Don't Sock the Elderly, Help Them: Old Age Is Hard Enough

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In this essay, originally presented as the first Elder Law Journal Lecture at the University of Illinois College of Law, Professor Eisner challenges the view that Social Security faces a crisis. Professor Eisner first examines the use and financing of the Old Age and Survivors Disability Insurance trust funds. He determines that the suggestion that Social Security has to be cut to avoid present and future solvency problems is economically unsound. Next, Professor Eisner examines the implications of the greater burden that eventually would be imposed by increasing proportions of nonworking elderly. He points out that with likely economic growth, even very modest growth, that eventual burden can be shared equally among young and old with increasing income and output for all. Professor Eisner concludes by recommending the preservation of all current benefits of Social Security, while keeping the trust funds solvent indefinitely, encouraging saving, and increasing retirement benefits.

A lot of nonsense is being spewed forth about Social Security. The public is bombarded with apocalyptic warnings that the system will go bankrupt before it can pay out all of the retirement benefits due the baby-boom generation. To avoid that, we have to do something now. Most frequently the "something" turns out to be open or disguised cuts in benefits to the elderly. Other less painful solutions entail some form of privatization to enable retirees to realize the higher returns that have *in the past* been associated with stock market investments.

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The facts are that there is no crisis in Social Security now and there is none looming in the future. There is no need or justification for demanding sacrifice of the elderly of today or tomorrow. And whatever the merits—and there can be substantial demerits—of some form of privatization, it is utterly unnecessary to "save" our retirement benefits.

The issue of Social Security may only be understood by recognizing two separate problems: (1) the use and financing of the Old Age and Survivors and Disability Insurance trust funds (OASDI);[1] and (2) the real support of those not working—the dependent population, young and old—by those working.

The Nonsense About the Trust Funds

The problem with regard to the first of these, the OASDI trust funds, if there is one, is utterly trivial. Many act as if these "funds" contain piles of hundred-dollar bills, which we replenish with our contributions. In fact, there is no "money" in the trust funds; their assets are Department of Treasury (Treasury) obligations, as good as money but essentially computer entries and in recent years printed out each month so that the funds have hard-copy evidence of their security holdings. These printouts indicate what the Treasury has credited the funds, net of payment benefits to correspond to our payroll taxes on some of the benefits, and interest on their computer balances.

Because our Social Security checks come from the Treasury in any event, there is no real reason we have to go through the accounting procedure of building up the computer balances and then drawing them down. The funds could be abolished, and the Treasury ordered to go on paying the benefits prescribed by law, borrowing to finance these expenditures, if necessary, just as it does now to finance Social Security or anything else. Payroll taxes, like other taxes, go into the general Treasury pot that finances expenditures, and dropping a separate account for them would make no economic difference,

1. The OASDI program provides protection against the loss of earnings due to retirement, death, or disability. A Board of Trustees oversees the financial operations of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds. *See* BOARD OF TRUSTEES OF THE FED. OLD-AGE & SURVIVORS INS. & DISABILITY INS. TRUST FUNDS, 1996 ANNUAL REPORT, H.R. DOC. NO. 104-228, at 1 (1996) [hereinafter OASDI 1996 ANNUAL REPORT].

although it might change some public perceptions and political calculations.

To the argument that retirees would be less secure without the funds, it may be observed that the integrity of commitments to the elderly depends ultimately on the political will to meet them and our real economic ability to do so. Neither of these should be in doubt. It is true, unfortunately, that a combination of budget deficit political paranoia and the desire of some to reduce "entitlements" has been fueling a substantial campaign to reduce benefits significantly below what they would otherwise be, by reducing cost of living adjustments.

The alleged future problems of the solvency of the funds under current law stem from what is known as the "intermediate" long run projections of the Fund Trustees (and their actuaries and economists). These indicate now that by the year 2029 the fund assets, which will have grown enormously in the intervening years, reaching $2.87 trillion in 2018,[2] will be exhausted and current receipts will be insufficient at that time to fully finance expenditures.[3] What most alarmists fail to mention is the observation, in the Trustees' report, that an increase in taxes of a mere 2.19% of taxable payroll would, by these intermediate projections, keep the funds fully solvent through the year 2070![4]

And I have an even easier solution that entails no increase in taxes on anybody. Simply credit the funds with the income taxes now paid on the Social Security payroll "contributions" that are not deductible in computing taxable incomes, and credit higher interest returns to the fund balances. The nondeductible Social Security contributions, attacked by some as entailing double taxation, include all of employee payroll taxes and half of the taxes paid by the self-employed. Their total is now running about $200 billion a year.[5] Making them deductible against taxable income would balloon the deficit—still of great, if unjustifiable concern to many—and would be a boon to the wealthy in the 39.6% income tax brackets. It would offer only modest tax benefits to middle-income households, and no benefits at all to millions of So-

2. *See* OASDI 1996 ANNUAL REPORT, *supra* note 1, at 4.

3. *See id.* at 24.

4. *See id.* at 28.

5. *See id.* at 102 tbl.II.F11. Net contributions from payroll taxes were projected to be $390 billion in 1997. *See id.* Employee taxes plus half of the taxes paid by the self-employed would come to half of this total.

cial Security contributors who do not earn enough to pay income taxes.

But with income tax rates averaging about 17%, crediting the trust funds with the income taxes on these payroll taxes would give them, this year, an additional $35 billion, about half of the 2.19% of taxable payroll that the intermediate projections indicate would be adequate for long-term solvency.[6] Crediting the funds with returns on their asset balances three percentage points more than under current law, thus about 9.3% instead of the 6.3% projected, would easily make up the rest of the gap.

The Treasury is already contributing out of general revenues to Medicare—$39 billion in 1995.[7] Crediting the income taxes on the payroll contributions to the Social Security trust funds is entirely reasonable and would make no difference whatsoever to government financing, the taxpayer, or the economy. The Treasury, after all, would be collecting these taxes as before and spending as before. Instead of the taxes going into a general funds account they would be credited to the OASDI accounts. And those worried about fund solvency might breathe easier.

Crediting the fund balances with higher returns is also amply justified. It would bring them closer to the market equity return which privatization advocates promise. Payroll contributions to the funds have saved the Treasury from public borrowing that would have substituted for private investment. It is only appropriate that Social Security contributors have their funds credited with the higher returns to private investors that their contributions made possible. And again, this additional credit to the funds would make no difference of any real magnitude. It would not even add to the relevant figure for the federal debt, which is the gross federal debt *held by the public*, currently some $3.8 trillion,[8] not the "debt" of one part of the government to another.

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6. The 17% is the author's estimate of average marginal personal income tax rate. On about $200 billion of payroll taxes that would come to about $35 billion. Taxable payroll is projected at 40% of GDP in 1997, and GDP is projected at $7,964 billion, implying that taxable payroll would be $3,186 billion. *See id.* at 187 tbl.II.C1. Taking 2.19% of that gives $69.8 billion, of which $35 billion is about half, as stated in the text.

7. *See* BOARD OF TRUSTEES OF THE FED. SUPPLEMENTARY MED. INS. TRUST FUND, 1996 ANNUAL REPORT, H.R. DOC. NO. 104-226, at 4 (1996).

8. *See* COUNCIL OF ECON. ADVISORS, 105TH CONG., ECONOMIC INDICATORS—FEBRUARY 1997, at 32 (1997) [hereinafter ECONOMIC INDICATORS].

And indeed, there is another simple procedure which is no more than an accounting change, but would take care of the trust funds. Instead of restricting fund tax revenues to those coming from payroll taxes, we might also credit the funds with some of our individual and corporate income taxes. About 1.5% of taxable individual and corporate income would be equivalent to the 2.19% increase in payroll taxes the fund trustees have calculated.[9]

The suggestion that Social Security is in crisis and has to be cut to avoid bankruptcy because the source of revenue—or accounting credits—for its dedicated fund is likely to be short makes no economic sense. Imagine that we had a dedicated fund for defense, with credits only from corporate income taxes, currently running some $200 billion per year,[10] while defense outlays are about $250 billion. There may be many good arguments for reducing defense expenditures in this post-Cold War era, but certainly the shortage in such a fund would not be one of them. If we wish to continue the higher level of defense outlays we need only, if we insist on a having a separate "National Defense Trust Fund," or whatever we chose to call it, credit additional tax revenues to that fund.

Not often noticed are the Fund Trustees' "low cost" projections.[11] They differ from the somber intermediate projections partly in assuming a long run unemployment rate of 5% instead of 6% (unemployment averaged 5.4% in 1996)[12] and a twenty-first century annual rate of growth of gross domestic product (GDP) of all of about 2.2%, instead of a very low 1.3%.[13] It may be noted that the Bureau of Economic Analysis's first estimate of 1996 fourth quarter real GDP growth, at annual rates, was 3.9%.[14] They also assume higher fertility and mortality rates and greater immigration.[15] With the low-cost projections, fund balances reach a temporary low in 2040 of four times annual expenditures![16] They then mount indefinitely thereafter. If

9. Taxable income is running at some $4,700 billion, including almost $700 billion of corporate profits. *See id.* at 6, 8; *see also* Robert Eisner, *The Proposed Sales and Wage Tax—Fair, Flat, or Foolish, in* FAIRNESS AND EFFICIENCY IN THE FLAT TAX (American Enter. Inst. ed., 1996) (author's projections from Statistics of Income for 1993). Multiplying $4,700 billion by 1.5% yields $70.5 billion.

10. *See* ECONOMIC INDICATORS, *supra* note 9, at 34.

11. *See* OASDI 1996 ANNUAL REPORT, *supra* note 1, at 10, 12.

12. *See* ECONOMIC INDICATORS, *supra* note 9, at 11.

13. *See* OASDI 1996 ANNUAL REPORT, *supra* note 1, at 54-55 tbl.II.D1.

14. *See* ECONOMIC INDICATORS, *supra* note 9, at 3.

15. *See* OASDI 1996 ANNUAL REPORT, *supra* note 1, at 12 tbl.I.F1.

16. *See id.* at 127 tbl.II.F20.

even some of the more "optimistic" assumptions underlying the low-cost projections are realized, the fund will remain solvent indefinitely.

The Real Issue: An Aging Population and Increasing Dependency Ratios

The only meaningful problem there could be with our Social Security is the real one of the working population producing the goods and services to be acquired by those not working. In regard to this we are told that there are now almost five people of working age—twenty to sixty-four years old—for every potential dependent aged sixty-five and over and that by the year 2030 that ratio will fall to less than three.[17] Precisely, according to the trust fund intermediate projection, the aged dependency ratio will grow from 0.214 in 1995 to 0.355 in 2030. That means, looking only at those of working age and the elderly, that every 1,000 persons of working age would have 1,355 people to support instead of 1,214. This represents an increase of 11.6%. If we make the pessimistic projection that labor force participation will decline, so that we will move from three workers per elderly dependent to two workers, that still means an increase (from 133 to 150) of only 12.5%.

It may well be argued, though, that the relevant numbers relate to all potential dependents, the young—under twenty years of age—and the old. Currently, for every 1,000 people of working age there are 709 young and old potential dependents. In the year 2030, the intermediate projection puts the number at 788. That means that those of working age would have to support 1,788 people—themselves and their dependents—instead of 1,709, a 4.62% increase in their burden.

17. This ratio is derived from Table 1 in the text. Refer to Table 1 for the references of the Aged Dependency Ratios discussed *infra*.

TABLE 1
Changes in Aged Dependency Ratios and Net Incomes Per Capita

YEAR	DEPENDENCY RATIO	BURDEN PER WORKER (1 + DEPENDENCY RATIO) AS PERCENT OF 1995	PERCENT CHANGE IN NET INCOME PER CAPITA BECAUSE OF INCREASE IN DEPENDENCY RATIO	PERCENT CHANGE IN NET INCOME PER WORKER FROM 1 PERCENT PER ANNUM GROWTH	PERCENTAGE NET CHANGE IN INCOME PER CAPITA
1995	0.214	100.0	0.0	0.0	0.0
2000	0.210	99.7	+0.3	5.1	+5.4
2005	0.207	99.4	+0.5	10.5	+11.0
2010	0.214	100.0	0.0	16.1	+16.1
2015	0.239	102.05	−2.0	22.0	+19.6
2020	0.275	104.98	−4.7	28.2	+22.2
2025	0.319	108.61	−7.9	34.8	+24.1
2030	0.355	111.61	−10.4	41.7	+26.9
2070	0.408	115.99	−13.8	110.9	+81.8

Source: BOARD OF TRUSTEES OF THE FED. OLD-AGE & SURVIVORS INS. & DISABILITY INS. TRUST FUNDS, 1996 Annual, H.R. Doc. No. 104–228, at 146 tbl.II.H.1. (1996).

But if productivity per worker grows at a modest 1% per year, well within historical experience, the growth in total output per worker will come to 41.6% by the year 2030. With this increase in output and the corresponding income, far more than the 4.62% increase in the burden, or even the 11.6% calculated by ignoring the lesser proportion of children or the calculation of 12.5% based on declining labor force participation, there would be enough to improve vastly the lot of all—the elderly, the young, and those in their working prime!

Of course, greater growth will improve that lot all the more. We can promote that greater growth by keeping our policy makers out of the game of slowing the economy in dubious efforts to fight an imagined danger of inflation. Over the long run, we can promote greater growth by bringing about more productive investment of all kinds. And most important in this regard, economists have been increasingly recognizing, is investment in human capital, that is, in jobs and in the skills and health of our people.

Sharing the Burden of Increasing Dependency Ratios in a Growing Economy

Ignoring the decrease in the under-twenty dependency ratio, the increase in the aged dependency ratio will require those in the twenty to sixty-four age group, presumably the working population, to devote a greater share of their increasing incomes to support of those sixty-five and over. This support must be current. Although we can save and invest now in more ovens that will be useful at a future time, the bread dependents eat at any time must be baked by those working then. Retirees cannot eat balances in Social Security trust funds, or stocks and bonds, or cash. In a real sense, for the economy as a whole, retirement benefits are thus always supplied on a pay-as-you-go basis.

Hence it makes perfect sense to finance Social Security on a pay-as-you-go basis, raising taxes on the working population to finance increasing proportions of aged as those increases occur. But then it must be recognized that this relative aging, about which there has been so much comment, is still much in the future. The aged dependency ratio, at 21.4% in 1995, according to the intermediate forecast of the Social Security Fund Trustees as noted above, will actually decline to 21.0% in 2000 and to 20.7% in 2005 before finally returning to 21.4% in 2010. Hence, there is no need whatsoever to raise taxes or cut benefits of the elderly over the next fourteen years.

When dependency ratios do increase, what proportions of increasing incomes and output must go to support the increasing proportions of elderly, in order to leave the working population and the elderly in the same relative position? Those numbers follow from the very simple formula we have been applying above. The number to be supported by the working population is the total of the working population and its dependents. Thus, with an elderly dependency ratio of 0.214 in 1995, each 1,000 of working age must support 1,214—themselves and 214 elderly. If the dependency ratio rises to 0.239 in the year 2015, as is forecast, each 1,000 of working age will have to support 1,239 people, again including themselves and the elderly. Their burden will thus have increased by some 2%, readily calculated as 100 times [(1,239/1,214) -1]. Correspondingly then, the per capita incomes of both the working population and the elderly will have to be reduced by 2% against what they would have been if their had been no increase in the dependency ratio.

For the working population this may be accomplished by increasing their taxes by 2% of their incomes. For the elderly we may cut retirement benefits by 2% or, preferably, to keep matters fully symmetrical, increase their taxes by 2% of their incomes. Ideally, we might adjust taxes so that the aggregate increase for the entire population is 2% and allow its incidence, as it does now, to relate to taxpayers' incomes. To the extent our tax structure remains progressive, the wealthy, young and old, would then pay more. Whichever group is wealthier would, correspondingly, also pay more.

By the year 2020, when the aged dependency ratio is up to 0.275 and the total burden per 1,000 workers is correspondingly up to 1,275, or 4.98% above the burden in 1995, net incomes per capita of the working population and the elderly will then have to be 4.7% less than they would have been without the increase in the elderly dependency ratio [100 times ([1,214/1,275]-1)]. In 2025, net incomes will have to be 7.9% less. In 2030, the year of the presumed apocalypse when the trust funds would no longer be able to finance all of currently legislated benefits, net incomes will have to be 10.4% less. At the end of the forecast period in 2070, seventy-three years from now, if the forecasts are correct, net incomes per capita will have to be 13.8% less than they would have been if there were no increase in the dependency ratio.

But none of these cuts in net incomes per capita is absolute. They are, again, all *relative to what incomes would have been with no increase in the dependency ratio*. If incomes per worker are increasing at even a very modest 1% per year, these reductions in net income per capita will still leave all, the young, the working population, and the aged, with higher absolute incomes and far better off than they are now.

Assuming this modest 1% per worker growth in output each year, but taking the worst case scenario, ignoring the savings from smaller proportions of children, we find that sharing the increasing burden of the increasing elderly dependency ratio equally among all of the population permits dramatic improvement for all. Per capita income—of young, middle-aged, and old—increases greatly over the years. It is up 5.4% by 2000, 16.1% by 2010, 22.2% by 2020, 26.9% by the "crisis" year of 2030, and all of 81.8% by 2070.

A Proposal for Supplementary Social Security

As noted, the intermediate projection of the Social Security trustees would have the Old Age and Survivors and Disability trust funds short of funds in thirty-three years. Some would cut benefits or raise payroll taxes or both to keep the funds fully solvent for at least seventy-five years. Others would combine this with "privatization," risking some of the guaranteed benefits of Social Security in the stock market. And some, embracing various elements of these prescriptions, focus on encouraging private saving.

I propose preserving all current benefits of Social Security, making the trust funds solvent indefinitely, raising no taxes, encouraging saving, and increasing the retirement benefits of most, if not all Americans. The basic proposal is simple, although there can be various useful elaborations and corollaries.

All participants in the Social Security system—which should be as universal as possible—should be offered the opportunity, but not be compelled to make supplementary contributions to the trust funds, and these contributions would be credited to their own individual accounts. Unlike current required employee contributions, these would be tax deductible. Income earned on the resultant balances would also be tax exempt, but the resulting additions to retirement income, as with private pensions, would be taxable. These additional taxes would be credited to the general balances of the trust funds.

Contributors to their supplementary accounts would have a choice of the following investments: (1) Treasury securities with a rate one percentage point higher than that on the securities acquired by the trust funds in connection with basic Social Security operations; (2) a fully passive, indexed stock fund; or (3) any combination of the two. These options would make such investments highly desirable to many, both as supplements to and substitutes for employer pension plans and individual retirement accounts. They would also draw in funds from many who try to provide for their retirement by uncertain individual investments with no economic annuity to which to convert their investments on retirement. And they may also attract entirely new saving from many who would find these new options sufficiently attractive to warrant sacrifice of present consumption in the interest of more in their golden years.

It might be deemed judicious to put an upper limit on the amount of tax-deductible contributions to prevent the very rich from using these contributions to make a mockery of the progressivity of the income tax. If so, however, the limit should be high, say 15% of adjusted gross income, so that the new investments can offer opportunities for much more than merely moving saving from existing pension and retirement plans. And although the increased tax deductions would cause some loss in income tax revenues, the Treasury would gain much more in the supplementary contributions to the trust funds. If we assume the average marginal tax rate applicable to additional contributions is, say, 20%, for every dollar in personal income taxes lost to the Treasury there would then be an immediate gain of five dollars in the additional contributions.

The Social Security trustees, as noted above, calculate that a 2.19-percentage-point increase in payroll tax contributions would, on the basis of their intermediate projections, keep the funds solvent for the seventy-five years which is the longest period they are asked to project.[18] My proposal for purely voluntary contributions would achieve the same long run fund solvency if individuals increased their contributions by about 2.6% of taxable payrolls or, currently about $85 billion, and devoted all of this to option 1 investments, that is, Treasury securities. This would be about 1.3% of personal income. It would appear a safe prediction that this much would come readily from the combination of diversion from other forms of investment that we have suggested and an increase in net saving.

The 2.6-percentage-point increase in voluntary contributions, rather than the 2.19% in payroll taxes suggested by the fund trustees for long run solvency, would be necessary because my proposal would entail increased benefits as retirees begin to receive the annuities generated by their increased contributions. But because the benefits would be paid out in the future—on the average some thirty years hence—the funds would enjoy the returns on these new investments over the intermediate period. The present value or current cost of a dollar to be paid out in thirty years, given the 6.3% rate of interest in the trust fund intermediate projections, is only sixteen cents. (At a 7.3% interest rate it is twelve cents.) And as more benefits are to paid out to retirees, there would continue to be new additional contributions, as in our current essentially pay-as-you-go system, coming in from those then working. Crediting to the trust funds the taxes paid by beneficiaries on their added income would enrich the funds—and the Treasury—all the more.

To the extent that much of supplementary contributions are earmarked to the indexed stock fund, and this does as many assume, actually offer higher returns, considerably less in the way of supple-

18. *See* OASDI 1996 ANNUAL REPORT, *supra* note 1.

mentary contributions would be needed for fund solvency. In this case, or if the additional contributions were more than that 2.6% of taxable payroll, there would be room within the parameters of fund "solvency" to offer an additional improvement to Social Security that would benefit all retirees. Recent arguments that the Consumer Price Index (CPI) is overstating inflation have generated new suggestions that cost of living adjustments for those on Social Security be reduced to correspond to a new, corrected CPI.[19] The widely mentioned 1.1% per year correction would result in reducing benefits, as against those calculated by the old measure, by some 10% over the average twenty-year period that retirees enjoy benefits. I would go the other way and generally increase benefits by tying them to average wages rather than any measure of prices.

This would mean that retirees would share in the gains—and occasional losses—of their working sons and daughters. With real wages rising perhaps 1% per year by the old measure, shifting the adjustment after retirement from prices to wages would be likely to increase benefits by that amount, or some 10% over the life of the average retiree.

One significant advantage of implementation of this proposal for supplementary contributions for Social Security, given all the attention to the matter, is that it would significantly reduce the budget deficit and the Treasury's need to borrow from the public. If, as I suggested, the voluntary contributions came to 1.3% of personal income, they would cut the deficit by more than half. If the new options had been in place last year, the deficit of $107 billion would have been reduced by some $66 billion, the difference between $83 billion in the tax-deductible contributions and, given the assumed average marginal tax rate of 20%, $17 billion in reduced personal income taxes.

Conclusion

So there we have it! We preserve Social Security as we know it, increase—not cut—retirement income for most if not all Americans, keep the trust funds solvent at least seventy-five years, increase personal saving, and significantly reduce the budget deficit. And all on a voluntary basis, with no increase in taxes!

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19. *See generally A Rational Way to Reduce the Deficit, Editorial*, N.Y. TIMES, Mar. 1, 1997, at A1; Jackie Calmes, *Momentum for CPI Commission Slows*, WALL ST. J., Mar. 6, 1997, at A2; *Do The Right Thing, Editorial*, WALL. ST. J., Mar. 6, 1997, at A14.

But cutting the retirement benefits or other "entitlements" that a rich and great economy has been able to provide has no part in that picture. Our Social Security system ain't broke. There is no excuse for emasculating it in the guise of fixing it. And there is indeed no excuse for socking the elderly. Old age is hard enough.