

IV. GENERAL REVENUE FINANCING AS AN ALTERNATIVE

The preceding discussion makes it clear that the OASDHI tax, like any other tax, exhibits the usual quota of faults, all of which become more acute as the level of the tax rises. In view of these shortcomings, should we abandon the present method of financing the social security system by turning in part to general revenue financing, as some have suggested?

There is one immediately apparent "advantage" to supplementing the finances of the system with funds from general revenues: benefit levels probably could be increased substantially without any further increases in payroll taxes, which possibly could even be frozen at their present level. While such a possibility may offer considerable appeal, it is important to think a few steps beyond such a nirvana before merging into it.

What, actually, does general revenue financing imply? Although there is temptation to think of general revenue as a never-failing cruse, in fact it is merely the conglomerate of collections from non earmarked taxes. In 1966, about 88 percent of Federal revenue came from income taxes (about two-thirds from individuals and the balance from corporations), 9 percent from excise taxes, and 3 percent from estate and gift taxes. For all practical purposes, then, general revenue financing amounts to income tax financing. It follows that general revenue financing for the social security system would require a choice between two unpleasant alternatives: scuttling of some present areas of expenditure—an unlikely prospect—or imposition of income tax rates higher than would otherwise be necessary.¹⁹ A capsule idea of the consequences of general revenue financing can be obtained by comparing the major ways in which payroll taxes and income taxes differ, as shown below:

	Increase in payroll tax	Increase in income tax
Effect of increased tax on resource allocation.	May be severe on new and marginal firms (taxes all firms). Especially severe on labor-intensive firms. Induces movement of resources to less heavily taxed industries.	Allows new firms to develop, marginal firms to survive (taxes profitmaking firms only). Especially severe on firms using large amounts of equity capital. Little, if any, tax-induced industry shifts.
Effect of increased tax on economic stability.	No predictable relationship to business cycle. ¹	Some degree of built-in stabilizer.
Effect of increased tax on individuals...	Possibly regressive. Benefits seem earned (tax-benefit link possible).	Progressive. Benefits are charity (no tax-benefit link possible).

¹ See Economic Aspects of the Social Security Tax, Tax Foundation, New York, 1966, pp. 51-54.

When the major differences between the two taxes are thus arrayed, the choice between financing additional benefits by increasing one tax rather than the other begins to look like the Scylla-Charybdis passage. For instance, one might prefer the income tax because it allows new firms to develop, but since the income tax also allows inefficient marginal firms to continue to operate, perhaps the OASDHI tax, with

¹⁹ This paper does not seem the place for a discussion of "fiscal drag," but for those who would contend the "surplus" could be channeled into the social security system, let it be noted that the "excess" funds would vanish under suitable rate reduction.