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Social Security Reform: The Budget Debate All Over Again

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Social security and Medicare reform suffer from the same problem that for so long made budget reform difficult. They measure gains and losses, winners and losers, from a base of a system that is imbalanced and whose promises don't add up. If our elected representatives convert the system to one that is more sustainable, however, they are accused of creating only losers—those who get smaller increases in benefits or higher taxes than are currently scheduled. But this is simply bad political accounting.

In budget policy, reducing future deficits was never given any formal credit for creating winners. Little recognition was given for all those who would get to pay fewer taxes, or receive additional benefits, if future interest costs on the federal debt were lower. Instead, the politics of budget reform implied there were only losers: those who would pay more taxes or receive fewer expenditures to keep the deficit lower.

Sometimes the list of losers would show up on distributional or other tables. For example, the 1982, 1984, 1990, and 1993 budget agreements all had some tax increases attached to them. In each case, the Joint Committee on Taxation would dutifully produce distributional tables by income class showing who would pay the additional taxes under the new law. Similarly, in many of the Medicare and other expenditure reforms that were debated as part of these budget efforts, calculations would sometimes be made of the additional cash burden for those individuals who might face some increased premium or copayment or lose some other benefit.

The problem with these calculations was not so much that some "losers" were identified; it was that the corresponding set of winners were ignored. Half the balance sheet was never calculated.

Ignore for the moment whether any particular tax and expenditure policy is good or bad for the economy in terms of behavior, incentives, poverty reduction, and so forth. Those are vital economic issues, but not usually part of the presentation of winners and losers. Absent those particular economic effects, the sum of losses plus gains to taxpayers from government action is exactly zero. That is, for every dollar paid in tax, there is a dollar that is expended for some purpose. This is easiest to see in the case of a direct cash transfer. One person pays, another receives. One dollar of loss to one is a dollar of gain for the other. The sum of transfers paid equal the sum of transfers received. If the expenditure is some good or service rather than a cash transfer, then each dollar's worth of that good or service for some people still represents a dollar of cost to other people.

Debt only confuses the issue, but the calculation is the same. Spend one dollar today and pay for it tomorrow. The present value—the sum of all values over time, discounted to the present—of all losses still equals the present value of all gains. Deferred taxes are still taxes. Similarly, if taxes are in excess of expenditures, then losses to current taxpayers or beneficiaries is made up for by gains to future taxpayers and beneficiaries.

This is simply basic accounting. If one looks only at a point in time, then it's easy to miscalculate winners and losers. Suppose one tries to calculate who wins by paying off current interest on the debt. At first it may look as if there are only losers—those taxpayers who fork over the extra money each year. That's because the winners likely were in the past—those who avoided paying the taxes to cover the cost of the benefits or expenditures they received.

From a measurement standpoint, it is obvious why only half the balance sheet is usually presented. Although we know that they must exist, the eventual winners from deficit reduction or bringing a system into balance are hard to identify. For example, reducing expected deficits allows the country to sell less debt. The future interest and principal payments that eventually have to be paid are lower. Nobody has to pay these amounts, and just who is "nobody" is vague at best. So, winners are hard to identify, and this side of the balance sheet is hard to create. It's not filled in, and it is hard to introduce it into the debate.

In contrast, losers from deficit reduction appear easy to identify. They are the ones who bear the lower benefits or higher taxes (the losses) from changing items already scheduled into the law. So, this side of the balance sheet is easy to fill in. It is the one that likely will be presented to the public and debated by the politicians because it is filled in.

That brings us back to taxes and expenditures in social security and Medicare. These systems promise higher and higher levels of benefits in the future, much more than current taxes can reasonably support. If one assumed that social security taxes were to support all of the promised increase in social security and Medicare benefits, those tax rates would almost have to double. Whether done through increased taxes or reduced expenditures, whether within social security and Medicare or through the general budget and general revenues, the shortfall must be covered. Promises must be reduced, taxes must be increased, or other programs must be cut back in size and scale. Identifying exactly who will bear these burdens is considered a political liability because it fills out the long-term accounting sheet.

What deters action on social security and Medicare, therefore, are precisely the same factors that kept the deficit reduction debate going without resolution for so many years. The only real difference is that the budget debate usually centered around deficits in the current year and the next few years. For social security and Medicare, the deficits of consequence are years, even decades, into the future—especially once the baby boomers more fully occupy the ranks of the retired.

Are there ways around this problem? Although not perfect, there are alternative ways to show changes over time. One need not show only differences from a set of promises that cannot be met. One alternative is to show changes from existing levels of benefits, rather than those benefits that are scheduled to grow over time. For instance, in today's dollars social security promises an insurance policy worth approximately $1/4 million in lifetime benefits to an average-income couple retiring today and $1/3 million to an average-income couple retiring in 30 years. If Congress cuts the growth in lifetime benefits so that the future couple only gets $300,000, that can be shown either as a $33,000 cut from "current law" promises, or an increase of $50,000 from "current levels" of benefits.

On the tax side of the budget, one could argue that the existing benefit schedule implies a future "tax" rate of, say, 15 percent to fund social security alone rather than about 10 percent. If the tax rate is kept at 10 percent for the future, then that could be shown as equivalent to a 5 percentage point reduction from the level of taxation implied in current law.

None of these measures is perfect, but at least they do a better job of balancing the tendency to look on only one side of the accounting sheet. The danger is that the political cost of identifying only losers will deter action by most of our elected officials, and that the country will be forced once again to go through years, even decades, of effort to get this longer term deficit into order. Along the way, most other policymaking will continue to be tied into knots.

Other Publications by the Authors

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