. Recent Policy Trends Encouraging Work

First, we have changed the focus of welfare programs to encourage work. For example, the earned-income tax credit subsidizes the earnings of low-income workers, and the Welfare Reform Act of 1996¹⁵ included many pro-work provisions.

Second, we have significantly reduced the income tax rates imposed on earned income. The maximum statutory rate is now just 35%, down from more than 70% in the 1950s, back when Ronald Reagan was just another movie actor.

Third, we have outlawed employment discrimination because of an individual's race, color, religion, sex, national origin, age, or disability. The result has been a remarkable increase in the labor force participation of workers in the affected groups and increases in their relative earnings. For example, 59% of women are working today, up from just 43% in 1971, and women workers now earn 81% as much as men, up from just 63% in 1979.

Fourth, we have changed Social Security, pension, and labor market policies to encourage elderly workers to remain in the workforce. For example, we have banned employment discrimination against older workers, and we have outlawed mandatory retirement.

III. The Need for Further Reform

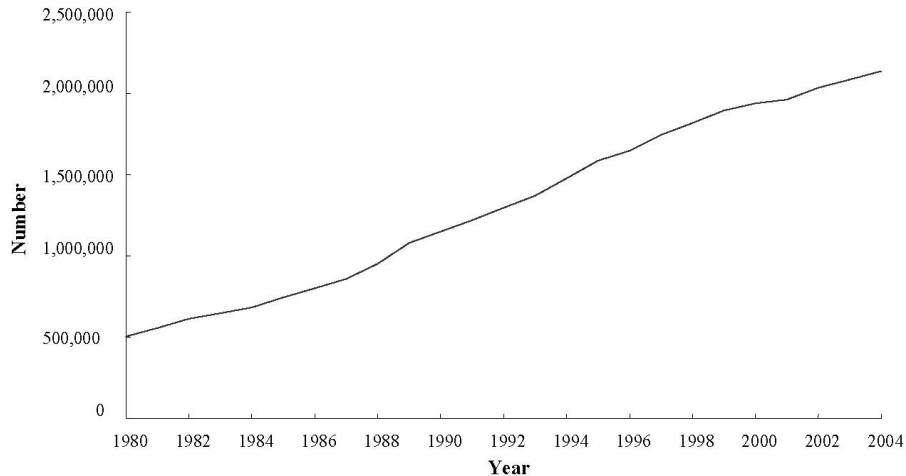
But, there is still more for us to do.

A. Increase the Economic Rewards for Low-Skilled Workers

First, government policies should increase the economic rewards for low-skilled workers. That will make work more attractive than welfare, and it will make honest work more attractive than the wages of crime. Pertinent here, the United States has the highest incarceration rate in the world — 486 adults per 100,000 in 2004 — and the U.S. incarceration rate has increased dramatically in the past couple of decades. Indeed, Figure 7 shows that the number of people in prison or jail increased from 500,000 in 1980 to more than 2.1 million in 2004. Almost 90% of those incarcerated are men, and almost 56% of those men are under the age of thirty-five.

15. Personal Responsibility and Work Opportunity Reconciliation Act of 1996, Pub. L. No. 104-193, 110 Stat. 2105 (codified as amended in scattered sections of 42 U.S.C.).

Figure 7. Persons in Jail and Prison 1980-2004



Source: Jonathan Barry Forman, *Making America Work* (2006), 23 (figure 2.3)

As part of the solution, I believe that we should increase the earned-income tax credit, and we should increase the child care and health care subsidies for low-income working parents. Expanding these programs would increase the rewards from work for low-skilled workers, increase productivity, and reduce inequality.

B. Keep Effective Tax Rates on Earned Income Low

Second, we should lower the tax rates on earned income. Since 2003, the maximum tax rate on dividends and capital gains has been just 15%. Sadly, however, many workers — especially those earning low wages and those who are eligible for retirement — face tax rates two or three times that high. Those high tax rates discourage people from working or improving their work skills so they can earn a higher wage.

In order to have low tax rates, a tax system must have a broad tax base. Unfortunately, the current tax system has tax breaks for everything from horse farms to walnut trees. We have known since Stanley Surrey was the Assistant Secretary of the Treasury in the 1960s that the more of these so-called “tax expenditures” that we can get rid of, the lower our tax rates could be.

My favorite tax break is a little-known tax credit that was added to the Internal Revenue Code in 1999 by the late Senator William Roth of Delaware. Then chair of the Senate Finance Committee, Senator Roth was able to expand the tax code’s renewable energy tax credit to include energy produced from

poultry waste.¹⁶ Excuse my French, *madams et messieurs*, but this chickenshit tax credit costs the taxpayers about \$135 million a year.

We also need to keep the benefit-reduction rates in welfare programs as low as possible. Since Milton Friedman first proposed a “negative income tax” in 1962, we have known that we would be better off with a single, comprehensive welfare system instead of the current system — with its dozens of overlapping and conflicting welfare programs.

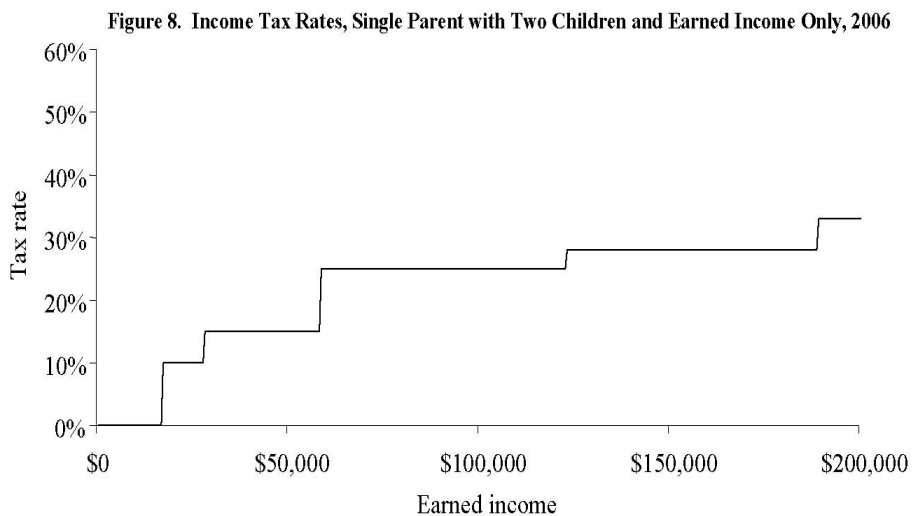
IV. Some Specific Recommendations

In the time I have remaining, I want to offer a few specific reform proposals.

A. Making Taxes Work

First, we should reform the tax system. Many of the problems of the current tax system are the result of having two major taxes imposed on individual income: income taxes and Social Security payroll taxes.

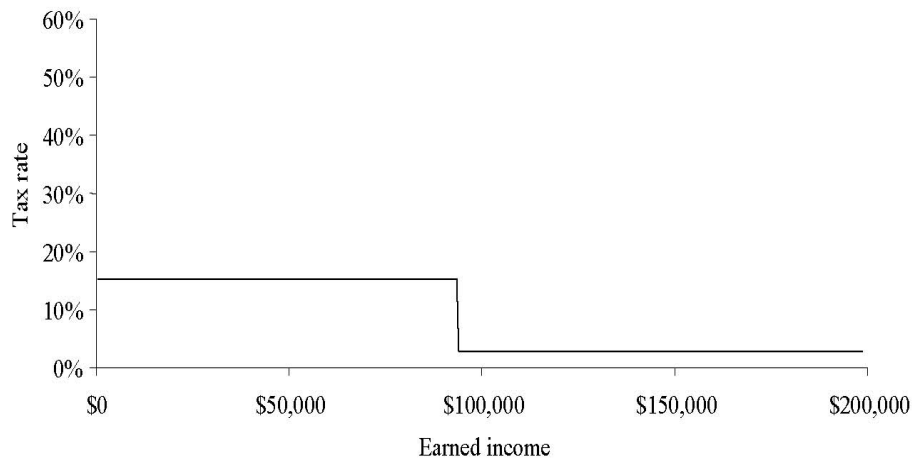
Figure 8 shows that the stated federal income tax rates on a single parent with two children gradually increase from 0%, to 10, 15, 25, 28, and 33%, and eventually to 35%.



16. See Tax Relief Extension Act of 1999, Pub. L. No. 106-170, § 507, 113 Stat. 1860, 1922-23 (codified as amended at 26 U.S.C.A. § 45(c), (e) (West Supp. 2006)).

On the other hand, Figure 9 shows that Social Security taxes are collected on every dollar of earned income, starting at 15.3% of the first \$94,200 of wages in 2006. That's 7.65% on each worker and a matching 7.65% on the employer. Once earnings reach \$94,200, however, the tax rate drops to just 2.9% — 1.45% on the worker and a matching amount on the employer.

Figure 9. Social Security Tax Rates on Earned Income, 2006



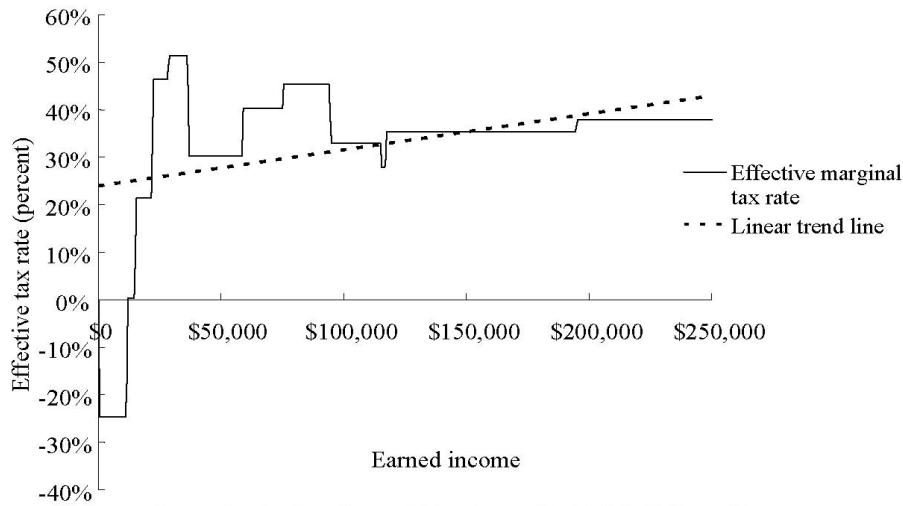
Source: Jonathan Barry Forman, *Making America Work* (2006), 68 (figure 4.5)

The income tax system then uses the earned-income tax credit to refund at least part of the Social Security taxes paid by some low-income workers. Unfortunately, the combination of income taxes, Social Security taxes, and the phase out of the earned-income tax credit results in relatively high cumulative tax rates on earned income.

I won't bore you with the details, but Figure 10 shows the actual effective tax rates imposed on single parents with various amounts of earned income. These tax rates bounce all over the place, rather than steadily increasing as the dotted trendline shows. Worse still, the very highest rates are imposed on single parents earning around \$30,000 a year.

If it were up to me, I would combine the individual income tax and the Social Security payroll tax into a single income tax system with a broad base and low tax rates on earned income. That combined tax system could have a logical tax rate structure, as opposed to the roller-coaster rate structure of the current system. In addition, that system could easily accommodate a few refundable tax credits to help low-income workers and their families.

Figure 10. Actual Tax Rate on Single Parents with Two Children and Earned Income Only, 2006



Source: Jonathan Barry Forman, *Making America Work* (2006), 70 (figure 4.7)

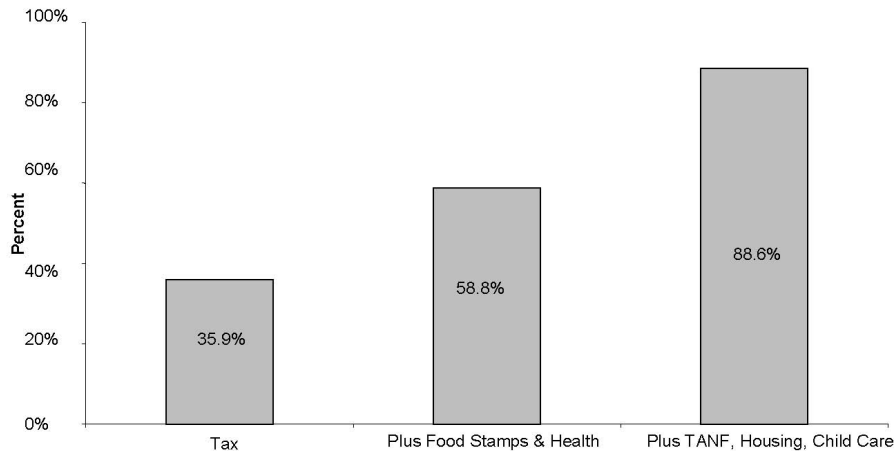
B. Making Welfare Work

Second, we should reform the welfare system. Right now, eighty-five separate federal programs provide income-tested welfare benefits. To keep costs manageable, virtually all of these programs phase out benefits as family income increases. Unfortunately, these phase-outs often combine with income and payroll taxes to subject beneficiaries to confiscatory tax rates, especially on low-income workers. For example, Figure 11 shows the average tax rates confronting low and moderate income families. At some points between \$10,000 and \$25,000 of income, the cumulative tax rate on a single parent can even exceed 100%. Needless to say, such high tax rates discourage low-income Americans from working or from improving their work skills.

I believe that we should replace most of the current welfare system with a system of refundable tax credits. The general idea is to “cash out” as many welfare programs as possible and use that money to pay for refundable personal tax credits, earned-income credits, child care credits, and health care credits.

For example, we could replace the current tax system and most of the current welfare system with a comprehensive tax and transfer system. Instead of the current jumble of income and Social Security tax rates, that system could have just two tax rates, say, 20% of the first \$50,000 of income and 35% on income above \$50,000.

Figure 11. Average Cumulative Tax Rates Confronting Low-to-Moderate-Income Families (\$10k - \$40k)



Source: Adam Carasso and C. Eugene Steuerle, *The True Tax Rates Confronting Families with Children*, *Tax Notes*, October 10, 2005, at 253

To encourage work, instead of the current family-based earned-income tax credit, that system should have a \$2,000-per-worker earned-income tax credit, computed as 20% of the first \$10,000 of earned income.

Also, to simplify the tax and welfare systems, we should replace personal exemptions, standard deductions, child tax credits, and much of the current welfare system with universal \$2,000-per-person refundable tax credits. Under such a system, a working, single parent with two children would receive \$6,000 a year in personal tax credits and a \$2,000 worker credit. These tax credits should be paid out on a monthly basis. Each individual would present something like the current IRS Form W-2, Wage and Tax Statement, to her employer or to a bank. Employees would then receive advance payment of their tax credits from their employers in the form of reduced withholding, while other claimants would have their monthly payments directly deposited into their bank accounts.

This comprehensive tax and transfer system would be simpler than the current system, it would encourage low-income Americans to enter the workforce, and it would minimize the work disincentives on higher-income workers.

As an initial step toward a comprehensive tax and transfer system, we should cash out the Food Stamp Program.¹⁷ In 2005, we gave an average of ninety-three dollars a month in food stamps to twenty-six million low-income

17. *See generally* 7 U.S.C.A. §§ 2011-2036 (West 1999 & Supp. 2006).

Americans. Like most welfare programs, the Food Stamp Program is extraordinarily complicated. It has arcane eligibility criteria and baffling administrative procedures. The Food Stamp Program is also inefficient. In 2003, for example, only 54% of those eligible for food stamps actually received them. The Food Stamp Program also has high administrative costs—currently about 8% of total expenditures, compared with just 1% of total expenditures for the Social Security system. Food stamps are just more expensive to distribute than cash benefits or tax credits.

Tinkering with the Food Stamp Program will not solve these problems. Instead, we should repeal the program and use its \$31 billion-a-year appropriation to help pay for refundable personal tax credits, worker credits, child care credits, and health care credits.

Next, we should cash out housing assistance. Instead of providing a fraction of low-income families with rental subsidies or mortgage interest subsidies, we should give all low-income families \$2,000-per-person tax credits and let them choose their own housing.

The bottom line is that we are unlikely to achieve any meaningful reform of the welfare system by simply, in Edgar K. Browning's words, "trying to patch up each one of the innumerable and uncountable programs."¹⁸ Instead, we should replace the current system with an integrated tax and transfer system—with large personal tax credits, large per-worker earned-income credits, and low tax rates on earned income.

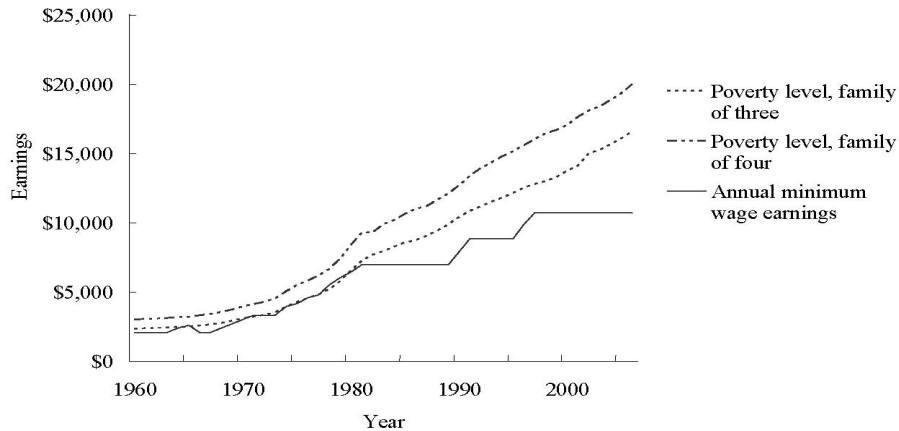
C. Modestly Raise the Minimum Wage and Index It for Inflation

Third, we should increase the minimum wage and index it for inflation. Figure 12 shows how the value of the minimum wage has fallen in recent years relative to poverty levels.

Most economists believe that increasing the minimum wage would reduce employment opportunities for low-skilled workers. On the other hand, earnings subsidies like the earned-income credit can actually increase the demand for low-skilled workers by making it relatively cheaper for employers to hire them. The earned-income credit is also better targeted to help low-income families.

Still, it would make sense to modestly increase the minimum wage and index it for inflation. Combining a modest increase in the minimum wage with an expanded earned-income credit would help ensure that virtually every low-income worker would make enough to bring his or her family out of poverty.

18. Edgar K. Browning, *Commentary*, in *INCOMEREDISTRIBUTION207* (Colin D. Campbell ed., 1977).

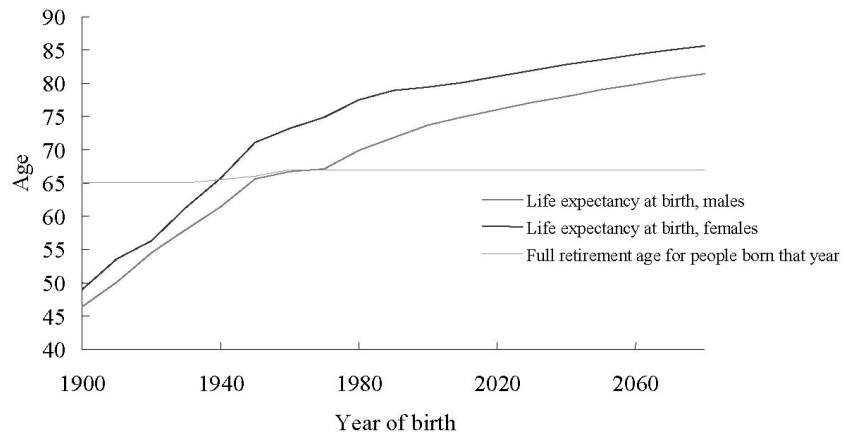
Figure 12. Minimum-Wage Earnings versus Poverty Levels 1960-2006

Source: Jonathan Barry Forman, *Making America Work* (2006), 85 (figure 4.13)

D. A Two-Tiered Social Security System

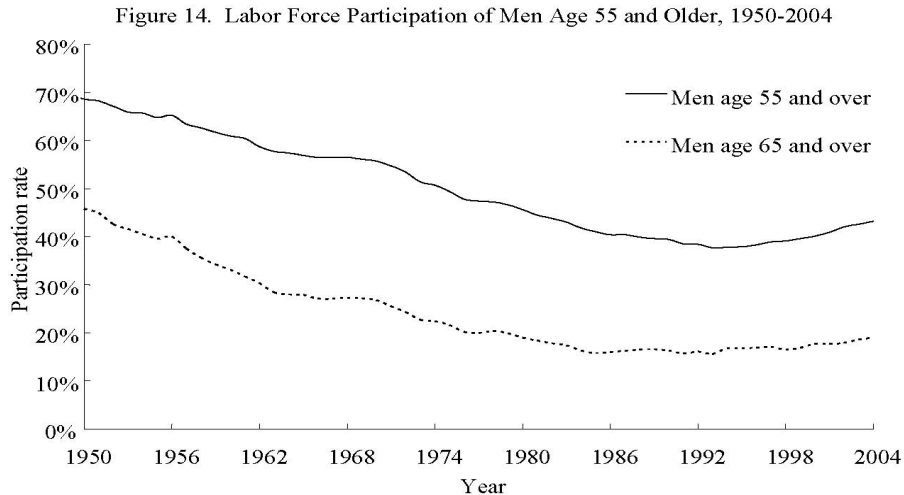
Finally, I believe that we should reform the Social Security system. The current system is in deep financial trouble, and it discourages older Americans from working just when we should instead encourage them to work longer and save more for retirement.

The primary reason that Social Security is in financial trouble is that people are living longer and retiring earlier. For example, Figure 13 shows that life expectancies have increased dramatically since 1900, but we have only modestly increased Social Security's full retirement age — from sixty-five for my parents to sixty-seven for my children.

Figure 13. Life Expectancies at Birth versus Social Security Retirement Age

Source: Jonathan Barry Forman, *Making America Work* (2006), 204 (figure 8.3)

Despite the fact that life expectancies have increased, workers are retiring earlier. For example, Figure 14 shows that the labor force participation rate for men over age fifty-five fell dramatically from 1950 to the mid-1980s, and it has increased only slightly since then.



Source: Jonathan Barry Forman, *Making America Work* (2006), 22 (figure 2.2)

Of course, it's great that we are living longer, and it's wonderful that we can expect to have long and leisurely retirements. But it has led to the current financing problem. Social Security must either find new sources of revenue or cut benefits.

Worse still, the current system generally discourages elderly individuals from working. The availability of Social Security benefits at age sixty-two is a powerful incentive to retire. Moreover, once an individual has worked thirty-five years in Social-Security-covered employment, he or she is unlikely to see much of an increase in benefits from working longer.

Continuing to work can also subject elderly individuals to confiscatory tax rates. Those who work past age sixty-two must pay income taxes and Social Security payroll taxes on their additional earnings. Many will also have to pay income tax on up to 85% of their Social Security benefits, and many more will lose up to one dollar of benefits for every two dollars of earnings, because of the so-called Social Security retirement earnings test. Not surprisingly, more than 56% of the elderly retire as soon as they can — at age sixty-two — and nearly 80% claim their benefits by age sixty-five. The average age at which workers claim their Social Security benefits has fallen from 68.5-years-old in 1950 to just 63.6-years-old today.

My solution is to raise Social Security's full retirement age to sixty-eight or, perhaps, even seventy, raise the minimum retirement age to sixty-five, and replace the current system with a new, two-tiered Social Security system.

The first tier of the new system would provide a basic Social Security benefit to every older American — paid for out of general revenues. For example, the government might guarantee every retiree a benefit equal to 100% of the poverty level — about \$800 a month in 2006.

In addition to that benefit, every worker would also earn a benefit based on earnings. These second-tier benefits would be financed with a much-reduced system of payroll taxes. Each worker would have an Individual Retirement Savings Account, and the payroll taxes that they pay would be deposited into those accounts — and earn interest. At retirement, the balance in a worker's individual retirement savings account would be used to buy a lifetime annuity to supplement that worker's basic, first-tier benefit.

V. Conclusion

In conclusion, I believe that government can, and should, intervene in the free market to encourage work and to reduce economic inequality. We simply do not have to settle for a society where the top 5% of households have dozens of times as much income as the bottom 20% and hundreds of times as much wealth.

The tax, spending, and regulatory proposals that I have outlined today would encourage low-income Americans to enter and remain in the workforce. Consequently, these proposals would increase the size of the economic pie *and* allow us to divide it more equally. In short, these proposals would help make America work even better than it already does.