



GW Law Faculty Publications & Other Works

Faculty Scholarship

2007

Social Security and Government Deficits: When Should We Worry?

Neil H. Buchanan

George Washington University Law School, neilhbuchanan@gmail.com

Follow this and additional works at: https://scholarship.law.gwu.edu/faculty_publications



Part of the [Law Commons](#)

Recommended Citation

Neil H. Buchanan, Social Security and Government Deficits: When Should We Worry?, 92 Cornell L. Rev. 257 (2007).

This Article is brought to you for free and open access by the Faculty Scholarship at Scholarly Commons. It has been accepted for inclusion in GW Law Faculty Publications & Other Works by an authorized administrator of Scholarly Commons. For more information, please contact spagel@law.gwu.edu.

SOCIAL SECURITY AND GOVERNMENT DEFICITS: WHEN SHOULD WE WORRY?

Neil H. Buchanan[†]

INTRODUCTION	257
I. BASICS OF RETIREMENT SECURITY.....	262
A. Workers Supporting Nonworkers: No Demographic Time Bomb	263
B. Prefunded and PAYGO Retirement Systems and Just Deserts	267
C. The Trust Funds.....	270
D. Are the Trust Funds “Real”?	273
II. SOCIAL SECURITY IN ISOLATION: THE LONG-TERM TRUST FUND BALANCE	274
A. Long-Term Balance and Imbalance	276
B. Does Trust Fund Depletion Mean Anything, Really?.....	279
III. SOCIAL SECURITY AS PART OF THE FEDERAL FISCAL PICTURE: WHAT ABOUT LONG-TERM DEFICITS?.....	282
A. Social Security’s Interaction with the Budget Deficit.....	282
B. Progressivity and Social Security	286
CONCLUSION	288

INTRODUCTION

During his 2006 State of the Union address, President George W. Bush faced an unexpected show of unity from Democratic legislators. After the President noted, with visible regret, that Congress had failed to push forward his plan to privatize at least part of the Social Security program,¹ the Democrats—who had precious little to cheer about in the President’s speech up to that point—spontaneously rose to their

[†] Associate Professor of Law, George Washington University Law School; Visiting Professor of Law, New York University School of Law. J.D., University of Michigan Law School; Ph.D. (economics), Harvard University. I would like to thank Lily Batchelder, Charles Davenport, Michael Dorf, David Gamage, and the participants in the 2006 Junior Tax Scholars Conference for helpful feedback, and the editors of this Symposium for inviting me to participate in this important discussion. Ketan Pastakia provided excellent research assistance, as always. The editors at the *Cornell Law Review* were unfailingly helpful and patient, and their efforts substantially improved the final product.

¹ See WHITE HOUSE, MESSAGE FROM THE PRESIDENT OF THE UNITED STATES TRANSMITTING A REPORT ON THE STATE OF THE UNION, H.R. DOC. NO. 109-80, at 6 (2006).

feet and applauded.² The Democrats were clearly proud that they had prevented what they viewed as an assault on a signature social program³ and had derailed the major domestic policy initiative of the President's second term.⁴ After regaining his composure, President Bush shook his finger at the Democratic side of the chamber⁵ and stated, "[Y]et the rising cost of entitlements is a problem that is not going away—and with every year we fail to act, the situation gets worse."⁶ He then called on Congress to create a bipartisan commission "to examine the full impact of Baby Boom retirements on Social Security, Medicare, and Medicaid."⁷

Thus, even though President Bush's own tax reform commission's late 2005 recommendations had gone nowhere in Congress,⁸ the President called for yet another commission to study Social Security and the country's two government-financed medical care programs, Medicare and Medicaid.⁹ The President warned that those three programs "would soon swamp the federal budget if Congress failed to act as millions of Baby Boomers turn 60 and prepare for retirement."¹⁰ President Bush's proposal to create a bipartisan commission may have been a cynical attempt to sweep a difficult problem under the rug, or it may have been an honest attempt to seek expert assistance with what he believes is an intractable problem.¹¹ The more fundamental question, however, is whether there really is an in-

² See Elisabeth Bumiller & Adam Nagourney, *Bush, Resetting Agenda, Says U.S. Must Cut Reliance on Oil*, N.Y. TIMES, Feb. 1, 2006, at A1.

³ See, e.g., Press Release, Charles B. Rangel, Ranking Member Rangel on House Republicans "Frontal Assault" on Social Security (June 22, 2005), available at http://www.house.gov/list/press/wm31_democrats/050622_Rangel_Frontal_Assault_on_SS.html ("[T]he House Republicans have announced a direct frontal assault on Social Security through privatization.").

⁴ See White House, Policies and Initiatives, <http://www.whitehouse.gov/infocus/> (claiming that the President is committed to strengthening Social Security) (last visited October 9, 2006).

⁵ See Bumiller & Nagourney, *supra* note 2.

⁶ WHITE HOUSE, MESSAGE FROM THE PRESIDENT OF THE UNITED STATES TRANSMITTING A REPORT ON THE STATE OF THE UNION, H.R. DOC. NO. 109-80, at 6 (2006).

⁷ *Id.*

⁸ Cf. Neil H. Buchanan, *The Case Against Income Averaging*, 25 VA. TAX REV. 1151, 1153 & n.2 (2006) (discussing the limited attention that President Bush's tax reform recommendations received from Congress and noting the lack of action it generated).

⁹ See WHITE HOUSE, MESSAGE FROM THE PRESIDENT OF THE UNITED STATES TRANSMITTING A REPORT ON THE STATE OF THE UNION, H.R. DOC. NO. 109-80, at 6 (2006); cf. Carla Anne Robbins, *Waiting (and Hoping) for Jim Baker*, N.Y. TIMES, Nov. 18, 2006, at A16 ("Blue-ribbon panels . . . are a staple of Washington life. Some—like the 1980s Social Security commission—produce real solutions. Many are forgotten hours after their embargoed-for-release stamp expires.").

¹⁰ Bumiller & Nagourney, *supra* note 2.

¹¹ Cf. WHITE HOUSE, MESSAGE FROM THE PRESIDENT OF THE UNITED STATES TRANSMITTING A REPORT ON THE STATE OF THE UNION, H.R. DOC. NO. 109-80, at 6 (2006) (stating the need to "save" Social Security and its worsening problems).

tractable problem with Social Security that the government must deal with, and if so, whether the government must address that problem sooner rather than later. There certainly is a widely held assumption that a serious problem is on the horizon for the Social Security program,¹² as well as for Medicare and Medicaid.¹³

Democrats appear to share this assumption,¹⁴ differing from Republicans only in how to address the problem.¹⁵ In their opposition to privatization,¹⁶ the Democrats' position begins with a fundamental difference in philosophy about the appropriate size and scope of government. As an analytical matter, and assuming that there really is a long-term financing problem facing Social Security, the Democrats were correct in claiming that private accounts would not solve the problem.¹⁷ Indeed, creating private accounts would not change any underlying demographic or financial challenges but would simply change the form in which national dissaving would occur over the next several decades.¹⁸

¹² Compare *Exploring the Economics of Retirement: Hearing Before the Special Comm. on Aging*, 109th Cong. 7 (2005), available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_senate_hearings&docid=f:21037.pdf [hereinafter *Economics of Retirement*] (statement of Sen. Susan Collins, Member, Special Comm. on Aging) ("Unfortunately, as successful as Social Security has been, we know that the system faces serious long-term financing problems and is simply not sustainable in its current form. While the system is sound today, it will not be able to meet its obligations to future retirees unless it is modernized."), with Editorial, *No Social Security "Crisis,"* WASH. POST, Feb. 1, 2005, at A16 (asserting that Social Security is "less a crisis than a problem").

¹³ See *Economics of Retirement*, *supra* note 12, at 3 (statement of Sen. Herb Kohl, Member, Special Comm. on Aging). For example, even in a news item that is not labeled as commentary or opinion, journalists feel comfortable stating as fact that "either benefit cuts or tax increases [are necessary] to deal with the financial problems looming over the social welfare programs." Bumiller & Nagourney, *supra* note 2.

¹⁴ See Robert J. Samuelson, Editorial, *It's More than Social Security*, WASH. POST, Jan. 14, 2005, at A19.

¹⁵ See *id.* ("Democrats argue that 'the Social Security problem' can be fixed with tolerable tax increases and benefit cuts, imposed mostly on the upper middle class and the rich.").

¹⁶ See Susan Milligan, *Democrats Vow No Negotiation on Plan to Alter Retirement Program*, BOSTON GLOBE, Mar. 7, 2005, at A4.

¹⁷ See *Economics of Retirement*, *supra* note 12, at 2 (statement of Sen. Herb Kohl) ("Mr. Chairman, as you have said, private accounts will do nothing to improve Social Security's solvency, and they would not meet your goal, which I share, of increasing national saving.").

¹⁸ See *infra* Part I.A. See generally MICHAEL HILTZIK, THE PLOT AGAINST SOCIAL SECURITY 125-42 (2005) (discussing the development of lobbying for private saving). We can paraphrase the issue as follows: President Bush's plan would divert trillions of dollars of revenues from the Social Security system into private accounts. See Rick Klein, *Bush Agenda Faces Some GOP Resistance*, BOSTON GLOBE, Jan. 18, 2005, at A1. Those accounts would then be invested in the financial markets, to which the Social Security system (through the Treasury) would then have to turn to finance the very revenue shortfall that the introduction of private accounts created. See Aaron Bernstein, *Social Security: Are Private Accounts a Good Idea?*, BUS. WK., Jan. 24, 2005, at 64 ("The Bush Commission plan would require Washington to borrow at least \$160 billion a year in the early years."). The plan would not change net national saving. See Edmund L. Andrews, *Savings: Lots of Talk, But Few Dollars*, N.Y.

Although their opposition to the President's call for private accounts was sound, the Democrats predicated that opposition on a politically expedient—but ultimately false—premise. They conceded that Social Security was in trouble on a long-term basis,¹⁹ faulting the President only (albeit correctly) for saying that private accounts would fix that problem.²⁰ Democratic Senator Edward M. Kennedy bluntly stated: "We're not going to negotiate with someone that's trying to destroy [Social Security]. . . . Privatization cannot be on the table."²¹ Senate Minority Whip Richard Durbin declared: "The privatization proposal of the president is going to destroy Social Security as we know it. . . . It doesn't strengthen Social Security. It weakens it. It doesn't address the *solvency problem*."²² Democrats also argued that Bush would have to drop his privatization proposal "before they negotiate to *save* Social Security."²³ The Democrats' current position thus continues an approach begun by former President Bill Clinton, who argued that the government should use the projected budget surpluses to "save Social Security first,"²⁴ a call that Republicans later used to argue that the system really was in crisis.²⁵

In a recent article,²⁶ I examined whether a proposed system of accounting known as "Generational Accounting" was an appropriate way to measure the long-term fiscal position of the U.S. government. I concluded that it was not.²⁷ In introducing that analysis, I described

TIMES, Mar. 13, 2005, § 3, at 6 ("Moving to a forced savings account technically does not materially affect net national savings." (quoting Alan Greenspan, chairman of the Federal Reserve)). This assumes away any effects on saving or other behavior that might result from the change in retirement policies. Note that "dissaving" means either a decrease in saving or an increase in borrowing. See MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY 362 (11th ed. 2004); F.H. Buckley, *The Fragile Middle Class: Americans in Debt*, 87 CORNELL L. REV. 1078, 1081 (2002) (book review).

¹⁹ See Milligan, *supra* note 16 (noting that both parties admit there is a strain on the Social Security system).

²⁰ See *id.*

²¹ *Id.*

²² *Id.* (emphasis added).

²³ Steven Thomma, *Personal Accounts Could Hasten Social Security Shortfall*, GAO Finds, KNIGHT RIDDER, Mar. 10, 2005, <http://www.commondreams.org/headlines05/0310-02.htm> (emphasis added).

²⁴ John F. Harris, *Clinton Pledges Activist Agenda: "Save Social Security First," President Says; Iraq Gets Warning*, WASH. POST, Jan. 28, 1998, at A1 ("What should we do with this projected surplus?" Clinton asked. "I have a simple four-word answer: Save Social Security first.").

²⁵ See Jonathan Weisman, *New Strategy on Social Security: With Some Risk, Bush Officials Invoke Clinton, Moynihan*, WASH. POST, Jan. 24, 2005, at A3 ("With their push to restructure Social Security off to a rocky start, Bush administration officials have begun citing two Democrats—former President Bill Clinton and the late senator Daniel Patrick Moynihan—to bolster their claims that the retirement system is in crisis.").

²⁶ See Neil H. Buchanan, *Social Security, Generational Justice, and Long-Term Deficits*, 58 TAX L. REV. 275, 281–83 (2005).

²⁷ See *id.* at 325–26.

the basic structure of the Social Security system,²⁸ although Social Security was not the focus of that article. This Article will build upon that earlier analysis to examine the current state of the Social Security system from a budgetary standpoint.

In this Article, I critically examine the assumption that the Social Security system faces a financing crisis and that the government can avert the crisis only by acting now to cut benefits or to raise taxes.²⁹ I look at the Social Security system in isolation—as a program that one can think of as meaningfully separate from the government sector’s other fiscal activities—and as part of the aggregate taxing and spending activities of the federal government. In isolation, the Social Security system’s future looks surprisingly robust, with much of the current concern about its future based on unnecessarily pessimistic economic assumptions and a widespread failure to understand that future changes in the proportion of retirees to workers will be more than offset by future increases in worker productivity.³⁰ Furthermore, if the economy’s future path really does turn out to be worse than is currently reasonable to expect, there will be sufficient time to make adjustments and to keep the system solvent.

As part of the larger fiscal picture, it is possible that the government ought to adjust even an otherwise healthy Social Security system in the face of large deficits caused by tax cuts for the wealthy³¹ and the rising costs of medical care.³² I therefore examine arguments for using Social Security to offset deficits in other sectors of the government, and I conclude that the better policy is to leave Social Security alone.³³

²⁸ See *id.* at 298–306.

²⁹ See Soc. Sec. Admin., Social Security’s Future—FAQs, <http://www.ssa.gov/qa.htm> (last visited Oct. 10, 2006).

³⁰ See, e.g., Jonathan Weisman, *Fixing Social Security No Longer the Third Rail of U.S. Politics*, SUN (BALT.), Mar. 1, 1998, at 1A (“With a smaller workforce supporting a much larger group of retirees, worker productivity would have to increase dramatically . . .”). It is unclear what “dramatically” might mean in such a context, given that even weak productivity growth would be enough to compensate for changes in the ratio of retirees to workers. See *infra* Part I.A and note 53.

³¹ See *Economic Outlook and Current Fiscal Issues: Hearing Before the H. Comm. on the Budget*, 108th Cong. 8 (2004), available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=108_house_hearings&docid=f:92239.pdf (statement of Alan Greenspan, Chairman, Bd. of Governors of the Fed. Reserve Sys.) (“Tax reductions . . . also contributed to the deterioration of the fiscal balance.”).

³² See Office of Mgmt. & Budget, The Nation’s Fiscal Outlook, <http://www.whitehouse.gov/omb/budget/fy2006/outlook.html> (last visited Oct. 10, 2006) (“Medicare’s problems are compounded by the rising cost of health care.”).

³³ While I do not discuss them here, I have no objection to policy changes for Social Security that are appropriate not because of budgetary constraints but because of changing demographics or other reasons. Ending the current systemic incentives to retire sooner than a person might otherwise desire, for example, would certainly have an impact on the system’s finances, but doing so would be good policy even if everyone agreed that the

In short, the current political debate in the United States about Social Security financing is wrong on two counts: politicians on a bipartisan basis agree that Social Security should be viewed in isolation,³⁴ and they further appear to agree that Social Security is doomed when so viewed.³⁵ A better approach would be to view Social Security for accounting purposes as part of the federal government, because doing so allows us to see the larger budgetary context within which Social Security operates. While adopting that viewpoint actually strengthens the case for doom-and-gloom compared to viewing Social Security in isolation, the best conclusion we can draw from the current evidence is that the system is not doomed and that it is not necessary to institute immediate changes. We should, of course, continue to monitor the situation closely to determine whether future changes become necessary. This conclusion is further strengthened by the likelihood that any changes the government makes to the Social Security system today will be regressive, harming the middle class and the least fortunate in order to forestall a crisis that may never occur or that future progressive changes in policy will be able to address.

I

BASICS OF RETIREMENT SECURITY

A discussion of the long-term prospects of the Social Security system must begin with a summary of the alternatives that are available to any society that wishes to allow people to retire at some point in their lives. The details can vary widely, but there are a surprisingly small number of basic issues that determine the nature of a retirement system.³⁶

system was in financial clover for centuries. See, e.g., Barbara A. Butrica et al., *The Implicit Tax on Work at Older Ages*, 59 NAT'L TAX J. 211, 229–30 (2006) (“This study shows that Social Security, federal taxes, and employee benefits create work disincentives for older adults.”); Morris Shanker, *Social Security Tax: Confiscatory Policy*, NAT'L L.J., Oct. 11, 2006, <http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1160471128866> (“Our Social Security laws should be changed to encourage, not discourage, our older workers who wish to continue to work.”).

³⁴ See *Economics of Retirement*, *supra* note 12, at 2 (opening statement of Sen. Gordon H. Smith, Chairman, Special Comm. on Aging) (“Much of the recent debate considers Social Security in isolation from the rest of the government, the economy, and other means by which people strive for retirement security.”).

³⁵ Cf. Editorial, *Dishonest Debate*, WASH. POST, Mar. 25, 2005, at A18 (arguing that Democrats are being disingenuous by publicly criticizing President Bush for “inventing” the Social Security crisis, when President Bush is “taking on an issue that the Clinton administration also regarded as important”).

³⁶ The analysis in this section builds on my analysis in Buchanan, *supra* note 26, at 298–306.

A. Workers Supporting Nonworkers: No Demographic Time Bomb

In a world where people were literally or figuratively living independently on their own economic islands, where all adults were at all times responsible for providing themselves with the means of survival, retirement would be irrelevant. When people stopped working, they would quickly die.³⁷ The only way to avoid death would be to build up a store of nonperishable goods and to secure those goods against predators.³⁸ This primitive form of saving would allow people to retire, and it would also permit many other patterns of self-provision, working to store up food and then drawing it down in both regular (seasonal, cyclical, or lifetime) and irregular (sickness, leisure, or emergency) patterns.³⁹

In a modern economy, every person makes a small and unique contribution to the overall output of the economy.⁴⁰ Division of labor allows workers to band together to produce larger amounts of a wider variety of goods than they could produce without specialization or joint efforts.⁴¹ Bricklayers lay bricks, nurses provide care to the ill, truck drivers transport goods, and professors teach classes. None of those workers produces food, yet all expect that their efforts will be sufficiently valuable to others to entitle them to a share of the food that is produced. Food producers, meanwhile, do not produce medical care, shelter, entertainment, or education, which makes them just as dependent upon the rest of society for the provision of all of the varied goods and services that they wish to consume in a given day, month, year, or lifetime.

It is useful to keep in mind this elementary view of the economy when analyzing retirement systems, because the core problem of how to provide for retirement flows from these basic concepts. Given that everyone is dependent upon one another for almost all of the goods and services that each person consumes, some people might consume

³⁷ See Patricia E. Dilley, *The Evolution of Entitlement: Retirement Income and the Problem of Integrating Private Pensions and Social Security*, 30 LOY. L.A. L. REV. 1063, 1086–90 (1997) (discussing the rarity of retirement and old age prior to the modern era).

³⁸ See *Economics of Retirement*, *supra* note 12, at 11 (statement of Alan Greenspan, Chairman, Fed. Res. Bd.) (“At the most rudimentary level, one could envision households actually storing goods purchased during their working years for use during retirement.”); Paul A. Samuelson, *An Exact Consumption-Loan Model of Interest With or Without the Social Contribution of Money*, 66 J. POL. ECON. 467, 468 (1958) (“If there were only Robinson Crusoe, he would hope to put by some durable goods which could be drawn on in his old age.”).

³⁹ Cf. Samuelson, *supra* note 38, at 468.

⁴⁰ See ADAM SMITH, *THE WEALTH OF NATIONS* 4–5 (Alfred A. Knopf, Inc., 1991) (1776) (describing the specialization of labor).

⁴¹ See *id.* at 4–11.

goods even when they have not contributed to the harvest.⁴² Pure charity is one such possibility; theft is another. Retirement is a distinctly modern form of sanctioned nonwork, allowing some people to stop working but to continue living—not by drawing down stores of dried food in their cellars but by exercising an entitlement to consume out of the rest of society’s current production.⁴³

Children are another category of nonworking consumers whose existence and propagation we can assume away in the Robinson Crusoe-style scenario I noted above. Thus, for purposes of aggregate economic analysis, the key issue is not how many retirees exist at any moment but how much total consumption will be available to nonworkers at any given time. The greater the consumption by nonworkers, the fewer goods and services will be available to the people who produced them.

The economist Paul Samuelson formalized this basic insight and popularized it into a model of “overlapping generations.”⁴⁴ Samuelson’s model focuses on three stages in a person’s life: childhood, work, and retirement.⁴⁵ In only the middle stage does a person produce goods and services that others might wish to consume.⁴⁶ As a result, children, retirees, and others who are currently not working depend upon those who are working for sustenance. The total “dependency ratio” is therefore defined as the number of nonworkers divided by the number of workers.⁴⁷

⁴² See *id.* at 2 (“Among civilised and thriving nations, . . . though a great number of people do not labour at all, many of whom consume the produce of ten times, frequently of a hundred times more labour than the greater part of those who work . . .”).

⁴³ See Wilma Donahue et al., *Retirement: The Emerging Social Pattern*, in HANDBOOK OF SOCIAL GERONTOLOGY 330, 331 (Clark Tibbitts ed., 1960) (“Retirement is the creation of an economically non-productive role in modern societies which are capable of supporting large numbers of persons whose labor is not essential to the functioning of the economic order.”).

⁴⁴ Samuelson, *supra* note 38, at 468.

⁴⁵ See *id.*

⁴⁶ See *id.* Strictly speaking, children and retirees can produce valuable services inside the home, just as an adult who does not work for pay outside the home can produce in-home health care services, cleaning services, food preparation services, and home maintenance services. These productive activities typically have a smaller number of potential claimants, most of whom are in some sort of close personal relationship with the person who actually produces them. Therefore, ignoring such activities for the purpose of analyzing a society’s aggregate support of retirement consumption is arguably appropriate.

⁴⁷ See Theodore R. Marmor, *How Not to Think About Medicare Reform*, 26 J. HEALTH POL. POL’Y & L. 107, 110 (2001); see, e.g., U.S. CENSUS BUREAU, AGE DEPENDENCY RATIO OF THE TOTAL POPULATION: 2005, http://factfinder.census.gov/servlet/GRTTable?_bm=y&-geo_id=01000US&-_box_head_nbr=R0105&-ds_name=ACS_2005_EST_G00_&-redoLog=false&-mt_name=ACS_2004_EST_G00_R0105_US30&-format=US-30 (last visited Nov. 27, 2006) (“The age dependency ratio is derived by dividing the combined under-18 and 65-and-over populations by the 18-to-64 population and multiplying by 100.”). This official statistical measure of dependency assumes, with a great deal of imprecision, that everyone over sixty-four and under eighteen is non-working and that everyone aged from eighteen to sixty-

Calculating the dependency ratio, however, is only the necessary first step in examining the ease or difficulty with which a society's working population can support its nonworking population. Worker productivity is also essential in determining the burden that nonworkers impose on workers.⁴⁸ In 2006, the U.S. Census Bureau categorized roughly 144 million in the United States as employed⁴⁹ out of a total population of more than 300 million.⁵⁰ These workers produced approximately \$13.2 trillion of gross domestic product,⁵¹ meaning that the average worker produced a bit more than \$91,000 worth of goods and services during that year. If workers in the future produce more goods and services, they will be able to provide more for themselves and others.⁵²

Combining the dependency ratio with worker productivity yields output per capita, or the average amount of goods and services available to each person—working and nonworking—in the society.⁵³ In the United States in 2006, the average citizen could consume \$44,000 worth of goods and services,⁵⁴ though one would expect a wide range of actual consumption, not just because of the wide disparities in in-

four is working. Note that the age cut-offs are arbitrary. For example, the Social Security Trustees use twenty and sixty-four as their cut-offs for the dependency ratio. See THE 2006 ANNUAL REPORT OF THE BOARD OF TRUSTEES OF THE FEDERAL OLD-AGE AND SURVIVORS INSURANCE AND FEDERAL DISABILITY INSURANCE TRUST FUNDS, H.R. DOC. NO. 109-103, at 79 tbl.V.A2 & n.1 (2006), available at <http://www.ssa.gov/OACT/TR/TR06/tr06.pdf>.

⁴⁸ See, e.g., Patricia E. Dilley, *Taking Public Rights Private: The Rhetoric and Reality of Social Security Privatization*, 41 B.C. L. REV. 975, 992 (2000) (observing that a payroll tax is a tax on productivity, so more productive workers generate the tax revenue that the government distributes to nonworkers).

⁴⁹ See BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, EMPLOYMENT SITUATION SUMMARY tbl.A (last modified Oct. 6, 2006), <http://www.bls.gov/news.release/emp-sit.nr0.htm> (showing civilian employment at above 144.3 million in July 2006).

⁵⁰ U.S. Census Bureau, American FactFinder, <http://factfinder.census.gov/home/saff/main.html> (last visited Nov. 26, 2006) (showing the estimated population of the United States as 300,290,227).

⁵¹ BUREAU OF ECONOMIC ANALYSIS, U.S. DEP'T OF COMMERCE, NEWS RELEASE: GROSS DOMESTIC PRODUCT: SECOND QUARTER 2006 (FINAL); CORPORATE PROFITS: SECOND QUARTER 2006 (FINAL) 3 (2006), <http://bea.gov/bea/newsrelarchive/2006/gdp206f.pdf> ("Current-dollar GDP—the market value of the nation's output of goods and services—increased . . . in the second quarter to a level of \$13,197.3 billion.").

⁵² See Marmor, *supra* note 47, at 110 ("What we have as burdens depends, in short, on what else we are supporting."); cf. Jonathan Barry Forman, *How Federal Pension Laws Influence Individual Work and Retirement Decisions*, 54 TAX LAW. 143, 146–47 (2000) (discussing the problem of decreasing the numbers of workers relative to retirees and arguing that the solution lies in extending the working lives of Americans).

⁵³ For these purposes, it is not directly the dependency ratio that matters but the ratio of all members of society (working and nonworking) to those who are working, which is simply the dependency ratio plus one. Then, per-capita output can be computed simply by dividing worker productivity (output per worker) by the ratio of all citizens to workers (people per worker).

⁵⁴ This figure is based on dividing \$13.2 trillion by 300 million people.

comes⁵⁵ but even within families. If the dependency ratio were to rise, productivity would have to rise sufficiently to make it possible to offset the larger number of dependents per worker. As long as the change in output per capita is positive, worker productivity will grow faster than any change in dependency.

In fact, projections for the U.S. economy do predict consistent annual increases in output per capita.⁵⁶ Indeed, using even the pessimistic assumptions in the Trustees' "high cost" scenario, real GDP will grow at least one percent per year through 2080, while the U.S. population is projected to grow at a rate of less than two-tenths of one percent annually, meaning that output per worker will grow approximately eight-tenths of one percent per year. Compounded over a seventy-five-year period, even such a seemingly low annual rate of increase results in a total increase in average per capita income of eighty percent.⁵⁷ Moreover, I am unaware of any longer-term forecasts of output per capita that are negative. In other words, no forecaster is so pessimistic about the interaction of future population growth and future productivity growth that they predict that output per capita will go down.

Any concern, therefore, that impending demographic changes must inevitably lead to smaller average amounts of goods and services to be shared among a growing number of retirees and a shrinking number of workers is misplaced. There are certainly other issues worthy of concern, but the aggregate picture is still very positive. Both workers and nonworkers can thus enjoy higher material living standards in the future even though there will be, relatively, more nonworkers to support.

⁵⁵ See James H. Moore Jr., *Projected Pension Income: Equality or Disparity for the Baby-Boom Cohort?*, MONTHLY LAB. REV., March 2006, at 59 ("[P]ension eligibility and income have historically been unequally distributed.").

⁵⁶ See H.R. DOC. NO. 109-103, at 95 tbl.V.B2 (2006), available at <http://www.ssa.gov/OACT/TR/TR06/tr06.pdf> (forecasting long-term annual growth rates of real GDP after 2015 of at least 1% for high-cost assumptions); *id.* at 79 tbl.V.A2 (showing, under the pessimistic high-cost scenario, the population increasing from 323,277 in 2015 to 354,301 in 2080—an annual rate of increase of less than two-tenths of 1%); *cf.* CONG. BUDGET OFFICE, THE BUDGET AND ECONOMIC OUTLOOK: AN UPDATE 63 tbl.C-2 (2006), <http://mirror2.cbo.gov/ftpdocs/74xx/doc7492/08-17-BudgetUpdate.pdf> (showing annual rates of change of real GDP between 3.4% and 2.5% from 2006 through 2016).

⁵⁷ This estimate is actually even more pessimistic than the high-cost assumptions would suggest, because the high-cost assumptions include GDP growth rates above 1% for all but seventeen years in the seventy-five-year projection range. Using the GDP growth rates in the high-cost assumptions, per capita GDP more than doubles, rising by 131% in 2080. In the intermediate scenario, per capita income more than triples (rising by 225%), while in the low-cost scenario, per capita income more than quadruples (rising by 342%). See H.R. DOC. NO. 109-103, at 94–95 tbl.V.B2 (2006); *id.* at 78–79 tbl.V.A2, available at <http://www.ssa.gov/OACT/TR/TR06/tr06.pdf>. Computations by author available upon request.

The lesson from this review of the evidence and basic growth theory is that the United States does not face a retirement crisis. Higher living standards for all are possible. The question is whether the U.S. system of financing retirement is currently set up to allow the goods and services produced now and in the future to flow to both workers and nonworkers without creating a financial crisis.

B. Prefunded and PAYGO Retirement Systems and Just Deserts

The discussion above describes what one might call a “real view” of retirement, abstracting from financial issues to describe retirement as a variation on the timeless concept of an economy where some people consume goods and services but do not work to help produce them. What matters in the real view is whether the workers are producing enough goods and services to allow everyone, including the nonworkers, to enjoy an acceptable material standard of living.

A complementary analysis, which I will call the “financial view” of retirement, would recognize that even where—as in the United States—there is no trend toward a shrinking pie from which more people will be taking slices, retirement systems must nevertheless coordinate the allocation of goods and services among workers and nonworkers. Absent a command economy,⁵⁸ the alternatives are what I shall refer to as “prefunded” retirement systems (in which retirement benefits are paid out of accumulated savings balances) and “pay as you go” retirement systems (or “PAYGO” systems, in which benefits are paid out of current workers’ payroll taxes).⁵⁹ As I discuss below, the similarities between these two methods of financing are arguably as important as their differences.

A “prefunded” retirement system in its purest form is simply individual saving. By some standards, private saving does not constitute a “retirement system” at all, because one need not undertake private saving solely for purposes of retirement; also, such a system has no separate financing or governance mechanisms commonly associated with retirement plans.⁶⁰ Still, if enforceable contractual mechanisms

⁵⁸ See Kevin Trost, Note, *Russia’s Federal Law on Advertising: Permanent Solution or Provisional Stopgap?*, 16 WIS. INT’L L.J. 529, 532 n.31 (1998) (“A command economy is where the state directs and controls all production, distribution, and sale of goods; no private industry.”).

⁵⁹ Cf. LAURENCE S. SEIDMAN, *FUNDING SOCIAL SECURITY: A STRATEGIC ALTERNATIVE* 19 (2006) (using the terms “PAYGO” and “funded” to describe Social Security funding alternatives). This use of the term PAYGO should not be confused with the budgetary rule of the same name that “compels new spending or tax changes to not add to the federal deficit.” C-SPAN Congressional Glossary, <http://www.c-span.org/guide/congress/glossary/paygo.htm> (last visited Nov. 3, 2006).

⁶⁰ Cf. Joseph F. Quinn, *Social Security on the Table*, AM. PROSPECT, May 1, 1996, available at <http://www.prospect.org/web/page.wv?section=root&name=ViewPrint&articleId=4926> (describing the financing and governance mechanisms associated with Social Security).

enable workers to spend less than they earn in order to have money to spend after they stop working, such a regime constitutes a retirement system. A government may also create a separate legal regime with its own set of rules for retirement savings, which creates a subset of savings accounts that one can explicitly think of as retirement savings.

The key here is that a savings account (which may come in different forms, such as bonds or mutual funds) is a recognized legal arrangement that contractually binds the saver and the borrower.⁶¹ The agreement's basic form is as follows: a saver agrees not to buy as many goods and services as the saver could currently buy and gives the borrower the power to buy goods and services that the borrower did not produce; in return, the borrower will provide the saver with the legal entitlement to buy goods and services in the future that the saver did not produce. This admittedly stilted description of the logic of the classic lending arrangement is helpful in understanding the fundamental similarity between prefunded and PAYGO retirement systems.

In a prefunded retirement system, nonworkers draw upon their retirement savings to purchase the goods and services that they consume while not working. Nonworkers "deserve" to consume those goods in the sense that they abstained from consuming all that they could have consumed while working, allowing others to consume what they did not consume; in retirement, the former workers are simply asking that their savings contract be enforced.⁶² Current workers have no right to object that the current retirees did not produce the goods that they now consume because the retirees have the legally protected right to buy goods by withdrawing funds from deposit accounts.

In a PAYGO retirement system, retirees have also earned the right to consume goods that they did not produce.⁶³ That right is not memorialized in a bank statement but in the right to receive periodic payments from the government (or another designated entity), with which the retiree may purchase goods and services.⁶⁴ As in a prefunded retirement system, current workers in a PAYGO system have no basis on which to claim that retirees may not receive these

⁶¹ See *Suburban Bank of Hoffman-Schaumburg v. Bousis*, 578 N.E.2d 935, 941 (Ill. 1991) (indicating that a savings account forms a binding contractual agreement).

⁶² See Robert C. Atchley, *Retirement: Leaving the World of Work*, ANNALS AM. ACAD. POL. & SOC. SCI., Nov. 1982, at 121 ("Retirement is the withdrawal of an individual from employment, along with entitlement to income that is based on having been employed over a period of years.").

⁶³ See Rick Santorum, *Wealth Creation in the New Millenium: Transforming Poverty in America*, 16 NOTRE DAME J.L. ETHICS & PUB. POL'Y 383, 388 (2002) (describing the PAYGO system as "an intergenerational income transfer program where current workers contribute FICA/payroll taxes that go directly to fund benefits of current retirees and other beneficiaries").

⁶⁴ See *id.*

payments, because during the time that the retirees were working, they received reduced pay and restricted their consumption to allow nonworkers to consume.⁶⁵

Admittedly, retirees in a PAYGO system might receive larger or smaller payments than anticipated should the government increase or decrease their benefit payments. Such a scenario, however, is also possible in a prefunded system: participants in a prefunded system might find that they can purchase more (or fewer) goods than they anticipated because their retirement savings accounts pay higher (or lower) returns.

Therefore, the notion that only persons in a prefunded system deserve—or have earned—their postretirement consumption is purely artificial. In both systems, the right to consume is at least partially based on a retiree's underconsumption during his or her working life. A PAYGO system does not directly equate market returns with "just deserts," whereas a prefunded system implicitly bases the right to consume in retirement on abstinence from consumption while working and on whether a retiree's savings accounts—assuming they still exist—pay relatively high interest rates.⁶⁶

The key to both the prefunded and PAYGO systems is the speed of economic growth, if any, between the time that a person works and the time the person retires. If the economy grows rapidly during that period, it will be relatively easy to provide increasingly large amounts of goods and services for both workers and nonworkers. If the economy grows less rapidly, on the other hand, the provision of those goods and services will become more difficult. In a prefunded system, slow growth generally means lower financial returns on retirement accounts, leading to lower consumption potential during retirement. In a PAYGO system, slow growth intensifies the conflict between workers and nonworkers as the retirement system's tax and benefit structure are adjusted over time.

The difference between prefunded and PAYGO systems, therefore, depends on the decisions that dictate the entitlements earned by nonconsumption. Prefunded systems are based on the political decisions that determine the rules by which retirement accounts are created and protected from risk, if at all. PAYGO systems are based on political decisions in setting tax and benefit formulas on an ongoing basis. One might prefer one set of political decisions to the other, but

⁶⁵ Cf. *id.* ("When today's workers reach retirement, they in turn will expect tomorrow's workers to contribute taxes sufficient to fund their promised benefits.")

⁶⁶ Cf. Leigh Allyson Wolfe, *Is Your Pension Safe? A Call for Reform of the Pension Benefit Guaranty Corporation and Protection of Pension Benefits*, 24 SW. U. L. REV. 145, 164 (1994) ("Implicit in prefunding pension benefits is that a variety of assumptions must be made . . . includ[ing] assumptions about future] interest rate[s].").

both systems are inherently political.⁶⁷ As such, participants in both systems can reasonably claim the moral right to consume during retirement under the rules of their respective systems.

C. The Trust Funds

Moving from the conceptual and moral issues of retirement funding to the current policy framework, the current retirement system in the United States is designed as a PAYGO system.⁶⁸ The system forces current workers to consume less than they otherwise would,⁶⁹ but no individual accounts exist for workers to monitor and determine ongoing funding levels. Instead, they simply earn the right to future benefits under the rules of the system.

In what economists call a long-term steady state, the U.S. system would be perfectly in balance every year.⁷⁰ Population change, retirement rates, productivity growth, and all other relevant economic and demographic variables would move along smooth and predictable paths.⁷¹ In such a system, one could easily set tax and benefit formulas such that the anticipated worker revenue exactly equals the anticipated retiree benefits.⁷² Such a system would not need to borrow or collect extra funds because the money entering the system would, by design, equal the money paid out.

Such a financial balance is possible even when the economy is not on a smooth path. One could design a PAYGO system such that the annual revenues come as close as possible to covering annual benefits. Depending on the volatility of the key demographic and economic variables, financial balance could require significant and frequent changes in the retirement system's tax and benefit formulas.

In the early 1980s, the United States faced just such a significant change in a key demographic variable.⁷³ The youngest members of the Baby Boom generation were then moving into the workforce, and the oldest members of that generation were approximately thirty years

⁶⁷ See, e.g., Eric M. Patashnik, 29 J. HEALTH POL. POL'Y & L. 1235, 1236–37 (2004) (book review) (discussing some of the political implications of Social Security privatization).

⁶⁸ See, e.g., Santorum, *supra* note 63, at 388.

⁶⁹ See Buchanan, *supra* note 26, at 300 (explaining that retirees are able to consume goods that they have not produced because workers consume “less than they otherwise could purchase”).

⁷⁰ See ANDREW B. ABEL & BEN S. BERNANKE, MACROECONOMICS 224 (5th ed. 2005).

⁷¹ See *id.*

⁷² With all variables changing in predictable patterns, tax and benefit rates could reliably be set each year to produce annual balance.

⁷³ For a brief summary of the recent history of the Social Security system, see Neil H. Buchanan, *The Trillion-Dollar Breach of Contract: Social Security and the American Worker* (Aug. 30, 2001), http://writ.news.findlaw.com/commentary/20010830_buchanan.html [hereinafter *Contract*]; see also Buchanan, *supra* note 26, at 300–01.

from retirement.⁷⁴ Looking forward to the time when the Baby Boomers would begin retiring, many politicians grew concerned about the very long-term financing challenges that the retirement of such a large cohort would create.⁷⁵

One possible response to this concern would be to treat it not as a problem but as the background against which to set tax and benefit formulas. As previously noted, it would not have been difficult to set policy such that the system would take in no more money in a given year than it would pay out.⁷⁶ During the years the Baby Boomers were in the workforce, this would have involved some combination of higher benefits for the Boomers' retired parents and lower taxes for the Boomers. Upon the retirement of the Baby Boomers, the system would have required lower benefit payments for Boomers and higher taxes for the relatively small cohort of people then working.

This option would have required rather dramatic shifts in tax and benefit formulas over the span of a few decades. Most likely concerned about the political conflict that such large (and unfavorable) changes would create during the Boomers' retirement, Congress changed the Social Security system in 1983 so that it would balance, not yearly, but over a much longer time period.⁷⁷ This required the system to collect more funds over the following several decades than it would pay out, which in turn required an accounting of the excess funds that it would accumulate during that time. The system thus started to accumulate large balances in the Trust Funds.⁷⁸

Given the near universality of the Social Security system, the Trust Funds superficially resemble large savings accounts held in the name of the Social Security system on behalf of nearly all citizens.⁷⁹ The question, of course, was where to "deposit" such large amounts of savings. If the government deposited the annual surpluses in private financial markets, it would directly tie the performance of the Trust

⁷⁴ See *Contract*, *supra* note 73.

⁷⁵ See *id.*; see also John A. Svahn & Mary Ross, *Social Security Amendments of 1983: Legislative History and Summary of Provisions*, 46 SOC. SEC. BULL. 3, 5 (1983) ("[I]n 1981, when the 97th Congress convened and the Reagan administration took office, Social Security financing issues were a major concern.").

⁷⁶ See *supra* text accompanying note 72.

⁷⁷ See Svahn & Ross, *supra* note 75, at 43–44 & tbls.2, 3 & 4.

⁷⁸ It is common to refer to the Trust Funds in the plural, referring to the Old-Age and Survivors Insurance (OASI) trust fund and the Disability Insurance (DI) trust fund, which together represent the net financial position of the Old-Age, Survivors, and Disability Insurance Program (OASDI). See CONG. BUDGET OFFICE, *supra* note 56, at 1.

⁷⁹ In fact, many directly analogize the Social Security system to a system of savings accounts. See Judd Gregg & Charles Blahous, Policy Essay, *Mobilizing the Marketplace to Renew American Productivity: A Program for the Twenty-First Century*, 35 HARV. J. ON LEGIS. 63, 77 (1998).

Funds to market rates of return.⁸⁰ This would also mean, of course, that the government was in the position of holding large quantities of private financial instruments.

Because the federal government is, in the aggregate, a net borrower on the financial markets, there was an alternative strategy available.⁸¹ Congress finances annual deficits by having the Treasury issue bonds to private lenders and repay those bonds with interest upon maturity.⁸² If the Social Security system was collecting more revenue than it was distributing, the federal government could use the surplus to reduce its annual borrowing.

In 2005, for example, the Trust Funds ran a surplus of \$173 billion⁸³ while the rest of the federal government ran a deficit of \$491 billion.⁸⁴ The federal government as a whole thus ran a deficit of \$318 billion.⁸⁵ If the Trust Funds had loaned \$173 billion to private borrowers while the Treasury borrowed \$491 billion to finance its shortfall on non-Social Security operations, the net effect of the government on the private financial markets would have been the same. Therefore, the Trust Funds are simply “invested” directly in Treasury securities.⁸⁶ The total balance of the Trust Funds at the end of 2005 was \$1,858.7 billion, representing the accumulated value of all previous Trust Fund surpluses, plus interest.⁸⁷

This positive balance in the Trust Funds means that when the Social Security system reaches the point at which it collects less in a given year than it pays out in benefits, it must order the Treasury to procure extra funds on Social Security’s behalf.⁸⁸ The Treasury will do so from a surplus, if one exists, or, if one does not, by borrowing on the private financial markets.⁸⁹ As long as a positive balance in the Trust Funds persists, the Treasury has no choice but to honor the re-

⁸⁰ Cf. Regina T. Jefferson, *Privatization: Not the Answer for Social Security Reform*, 58 WASH. & LEE L. REV. 1287, 1297 (2001) (“[R]estrictions on the investment of the trust fund assets protect them from the volatility of the private market; however, they also cause the funds to experience relatively low rates of investment return.”).

⁸¹ See BUREAU OF THE PUBLIC DEBT, U.S. DEP’T OF THE TREASURY, THE DEBT TO THE PENNY, <http://www.publicdebt.treas.gov/opd/opdpenny.htm> (last visited Oct. 11, 2006) (providing current debt calculations).

⁸² See Bureau of the Public Debt, The Basics of Treasury Securities, <http://www.publicdebt.treas.gov/of/ofbasics.htm> (last visited Oct. 11, 2006).

⁸³ See CONG. BUDGET OFFICE, *supra* note 56, at 2 tbl.1-1.

⁸⁴ See *id.* (showing a Postal Service surplus of \$2 billion and an on-budget deficit of \$493 billion).

⁸⁵ See *id.*

⁸⁶ See Social Security Online, Trust Fund FAQs, <http://www.ssa.gov/OACT/ProgData/fundFAQ.html> (last visited Mar. 1, 2006).

⁸⁷ See H.R. DOC. NO. 109-103, at 4 tbl.II.B1 (2006), available at <http://www.ssa.gov/OACT/TR/TR06/tr06.pdf>.

⁸⁸ See Social Security Online, *supra* note 86 (explaining that one of the purposes of the Trust Funds is to “provide automatic spending authority”).

⁸⁹ See *id.*

quest for money.⁹⁰ If no money remains in the Trust Funds, Social Security must either do without or secure additional funds through an explicit act of Congress.⁹¹

D. Are the Trust Funds “Real”?

It is crucial to note that the Trust Funds are both an accounting fiction and the product of an actual decision on the part of policymakers. The Trust Funds have accumulated balances because workers pay higher Social Security taxes than necessary if the goal were simply to run an annual balance.⁹² To say that the Trust Funds are invested in Treasury securities means simply that the Social Security system’s surpluses have allowed the federal government to borrow less money from private parties than it otherwise would have in the absence of the Trust Funds.⁹³ This difference can be extremely confusing and has led to serious political consequences.

One useful comparison is to the question of whether a paper dollar is in fact worth anything. Because modern economies no longer operate under a gold standard (or any other commodity-based standard), U.S. currency is not backed by any precious metal or item of nonarbitrary value.⁹⁴ In that sense, the dollar is not backed by anything “real.” This fact, however, does not mean that people are foolish to hold onto paper currency. People know that even fiat currency—currency backed by nothing more than a government’s full faith and credit⁹⁵—has value. Promises mean something, and the economy would stagger to a halt if the public stopped believing in the value of dollars.

Social Security’s Trust Funds are also backed by the full faith and credit of the U.S. government.⁹⁶ This backing is more than mere words. The Trust Funds’ assets are Treasury bonds, which are enforceable legal obligations by which the federal government promises to repay its lenders.⁹⁷ While parties often breach their contractual

⁹⁰ See *id.*

⁹¹ See *id.* (noting that when the assets of the OASI trust fund were nearly depleted in 1982, Congress enacted emergency legislation that permitted borrowing from other trust funds).

⁹² See Paul Krugman, *Confusions About Social Security*, 2 *ECONOMISTS’ VOICE* 1, 1–3 (2005), <http://www.bepress.com/ev/vol2/iss1/art1>.

⁹³ See Social Security Online, *supra* note 86; see also *Contract*, *supra* note 73.

⁹⁴ See, e.g., Kenneth W. Dam, *From the Gold Clause Cases to the Gold Commission: A Half Century of American Monetary Law*, 50 *U. CHI. L. REV.* 504, 504 (1983).

⁹⁵ See William Mitchell & Martin Watts, Symposium, *Centre of Full Employment & Equity* 9 (Ctr. of Full Employment and Equity, Working Paper No. 04-05, 2004), available at <http://pandora.nla.gov.au/pan/58738/20060518/e1.newcastle.edu.au/coffee/pubs/wp/2004/04-05.pdf> (“The government is the sole provider of *fiat* currency or money.”).

⁹⁶ See Social Security Online, *supra* note 86.

⁹⁷ See *id.*

obligations, Treasury bonds are a uniquely powerful promise because the U.S. government puts its full faith and credit behind its debts.⁹⁸ Putting one's trust in Treasury bonds is hardly a sign of financial naiveté: financial managers and economists treat Treasury bonds as risk-free.⁹⁹ Indeed, Treasuries are the gold standard of risk-free assets against which to compare all other financial assets.¹⁰⁰ The value of the accounting entries in the Trust Funds is thus ultimately based on the government's commitment not to default on the most trusted financial instrument in human history.

In 1983, the government could have guaranteed its promise to pay future Social Security benefits in a number of ways. For instance, it could have passed a law with a supermajority requirement that would allow future legislative minorities to block changes in the law. On the other hand, it could have simply included a passage in the statute to the effect that "future Congresses should take note of the promises made here." The method that the government settled on, however, was in some ways the most powerful guarantee available: It made the promises in the form of Treasury bonds. Promises can be broken, but never the promises that the Treasury bonds embody. The Trust Funds represent an automatic appropriation of funds for Social Security benefits during the years when, entirely by design, the system will collect less annually in taxes than it pays out in benefits.¹⁰¹

II

SOCIAL SECURITY IN ISOLATION: THE LONG-TERM TRUST FUND BALANCE

The Social Security system is frequently treated as if it were separate from the rest of the federal government.¹⁰² The system's dedicated financing mechanism (i.e., payroll-tax withholding) makes it easy to measure whether the inflows and outflows of the system are

⁹⁸ See, e.g., U.S. Treasury, Statement of Secretary John W. Snow on Debt Limit (Mar. 16, 2006), <http://www.treas.gov/press/releases/js4123.htm> ("I commend Congress for protecting the full faith and credit of the United States with today's action on the debt limit. This legislation ensures that the U.S. can deliver on promises already made, such as Social Security and Medicare payments and aid for the victims of the 2005 hurricanes.").

⁹⁹ See, e.g., TIA-CREF Brokerage Services Investment Glossary, http://www.tiaa-cref-brokerage.com/invest_glosry_GoGq.htm (last visited Oct. 22, 2006) (defining Treasury bonds as "the most credit-worthy of all debt instruments").

¹⁰⁰ See *id.*

¹⁰¹ See U.S. GOV'T ACCOUNTABILITY OFFICE, SOCIAL SECURITY REFORM: ANSWERS TO KEY QUESTIONS 26 (2005), <http://www.gao.gov/new.items/d05193sp.pdf> ("[B]enefit costs will exceed income in 2017 Starting in 2017, the Treasury Department will begin to redeem trust fund securities in order to continue to pay full promised benefits.").

¹⁰² See, e.g., CONG. BUDGET OFFICE *supra* note 56, at 2 tbl.1-1 (listing separately the federal government deficit and the Social Security surplus); see also Krugman, *supra* note 92, at 2 (discussing the internal inconsistencies resulting from viewing Social Security separately).

currently balanced and to forecast whether they will be balanced in the future.¹⁰³

This entire exercise, however, is rather odd for governmental accounting. Most activities of government are financed out of general funds,¹⁰⁴ making the question whether any particular program is “in balance” nonsensical. For example, the Department of Homeland Security does not issue an annual balance sheet telling citizens whether its revenues and expenditures are in balance.¹⁰⁵ The department has no revenues of its own, so such an exercise is impossible.¹⁰⁶

Social Security, however, can be put to such a balancing test. Although it seems somewhat arbitrary to hold Social Security to this standard without doing the same for other government programs, perhaps the very elements that make Social Security so enduringly popular—its universality, its appearance of making meaningful guarantees to workers—also justify making the program self-financing. If so, it becomes rather difficult to justify the deliberate running of surpluses in the system that began in 1983, because doing so meant that the system was being used for more than its inherent purpose. Either we should treat Social Security as a separate entity unrelated to the rest of the government, or we should recognize that it is just another government program. Treating it as a piggy bank for several decades and then refusing to replace the money when it is needed seems highly opportunistic.

Rather than opportunism, however, this might be a matter of radically changed circumstances. With Social Security surpluses set to disappear very soon, it might be regrettable but necessary to recognize that we can no longer pretend that Social Security is a separate entity. Promises made in 1983 might simply no longer be realistic in 2007, 2040, or 2080. Appeals to contract-like commitments that span decades might simply not be the best way to analyze the system’s current and future health.

There is, however, a noncontractarian argument in favor of treating the system as a separate entity. Specifically, if we do not treat Social Security as separate, there is no principled basis for setting the tax

¹⁰³ This is, in fact, the point of issuing the annual Trustees’ Reports, which focus on the financial condition of the Social Security system as a unique entity and not simply as one part of the federal government’s fiscal operations. See H.R. DOC. NO. 109-103 (2006), available at <http://www.ssa.gov/OACT/TR/TR06/tr06.pdf> (reporting updates on the Social Security system as a separate entity independent from other government systems and agencies).

¹⁰⁴ See, e.g., EXECUTIVE OFFICE OF THE PRESIDENT OF THE U.S., BUDGET OF THE U.S. GOV’T, FISCAL YEAR 2007, at 341, available at <http://www.gpoaccess.gov/usbudget/fy07/pdf/spec.pdf>.

¹⁰⁵ See U.S. DEP’T OF HOMELAND SEC., BUDGET-IN-BRIEF, FISCAL YEAR 2007, at 5, available at http://www.dhs.gov/xlibrary/assets/Budget_BIB-FY2007.pdf.

¹⁰⁶ See *id.*

and benefit formulas of the system. Treating Social Security as part of the general fiscal mix means that Social Security taxes and benefits need not be set with reference to each other at all. In addition, it is not obvious how to set the tax and benefit levels when those decisions will simply be one of many inputs into the overall fiscal balance or imbalance.

Moreover, once Social Security's fiscal elements are viewed simply as part of the aggregate fiscal mix, questions arise as to whether we should replace payroll taxes with wealth or inheritance taxes, or vice versa. The benefit of the current arrangement is that it takes some choices off the table and constrains other choices in ways that might make policymaking more understandable.

Viewing certain choices as out-of-bounds, of course, does not mean that we are not making choices. If we decide that Social Security's tax and benefit levels must be related to each other in some mechanical way (annual balance, cyclical balance, long-term balance), and if we decide that the tax base is labor income, then we are deciding not to set levels by any other formula and not to use a different tax base. While as a matter of political expediency it might be useful to pretend otherwise, pretending does not change reality.

For the remainder of Part II, I will treat Social Security as a separate entity. When Social Security is so viewed, the question becomes whether it is financially sound as currently structured. I conclude not only that it is in good condition when viewed from this perspective, but that even a long-term imbalance in Social Security's financial condition would simply force changes that are manageable and even acceptable. In Part III of this Article, I examine whether treating Social Security as one (rather large) part of the federal budget changes the conclusions of the analysis.

A. Long-Term Balance and Imbalance

As previously noted, the 1983 plan for the Social Security Trust Funds entailed a departure from a plan by which the system balanced intake and outflow every year and instead attempted to create a much longer-term balance.¹⁰⁷ During the years in which the Baby Boom cohort was working, the Baby Boomers would pay higher taxes than necessary, with the surplus being memorialized in the Trust Funds, which would accumulate interest at the same rate at which private holders of Treasury bonds earn interest.¹⁰⁸ When the Baby Boomers began to retire, the annual surpluses would start to disappear and then turn

¹⁰⁷ See *supra* Part I.C.

¹⁰⁸ See *Contract*, *supra* note 73.

into annual deficits.¹⁰⁹ The deficits would not be a sign of fiscal distress but rather an inevitable part of the plan.

This plan thus implied that there would be four phases for Social Security's finances. During the first phase, as Baby Boomers entered their prime earning years, Social Security would have growing surpluses. During the second phase, the surpluses would still exist but would start to shrink, as the oldest Baby Boomers stopped working and started to collect benefits. At some point, the system would cross the threshold to the third phase, in which the system would run deficits that became larger with each year. Finally, the fourth phase would show annual deficits in the system shrinking toward zero, eventually returning to annual balance after the Baby Boomers had all moved through the system to their final rest. Although the plan logically suggests these four phases, the discussion among both politicians and policy analysts has focused on the end of the second phase, the point at which surpluses turn to deficits, and the point at which the Trust Funds are depleted.¹¹⁰

With such a carefully balanced plan that would take place over many decades, it became important to monitor the system to ensure that it would be reasonably on track to meet its targets.¹¹¹ The annual Trustees' reports thus describe the ongoing experience of the system, assessing on an annual basis whether the paths of revenues and expenditures will meet at the appropriate date in the future.¹¹² The annual reports provide three sets of projections: intermediate, low-cost, and high-cost.¹¹³ The intermediate projections "reflect the Trustees' best estimates of future experience," whereas the low-cost calculations represent a relatively optimistic estimation, and the high-cost calculations represent a very pessimistic estimation.¹¹⁴

Social Security is currently running large annual surpluses, with the 2005 surplus measured at \$171.8 billion.¹¹⁵ According to the Trustees' intermediate estimates, the first phase, of growing surpluses,

¹⁰⁹ See *id.*

¹¹⁰ See, e.g., Karen Tumulty & Eric Roston, *Social Security: Is There Really a Crisis?*, TIME, Jan. 24, 2005, at 22. Interestingly, the political discussion has ignored the transition from the first phase to the second phase. While it would be possible to declare a crisis at the point where Social Security's ability to finance part of the overall deficit starts to decline, I am unaware of anyone having made that argument. The two dates of interest are the first year of deficits and the year of trust-fund depletion. See H.R. Doc. No. 109-103, at 2-3 (2006), available at <http://www.ssa.gov/OACT/TR/TR06/tr06.pdf>.

¹¹¹ See 42 U.S.C. § 401(c) (2000) (creating the Board of Trustees to oversee the Trust Funds).

¹¹² See 42 U.S.C. § 401(c)(2) (2000) (creating the duty of the Board of Trustees to report to Congress the current and expected future performance of the Trust Funds).

¹¹³ See H.R. Doc. No. 109-103, at 6 (2006), available at <http://www.ssa.gov/OACT/TR/TR06/tr06.pdf>.

¹¹⁴ *Id.*

¹¹⁵ See *id.* at 37 tbl.IV.A3.

will end in 2013,¹¹⁶ at which point Social Security will quickly run through the second phase, of shrinking surpluses, and will begin to run annual deficits after 2017.¹¹⁷ Under the high-cost assumptions, deficits begin in 2013,¹¹⁸ while under the low-cost assumptions, deficits do not begin until 2022.¹¹⁹

The Trustees do not distinguish between the third and fourth phases, noting that their intermediate projections show that the Trust Funds will be depleted in 2040.¹²⁰ The high-cost scenario estimates depletion of the Trust Funds in 2030.¹²¹ Significantly, in the low-cost scenario, the Trust Funds are never depleted through 2080.¹²²

Given the dramatic differences in the projected depletion dates of the Trust Funds in the three scenarios,¹²³ the differences among those scenarios are important. The Congressional Budget Office (CBO) provides its own estimates of the long-term health of Social Security and, significantly, its intermediate estimates are much less dire than the Trustees' intermediate forecasts.¹²⁴

It is not the goal of this Article to resolve the differences between the two agencies' estimations. However, it is at least imaginable that these differences reflect the Trustees' desires to produce more pessimistic assumptions than warranted.¹²⁵ Indeed, it might be true that the Social Security "deficit is in fact nonexistent . . . [and] was arrived at by violating professional actuarial practice standards resulting from the politicized trustees having final say over projection assumptions of the actuaries, much as Enron prevailed on its accountants to ignore accounting standards."¹²⁶

Even if there are no political motives at play, the trustees' estimations do appear to be unduly gloomy:

[T]here is a strong case to be made that the [trustees are] erring on the side of being overly pessimistic. . . . Over a recent 10-year span, the trustees' intermediate guesses turned out to be quite pessimis-

¹¹⁶ See *id.*

¹¹⁷ See *id.* at 43 tbl.IV.B1.

¹¹⁸ See *id.* at 44 tbl.IV.B1.

¹¹⁹ See *id.*

¹²⁰ See *id.* at 52 tbl.IV.B3.

¹²¹ See *id.*

¹²² See *id.*

¹²³ See *id.*

¹²⁴ See Buchanan, *supra* note 26, at 304 (discussing the 2005 mid-range estimation of the CBO); see also CONG. BUDGET OFFICE, UPDATED LONG-TERM PROJECTIONS FOR SOCIAL SECURITY 4 (2006), <http://www.cbo.gov/ftpdocs/72xx/doc7289/06-14-LongTermProjections.pdf> (estimating a mid-range exhaustion date of 2046).

¹²⁵ See David Langer, Letter to the Editor, *Social Security Tricks*, N.Y. TIMES, JUN. 22, 2002, at A10 (letter from the chairman of Employee Benefits Committee, Actuarial Society of Greater New York).

¹²⁶ *Id.*

tic. Its optimistic guesses were dead on, and its pessimistic case—sort of a doomsday situation—was wildly inaccurate.¹²⁷

Except as noted below,¹²⁸ I will, however, treat the Trustees' intermediate scenario as if it provided the best available estimates.

B. Does Trust Fund Depletion Mean Anything, Really?

If the Trust Funds are never depleted, then there is no cause for alarm. In the event that the Trust Funds are depleted in the year before the system returned to annual balance,¹²⁹ the ultimate demise of the last Baby Boomer would be macroeconomically unimportant. This is due to the fact that in the years preceding the Trust Funds' depletion, the annual borrowing necessitated by the Social Security system would gradually shrink to nothing so that the year-to-year change would be smooth and uneventful.¹³⁰

If the Trust Funds really will be depleted by 2040,¹³¹ the outlook is rather different. In the year before depletion, the Trust Funds would run a substantial deficit, requiring the Treasury to cover that deficit with its own borrowing if it could not cover it with a surplus in the rest of the budget.¹³² However, as soon as the Trust Funds are depleted, the Social Security system would be forced to run a balanced annual budget immediately.¹³³ While this would be a jolt to the Social Security system (absent a highly likely correction by Congress by that time), the jolt would be positive for the overall deficit. The depletion of the Trust Funds would, in a very real sense, require an immediate cut in government expenditures because the Social Security system would be forced to run an annual balance between expenditures and revenues. Assuming that the cut in expenditures would not create a recession, the overall budget would then show a smaller deficit.

¹²⁷ Roger Lowenstein, *A Question of Numbers*, N.Y. TIMES, Jan. 16, 2005, § 6 (Magazine), at 40.

¹²⁸ See *infra* note 149 and accompanying text (discussing a hypothetical involving the low-cost scenario).

¹²⁹ In fact, the system was deliberately devised to function in such a manner. See Buchanan, *supra* note 26, at 301–02.

¹³⁰ See *id.* at 301–03.

¹³¹ See H.R. DOC. NO. 109-103, at 52 tbl.IV.B3 (2006), available at <http://www.ssa.gov/OACT/TR/TR06/tr06.pdf>.

¹³² See OFFICE OF ECON. POLICY, U.S. DEP'T OF THE TREASURY, SOCIAL SECURITY AND MEDICARE TRUST FUNDS AND THE FEDERAL BUDGET 12 (2006), available at http://www.treas.gov/offices/economic-policy/reports/budget_trust_fund_perspectives_2006.pdf (illustrating the effect of a deficit in the Trust Funds on the federal budget).

¹³³ See H.R. DOC. NO. 109-103, at 16 (2006), available at <http://www.ssa.gov/OACT/TR/TR06/tr06.pdf> (discussing the extensive changes that would be necessary to bring Social Security out of deficit after exhausting the Trust Funds).

The effect of the federal government's fiscal decisions on the future growth of the economy is not directly tied to the Trust Funds. The government's net borrowing can lead to "crowding out" of private investment, which can decrease future levels of output,¹³⁴ and reductions in the government's net borrowing can thus reduce crowding out and raise future living standards.¹³⁵ Except in the year when the Trust Funds are depleted, though, the annual change in the deficit due to the Social Security system will be relatively mild as the system moves smoothly toward a zero balance in the Trust Funds.¹³⁶

From the standpoint of future retirees, however, the depletion of the Trust Funds could be significant. The Social Security system would not be forced to shut down, of course, because the system would continue to collect taxes each year.¹³⁷ The system would, however, be forced to reduce benefits to the point where they were equal to total tax revenues. How much of a reduction would be necessary? "Present tax rates would be sufficient to pay 74 percent of scheduled benefits after Trust Funds exhaustion in 2040 and 70 percent of scheduled benefits in 2080."¹³⁸ Although a reduction in future benefits of twenty-six to thirty percent is significant,¹³⁹ the reduction is less dramatic when one considers that those future benefits are quite high compared with benefit levels today. Indeed, in a 2006 report, the CBO notes that "CBO's projections of benefit levels indicate that future beneficiaries will receive higher retirement benefits—and pay higher Social Security taxes—than current beneficiaries do."¹⁴⁰

Even if the future cuts in benefits do not result in any generation of beneficiaries doing worse than its predecessors, it is plausible that such a sudden change could be politically problematic.¹⁴¹ If so, it might be wise to prevent such a one-time shock to the system. However, this necessarily implies that in order to shield the current generation's progeny—who are projected to have higher real living standards both before and during retirement than current genera-

¹³⁴ See Alan S. Blinder, *Is the National Debt Really—I Mean, Really—a Burden?*, in *DEBT AND THE TWIN DEFICITS DEBATE* 209, 219 (James M. Rock ed., 1991).

¹³⁵ See *id.* at 219, 224.

¹³⁶ See CONG. BUDGET OFFICE, *supra* note 124, at 12 fig.1-2 (showing the smooth path of the OASDI Trust Fund Ratio before and after reaching zero balance).

¹³⁷ See H.R. DOC. NO. 109-103, at 8 (2006), available at <http://www.ssa.gov/OACT/TR/TR06/tr06.pdf>.

¹³⁸ See *id.*

¹³⁹ See *id.*

¹⁴⁰ CONG. BUDGET OFFICE, *supra* note 124, at 1; see also Buchanan, *supra* note 26, at 314–15 (discussing the CBO's 2005 prediction that future generations will have lower benefits).

¹⁴¹ See H.R. DOC. NO. 109-103, at 17 (2006), available at <http://www.ssa.gov/OACT/TR/TR06/tr06.pdf> (noting the large number of people that rely on Social Security benefits and suggesting that an abrupt change in the Social Security system could have a detrimental effect on many people).

tions¹⁴²—from a sudden adjustment in taxes or benefits in thirty-five to forty-five years, current generations would have to pay more taxes or receive fewer benefits.

Reasonable people may differ as to whether that is an appropriate sacrifice, but I am not persuaded that it is. At most, if there is to be a premium placed on smooth transitions, this would argue for enacting gradual changes in both taxes and benefits leading up to and after the date of the depletion of the Trust Funds.¹⁴³ It is unclear, though, when such a phased-in policy change should begin.¹⁴⁴ Given the payroll tax increases in 1983 that created the Trust Funds,¹⁴⁵ there is precedent for the government to impose fiscal changes on the Social Security system without a phase-in period—and without a political backlash.¹⁴⁶ However, if such a phase-in period is desirable, the arguments for when and how big the phase-in should be are arbitrary or at least lack a coherent theoretical basis.¹⁴⁷

It is also wise to bear in mind that these long-range estimates are subject to error.¹⁴⁸ If there is no obvious reason why the government must plan now for a smooth transition through the date of the Trust Funds' depletion, there is greater reason for policymakers to hold off on immediate policy changes pending future developments. If it turns out that the low-cost estimates are more accurate than the intermediate- or high-cost estimates,¹⁴⁹ Social Security may simply never reach the date of the Trust Funds' depletion. If the high-cost estimates are correct, the accuracy of those estimates will become evident within a few years and will still allow for a phased-in adjustment to deal with the 2030 depletion date.¹⁵⁰

Finally, it would also be possible for a future Congress to phase in the necessary changes both before and after the depletion date. Since

¹⁴² See *supra* text accompanying notes 137–40.

¹⁴³ See H.R. Doc. No. 109-103, at 17 (2006), available at <http://www.ssa.gov/OACT/TR/TR06/tr06.pdf> (advocating the benefits of a gradual phase-in).

¹⁴⁴ Cf. *id.* (advocating the implementation of a gradual phase-in in a “timely way”).

¹⁴⁵ See Social Security Amendments of 1983, Pub. L. 98-21, § 121, 97 Stat. 65, 80–84 (1983).

¹⁴⁶ See, e.g., President Ronald Regan, Remarks on Signing the Social Security Amendments of 1983 (Apr. 20, 1983), <http://www.ssa.gov/history/reaganstmts.html#1983> (discussing the bipartisan efforts that went into passing the Social Security amendments that raised tax rates in order to fund the Trust Funds).

¹⁴⁷ See H.R. Doc. No. 109-103, at 17 (2006), available at <http://www.ssa.gov/OACT/TR/TR06/tr06.pdf> (failing to recommend a timeline for a gradual phase-in beyond that it be “timely” and giving as the only rationale for a gradual phase-in to provide “advance notice to workers”).

¹⁴⁸ See *id.* at 6 (listing factors that can lead to uncertainty in predictions).

¹⁴⁹ See Lowenstein, *supra* note 127, at 43 (noting that, historically, the Trustees' low-cost predictions are more accurate).

¹⁵⁰ See H.R. Doc. No. 109-103, at 52 tbl.IV.B3 (2006), available at <http://www.ssa.gov/OACT/TR/TR06/tr06.pdf>.

Congress can appropriate funds as it sees fit,¹⁵¹ it could decide that a one-time twenty-six percent cut is inappropriate and instead authorize extended but phased-down borrowing while benefit cuts are phased-in. Such an extended phase-in would partially defer the decrease in the overall deficit (or increase in the overall annual surplus), but it would not require a dramatic increase in the deficit from the year prior to the Trust Funds depletion.¹⁵²

The most basic issue here is appropriately summarized by the question in the title of this Article: When should we worry about Social Security deficits? If we are focusing on the Social Security system as an entity that might need adjustment to prevent future problems, the fact is that current law will allow Social Security to continue on its current path until at some point it might require large but manageable changes in its tax and benefit structure. While we should always be vigilant about our fiscal policies, we currently have little reason to change taxes or benefits to address an uncertain future adjustment. If there is to be a debate about whether now is the time to worry about Social Security, it must be based on an analysis of the interactions of Social Security with the overall federal deficit.

III

SOCIAL SECURITY AS PART OF THE FEDERAL FISCAL PICTURE: WHAT ABOUT LONG-TERM DEFICITS?

Up to this point, I have argued that there is no reason to believe that overall living standards will fall in the United States, such that even pessimistic scenarios should not envision a future in which we must decide how to divide a shrinking pie.¹⁵³ Further, I have demonstrated that the arguments for treating Social Security as a separate entity within the federal government are relatively unconvincing. I have also demonstrated that if we do treat Social Security separately, its prospects are either not worrisome or will become worrisome with enough warning that there will be time to react appropriately.¹⁵⁴ In this final section, I analyze the interaction between the Social Security system and the rest of the federal budget and assess whether the problems elsewhere in that budget might offer a reason to change Social Security's finances.

A. Social Security's Interaction with the Budget Deficit

For the purposes of this Article, I will not discuss the arguments about whether budget deficits are harmful, including arguments

¹⁵¹ See U.S. CONST. art. I, § 8.

¹⁵² See *supra* note 130.

¹⁵³ See *supra* Part II.A.

¹⁵⁴ See *supra* Part II.B.

about the composition of deficits and problems with how deficits are measured.¹⁵⁵ While I continue to believe that there are troubling inconsistencies in the standard story of deficits,¹⁵⁶ the present analysis will proceed from the conventional starting point that deficits reduce future economic growth.

As discussed earlier,¹⁵⁷ the current annual surpluses that the Social Security system runs¹⁵⁸ allow the government to borrow less on the private financial markets than it would need to borrow in the absence of the Trust Funds.¹⁵⁹ Because of this decreased need for government borrowing, Social Security's post-1983 surpluses have allowed the economy to grow faster than it otherwise would have grown.¹⁶⁰

Given current projections,¹⁶¹ the remainder of the federal budget likely will not achieve balance or surplus any time soon. If it does not, after the Social Security surplus turns to an annual deficit, the total borrowing by the federal government will be higher than it otherwise would have been.¹⁶² If the total borrowing by the federal government is high enough to create a crisis in the financial markets, of course, not only will Social Security be in trouble, but everything else in the economy will be at risk as well.

To be clear, making changes in the face of large overall deficits has nothing to do with Social Security's financial health. If long-term fiscal deficits are a sufficiently large problem, there would be strong reason to find places in the budget to cut expenditures and to raise revenues, no matter what the financial realities of any specific program. In other words, even a Social Security program that was projected to run persistent surpluses forever might be called upon to run

¹⁵⁵ I have discussed these issues in Buchanan, *supra* note 26, at 286–98, and in Neil H. Buchanan, *Debt, Deficits, and Fiscal Policy: Three Essays* (Aug. 5, 1996) (unpublished Ph.D. dissertation, Harvard University) (on file with author).

¹⁵⁶ See ROBERT EISNER, *THE GREAT DEFICIT SCARES* 25 (1997) (criticizing the omission of public investment from most discussions of deficits).

¹⁵⁷ See *supra* Part I.C.

¹⁵⁸ See H.R. DOC. NO. 109-103, at 37 tbl.IV.A3 (2006), available at <http://www.ssa.gov/OACT/TR/TR06/tr06.pdf> (showing a 2005 surplus of \$171.8 billion).

¹⁵⁹ Borrowing from foreign lenders is less than it would have been as well because borrowing on the private financial markets has increasingly meant borrowing from foreign governments that are active lenders in those markets. See Blinder, *supra* note 134, at 219–21 (discussing the relationship between rising deficits and U.S. foreign indebtedness).

¹⁶⁰ This follows from the model of crowding out discussed. See *id.* Less borrowing by the government implies more spending by private businesses, increasing investment and future GDP. See *id.*

¹⁶¹ See CONG. BUDGET OFFICE, *supra* note 56, at 3 fig.1-1 (projecting deficits every year through 2016, even assuming that tax cuts expire as currently scheduled).

¹⁶² This is because the government can use funds from the Trust Funds for other programs while Social Security runs a surplus, but the government must borrow from other sources while Social Security is running a deficit. See Lowenstein, *supra* note 127, at 42; see also OFFICE OF ECON. POLICY, *supra* note 132, at 12 (illustrating the interaction between the Trust Funds' balance and the federal budget).

still larger surpluses to offset larger problems elsewhere.¹⁶³ Similarly, other taxes and user fees might be increased, and even well-run but nonessential government spending programs might be cut.

The appropriate analysis from an aggregate viewpoint, therefore, first asks whether the overall budget will require future spending cuts or revenue increases and, if so, where such changes should be made. Projections of the overall future budget situation are necessarily uncertain, but it is possible to reach some broad conclusions by looking at a relatively pessimistic long-term budget forecast.

The long-run fiscal gap is a measure of the net present value of all future deficits and surpluses likely to be run by the federal government.¹⁶⁴ In an earlier article analyzing fiscal-gap measures, I pointed out several significant analytical shortcomings in scholarly attempts to measure the fiscal gap, focusing in particular on an analysis by Gokhale and Smetters.¹⁶⁵ I argued that fiscal-gap measures are a poor alternative to the (admittedly flawed) ten-year deficit forecasts that are currently available.¹⁶⁶

While the fiscal-gap measure is an inadequate guide for overall fiscal policy, Gokhale and Smetters's computations can provide some insight into the relative magnitude of the overall long-term budget problem and into the composition of future deficits. Gokhale and Smetters calculate separate estimates of long-term deficits using a seventy-five-year forecasting window—the approach used by Social Security's trustees in their annual reports¹⁶⁷—and using an infinite horizon.¹⁶⁸ In each approach, their analysis projects large long-term deficits that are overwhelmingly caused by Medicare expenditures. For example, in estimates calculated using an infinite horizon, the overall fiscal gap is \$44.2 trillion, consisting of a \$7 trillion Social Security shortfall and a \$36.6 trillion Medicare gap; only \$0.5 trillion is attributable to the rest of the federal government.¹⁶⁹ Social Security's gap is thus less than one-fifth of the Medicare gap.¹⁷⁰ (In estimates calculated using the seventy-five-year horizon, Social Security's gap is

¹⁶³ See OFFICE OF ECON. POLICY, *supra* note 132, at 12.

¹⁶⁴ See Buchanan, *supra* note 26, at 282.

¹⁶⁵ *Id.* at 310–15 (criticizing JAGADEESH GOKHALE & KENT SMETTERS, FISCAL AND GENERATIONAL IMBALANCES: NEW BUDGET MEASURES FOR NEW BUDGET PRIORITIES (2003)).

¹⁶⁶ See Buchanan, *supra* note 26, at 285–86.

¹⁶⁷ See H.R. DOC. NO. 109-103, at 2 (2006), available at <http://www.ssa.gov/OACT/TR/TR06/tr06.pdf>.

¹⁶⁸ See GOKHALE & SMETTERS, *supra* note 165, at 2.

¹⁶⁹ See *id.*

¹⁷⁰ Given that the net present value of future GDP is estimated to be \$682 trillion, see *id.* at 36–37 tbl.4, Social Security's shortfall, even in this pessimistic scenario, is only about 1% of future output.

\$1.6 trillion while Medicare's gap is \$15.1 trillion,¹⁷¹ making Social Security's long-term shortfall roughly one-ninth that of Medicare.

Given the relatively small magnitude of Social Security's projected deficit and the uncertainty of whether there will be any Social Security deficit at all,¹⁷² there is insufficient reason to move quickly to fight a problem that might not materialize. In the context of much larger projected Medicare shortfalls, however, there might be a stronger case for finding savings wherever they can be found, including in the Social Security program.

However, two further considerations call this recommendation into question. First, the long-term estimates of Medicare's ill health are themselves questionable. The large fiscal-gap numbers are derived from an assumption that the cost of medical care will grow for the next seventy-five years at a rate of one percentage point faster than the growth rate of GDP.¹⁷³ This rather arbitrarily assumes that medical care will consume ever larger shares of national income for at least seventy-five years, an assumption that is certainly contestable.¹⁷⁴ As I will argue in future work, there are strong reasons to believe that the cost of medical care will not grow nearly as quickly in future decades.

Second, the decision to cut Social Security (which is not far out of balance and may indeed turn out not to be in long-term imbalance at all) to finance Medicare—or to finance Medicare by cutting the rest of the federal budget, which even Gokhale and Smetters estimate to be essentially balanced¹⁷⁵—might not be in the country's best long-term interests. Even if Medicare's costs do not decrease due to other factors, it is bad policy to continue to enable health care expenditures to rise by diverting resources from other areas of the budget.¹⁷⁶ Rather, the government should control Medicare, and health-care costs in general, sooner rather than later. Put differently, this is an independent reason to treat Social Security separately from the rest of the budget. The reason to do so, however, is not based on anything unique about Social Security but rather on a desire for overall budget discipline. Isolating health care from the rest of the budget—both Social Security and “other”—will force the difficult choices that will finally address the bloat in our health-care system.

¹⁷¹ See GOKHALE & SMETTERS, *supra* note 165, at 34.

¹⁷² See Robert Eisner, *Don't Sock the Elderly, Help Them: Old Age Is Hard Enough*, 5 ELDER L.J. 181–82 (1997) (“[T]here is no crisis in Social Security now and there is none looming in the future.”).

¹⁷³ See GOKHALE & SMETTERS, *supra* note 165, at 23.

¹⁷⁴ See Buchanan, *supra* note 26, at 313–14.

¹⁷⁵ See GOKHALE & SMETTERS, *supra* note 165, at 3.

¹⁷⁶ See *id.* at 314 (“[W]hile it is possible to starve everything else in the service of health care, it would be more sensible to recognize that the core of the problem lies not in the public finance but in health policy.”).

If the government cannot bring Medicare costs under control, then it may ultimately be necessary to make hard choices about Social Security and other financially sound programs. However, the government should at least try to fight the real problem first. Acting in advance, moreover, can impose its own burdens by creating a fiscal drag on the economy.¹⁷⁷ This could work against our purported overall goal of creating a robust economy that is better able to finance our obligations while increasing future worker productivity.¹⁷⁸

In the end, what is most important is to maintain perspective. Waiting until a problem is too big to handle is one danger, but acting hastily also has its costs. Politicians of both parties have their reasons for appearing concerned about a long-term problem, but the wrong solution at the wrong time—especially to a problem that might not exist—is hardly prudent stewardship for future generations.

B. Progressivity and Social Security

Finally, it is worthwhile to consider the distributive justice aspects of the policy choices under discussion here. The Social Security system is overall a progressive program that paradoxically relies on a non-progressive (and, above a relatively low limit, regressive) tax structure.¹⁷⁹ While attempts to wring money out of Social Security could be done progressively, any across-the-board cuts in benefits or increases in rates would be regressive.¹⁸⁰

The progressivity or regressivity of policy changes should be at the forefront of all fiscal policy decisions, as I have argued elsewhere.¹⁸¹ The issue is especially important here, both because of the fundamentally important role that Social Security plays in making the overall tax system progressive and because of a concern that arises from the contractarian perspective I discussed above.¹⁸²

The changes in Social Security's tax structure enacted in 1983 were an explicit attempt to create a long-term deal by which the rest

¹⁷⁷ See EISNER, *supra* note 156, at 28 (“[R]educing . . . deficits can . . . slow the economy and even bring on a recession.”).

¹⁷⁸ See discussion in *supra* Part I.A regarding the relationship between productivity and the relative burden of supporting retirees.

¹⁷⁹ Social Security's tax structure imposes a 6.2% tax on both the employer and the employee for the employee's earnings from work, up to an annual maximum adjusted for inflation (currently \$94,200). See H.R. Doc. No. 109-103, at 4 & tbl.II.B2 (2006), available at <http://www.ssa.gov/OACT/TR/TR06/tr06.pdf>. With the cutoff, those who earn more than \$94,200 pay average tax rates below 6.2%, making the system regressive in that range. See *id.*

¹⁸⁰ Because of Social Security's truncated tax structure, across-the-board tax increases would proportionately harm higher-income workers the least. Similarly, because of the progressive nature of the benefit structure, across-the-board cuts in those benefits would reduce the system's redistributive mechanism.

¹⁸¹ See Buchanan, *supra* note 8, at 1184–93.

¹⁸² See *supra* Part I.C–D.

of the federal budget would be able to use Social Security's surpluses so long as the Treasury finances the retirement of the Baby Boomers through general funds or borrowing later.¹⁸³ If the distributive burden of Social Security's payroll taxes were the same as the distributive burden of the taxes that we would otherwise have had to impose, then there would be no distributive issue here. In fact, however, the federal government's income tax structure is progressive, while payroll taxes are regressive, meaning that the imposition of higher payroll taxes on middle- and lower-income workers while cutting income taxes plausibly resulted in an overall regressive shift in the tax burden.¹⁸⁴

Cutting the benefits of Social Security recipients over the next few decades, therefore, amounts to forcing middle-class people to pay higher taxes when they were working but refusing to pay them the higher benefits (financed by income taxes) that were implicit in the 1983 law.¹⁸⁵ Moreover, raising Social Security payroll taxes in order to reduce future deficits shifts the burden onto the children of those who paid higher-than-necessary payroll taxes.

As before, of course, the contractarian perspective has its limits. It might be that the current situation forces us to make regressive changes that we originally thought would be unnecessary. Given the overwhelmingly regressive effect of the Bush tax cuts,¹⁸⁶ though, there is strong reason to believe that federal fiscal policy during this time precisely reflects the perverse outcome described above: tax cuts for the rich financed by tax increases for the non-rich.¹⁸⁷ Even if there were no social contract implied by the 1983 changes, the realities of the current situation call not for regressive changes in the Social Security program but for a rollback of the regressive tax cuts of the early twenty-first century. If more deficit cutting is necessary, the best approach would be to look for additional progressive policies, such as reinvigorating (rather than repealing) the estate tax and other taxes on large concentrations of wealth.

¹⁸³ See generally *Contract*, *supra* note 73 (discussing 1983 changes in Social Security from a contractarian perspective).

¹⁸⁴ It is possible, again, that in the absence of the Social Security surplus, the government might have imposed taxes or budget cuts regressively. If the changes had roughly mirrored the existing structure of taxes, though, the most likely outcome would have been an increase in income taxes on upper-income taxpayers.

¹⁸⁵ See *Contract*, *supra* note 73.

¹⁸⁶ See Jobs and Growth Tax Relief Reconciliation Act of 2003, Pub. L. No. 108-27, 117 Stat. 752; Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38.

¹⁸⁷ See Teresa Tritch, Editorial, *Tilting the Tax System in Favor of the Rich*, N.Y. TIMES, Oct. 4, 2005 (arguing that the \$173 billion Social Security Trust Funds surplus, "which comes from taxes paid by working people at the middle and lower rungs of the income ladder, . . . is being used to mask the true cost of today's deficit-financed tax cuts on estates, capital gains and corporations").

In the current political climate, of course, progressive tax changes appear to be unlikely. That climate, however, can change quickly. Even if it does not, the vagaries of the long-term budget projections should make us especially loath to “fix” Social Security by engaging in immediate regressive tax and spending changes.

CONCLUSION

In this Article, I discussed the basic nature of retirement financing and put Social Security in perspective as a pay-as-you-go system that has been adjusted to address long-term demographic trends. I then analyzed whether the Social Security system faces long-term funding problems that require changes in the structure and benefits of the program. Finally, I extended the analysis to consider whether the overall budgetary situation in the United States over the next few decades is so dire that it requires changes in Social Security as part of a broader financial rescue effort.

As a threshold issue, I demonstrated that any changes in Social Security cannot be justified by the concern that demographic changes will result in lower standards of living. Even though the ratio of nonworkers to workers will rise as the Baby Boom generation retires, increases in productivity will more than make up for that increase, allowing future workers to support both themselves and future retirees at higher standards of living than are now possible. Without question, there will be higher per-capita standards of living in the future, distributive issues aside.

Even so, it is possible that the Social Security system is currently on an unsound financial footing, requiring a change in its financing even though both future workers and future retirees will be able to enjoy higher standards of living than we enjoy today. Looking at the Social Security system’s finances as separate from the rest of the federal government’s fiscal activities, I have argued that the purported long-term challenges facing Social Security either are unlikely to occur or at least do not require immediate action to address possible future problems.

It is possible, however, that Social Security—even if it is healthy on its own merits—should be part of a larger effort to address long-term fiscal shortfalls. Looking at one particularly pessimistic projection, I noted that the predicted large future deficits are overwhelmingly due to predicted large shortfalls in Medicare financing and not in Social Security. While it is possible to use Social Security and other parts of the federal budget to enable Medicare’s problems to go unaddressed, I have suggested that it is wise at least to start with an attempt to solve Medicare’s problems directly. Given the regressive nature of likely Social Security cuts (or tax increases), moreover, I have sug-

gested that we should be especially unwilling to fix our fiscal problems through Social Security changes rather than through progressive tax policies.

We should always be concerned about the possibility of long-term budget imbalances, but the current arguments for changing Social Security now to address possible future imbalances are unconvincing.

