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Making Sense of the Moynihan Gambit: A Perspective on the Social Security Debate

by David Altig

The American Social Security system, which inspires feelings that tend to both the political and the religious, is a topic best avoided in polite company. It is surprising, then, to see the vigor of the current debate on Social Security taxation and its role in the federal budget process. Surprising, but understandable: in fiscal year (FY) 1989, taxes collected under the provisions of the Social Security Act accounted for a full 36 percent of federal receipts.[1]

Moreover, it is almost certain that Social Security revenues will increase considerably, and at a rate that substantially exceeds the rate of increase in Social Security outlays. The Congressional Budget Office projects that the Social Security trust fund surplus will equal $128 billion by FY 1995.[2] Even adjusting for the CBO's projected inflation path, this estimate is more than twice the size of the real trust fund surplus collected in FY 1988.

In the context of growing Social Security surpluses has come New York Senator Daniel Patrick Moynihan's dramatic proposal to slash Social Security payroll taxes and bring actual Social Security receipts and outlays back into rough balance. Senator Moynihan's surprise attack on the status quo apparently unleashed some pent-up demand to breach the Social Security taboo, for his proposal quickly brought a stampede of counterproposals.

The Moynihan position can be summarized as follows: As a result of the 1983 amendments to the Social Security Act, Social Security tax collections have considerably outpaced outlays. This result was intentional, but, according to Senator Moynihan, the understanding of Congress was that surplus funds were to be held in trust to finance future Social Security benefit payments.

In fact, Moynihan contends, surplus Social Security funds are being used as a source of general revenue, financing non-Social Security government outlays, and disguising the true magnitude of the federal deficit. Using the surplus funds in this way not only violates the spirit of the legislation that created them, but is unfair, since financing federal expenditures with Social Security taxes makes the deficit, in Senator Moynihan's words, "...the peculiar burden of people who get paid by the hour."[3]

Indeed, the Social Security surplus comes at a time when income taxes are playing a smaller role as a revenue source. The share of personal income taxes in total federal government receipts declined from 48 percent in 1981 to 45 percent in 1989. At the

Is the U.S. Social Security system more like a pension plan, wherein Social Security taxes represent a form of premiums for its contributors, or more like a tax and transfer system, which provides a pay-as-you-go income support program for its beneficiaries? Before linking the current Social Security financing debate to legislative attempts to balance the federal budget, we should define the nature of Social Security policy and evaluate whether the present level and composition of government expenditures are prudent.

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same time, total Social Security tax collections increased from 30 to 36 percent of total revenues.

To reverse this trend toward collecting revenues through the payroll tax, the Moynihan plan would return the Social Security system to a strictly pay-as-you-go basis by rolling back scheduled increases in the payroll tax. In response to the contention that we need the revenues that would be raised by the scheduled tax increases, Senator Moynihan argues that those revenues should be raised so that those with the greatest ability to pay bear a greater share of the burden.

My goal in this *Economic Commentary* is to disentangle some of the subtle economic issues at the heart of the Moynihan-inspired proposal to reform the Social Security system. Central to my position is the belief that how one thinks about the Social Security tax "burden" depends on whether the entire system is perceived as a pension fund for its contributors, or whether it is a pay-as-you-go income support program for its beneficiaries. I argue that the system can be legitimately called regressive only when it is viewed as an income support program. When viewed as a pension plan — and this is the view I believe consistent with political reality — reasonable expectations of the combination of taxes and benefits over a current worker's lifetime strongly suggest that the system is progressive.

Quite apart from the issue of whether the system's tax burden is progressive or regressive, fair or unfair, it is very clear that Social Security trust funds are being used as a source of general revenue for the Treasury, and will continue to be for several more decades under present law. But using the trust fund in this way is not necessarily inconsistent with the pension-fund interpretation of the Social Security system.

The capacity for the government to honor benefits promised to current workers depends critically on our economy's future capacity to generate income. Future benefits thus depend on our ability to scrutinize expenditures financed by Social Security taxes and to judge whether those outlays will ultimately enhance productive capacity.

■ Economics and Reality: What Is Social Security?

The mechanics of our Social Security system easily lend themselves to support of the view that the system is primarily a tax and transfer plan. Even when realizing a surplus, Social Security retains the salient characteristics of a pay-as-you-go system, with current benefit payments being financed directly by taxing the working population. It is because Social Security is funded only by the ability of the federal government to transfer resources from one group of people to another that economists are traditionally trained to view our Social Security system as a redistributive tax policy.

However, one need look no further than the concern that current Social Security policy violates the public trust to recognize that most of us do, indeed, assume that there is something special about Social Security contributions. What makes Social Security different from a garden-variety tax and transfer program is the expectation, consistently expressed through the political process, that benefit levels bear an explicit relationship to taxpayer contributions, and that taxpayers view these benefits as rightfully theirs. Anyone venturing the opinion that this expectation is unjustified will quickly find that hell hath no fury like a potential Social Security recipient scorned.

Senator Moynihan himself adamantly maintains that his plan to alter Social Security's financing arrangements should in no way be construed as opposition to the perpetuation of Social Security benefit payments to past, current, and future contributors to the system. Clearly, then, there is a need to resolve the contradiction between the standard tax and transfer view of Social Security suggested by the simple mechanics of the system, and the political perception that Social Security has the implied contractual force of a pension plan. The relevant question thus becomes, in what sense is our Social Security system analogous to a private pension plan?

When a private pension fund invests its contributions, it typically purchases assets backed by the income-generating activities of other institutions, either for-profit activities of other firms or direct claims on the resources of governmental entities. Unlike a private pension fund, when the government runs a surplus on its pension fund accounts, it must purchase only U.S. government securities, which are a general liability of the U.S. government itself.

Since trust fund surpluses are used to purchase the liabilities of the federal government itself, the surplus simply represents the government's promise to raise enough taxes in the future to honor its maturing securities, thereby financing its Social Security benefit obligations. The revenues that back government securities ultimately come from a single source: the American taxpayer.

Because Social Security trust funds are backed by nothing more than the government's promise to pay itself, our Social Security system is not funded in the conventional sense. But tax contributions to the system are nonetheless invested: They are invested in the activities sponsored by federal fiscal policy. It is not necessarily unreasonable to assume that well-chosen government expenditures might help to generate, directly or indirectly, the future income —and hence the tax base—from which future Social Security benefits can be financed.[4]

One may argue, as many do, that investment in the future tax base is best accomplished by having the government entirely eliminate the deficit, but that is a different issue.[5] The broader point is that, if public expenditures are sufficiently productive, the current policy of using surplus Social Security funds as a source of general revenues is perfectly consistent with preserving the public trust. As a public pension plan, our Social Security system is funded by the effects of particular fiscal policy

BOX 1 TWO DIFFERENT APPROACHES TO SOCIAL SECURITY

Issues	Tax and Transfer System	Pension Plan
Evidence in support of this view	Mechanics of the system. Current benefits are paid from current revenues, even if the revenues are raised by redeeming the government debt held in a trust fund.	Political and, probably, economic decision-making evolves as if promised benefit payments have the force of a binding contract.
Is Social Security regressive?	Yes. Higher-income individuals pay a lower proportion of their income than do those with lower incomes.	No. Social Security taxes are like premiums. In the long run, higher-income individuals get a lower return on their contributions, so, if anything, the system is progressive.
Should the Social Security surplus fund the deficit from non-Social Security federal expenditures?	Why not? Under this view, Social Security taxes are just like any other tax.	Why not? The surplus is held in the form of government securities. Since this means that surpluses are backed only by the federal government's promise to pay itself, the *economic* reality is that the surpluses cannot be separated from the overall budget.

choices on the overall performance of the economy and, hence, on the future tax base from which benefits must ultimately be paid. There is no a priori reason to believe that funding current government expenditures with Social Security surpluses is an unwise choice.

■ Is the Social Security System Regressive?

If we accept Social Security as a pension plan, then the claim that the system is regressive in the long run is not justified. In general, insurance premiums and benefits are not characterized as "regressive" or "progressive." A more relevant concept is whether the benefits to low-income earners will be greater or lesser (relative to their contributions) than benefits to high-income earners.

According to one calculation, an individual who earns the average wage in each year of his or her working life, and retires at age 65 in 2025, will receive benefits equal to 192 percent of personal contributions, plus interest. By contrast, an individual with lifetime annual real wage earnings equal to the maximum income currently subject to the payroll tax in each working year would receive only 116 percent of personal contributions, inclusive of interest, at retirement.[6]

This is not to say that Social Security contributions do not disproportionately burden lower- to middle-income wage earners. Younger households, with relatively high expenditure requirements for child care, education, and related items, are overrepresented in the lower part of the income distribution. Mandatory Social Security contributions can therefore create special hardships for young families, since it is not generally possible to borrow against future Social Security benefits. But this issue concerns the interaction of capital market imperfections and the timing of Social Security payments rather than the inherent progressivity of the system.

Thinking of the Social Security system as a true pension plan thus leads to a much different conclusion about the progressivity of the system than would be reached under the tax and transfer view. In the latter, the system appears decidedly regressive; in the former, it is, at least to some degree, progressive.

■ What Is to Be Done?

Senator Moynihan's gambit has had the salutary effect of dragging some easily ignored issues back into the political arena. Political discourse, however, too often starts at the end, proposing solutions without adequate attention paid to the precise nature of the problem. Such is unfortunately the case in the current Social Security debate.

The need to define the nature of the problem is abundantly clear in public discussions of Social Security policy. Informed opinion necessarily starts with a decision on how best to think about the system: is it more like a pension plan, or more like a tax and transfer system? Each position carries with it certain logical imperatives, summarized in box 1. Sorting through the issues would be much easier if participants in the debate would clearly articulate their operating assumption at the outset.

In any event, the argument about the inclusion or noninclusion of excess current receipts in budget deficit calculations is a red herring. The requirement that surplus Social Security receipts be used to purchase government securities means that they always will be used to finance government expenditures (or to retire the debt in the event that the rest of the budget is in balance). Consequently, decisions about the *accounting* relationships among the Social Security trust fund, the rest of the federal government budget, and the Gramm-Rudman-Hollings deficit reduction procedure have absolutely no direct consequences on resource allocation.

Current political dynamics have resulted in an unfortunate linkage between the Social Security financing debate and legislative attempts to balance the federal budget; the economics of the matter argue for capitalizing on this public discussion by paying more attention to how overall fiscal strategies affect the allocation of our economy's resources. If current Social Security policy is violating the public trust, it is not because we are financing general expenditures, but because the expenditures we are financing are unproductive. The most useful result that could emerge from the current debate would be a renewed focus of our collective energies on determining whether our current level and composition of government expenditures represent the choices we really want.

■ Footnotes

1. This figure, obtained from the Office of Management and Budget and the Social Security Administration, includes employer contributions to the Social Security system.

2. See *The Economic and Budget Outlook: An Update,* Congressional Budget Office, January 1990.

3. "Critics Count Badly, Moynihan Contends," *The Plain Dealer*, Cleveland, Ohio, February 13, 1990, p. 7-B.

4. See David Alan Aschauer, "Is Public Expenditure Productive?" *Journal of Monetary Economics*, vol. 23, no. 2 (March 1989), pp. 177-200; Alicia H. Munnell, "Why Has Productivity Growth Declined? Productivity and Public Investment," *New England Economic Review*, Federal Reserve Bank of Boston, January/February 1990, pp. 3-22; and Robert J. Barro, "A Cross-Country Study of Growth, Saving, and Government," National Bureau of Economic Research Working Paper No. 2855, February 1989.

5. The economic importance of the deficit per se is still a point of contention among economists. The Spring 1989 issue of the *Journal of Economic Perspectives* provides an enlightening review of the issues.

6. See Spencer Rich, "Social Security: Another View," *The Washington Post*, January 17, 1990, p. A19.

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