Wilf Csaplar Jr. Economics 162 Homework #3 Due 02/14

Do not write your name on the assignment. Write your name only on the back of this sheet of paper and staple your answers on the front of this sheet of paper. Your assignment will be typed, except graphs can be drawn by hand and mathematical equations can be done by hand. Failure to follow these directions will cost you 1 point on the assignment and failure to type it will cost you 10 points.

1) (20 points) Given the tax brackets on page 107 for single people, if you earned $30,000.00, then how much taxes would you owe? What are your marginal and average tax rates? Show all work and briefly explain your logic for all three parts.

2) (15 points) When the "Kennedy tax cuts" went into effect under Johnson, the top tax bracket went from 92% to 75%. What happened to tax revenue? Explain the economic reason for the effect you describe.

3) (30 points) Draw a steep demand curve with a flat supply curve. Place a tax on the good. Explain why the curve(s) moved as drawn. Who pays most of the tax? What is the economic reason they pay most of the tax and how does the diagram show that?

4) (20 points) Given the three "articles" below, would you agree with the President's proposal to privatize social security? Explain your logic with references to the information below and other facts.

5) (15 points) Assuming there is a problem with social security, would it be sensible to raise the retirement age? Explain your logic.

The three "articles" below can be found on CNNFN.com at:
http://money.cnn.com/2005/01/13/retirement/straight_dope/index.htm

Half truth/exaggeration: The system is going bankrupt. The system is not going bankrupt.

If you define "bankrupt" as not being able to pay your obligations in full, then you might argue Social Security will be bankrupt come 2042, using projections from the Social Security trustees, or 2052, using estimates from the Congressional Budget Office.

That's when they project the system will have exhausted its surplus, which it will begin tapping in 2018 when there is less revenue than needed to cover promised benefits.

By that logic, though, you also might argue that the U.S. government - with its roughly half-trillion-dollar deficit - is or will be bankrupt.

Some people have the impression that "bankrupt" means penniless. A full 50 percent of non-retired respondents in a recent USA Today/CNN/Gallup poll said they didn't think Social Security would be able to pay them a benefit when they retire.

Not true, according to government estimates.

The system still will be taking in enough revenue to cover 75 percent to 80 percent of what is currently promised.

What's more, even if benefits were reduced to that level, they still would be higher in today's dollars than what current retirees are getting, according to CBO estimates.

Half-truth: The system faces an $11 trillion shortfall.

$11 trillion is the number President Bush often uses to illustrate why he considers the system to be in crisis.

It is based on projections from the 2004 Social Security Trustees report, a measure in today's dollars of the projected shortfall over an infinite time horizon. (The actual number in the report was $10.4 trillion.)

So what's the problem? A shortfall measured over an infinite time horizon has limited value to policymakers, according to the nonpartisan American Academy of Actuaries.

The health of Social Security is typically measured over 75 years. (The estimated shortfall over 75 years is $3.7 trillion.)

"Many observers question the reliability or usefulness of calculating Social Security's unfunded obligation over 75 years. Calculations over an infinite period are even less reliable," an Academy report noted.

A more digestible way to express long-term shortfalls is as a percentage of taxable payroll. That's the portion of your wages paid into the system. Currently, it's 12.4 percent -- half paid by you and half paid by your employer.

Using assumptions made by the Social Security trustees, to bring the system into actuarial balance over the next 75 years, the payroll tax would need to increase today by 1.89 percentage points, to 14.29 percent. Over the infinite time horizon, it would need to increase by 3.5 percentage points, to 15.9 percent.

Half-truths: There is a surplus. There isn't a surplus.

Here's what we know: Social Security has collected more than it has paid out for 20 years.

The excess money has been loaned to the U.S. Treasury in exchange for special-issue Treasury bonds.

Those who deride the notion of the "surplus" refer to such bonds as nothing more than pieces of paper in a drawer.

Here are two of their complaints: 1) the money lent to the U.S. Treasury has already been spent on things other than Social Security; and 2) paying back the money means the government will have to borrow more money, raise taxes, cut spending elsewhere or reduce benefits.

Those who argue the surplus is very real note that the special Treasury bonds are backed by the full faith and credit of the U.S. government.

So unless the government defaults on its debt -- which it has never done and is not likely to do -- it will honor its obligations to Social Security when the system needs to redeem those bonds in order to continue paying benefits in full.