

PUBLIC POLICY ADVISOR

Social Security: The Burden to Come

by Frances Spring, Economist

Several factors must be considered in the current debate about the economics and politics of the U.S. social security system. One is the actuarial soundness of the program. Will the system be able to pay benefits to future retirees out of current and projected surplus accumulations at presently legislated tax rates? Another is the ratio of workers paying into the system to those drawing benefits. When the baby boomers reach retirement age—starting in 2010 and peaking in 2030—will the relatively smaller working population face a disproportionate burden?

A third factor is the use to which the accumulated funds now in the combined social security trust fund accounts are being put. Currently, there are surpluses totalling approximately \$63 billion; they are projected to increase to \$12 trillion by 2030. Are these surpluses being used in a way that will minimize the burden of rising social security costs to future workers, or are they instead financing current government consumption and, until recently, being used to obscure the true size of the federal budget deficit?

We will examine briefly (1) the history of the social security system, (2) the effect on the social security account balances of projected demographic changes, and (3) the surpluses—how their investment affects the economy. We will describe some of the options offered to solve the problems with the system and make some recommendations of our own.

A BRIEF HISTORY

The purpose of the Social Security Act of 1935 was to alleviate the poverty and high unemployment experienced by the nation's elderly. The plan—the first pension plan of its type in the United States—was designed to provide periodic benefits to workers upon retirement. By the time the first checks were issued in 1940, the act had been amended to include not only retirees but also their spouses, survivors, and dependents, and those disabled in the course of work. Therefore, what commonly is referred to as “social security” actually is a combination of several benefit programs, including old-age survivor insurance (OASI), disability insurance (DI), and hospital insurance (HI). (In this paper we refer only to the first two, known as OASDI).¹

Until the early 1980s the social security system was financed on a pay-as-you-go basis—that is, the rate of the payroll tax levied to finance it was set at a level sufficient to pay currently conferred benefits

¹ Some analyses also include HI (part A of Medicare) and/or supplementary medical insurance (SMI, or part B of Medicare) in their examinations of the social security system. Although HI payments are mandatory and benefits entitled (as are those for OASDI), we do not include them here; such an inclusion would require an exploration of the health care system, including the problems and questions relating to escalating medical costs, which is beyond the scope of this paper. SMI also is not included as its programs are need based, and/or voluntary.

and administrative costs. Pay-as-you-go financing was suitable in the early years because the ratio of taxable wage earners to benefit recipients was high, and worker productivity was growing. These combined effects resulted in wage growth sufficient to fund the system without increasing the tax rate.

In 1968 and in each year from 1970 to 1972, Congress increased benefits to compensate recipients for real wage growth and the erosion of benefits by inflation.² To avoid having continually to adjust benefits in this manner, the 1972 legislation included a cost-of-living adjustment (COLA) provision to index (tie) benefits to inflation; no threat to the trust funds was anticipated because wage growth—which provides additional income to the funds—had outstripped inflation since the 1950s.³

This comfortable state of affairs was short-lived, however. The oil shocks of the mid-1970s posed problems for the system. Rapid inflation resulting from spiraling oil prices caused benefit payments to expand (increasing outflows from the funds) at the same time that productivity and wage growth were slowing (reducing fund inflows). In addition, errors in devising the indexing formula caused benefits to rise more than intended by Congress. Congress responded in 1977 by revising the indexing formula and trimming benefits. Although Congress in part was rectifying errors, the public began to feel nervous about the soundness of the social security system. Public pessimism grew when shortly after the legislation passed, the system managers projected that in the long run the system would be in a deficit. (One reason was that the long-run projection period was increased from 50 to 75 years.)

In response to both the long-run deficit forecast and the deterioration of public confidence, in 1983 amendments to the Social Security Act raised payroll tax rates through 1990 in order to build up a reserve sufficient to handle the increased demand on the system when the baby boomers retire. (Subsequent legislation resulted in the additional increase scheduled for January 1, 1991.) The 1983 amendments also stopped the practice of figuring the social security trust funds in the “unified budget” (the portion that reflects current expenditure and revenues—the most widely publicized portion of the federal budget) but until recently continued to permit them to be figured in the formula for calculating (read reducing) the size of the federal deficit to which Gramm-Rudman-Hollings (GRH) cuts must be applied.

PAYMENTS AND BENEFITS

With few exceptions, nearly every person receiving wage and salary income must pay social security payroll taxes; the levy is deducted from the worker’s pay, and the employer must contribute an equal amount. The tax is a flat rate levied on earnings of up to \$51,300.⁴ Taxes are not imposed on nonwage benefits (such as health, dental, and dividend benefits), although for retirees, survivors, and the disabled

2 Merton C. Bernstein and Joan B. Bernstein, *Social Security* (New York: Basic Books, Inc., 1988), p. 29.

3 *Ibid.*, p. 34.

4 The currently imposed rate is 6.2 percent of gross wage and salary income. [See Internal Revenue Service, U.S. Department of Treasury, “Employer’s Tax Guide,” Circular C, Publication 15 (Washington D.C.: U.S. Government Printing Office, January 1990).] The rate is scheduled to increase to 7.16 percent on January 1, 1991. An additional 1.45 percent is levied and remitted to the HI accounts.

who have "substantial income" in addition to their social security benefits, up to 50 percent of the benefits are subject to the federal income tax.⁵

Because it is a fixed percentage of wage and salary income, the payroll tax is *regressive*; that is, workers at the lower end of the income scale pay a larger percentage of their income as payroll tax than those at the higher end. Having a cap on the income subject to the tax further increases the tax's regressivity: As income above the wage cap goes up, an even smaller share of total income is paid in social security taxes than would be if there were no cap.

The size of a retiree's social security benefit check depends in part on three factors: his/her average wage and salary income during the years in which earnings were at their maximum;⁶ a redistributive formula that results in those with average lifetime earnings below the national average wage receiving benefits constituting a larger proportion of their former wage than those who earned an above-average wage (see Exhibit 1); and an established maximum and minimum.⁷ (The latter two adjustments offset some of the regressivity of the payroll tax.) Because benefit payments are indexed to inflation, any increase or decrease in their level results in real change.

THE EFFECT OF DEMOGRAPHIC TRENDS ON THE SOCIAL SECURITY TRUST FUNDS

Two demographic trends of the last 35 years will have a significant effect on the social security system in the future.

- Birth rates rose dramatically following World War II (creating the so-called baby boom generation) but have declined since the late 1950s and remained fairly constant since the mid-1970s. The birth rate (the number of children the average woman bears during her lifetime) peaked in 1957 at 3.7, falling to 1.7 in 1976, and stabilizing at about 1.8 since then.⁸
- Average life expectancy has increased from 68.2 years in 1950 to 74.9 years in 1988.⁹

Based on these trends, the decline in the ratio of payers (workers) to the number of benefit recipients is expected to continue for the next 75 years, the commonly used long-run projection period. When the

5 Social Security Administration, U.S. Department of Health and Human Services, *Social Security Handbook, 1988*, 10th ed., SSA Publication No. 05-10135 (Washington D.C.: U.S. Government Printing Office, October 1988), p. 3.

6 The exact number of years used to compute benefits is determined by a formula that takes into consideration the beneficiary's years of birth and retirement; each year's wage then is adjusted for growth in the national average wage.

7 Henry Aaron, Barry P. Bosworth, and Gary Burtless, *Can America Afford to Grow Old?* (Washington, D.C.: The Brookings Institution, 1989), pp. 28-29.

8 Bernstein and Bernstein, *Social Security*, p. 66.

9 Bureau of the Census, U.S. Department of Commerce, *Statistical Abstract of the United States: 1990*, (Washington, D.C.: The Bureau), p. 72.

EXHIBIT 1

**Old-Age Insurance Benefits for Retirement
at Age Sixty-five, By Earning Level, Selected Years, 1950-2040
(percent of previous year's earnings^a)**

Year	Low Earner ^b	Average Earner ^b	High Earner ^b
1950	44.7%	30.0%	26.8%
1955	49.6	34.6	32.8
1960	45.0	33.3	29.8
1965	40.0	31.4	32.9
1970	42.7	34.3	29.2
1975	59.5	42.3	30.1
1980	64.0	51.1	32.5
1985	63.8	40.9	22.8
1990	69.7	42.3	24.7
2000	66.5	41.3	25.6
2010	59.1	38.5	25.4
2020	56.1	38.1	25.6
2030	51.0	35.8	24.1
2040	51.0	35.8	24.1

SOURCES: *Background Material: 1987 Edition*, p. 93; Sylvester J. Schieber, *Social Security: Perspectives on Preserving the System* (Washington, D.C.: Employee Benefit Research Institute, 1982), p. 26, for 1950 rates; and *Social Security Bulletin, Annual Statistical Supplement*, 1987, p. 14. As reprinted in Aaron et al., *Can America Afford to Grow Old?*, p. 28.

^aFor single workers becoming entitled in January at age sixty-five, the sum of twelve monthly benefit payments divided by earnings in year prior to entitlement. Rates in 2010 and later years adjusted to reflect the rise in normal retirement age scheduled under the 1983 social security amendments.

^bFor the average earner, annual earnings in each year of the work career are assumed to be equal to average earnings in the economy. The low earner is assumed to receive earnings approximately one-half those of the average earner, and the high earner to earn the taxable maximum earnings throughout his career.

first benefit checks were issued during the 1940s, the ratio of the working-age population to the retirement-age population was 30:1; by 1950 it had fallen to 16:1; by the early 1980s it was 3.5:1. *By 2020-30, due both to lower birth rates and longer life expectancy, the ratio is projected to fall to 2:1.*¹⁰ Also, given the current tax and benefits schedules, the surplus in the OASDI trust fund will peak in about 2030 (at \$12 trillion); *by 2050, excess funds will have been exhausted, and deficits will begin to accumulate* (see Exhibit 2).

The accuracy of these projections depends, of course, on the validity of the assumptions made in their calculation.¹¹ The assumptions involve population growth, mortality rates, worker productivity, economic performance, and how the system's surpluses are used.

10 Bernstein and Bernstein, *Social Security*, p. 70.

11 The Social Security Administration projects revenues to and payment from the trust funds using a range of economic and demographic assumptions. The projections cited throughout this report are based on II-B, or "intermediate, pessimistic" assumptions.

EXHIBIT 2

**Projected Status of the Social Security
(OASDI) Trust Funds, Selected Years
(billions of dollars)**

Calendar Year	Income	Outgo	End-of-Year Balance
1990	\$309.5	\$252.2	\$211.9
1995	447.9	338.3	645.5
2000	631.5	446.8	1,409.4
2005	886.3	595.1	2,632.5
2010	1,237.9	825.8	4,460.6
2015	1,686.3	1,203.7	6,730.0
2020	2,226.2	1,775.4	9,124.3
2025	2,857.0	2,549.4	10,996.2
2030	3,590.7	3,524.4	11,837.5
2035	4,452.6	4,703.3	11,240.0
2040	5,470.6	6,121.7	8,840.4
2045	6,674.3	7,966.8	3,799.4
2050	0 ^a	0 ^a	0 ^a

SOURCE: U.S. General Accounting Office, "The Trust Fund Reserve Accumulation, the Economy, and the Federal Budget," Report to the Chairman, Subcommittee on Social Security and Family Policy, Committee on Finance, U.S. Senate, GAO/HRD-89-44 (Washington, D.C.: GAO, January 1989), p. 50.

NOTE: These are the 1988 projections made by the OASDI trustees using II-B ("intermediate pessimistic") assumptions.

^aTrust funds estimated to be exhausted.

THE EFFECT OF THE TRUST FUND SURPLUSES ON NATIONAL SAVINGS AND FUTURE GENERATIONS

In the late 1970s it became obvious that by about 2010 the decline in birth rates and the rise in the average life span would have a detrimental effect on the worker-to-recipient balance. Although social security had been financed on a pay-as-you-go basis, continuing to do so would raise the ante significantly for future generations of workers. To hold down future levies, the 1983 legislation scheduled a gradual rise in the payroll tax so that a reserve (the trust surpluses) would accrue—and grow through investment—to fund the retirement of the baby boom generation. At the end of the 1990 fiscal year (September 30), surplus reserves—which may be invested only in certain U.S. government securities and must yield a minimum rate of return equivalent to the average on all U.S. government issues—amounted to approximately \$63 billion.

The buildup of a surplus in the social security account has several appealing elements, the most attractive being the positive effect it can have on *national savings* (the amount of current income not spent on consumption). This is because the accumulation of the surplus is the result of an increase in (payroll) taxes, which reduced disposable income and consequently consumption. Assuming that *government consumption* does not rise (i.e., the deficit does not increase), the accumulation of the surplus will increase national savings.

An increase in national savings can fuel economic expansion because the surplus is used to purchase government securities. Since government securities are issued to cover the national deficit, if the deficit does not increase, the amount of such securities also will not increase, and their purchase with social security surplus monies will reduce the number of them available to nongovernment purchasers. Purchasers then must turn to private sector issuances, and, assuming that these issuances are used to increase the country's *capital stock* (capital goods are economic goods used in the production of other goods; they include factories, buildings, and machinery but usually not land and money), the nation's productive capacity is increased, resulting in economic expansion and higher national income. Higher income usually means more savings, that is, more money that does not have to be spent on current consumption. If the unspent income is used in ways that increase the nation's capital stock, it stimulates economic growth, and the cycle continues: The size of the economic pie expands and so does the size of everyone's share.

A rise in national savings therefore will reduce the burden of social security on future generations. The increase in living standards (income) that results from economic expansion means that the tax rate imposed on future workers to support a given level of social security benefits will not have to be as high as it would if incomes levels were lower. Therefore, the cost to today's workers of foregoing consumption—that is, paying a little extra in taxes instead of spending it in order to accrue a surplus—is offset by a higher standard of living and justified by a decline in the burden of the payroll tax on future workers.

As is inevitably the case, there is a catch: Increasing national savings through accumulating and investing the social security surplus is contingent on a reduction in the size of the overall federal budget deficit. A rising deficit means current government consumption is increasing, nullifying the effect on national savings achieved when taxpayers forego consumption due to higher payroll taxes. In addition, if the deficit continues to grow, more and more government securities must be issued to cover the spending; because of the safe, guaranteed return of government securities, they attract investors who otherwise would put their money in the private sector. When the number of such securities grows, purchases by the OASDI trust funds fail to reduce the overall amount available to the general public. Therefore, there is no increase in purchases of private sector securities and no corresponding rise in the capital stock. If the investment of social security surpluses serves only to finance current government consumption (for items such as defense, interest on the debt, and services), national savings will not rise, and taxes will have to go up again when baby boomers retire and claim their benefits.

One other factor important in analyzing the burden on future workers is the expected productivity growth rate. (An improvement in productivity simply means that more output is produced with less work. Productivity changes are a function of the size of the stock of capital, the skill and size of the labor force, and technological change.) The rate at which productivity expands will determine in large part the rate of growth in future living standards, and therefore the ability of future generations to absorb the increased costs associated with the retirement of the baby boom generation.

If productivity is expected to expand at a fairly *rapid* pace during the next 20–40 years (due, say, to rapid technological advancement), then asking workers to forego spending today (because the tax rate has been increased in order to accumulate a surplus in the OASDI accounts) may not be justified. Rapid growth in productivity will result in higher future living standards, and income may rise enough to absorb the increased cost of financing growing benefit payments as the baby boomers reach retirement.

Conversely, if productivity is expected to expand only *slowly*, then foregoing spending today (and accumulating a surplus to raise national savings) becomes very important. If growth of productivity is

relatively meager, wage growth will be correspondingly low, and down the road the living standard will not have improved enough to make up for the higher taxes that must be paid to finance retirement benefits to the baby boomers. In this case, the burden of the payroll tax on future generations will be heavier.

To illustrate the importance of increasing national savings now so as to raise future living standards and reduce the burden of social security on future generations, let us examine how national productivity has changed since the inception of the social security system. After World War II productivity was high (from 1948 to 1953, output per unit of input grew by an average of 1.52 percent; from 1953 to 1964 it averaged 1.67 percent), which was reflected in the growth of wage and salary income. Beginning in 1964 productivity slowed. From 1964 to 1969 annual growth averaged 1.36 percent; between 1969 and 1973 it slowed further, to 1.13 percent; between 1973 and 1976 there was a *decline*, with output per unit of input falling by an average of 0.66 percent.¹² Overall, between 1950 and 1987 labor productivity grew by an annual average of 1.5 percent, although between 1977 and 1987 the annual average was only 0.9 percent. (Figures for 1988–89 are not available.)

Given the sharp slowdown in productivity during the past 15 years and the improbability of our ever again experiencing the rapid growth of the 1950s and 1960s, the impetus today for raising national savings so as to stimulate economic growth becomes even more urgent.

ALTERNATIVES TO THE CURRENT SYSTEM

Federal policy makers purport to be building up a large surplus in the social security system in order to prepare for the retirement of the baby boom generation. The continual growth of the national budget deficit, however, results in the purpose of the surpluses being subverted: They end up financing current government expenditures rather than increasing national savings. When this is the case, the accumulation of the surpluses represents an unjustified decrease in taxpayers' current disposable income; it becomes even less justified in light of the regressive nature of the payroll tax.

There have been myriad suggestions as to how the social security system should be changed to rectify the current situation. Most include one or a combination of the following: changing how the surpluses are handled in the budget, privatizing the system, or returning to a pay-as-you-go financing scheme.

Excluding the Accounts from Deficit Targets

One suggestion offered to improve the social security system recently was enacted: The OASDI accounts no longer may be counted against the federal deficit for Gramm-Rudman-Hollings deficit reduction target purposes. Until the passage of the FY 1991 federal budget agreement in late October, the social security trust fund accounts were treated two ways with regard to calculating the deficit: Although they *were not* figured in the unified (current expenditure and revenue) budget, they *were* figured—on the plus side—in calculating the size of the deficit for the purposes of meeting the Gramm-Rudman-Hollings deficit target. The latter gambit, of course, had the effect of reducing the size of the deficit and thus the

12 Edward F. Denison, *Accounting for Slower Economic Growth: The U.S. in the 1970's* (Washington, D.C.: The Brookings Institution, 1979), pp. 108–9.

size of the required budget cuts. Those who favored the change reason that its enactment will reveal the true size of the deficit, and government officials will experience increased public pressure to reduce it.

Whether or not the OASDI surplus is included in or excluded from the budget accounts matters little in an economic sense—the *size* of the total budget deficit is what is of concern, because without an overall reduction in the deficit, savings cannot expand.¹³ But including the surplus in the GRH figure, the most often cited deficit figure, made the deficit look smaller and of less concern than it was.

Privatization

One of the most often cited remedies to the problems faced by social security (especially in relation to the budget deficit) is that all or a part of the system be taken out of government hands and turned over to the private sector. A related proposal is to allow some or all of the surpluses to be invested in private sector securities, such as corporate stocks and bonds.

One current proposal to transform the social security system to a private pension plan has been introduced by Congressman John E. Porter (R-Illinois). Under this plan the system gradually would be turned over to the private sector by refunding the surplus to workers in the form of special, tax-free “individual social security retirement accounts” (ISSRAs) similar to individual retirement accounts (IRAs). The funds would be controlled to some limited extent by the individual and could be invested in corporate stocks, bonds, or government securities.¹⁴ Upon retirement, an individual’s social security benefits would be reduced by the amount of money the worker already had received and invested in an ISSRA. Eventually, as the surpluses disappeared and the current system was eliminated, the entire social security system would become privatized. In one of his *Business Week* columns, political economist Paul Craig Roberts supports the idea that at least some of the social security revenues be converted to such a system, stating that it “would remove a portion of the benefits from the backs of future taxpayers and allow a corresponding reduction in the benefits payable by the government.”¹⁵

While the conversion of the social security system to a private pension program has some appeal, it is not a panacea. First, privatization would not fare any better than a government-run program if the federal deficit continues to grow. If the funds were to move to the private sector, and the deficit continue to grow, the government would have to increase its borrowing to compensate for its lost payroll tax revenue, thus squeezing out private-sector investment and holding down national savings.

Second, investing in government-issued securities means guaranteed returns (the federal government, no matter how serious the deficit, never will go broke), whereas investing in the private sector offers no such guarantee. While the reward to investors for taking a risk in the private sector is a higher rate of return than offered on government issues, there is the possibility of loss. Permitting the investment of ISSRAs in corporate stocks and bonds could result in many investors (retirees) losing money.

13 Aaron et al., *Can America Afford to Grow Old?*, p. 121.

14 Jeffrey H. Birnbaum and Michel McQueen, “Social Security ‘Refunds’ Interest Bush; Bentsen Mulls Tax Rise Tied to Gains Cut,” *Wall Street Journal*, January 25, 1990, p. A16, and John Porter, “Let Workers Own Their Own Retirement Fund,” *Wall Street Journal*, February 1, 1990, p. A14.

15 Paul Craig Roberts, “It’s High Time We Retired the Social Security Tax Surplus,” *Business Week*, January 15, 1990, p. 13.

Privatization also would result in a wider distribution of income than under the current system. As mentioned, the payroll tax itself is regressive, but the benefits formula counteracts this effect through its redistribution aspects. Benefits from a privatized fund no longer would be subject to such a formula, thus increasing the disparity of income between high- and low-income households.

If wholly privatizing the system is not acceptable, why not at least allow the government to invest trust fund monies in private issues, such as corporate stocks and bonds? The answer is the potential for disaster: If the public sector were permitted to invest sizable sums in the private sector, government conceivably could control large portions of the economy, possibly entire industries. The capability for political influence and its adverse effects may be too great to be tested. Even with careful controls, the entry of the public sector into the private domain to such a large extent would have a massive effect on the market.

Pay-As-You-Go Financing

Finally, the argument is made that the system should return to pay-as-you-go financing. During the last days of 1989, U.S. Senator Daniel Moynihan (D-New York) introduced legislation to cut social security tax rates, refund the \$63 million in surpluses, and start paying as we go. The plan was based on several factors, namely, that the surpluses are ending up financing current government consumption, and, in the absence of a decline in the federal deficit, the surpluses cannot add to national savings; without an increase in national savings, the current drain on personal spending cannot be justified. This is especially true in light of the fact that the growing level of current government spending is being financed by a regressive payroll tax. It was reasoned, therefore, that if the social security system is *functioning* as a pay-as-you-go plan, it should refund the surpluses and formally operate as one.

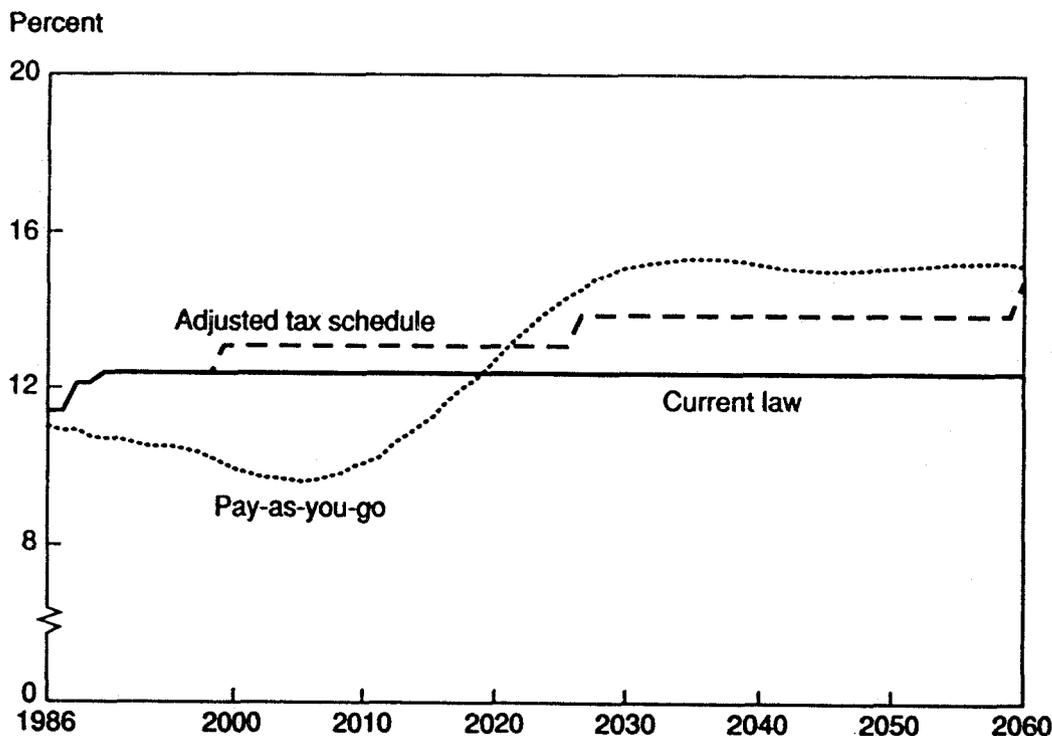
The problem with pay-as-you-go financing is the burden it would place on future workers; Exhibit 3 shows the estimated payroll tax increases necessary to finance such a system. In the absence of significant productivity growth, future workers would experience a lower standard of living, due both to the increase in taxes and the smaller share of total disposable income they would have relative to retirees. It must be remembered that social security benefits represent a claim on production: If the size of the economic pie fails to expand, then workers will have a smaller claim on the total pie than will retirees, thereby reducing the workers' standard of living.

RECOMMENDATIONS

Public Sector Consultants believes the social security system should continue to accumulate and invest surpluses in order to reduce the burden of higher future costs on future workers. To meet this objective, the effect of investing the surplus funds should be to raise national savings.

First, we support the action taken to remove the trust funds from the calculation of the deficit used to meet GRH budget deficit reduction targets. The true size of the deficit in current government spending can no longer be sidestepped, and this action increases the likelihood that public pressure will be brought to bear to reduce it.

EXHIBIT 3
**Social Security Payroll Tax Rates under Current Law,
 Pay-As-You-Go Financing, and a Periodically Adjusted Level Tax Schedule, 1986-2060**



SOURCES: 1986 OASDI Annual Report, p. 12; and Social Security Administration, Office of the Actuary, unpublished data in support of 1986 OASDI Annual Report. As reprinted from Aaron et al., *Can America Afford to Grow Old?*, p. 51.

Second, national fiscal policy should aim to reduce the government deficit to no more than a small, constant share of gross national product; we suggest a range not exceeding 2-3 percent. This would stimulate national savings as the trust funds accumulate government securities covering greater proportions of existing national debt.¹⁶

Third, in addition to the social security surpluses being allowed to accumulate, taxes automatically should be raised or benefits cut whenever the long-run (75-year) solvency of the trust funds is threatened.¹⁷ Aaron et al. show (under various sets of economic conditions) that the size of the combined

¹⁶ For a thorough examination of the deficit problem and recommendations for policies that could be implemented to accomplish this task, see Robert Kleine, "A Proposal to Reduce the Federal Deficit and Debt" (Lansing, Mich.: Public Sector Consultants, August 17, 1990).

¹⁷ Solvency of the fund may be defined simplistically as when projected income to the fund (based on inflows and interest earnings) is less than some fixed percentage of projected costs (benefit payments and administrative costs) during the following 75 years.

tax increases necessary to maintain long-run solvency (which they refer to as "close actuarial balance" and define as keeping projected income within 95 percent of projected costs) would be smaller, and their implementation more gradual, than under a pay-as-you-go financing scheme. Furthermore, the surplus accumulation would be larger than under the current financing plan.¹⁸ The higher tax rates necessary to finance a pay-as-you-go-system means a larger burden would be placed on future workers unless significant productivity gains are experienced, which is unlikely. In contrast, if the surpluses are allowed to grow *and* their effect is to increase national savings, smaller tax increases would be necessary. If the deficit declines, it is conceivable that someday it would be smaller than the system surpluses; in this case, the scope of allowable investments by the fund should be expanded to include certain other government-issued securities, such as FHA mortgages. This would ensure that sufficient no-risk securities are available to the private sector, preventing the flight of private capital to foreign markets.

Finally, if the above recommendations cannot be implemented, the social security system should return to a pay-as-you-go program. The current surpluses are being accumulated at the expense of workers who must pay extra money into the social security system rather than spending it for other purposes; this can be justified only if it results in an increase in future living standards. If the surplus *cannot* be used in such a way as to increase national savings but instead is expended on rising current government spending, or if the federal budget deficit is not reduced, tax rates will have to increase continually just to finance the growth in accumulated debt; this means current wage earners will forego even more current spending, and the burden on future generations will increase. A pay-as-you-go system would be no different, but the elimination of foregone current consumption, coupled with the regressivity of the payroll tax, justifies its reinstatement.

CONCLUSION

The social security system appears to be financially sound for at least the next 35 years. Even if this were not so, it is highly unlikely that the program ever will be allowed to collapse; rather, tax rates likely will be hiked in order to meet increased benefit requirements. In the absence of decreases in the federal budget deficit and/or substantial productivity gains, the rise in tax rates will impose a heavy burden on future generations. This is especially true for wage earners after 2010 when baby boomers begin to retire.

If the accumulation of a surplus in the trust fund accounts results in stimulating national savings, the resulting increased economic growth will lessen the burden on future workers. Tax increases today then can be justified because the resulting expansion in production and productivity will result in higher future living standards, making up for currently foregone spending. A corresponding decline in the national deficit (to the point where it is eliminated or at least absorbs only a small, constant share of total GNP) also is necessary to stimulate increased national savings or productivity.

While Senator Moynihan's plan succeeded in stirring up a hornet's nest on Capitol Hill, it failed to pass muster in Congress. Congressman Porter's proposal and other alternatives are pending and likely will foment further debate, but no changes are expected soon. Changing the system and/or reducing the federal deficit would require considerable political courage.

¹⁸ Aaron et al., *Can America Afford to Grow Old?*, pp. 46-54 and ff. Under current financing, the surplus in the trust funds will be depleted around 2025-30. Under an adjusted rate schedule designed to maintain solvency (which Aaron et al. define as a ratio of income to costs of 95 percent), there still would be surplus funds in the account beyond 2060.

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