

THE REAL RATE OF INTEREST ON LIFETIME CONTRIBUTIONS TOWARD RETIREMENT UNDER SOCIAL SECURITY

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The fifteenfold growth of Federal social security tax receipts since 1949 has stirred a debate over how well workers fare under the system. The expressed opinions are remarkably varied. For example, Paul Samuelson pictures a growing nation as "the greatest Ponzi game ever contrived," with its growth making possible ever-expanding social security benefits:

The beauty about social insurance is that it is *actuarially* unsound. Everyone who reaches retirement age is given benefit privileges that far exceed anything he has paid in. And exceed his payments by more than 10 times as much (or five times, counting in employer payments.)¹

On the other hand Milton Friedman speaks of a "raw deal" for young workers:

Retired persons currently enjoy a bonanza. But youngsters currently entering the system are getting a raw deal. * * * To finance the excess payments to the growing number of retired, taxes have had to be raised repeatedly. As a result the benefits promised younger workers are much smaller than the equivalent of the taxes paid on their wages.²

These disparate opinions invite a review of the arguments and a systematic evaluation of the evidence. However, the stress here will be on the real rate of interest or return on contributions under the system, rather than on the lifetime tax-benefit ratios referred to by Samuelson and Friedman. Projections by means of an abstract model suggest that even under a variety of assumptions the prospective return to most new participants under social security is far less attractive than indicated by Samuelson, but better than the "raw deal" suggested by Friedman. In particular it will be argued that most

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¹ "On Social Security," *Newsweek*, Jan. 13, 1967, p. 88.

² Milton Friedman, "On Social Security," *Newsweek*, Apr. 3, 1967, p. 81.