Budget policy II

- The conservative argument observed thus far is that in periods of deficit there are no real incentives for Congress to cut expenditures
  - Specifically, everything in the general budget suffers from the commons problem
- What about when the country and government are in surplus?
- The conservative argument here is that congress will spend the surplus

Budget II

- This argument is used for two purposes
  - 1. Proposals to fix social security over the long haul argue that a small adjustment in taxes and expenditures now—raising the retirement age and a slight increase in taxes—will generate surplus in the fund to get us by the baby boomer crisis. The argument that Congress will spend the money argues for privatization not adjustments
  - 2. Congresses tendency to spend means that any monies taken away from the government—tax cuts—is money they can not spend

Budget II

- Legislative history
  - The original act of 1935 contained a policy which sought to build a large reserve
    - This recognizes that future costs would exceed present costs
      - Older population would double
      - FDR wanted the policy to be self financing-no general funds
      - Moreover, the excess funds would be used to offset by reducing the national debt thus no reserve funds i.e. it was an accounting device
    - By 1939 the reserve policy had collapsed under attack from both left and right

Budget II

- The objections to the reserve included
  - Reserve would produce unwarranted benefit expansions—larger than necessary and unsustainable
  - Britain and Germany had tried reserves and they had failed
  - If the tax was used to reduce national debt it was a burden on lower income Americans because it was regressive
  - Republicans in 1936 called for an end to the reserve in their platform
Budget II

• In 1939 the Roosevelt administration abandoned the reserve
  – Congress in 1939 raised benefits, lowered the retirement rate and established benefits for survivors and dependents
• Under the new policy Social Security consisted of two parts
  – The contingency reserve—short term
  – Program be self sufficient in long run
    • Present value of income and outgo be zero

• The 1939 amendments also established a trust fund for SS
  – In practice the fund had no effect on the amount or manner in which taxes were collected nor how disposed once in Treasury and no effect on size of benefits
  – The trust was political protection against the politics of claiming that the funds were misspent
  – During WWII high employment and some tax hikes increased the surplus

Budget II

• The post war years from 1950 –1973 are interesting
• By 1950 the surplus was 11 billion enough to fund benefits for a decade
• Income exceeded outgo so by 1960 the surplus would be about 20 billion good for two decades of benefits
• Cogan argues that the benefit and expenditure increases of 1950, 1952 and 1954 are result of surpluses

Social security benefits 1950-73

<table>
<thead>
<tr>
<th>Year</th>
<th>% Change benefits</th>
<th>Reserve ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950</td>
<td>92.3</td>
<td>14.4</td>
</tr>
<tr>
<td>1952</td>
<td>9.4</td>
<td>7.2</td>
</tr>
<tr>
<td>1954</td>
<td>18.0</td>
<td>5.5</td>
</tr>
<tr>
<td>1956</td>
<td>3.1</td>
<td>3.9</td>
</tr>
<tr>
<td>1958</td>
<td>7.3</td>
<td>2.9</td>
</tr>
<tr>
<td>1960</td>
<td>0.7</td>
<td>1.8</td>
</tr>
<tr>
<td>1961</td>
<td>2.9</td>
<td>1.6</td>
</tr>
<tr>
<td>1965</td>
<td>10.4</td>
<td>1.2</td>
</tr>
<tr>
<td>1967</td>
<td>14.8</td>
<td>1.0</td>
</tr>
<tr>
<td>1969</td>
<td>15.0</td>
<td>1.0</td>
</tr>
<tr>
<td>Year</td>
<td>% Change benefits</td>
<td>Reserve ratio</td>
</tr>
<tr>
<td>------</td>
<td>-------------------</td>
<td>---------------</td>
</tr>
<tr>
<td>1971</td>
<td>9.9</td>
<td>0.9</td>
</tr>
<tr>
<td>1972</td>
<td>20.0</td>
<td>0.9</td>
</tr>
<tr>
<td>1973</td>
<td>11.0</td>
<td>0.7</td>
</tr>
</tbody>
</table>

**Budget II**

- Cogan argues that the surpluses gave rise to
  - Major expansions in 1950-52 and 54
  - In each case the benefits are octokyphonic
  - The long run financial outlook of a growing elderly population did not effect expenditures
- By 1958 the SS trust was in deficit and deficits occurred in three of next four years
  - The size of benefits from 1955 to 1964 were thus lower
- In 1965 the second burst of growth occurred

**Budget II**

- The growth of the economy in the 65 to 74 period was strong and the result was
  - Increased reserves in both short term ratio and long term growth and thus viability(not shown in lecture table)
  - During the eight years 65-73 seven across the board increases were enacted
  - In addition the program was expanded to include many more recipients
  - The 1972 election followed a familiar course
    - Announcements of increases in benefits in October
- By 1972 benefits had been raised by 68% more than necessary to compensate for inflation
- This resulted in Cost of Living Adjustments COLAS from 1975 onward
- Retrenchment
  - The economy deteriorated in 1974 and with it the reserves
Budget II

- An error in COLAS also contributed to the decline of the reserve
- In 1977 raised tax and cut benefits
- In the ensuing 4 years inflation produced rising expenditures and little growth
- In January 1983 Alan Greenspan produced a joint bipartisan plan which increased taxes and reduced benefits slightly
  - The retirement age was increased so as to help the long term viability
- Since 1983 no major SS legislation has passed
- We now turn to a regression analysis

<table>
<thead>
<tr>
<th>variable</th>
<th>coefficient</th>
<th>T-statistic</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reserve ratio</td>
<td>.023</td>
<td>6.2</td>
</tr>
<tr>
<td>Reserve growth</td>
<td>.135</td>
<td>2.2</td>
</tr>
<tr>
<td>Actuarial balance</td>
<td>.047</td>
<td>1.2</td>
</tr>
<tr>
<td>Inflation</td>
<td>.464</td>
<td>3.6</td>
</tr>
<tr>
<td>Constant</td>
<td>-.01</td>
<td>-.6</td>
</tr>
<tr>
<td>Autocorrelation</td>
<td>-.54</td>
<td>-6.2</td>
</tr>
<tr>
<td>R2 = .94</td>
<td></td>
<td></td>
</tr>
<tr>
<td>F-statistic</td>
<td>= 46.3</td>
<td></td>
</tr>
</tbody>
</table>

Budget II

- The reserve ratio and reserve growth are both positively related to increases in expenditures as are actuarial balance and inflation
  - The positive relationship between higher reserve ratios and growth plus balance show that expenditures rise as reserves do better
- Thus the conservative conclusion that unless the incentives are changed—constitutional amendment preferred (tax cuts as alternatives)—the inevitable result of government is more taxes and more spending