



## SAVING THE SOCIAL SECURITY SYSTEM

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Social Security is a system built to collapse. The Capital Homestead Act (CHA), a new, comprehensive national ownership strategy proposed by the non-partisan Center for Economic and Social Justice, would save the system, directly addressing three of the system's most serious structural flaws:

- (1) Social Security is a pay-as-you-go system and has no productive assets to stand behind the government's mounting promises. As such, it is frequently compared to a Ponzi or pyramid scheme.
- (2) An unhealthy generational political split is inevitable between workers and Social Security recipients. Potential beneficiaries are growing larger in number. 75 million baby boomers will soon join their ranks. The working population who pay into the system (and whose payrolls are taxed from dollar one) is shrinking in proportion to the recipient population. In 1935, when the program was first launched most Americans died before reaching the eligible Social Security age of 65, and the burden ratio was roughly 25 to 1. Now the burden ratio is about 3 to 1, putting more and more dependents on fewer and fewer backs.
- (3) The rich are largely exempted from sharing in this mounting burden. Not only is there is a cap on salaries taxed for the so-called trust fund, but also there is no tax on incomes from dividends, interest, and capital gains to support social security. The present program is a good example of regressive taxation. A disproportionate burden falls on the poor, relieving high-income workers and the wealthiest Americans of the responsibility to meet the nation's promises to poor and middle-class workers.

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### How would the Capital Homestead Act (CHA) address these structural flaws in the system?

First, under the CHA we would keep all benefit promises previously made. We would take measures to increase the

sources of taxes to cover the promises. The CHA would also offer an asset-backed supplement for retirement incomes not dependent on redistributive taxation or the Wall Street gambling casino. It would stabilize any future promises made at present levels. This would tend to "flatten out" the rate of increases in benefit levels, while increasing funding for current promises. Revenue sources would be shifted from the regressive 12.4% payroll tax on all wages below \$72,600, to general tax revenues paid from all sources of consumable income over a poverty level. Incomes below \$10,000 for each adult and \$5,000 per child would be exempt. Incomes from dividends, interest and inflation-indexed capital gains would be fully taxed at the same rate as wage and salary income. Above the poverty level, the rich and non-rich would pay a single rate calculated to balance the budget and perhaps pay down a portion of the national debt over 20 to 30 years. Thus, property incomes and a removal of the income cap would help increase revenues to prevent bankruptcy of the social security system.

Second, the Federal Reserve System would employ its Section 13 discount powers so that member banks could make low-interest, asset-backed, "non-recourse" Capital Homestead loans to enable every U.S. citizen to invest in newly issued, full dividend payout, full voting power shares of "eligible" private sector corporations. Such shares would finance the nation's annual growth needs for new technologies, new plant and equipment, new rentable space and new infrastructure.

Democratized capital credit would also free economic growth from the "slavery of past savings" or government subsidies.

Roughly a trillion dollars, or \$4,000 per citizen, worth of private sector growth assets would be monetized each year at present "growth" levels. Under this national strategy, a child born today could retire at age 65 with a Capital Homestead equity stake of about \$200,000, yielding a "second income" of \$30,000.

This scenario assumes no increase in America's capital growth rate, \$3,000 borrowed annually from local banks at an unsubsidized 3% "pure credit" borrowing rate for purchasing the newly issued Capital Homestead "growth" shares, no increase in share values, and a 15% annual pre-tax, pre-dividend return on investment as the sole source for repaying the stock purchase loans. When the trillion dollar capital "growth pie" is spread among all citizens, however, growth rates will probably increase. This would lift the American economy from the inherently inflationary and feudalistic "wage system" to a more inclusive and more participative market economy, with much less pressure for redistributive taxation.

One method for democratizing access to Capital Homestead loans is to allocate to each citizen and every member of his family an equal amount of Capital Homestead loans periodically (e.g., quarterly) based on periodic estimates of real demand for capital credit from private enterprises. The citizen could then go to his or her local bank, where the citizen would receive

investment advice. The bank would set up a "Capital Homestead Account" (similar to an IRA). This would receive on the citizen's behalf periodic loans from the bank for the purchase of "eligible" full voting, full dividend payout shares issued by "qualified" private sector enterprises in need of capital for expansion, modernization or for purchasing outstanding shares from present shareowners. The citizen would have the choice to invest his allotment of credit among shares of (1) the company for which a member of the family works, (2) a company, like a utility or transit system, in which he is a regular customer with a regular billing account, (3) a Community Investment Corporation for developing land and infrastructure in his local community or region, or (4) a diversified blend of mature companies with proven records of profitability and sound management. Before taking the loan paper to the discount window of the regional Federal Reserve Bank for monetizing at a discount rate of 0.5% (representing a Fed service charge), the local bank would have the option of self-insuring the loan or insuring against loan default with a commercial insurer of Capital Homestead loan paper. Loan default reinsurance, preferably offered by the private sector, would further spread the risk of default. Debt service, including risk premium charges, on each loan received by the citizen's Capital Homestead Account would be repaid from future pre-tax dividend distributions paid by each of the companies that issue the Capital Homestead shares.

The projected annual yield from the proposed Capital Homestead program requires no reduction in take-home pay, savings, or consumption incomes to purchase "eligible" shares from "qualified" companies. No taxpayer subsidies would be required. All borrowings could be insured privately against each issuing company's risk of default, using the "risk premium" included within each individual loan to sustain the insurance pool. Such insurance represents a private sector solution for overcoming the collateralization barrier for the poor and middle-income borrowers who have no assets to pledge and who would otherwise have no access to capital credit on the same basis as the rich and super-rich.

It should be noted that this alternative for financing America's future investment assets would produce higher annual incomes than most Social Security beneficiaries earn today. If properly implemented within economically feasible ventures, there would be no harmful inflationary effects to the economy, and future prices of U.S. goods and services would be more price competitive in global markets because of the "new social contract" offered workers under Capital Homesteading. In fact, these reforms would stabilize the value of the U.S. dollar since there would be real productive assets backing the U.S. currency, rather than non-productive government debt paper as is the case today. Applying the political and economic wisdom of Abraham Lincoln's Homestead Act to the development of America's 21st century technological frontier, Capital Homestead reforms

would level the playing field for all citizens to gain a real opportunity to acquire income-producing capital assets.

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For more details, see "The Capital Homestead Act: National Infrastructural Reforms to Make Every Citizen a Shareholder", an occasional paper published by the Center for Economic and Social Justice, P.O. Box 40711, Washington, D.C. 20016, Telephone: (703) 243-5155. This and other relevant papers of CESJ can be retrieved from CESJ's web site at <http://www.cesj.org>.

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