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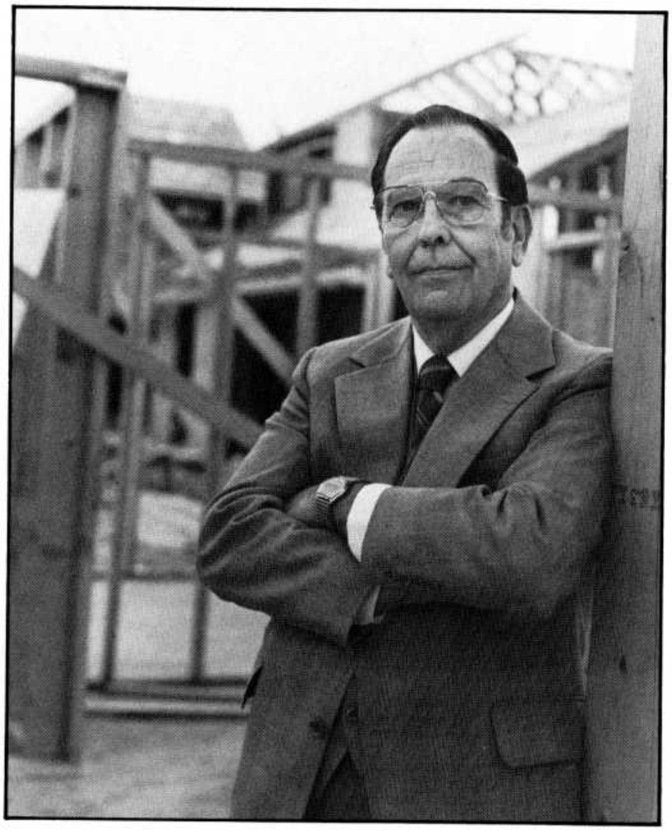


The Long-Term Solution

By STEVE RAY LINAM

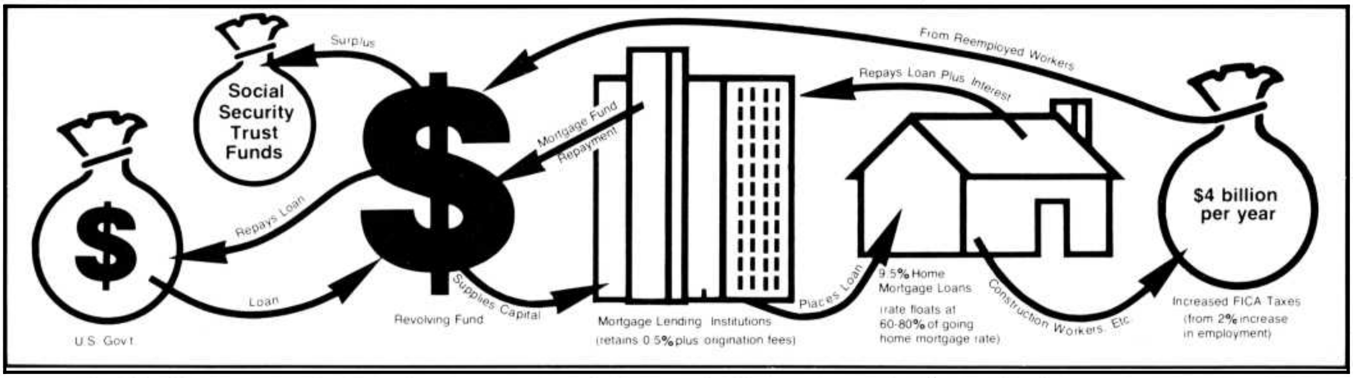
EDITOR'S NOTE: Among the many plans forwarded to the administrative/congressional committee charged with salvaging the endangered Social Security system was an OU finance professor's long-term proposal for turning astronomical deficits into a multi-billion dollar surplus. The committee chose to ignore permanent fiscal solvency in favor of another bailout. OU's Wilson B. Prickett warns in this Sooner Magazine article by Steve Ray Linam that short-term "fixes" are not enough. Linam is with the Norman Transcript.

Throughout the years that followed the Great Depression, Eleanor Roosevelt penned a syndicated column called "My Day," a regular reading of the pulse of the nation during those troubled times. As early as 1939, Mrs. Roosevelt warned that a high tax contribution for the care of the elderly might mean that other necessary government functions could fall by the wayside.

"This seems to me extremely costly management and means less opportunity for the children in the future. I doubt if any of us can justify that particular type of financial management. We want to provide adequately for old people, but we must not let young people suffer. A balance must be kept."

To one of the First Lady's readers, now a University of Oklahoma professor, Mrs. Roosevelt's comments were words of foreboding, borne out by the fiscal problems threatening today's Social Security system, particularly current warnings that the system will face a $1.5 trillion deficit in 75 years.

Wilson B. Prickett, associate pro-



In this illustration, the first three arrows on the bottom indicate a negative flow, all others a positive flow.

fessor of finance in the College of Business Administration, is gravely concerned about the recent borrowing of funds from the Medicare and Disability Trust to pay current Social Security benefits. He sees this congressional action as merely a short-term fix, not a long-term answer to the problems that plague the system.

Professor Prickett is doing more than just verbally sniping at the action — or lack of it — that is compounding Social Security's problems. Specifically, Prickett has devised his own remedy, a blueprint for long-term fiscal solvency of Social Security, which has been forwarded to members of President Reagan's special Social Security task force.

In essence, Prickett's plan is based on the creation of a Social Security revolving fund, supported by a temporary loan from the government's general revenues, that would be invested through existing financial institutions to provide lower interest, fixed-rate home mortgage loans.

The overall impact of this private sector proposal would be to (a) bolster Social Security reserves in the future; (b) assist young people in purchasing homes at lower interest rates; (c) revitalize a depressed housing industry; (d) take a bite out of unemployment; and (e) guarantee solvency for Social Security in the future by using the power of compound interest through private investment to partially fund the program.

U.S. Rep. David McCurdy, from Oklahoma's 4th district, opened the door for Prickett during a trip to Washington, D.C., where the professor sought support for his proposal.

"It is obvious that Professor Prickett spent a great deal of time perfecting his idea to resolve the financial crisis of Social Security," McCurdy said. "I have been more than happy to assist him in presenting his views in Washington, because I feel his proposal deserves a full airing.

"Mr. Prickett is a good American. His proposal had an impact on Congressman J. J. Pickle (D-Texas), who is chairman of the House Subcommittee on Social Security. Pickle supported our efforts to put the Prickett plan in the hands of members of the President's Social Security Task Force."

Oklahoma's senior U.S. Senator, David Boren, also was impressed by Prickett's plan, requesting copies for his Washington office which were then distributed to members of the Senate Finance Committee.

At the time this article is being written, recommendations have surfaced from the president's task force which favor raising FICA taxes, changing the retirement age, or cutting benefits. Prickett, who opposes all these methods, hopes that if his long-range solvency plan is not seriously considered at this point, at least it may be part of a future solution.

Prickett has been refining his proposal since 1981, working with a revolving fund idea which first occurred to him amid rumors in the 1970s that Social Security was in deep financial trouble.

To create his special Social Security Revolving Fund, Prickett suggests borrowing $11 billion from general revenues. The funds then would be funneled into existing mortgage lending institutions, at no cost, for placing and servicing of 9.5 percent home mortgages. The institutions would receive 0.5 percent for handling the loans and be permitted to retain mortgage origination fees.

Amortized monthly mortgage payments would be collected from homeowners, flowing through the mortgage institutions back into the new Social Security Revolving Fund to be re-allocated for investment in additional home mortgages.

Prickett recommends that the interest rates for the home loans under the revolving fund idea be lower than current market rates. Specifically, he would place the initial recommended rate at 9.5 percent.

In this attempt to make Social Security solvent, Prickett breaks down his proposal into two 13-year cycles. During the first cycle, the plan calls for $11 billion to be pumped into his Social Security Revolving Fund each year, increased by a margin of 4 percent for inflation. However, with amortized mortgage payments continually replenishing the fund, the advances from general revenues would diminish each year. Prickett estimates the advances no longer would be necessary after eight years and would be completely repaid within 12 years, making the revolving fund entirely self-sustaining. No permanent deficit would have been imposed upon the federal budget. At the same time, the revolving fund would net 9.0 percent and would be reinvested continuously, the $11 billion would be compounding at 9.0 percent rate.

With the end of the first 13-year cycle, a total of $182.5 billion will have been invested in home mortgages. Of that sum, an estimated $181.3 billion will have been recovered in cash flow from interest, principal and new FICA taxes generated by Prickett's proposal through reemployment of millions of workers now unemployed.

The real boon to the Social Security system will occur during the second

13-year cycle when the revolving fund will have developed a surplus of $252.5 billion, which could be transferred to the Social Security Trust Funds to lower FICA taxes. In addition, another $304.5 billion will have been reinvested and recovered. At this stage a clear view of Social Security solvency begins to emerge. The Social Security Revolving Fund by then, 26 years from the initiation of Prickett's proposal, will show a whopping working capital of about $404 billion in addition to the $252.2 billion surplus. And there's more on the horizon.

Prickett's computer data shows that, if the program were extended over an additional 30 years, the $404 billion could be invested to reap a revolving fund surplus of $5.4 trillion to be made available to Social Security. This concept, as developed by Prickett, is far more acceptable than the $1.5 trillion deficit predicted within 75 years by a 1981 Social Security Trustees report.

In 1981, U.S. Senator William Armstrong, chairman of the Senate Social Security Subcommittee, issued a similar warning regarding mounting deficits in Social Security: "Unless decisive action is taken, the trust funds will soon be unable to make ends meet; the Social Security system will be destroyed. Social Security has been operating in the red for six straight years, and now loses $10,000 per minute . . . Frankly, Congress has been promising benefits it can't deliver."

Aside from the welcome prospect of Social Security showing black instead of red ink in the future, Prickett's plan would bring about considerable side benefits.

Investment in the private sector and lower interest rates would rejuvenate a presently ailing homebuilding and construction industry. Related industries, such as lumber, furniture, carpeting and household appliances also would prosper. Unemployment would decrease perhaps by as much as two or three percent, according to Prickett's estimates. If unemployment did decrease by as much as two percent, the Social Security Revolving Fund would gain $4 billion annually in FICA taxes paid by newly employed workers.

Also, deficits in the federal budget would decrease by some $50 billion a year due to the increased employment rate's effect on the economy. Last January, President Reagan, in his State of the Union message, maintained that every one percent increase in unemployment contributes $25 billion to the federal deficit.

Prickett also predicts the lower mortgage interest rates would spur a "portfolio" effect leading to an overall decline in interest rate levels. The "seed money" made available to the financial institutions also would boost the construction loan business and hike deposits and IRA accounts by previously unemployed workers.

One of the more attractive aspects of Prickett's blueprint is the projected Social Security surpluses that could be used to lower FICA taxes. Prickett is steadfast in his opposition to raising FICA taxes in a continuous attempt to bail out Social Security on a short-term basis.

"The oncoming generation is being taxed at exorbitant rates to make up deficits. It's only in the last five years that taxes have jumped so appreciably," Prickett points out, insisting that demographics are beginning to catch up with Social Security, and the number of retirees are staging a close race with the number of workers paying FICA taxes.

The current level of taxation has prompted a growing "generation gap" with many of the young workers beginning to resent their elders, he warns. "What better way to close this gap than a revision in the program that eventually allows FICA taxes to be reduced."

Prickett insists that there is little difference in allowing Social Security to borrow initial funds for low fixed-rate mortgages for the American public and allowing another federal agency, the Export-Import Bank, to provide low interest loans to foreign buyers of Boeing airplanes, General Electric turbines and other U.S. goods, as was approved recently by the Reagan administration.

If proceeds from investments out of a revolving fund were to be continuously invested in the private sector, the power of compound interest would strengthen the fiscal base of Social Security, Prickett emphasizes.

The professor leaves the door open to modifications in his plan, as changing economic conditions warrant. Should the housing market become saturated, for example, he suggests investment of the Social Security Revolving Fund in high quality state and municipal bonds. If a number of federal programs are transferred to the states, as has been proposed by President Reagan, Prickett believes there will be a growing need for additional borrowing of funds at state and local levels. In the future, even public utility bond issues or mass transportation needs could provide suitable investment opportunities for his proposed Social Security revolving funds.

What would happen if interest rates fall below the initial 9.5 percent Prickett has suggested under this plan? The professor favors fund investment rates for home mortgages pegged at 60 to 85 percent of the going rates to allow young people to continue to buy homes and provide a continuing market for the Social Security Revolving Fund investments. A change in the interest rate would affect the projected growth of the revolving fund, of course, but the principle would remain the same.

Prickett contends that the present "pay-as-we-go" Social Security system, which has brought the program to the brink of bankruptcy, is a legalized "Ponzi Scheme," with today's receipts flowing immediately out to pay ever-increasing obligations.

"Present policies are analogous to consuming a potato to feed one person," he says. "I propose planting the potato to raise a crop that will feed the whole family."

Prickett is offering his proposal as a long-term solution to plug the fiscal leaks in the Social Security system, rather than to continue the emergency "Band-Aid treatments" currently being used.

"I like to think of my proposal as a kind of mutual fund 'by the people, for the people,' designed to provoke thought and interest in a new, different approach to the Social Security fiscal problems. With the application of creative imagination, it may serve as a base upon which others may build."