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Would Saving U.S. Social Security Raise National Saving?

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Abstract

Analysts agree that raising national saving is one of the key objectives of social security reform in the United States. Hence, to judge the merits of proposals requires a comparison of saving responses. The paper outlines the difficulties involved in making those comparisons, which arise from the unsustainability of the current social security system and the uncertainty regarding the use of projected budget surpluses. Building on previously developed arguments, it discusses three typical reform plans and also draws some conclusions about the relationship between social security reform and the long-run sustainability of fiscal policy.

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I. INTRODUCTION

Many Americans are concerned about the long-run financial stability of their social security system, which finances old-age pensions, survivor benefits, and disability benefits. The revenues of the Social Security Trust Funds exceeded their spending by almost $100 billion in 1998. That situation is expected to reverse, however, when more and more baby boomers leave the workforce and begin to draw benefits. Under the intermediate assumptions of the Social Security Board of Trustees, the Trust Funds will be in deficit after 2014, and trust fund reserves will be depleted in 2034.[2] After 2034, revenues will be sufficient to pay only about 71 percent of benefits under current law. Those financial pressures reflect the fact that Social Security is largely financed on a pay-as-you-go basis, implying that the government uses earmarked payroll tax revenues to pay for current social security benefits. For that reason, the expected increase in the retirees' share of the population will require changes to finance the social security benefits in the long run.

In response to the projected imbalance, a number of U.S. policymakers and economists have proposed plans that aim at restoring social security's long-run financial stability. Those plans range from modest changes to the current system—leaving its basic pay-as-you-go financing in place—to the introduction of mandatory individual accounts. The latter is also often called the privatization of social security because future retirement income would be based at least partly on the balances in those accounts, rather than income transfers from the government.[3] President Clinton has committed to "save Social Security

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[2] See Social Security Board of Trustees (1999).

[3] A number of countries have introduced individual account systems. For a survey, see Congressional Budget Office (1999a).

first" before expected budget surpluses are used for other purposes, and he has advanced a plan that would allocate additional resources to the Trust Funds.

The term "saving" social security originates with President Clinton, but it is not necessarily connected with his administration's proposal. A definition of saving Social Security in the true sense of the word would be to implement measures such that the resulting pension system is financially balanced in the long term without further changes to taxes or spending. It should be noted that this condition is more stringent than achieving financial balance of the Trust Funds alone. For example, policymakers could restore the Trust Funds' long-run balance through transfers from general revenues, with the result that current-law benefits could be financed without increasing the payroll tax. Such transfers would require, however, increasing general revenues or cutting other government spending at some point, thereby violating the condition that no further changes to taxes or spending are necessary. Some proposals that have commanded much attention recently, namely, President Clinton's plan and a proposal by Harvard Professor Martin Feldstein, also rely on yet unspecified future measures to cut spending or raise revenues and therefore do not go all the way to save social security as defined above.

One of the objectives of social security reform in the United States is to increase national saving (e.g. Aaron and Reischauer, 1998). Raising national saving would help to prepare the economy for future pressures arising from the aging of the population, because higher national saving today would increase the future capital stock and thus the productive capacity of the economy. Higher national saving would also improve the long-run sustainability of fiscal policy and indicate that current generations participate in defraying the cost of their retirement by forgoing some of their consumption.

Improving the sustainability of fiscal policy could be accomplished in different ways. Policymakers could run surpluses and pay down the federal debt and thus reduce an explicit liability through higher government saving. Alternatively, they could reduce social security benefits implicitly promised to current taxpayers, forcing them to save more for retirement in order to maintain their level of consumption in old age. A reduction of either explicit or implicit liabilities has similar salutary effects on the long-run sustainability of fiscal policy and the generational imbalance implied by a continuation of current fiscal policy.[4]

This paper discusses how saving social security may affect national saving. It puts particular emphasis on the conceptual issues arising from the interrelation between Social Security Trust Funds and budget surpluses, and draws some conclusions about the features of recently advanced reform proposals.[5]

II. The Algebra of National Saving

National saving, S, in any period t is by definition the sum of the private sector saving, S^P, and government saving, S^G. Government saving derives from the saving of the federal government, S^F, and the saving of state and local governments, S^L. Hence,

$$S = S^P + S^L + S^F. \qquad (1)$$

[4] See Congressional Budget Office (1998a) for a presentation of long-run fiscal projections and Gokhale, Page, and Sturrock (1999) for a recent measure of the fiscally induced imbalance between generations.

[5] For an extensive discussion of the impact of Social Security reform on national saving with application to reforms in different countries, see Engen and Gale (1997). Their paper also devotes much attention to the links between different components of national saving that are discussed shortly in the second section of this paper.

In the United States, the saving of the federal government is equivalent to the so-called unified budget surplus, which comprises on-budget and off-budget government activity. The operations of the Social Security Trust Funds, specifically the Old-Age and Survivor Insurance (OASI) and Disability Insurance (DI) Trust Funds, are recorded off budget. As a consequence, federal government saving can be split into the on-budget surplus, B, the balance of the Social Security Trust Funds, TF, and the balance of other off-budget activity, O. Thus, national saving can be decomposed as follows:

$$S = S^P + S^L + B + TF + O. \qquad (2)$$

Until 1997, the overall contribution of the federal government to national saving was negative. In other words, the unified budget was in deficit. However, that deficit was comprised of an on-budget deficit and a surplus in the Social Security Trust Funds and other off-budget operations. In 1998, the government ran a $70 billion unified surplus, composed of a $29 billion on-budget deficit, a $99 billion surplus of the Social Security Trust Funds, and a surplus of less than $500 million in other off-budget operations. The Congressional Budget Office expects that by 2001 the on-budget balance will also be positive.[6]

From a savings perspective, the ultimate division of payments between the Trust Funds and other government operations is not essential; what matters is the sum of the on-budget and off-budget balances. For example, a much-debated question without final conclusion is whether the 1983 Social Security Act contributed to higher national savings because it increased payroll taxes and led to positive trust fund balances. If, as some argue,

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[6] Congressional Budget Office (1999b).

U.S. policymakers target the overall unified budget balance, raising payroll taxes did not change national saving but simply altered the division between on-budget and off-budget balances. In other words, increasing the payroll tax allowed the U.S. Congress to run larger on-budget deficits, diluting the positive effect higher trust fund balances could have had on national saving.[7] Others believe that the surpluses of the Social Security Trust Funds contributed positively to national saving because policymakers did not increase on-budget spending by amounts sufficient to completely offset the surpluses in the Trust Funds.

The accounting identity (2) also demonstrates the importance of analyzing the changes of both private saving and public saving. If a reform plan raises private saving but does so by reducing public saving (issuing more public debt), it does not improve national saving. Hence, it is potentially misleading to look at only one piece of the national saving picture.

An analysis of private saving responses also has to take into account that private saving can take many forms. For example, households may own retirement accounts, assets in pension plans, and saving accounts at the same time. A change to one element of private saving, say retirement accounts, could entice households to change other forms of private saving, for example the wealth in private pension plans. In fact, the extent to which replacing Social Security with mandatory private retirement accounts would lead to reductions—also often called offsets—in other private saving has been the subject of a long-standing debate in economics. Because economic theory can support different outcomes, this

[7] Some U.S. policymakers, most prominently Senators Moynihan and Kerrey, have suggested that Social Security return to a pure pay-as-you-go system precisely because they believe that the surpluses of the Social Security Trust Funds have caused larger on-budget deficits. In their view, the increase in payroll taxes at least partly financed the income tax cuts and defense spending of the 1980s.

question is essentially an empirical one. As the survey in Congressional Budget Office (1998b) discusses, empirical evidence varies but supports on average a positive response of private saving to replacing social security benefits with individual accounts; however, the offsets would likely exceed 50 percent.

III. What is the Right Benchmark?

The first task in assessing the impact of any specific proposal to restore social security's long-run balance on national saving is to decide on the relevant benchmark for evaluating that proposal. Although it would be generally possible to evaluate all proposals at the same time and compare their paths of national saving directly with each other, such analysis is generally impractical in a political debate. Instead, one often finds statements similar to "proposal x would raise national saving by y percent of GDP." In that case, it is important to understand what the benchmark of the analysis is. If two proposals use the same benchmark, the changes in national saving vis-à-vis that benchmark can be compared to decide which proposal raises national saving more. If two proposals differ in benchmarks, one must identify the differences in national saving that result from the differences in the benchmark; otherwise, comparing the changes in national saving would be misleading.

Choosing a benchmark involves a judgment on how the trust fund balance, TF, the on-budget balance, B, and private saving, S^P, would evolve over time if the reform proposal were not to be implemented. There is no single answer to that question for two reasons. First, the current combination of social security benefits and tax rates is unsustainable. Thus, statements about the impact of any alternative policy on national saving must at the same time make at least an implicit assumption on how the social security system is kept

financially sound. Second, the budget surpluses are now projected to last at least for the next ten years. However, the surpluses might never materialize because they could entice policymakers in the United States to increase spending or lower taxes. Whether a proposal is evaluated against a benchmark with future budget surpluses being saved or against one with surpluses being spent may overturn the conclusion regarding the effect on national saving.

An unsustainable policy cannot serve as a sensible benchmark for the analysis of different policies. By definition, a policy that is unsustainable is also counterfactual; that is, such a policy must be changed at some point because it violates economic fundamentals. It is easy to see, for example, that comparing social security reform proposals with an alternative of constant current-law payroll taxes and benefits would be misleading. It would appear as if current-law benefits could be paid without making the difficult choices regarding who pays for them. Sustainable policies that spell out who pays and when would inevitably look worse than an alternative that is unsustainable.

Many sustainable benchmarks are possible. Fiscal policy could be rendered sustainable by raising taxes or cutting spending, or a combination of both. Each of the many alternative sustainable paths of taxes and spending could be chosen as a benchmark. However, different paths would have different implications for the intergenerational distribution of burdens and national saving. For example, raising the payroll tax over time to keep social security afloat would put the entire burden of adjustment on future taxpayers. By contrast, reducing benefits to a level that could be financed with current payroll tax rates would put most of the burden on currently living generations. Choosing a sustainable policy as a benchmark for other policies therefore has implications for the assessment of national saving responses.

The question of sustainability also affects the impact of reforms on private saving and creates additional ambiguity for the choice of the benchmark. In deciding how much to save and spend today, households in the United States must form an opinion about the future measures the U.S. Congress will take to balance social security. If they believe that future generations will finance present-law benefits through higher payroll taxes, they do not have an incentive to provide more for their own retirement, and a reform that puts some burden on them could entice higher private saving. By contrast, if households believe future benefits will be cut to 71 percent of current law, they might already raise their private saving today to make up for the expected loss in income. In that case, reforms may only induce them to substitute one form of private saving for another.

A popular sustainable benchmark for policy analysis is one in which payroll taxes are adjusted in the future to pay current-law benefits, called present-law pay-as-you-go, or "present-law paygo." For example, the 1994-96 Advisory Council on Social Security used present-law paygo as the benchmark for its three distinct proposals. Under present-law paygo, payroll taxes would have to rise to almost 19 percent by 2050.[8] Practically any plan that shifts some of the burden of adjustment to currently living generations—be it through modest changes to taxes and benefits today or through a fundamental overhaul of the system—raises national saving compared with present-law paygo. As a consequence, the statement that a certain proposal would raise national saving compared with present-law paygo says little about the ultimate economic effect of that proposal. Rather than the **sign**, the **size** of the saving response will vary across plans. It is also doubtful that present-law

[8] See also Feldstein (1999), who compares his plan to create individual savings accounts with the tax rates necessary to finance present-law benefits on a pay-as-you-go basis.

paygo characterizes the true beliefs of households, thus potentially biasing the private saving response upward.

The currently projected surpluses present another analytical difficulty for the assessment of national saving responses to reform. Using the present-law approach to define the benchmark implies that the government would be expected to run large unified budget surpluses over the next decade or more. Those unified surpluses would pay down the federal debt and add to national saving.

However, the expectation that large unified budget surpluses loom in future years may entice policymakers to spend some or all of the money by lowering taxes or increasing government consumption.[9] In that case, proposals that lock away surplus money could rightfully take credit for preserving surpluses and raising national saving. In fact, two of the most widely discussed plans on how to preserve some of the projected surpluses for social security, President Clinton's proposal and Martin Feldstein's personal retirement account plan, rely on the argument that, without the implementation of the respective plan, surpluses would not actually materialize.[10]

Is there a correct benchmark against which to judge the saving effects of different proposals? Probably not, because reasonable arguments can be made in favor of different benchmarks. Current law—which implies large budget surpluses—has the advantage that it

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[9] See Cogan (1998) for some historical evidence on social security surpluses and the Congressional response in the United States.

[10] For the most recent discussion of Martin Feldstein's proposal, see Feldstein (1999) and Feldstein and Samwick (1998). The argument that the President Clinton's plan would raise national saving has been made by U.S. Deputy Secretary of the Treasury Lawrence Summers in recent testimony before the House Committee on Ways and Means (U.S. House Committee on Ways and Means, 1999).

is a clearly defined benchmark. Moreover, it coincides with traditional conventions for budget scoring so that the economic analysis can make use of common budget baselines. By contrast, a benchmark that assumes surpluses would otherwise be spent is not clearly defined without the incorporation of more specifics because it matters for national saving whether surpluses are reduced through tax cuts or higher government consumption. However, there is some evidence that projected budget surpluses encourage higher spending and tax cuts. Thus, it should be recognized that a proposal may prevent spending of surpluses and therefore encourage higher saving; otherwise, the analysis may be biased against the proposal. It should also be recognized, however, that allowing policymakers to choose the benchmark can subject the analysis to manipulation.[11]

IV. Saving Social Security—Evaluating the Saving Response

The previous discussion can be summarized by postulating two major principles for analyzing saving responses under different reform proposals for U.S. social security. The first is to always be explicit about the benchmark, particularly if proposals cannot be directly compared with each other. The second is to avoid creating potential pitfalls by focusing only on a piece of national saving. In particular, any analysis should make sure to recognize policies that change the distribution of saving within the public sector, within the private sector, or between the two sectors without affecting national saving as a whole.

[11] It is common practice to compare the effect of higher spending with spending under current law. If, however, the proponents of certain types of spending could choose the benchmark, they would provide one that would have less of a positive impact than their proposal. Leaving the choice of the benchmark to the proponent therefore bears the risk that advantages and disadvantages cannot be clearly identified.

Numerous proposals for reforming U.S. social security have been introduced and discussed. To shed some light on how the two principles can be applied, the paper considers three typical reform plans that have been introduced into the U.S. debate: the "carve out," the "add-on," and "preserving the surplus."[12] In each case, the underlying assumption is that, without the reform, payroll taxes would be adjusted to pay present-law benefits (present-law paygo). Regarding the projected unified budget surpluses, the discussion considers two benchmarks: current law, under which surpluses would reduce the federal debt; and an alternative benchmark, under which the surpluses would be spent by raising government consumption.[13]

A. The Carve Out

A typical carve-out plan takes a portion of the payroll tax and allocates it to new individual savings accounts. In the long run, accumulated account balances replace some portion of the traditional social security benefit. The Personal Security Account (PSA) plan of the 1994-96 Advisory Council on Social Security, as well as the plan put forth by the National Commission on Retirement Policy (NCRP), chaired by U.S. Senators Gregg and Breaux and

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[12] There is a fourth typical reform element: investing the Trust Funds in the stock market. The effects of that provision on national saving are unclear because they depend on the extent to which households perceive the Trust Funds as substitutes for their own saving, as well as on how the risks of future stock market downturns are distributed between retirees and taxpayers. For a discussion of how trust fund portfolio choices may affect households and national saving under different assumptions, see Smetters (1999).

[13] The two benchmarks correspond to a lower and upper bound for the savings response. A case in which surpluses are otherwise reduced through tax cuts falls in between.

U.S. Representatives Stenholm and Kolbe, has such a carve-out provision.[14] The idea of a carve out is to convert current payroll tax contributions into private savings by funneling them into private accounts.

The critical question for any carve-out plan is how to finance the shortfall in payroll tax revenue because—unless the benefits of current retirees are cut—the current obligations of the Trust Funds remain the same in the short run. Simply transferring payroll tax revenues into private accounts cannot balance the system because one dollar transferred opens a hole of one dollar in the Trust Funds, and social security, as such, does not hold more wealth.

The same issue affects national saving. It is clear that a payroll tax dollar diverted from the Trust Funds reduces the trust fund surplus by a dollar. Unless the on-budget balance rises, the unified budget balance and, thus, public saving fall by a dollar. If households recognize the future burden resulting from higher public debt and do not reduce other private saving in response to placing a dollar in individual accounts, private saving rises by exactly the same amount that public saving falls, and national saving remains unchanged.[15]

A carve-out plan could raise national saving compared with current law through two channels. The first is to at least partly compensate for the shortfall in payroll tax revenue by improving revenues, that is, increasing taxes or cutting spending. This method is included in

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[14] See Advisory Council on Social Security (1996) and National Commission on Retirement Policy (1998).

[15] Of course, this outcome is the often-cited neutrality result: if individual accounts are entirely financed by raising government debt, "privatization" is economically neutral because government debt and social security's implicit promises are interchangeable. See, for example, Raffelhüschen (1989) and Kotlikoff (1993).

the PSA plan, which levies a 1.5-percent additional tax on wages for 75 years.[16] The precise change in national saving will depend on how much households will reduce some of their other private saving in response to the amounts placed in individual accounts—a question that, in turn, depends on their perception of the distribution of transitional burdens across and within generations.[17]

The second channel is to reduce benefits of current workers at a faster rate than money is accumulated in individual accounts—in other words, to cut guaranteed benefits by more than the amounts that are transferred into individual accounts. The NCRP plan includes this channel through an acceleration of retirement ages and a cut of promised benefits. Cutting benefits raises the incentive to provide for one's own retirement through private saving in addition to the new private accounts. As discussed earlier, analysts disagree on the amount by which people would increase their private saving in response to lower government benefits, but they generally agree that private saving would likely increase.

Of course, in times of a unified budget surplus, a carve-out plan without a tax increase or cuts in benefit promises could raise saving compared with a benchmark that spends the surpluses. The dollar transferred from the Trust Funds into individual accounts reduces the unified budget surplus and prevents it from being spent on anything else. However, because carve outs use payroll tax revenues to finance individual accounts, they would fall short of the goal of saving social security, unless they increase the revenue of the system later—when the unified budget is in deficit again—or cut benefits sufficiently.

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[16] The PSA plan accumulates initially some new public debt that is then paid off over time with the 1.5-percent additional tax.

In summary, compared with current law, a carve out's saving response is closely related to the way in which it brings the Trust Funds to actuarial balance. Because carve outs reduce the inflow of the Trust Funds, additional transition taxes must be implemented or benefits must be cut sufficiently. Compared with a benchmark under which surpluses are spent, a carve out could raise national saving. However, it would likely do so without achieving the goal of long-term balance of the social security system.

B. The Add-On

The typical add-on plan has the following two elements. The current system is put on an actuarially sound basis at current payroll tax rates by cutting future benefits. To make up for the reduction in benefits, individual accounts are created through an additional new tax. An example of an add-on plan is the Individual Account Plan of the 1994–96 Advisory Council on Social Security.

Compared with current law, add-ons have a positive impact on national saving. In the short term, the income and outgo of the Trust Funds remain unchanged, and in future years outlays are smaller than under current law, closing the current financing gap. The individual accounts financed with additional payroll contributions add to private saving and, because there is no offset in public saving, also add to national saving. How much private saving rises depends on the extent to which households may reduce their other saving. Private saving offsets under an add-on plan would probably be small because households perceive individual accounts as a substitute for the cut in future benefits. However, the exact

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[17] See Kotlikoff, Smetters, and Walliser (1998 and 1999) for a variety of simulations differing in transition taxes and the distribution of burdens within generations.

responses would depend on the size of the add-on relative to the reduction in guaranteed benefits financed by the Social Security Trust Funds and the current beliefs of households about future government measures.

In an environment with unified budget surpluses, add-ons may come with a disadvantage, though: they do not reduce the unified budget surplus and thus do not "lock in" the surplus. A typical add-on plan leaves the short-run finances of the Trust Funds unchanged or may even increase the Trust Funds' surplus by phasing in benefit cuts. Because the individual accounts are financed with an additional contribution, unified surpluses under the add-on plan are at least as large as projected under current law. If policymakers are enticed by projected unified surpluses to raise spending or cut taxes, the positive impact of an add-on on private saving may be offset by lower government saving.

C. Preserving the Surplus

Since the emergence of the budget surplus in fiscal year 1998 in the United States, proposals to improve Social Security's long-run finances have focused explicitly on using up portions of the projected future budget surplus. Those proposals aim at preserving the surplus for social security by making the surpluses unavailable for other budgetary spending or tax cuts. The two most widely discussed plans are the budgetary proposal by the Clinton administration and a proposal developed by Martin Feldstein.[18] In spite of all their differences, the proposals have two elements in common: they guarantee the current-law level of social security benefits and they do so by using general revenues without raising the payroll tax rate. However, both plans as currently specified fall short of the goal to save

[18] For an analysis of Feldstein's plan, see also Congressional Budget Office (1998c).

social security as defined above, because they rely on as yet unspecified changes to taxes or spending to achieve long-term balance.[19] Accordingly, neither plan can be clearly analyzed because it may ignore burdens that either current or future generations must bear to close the financing gap. However, because it is instructive to study the mechanism underlying the two plans, the subsequent discussion tacitly assumes the arising financing needs are met by higher taxes.

President Clinton's plan relies on transfers from general funds into the Trust Funds, a change in accounting rules, and an investment of funds in the stock market. A transfer of general funds to the Trust Funds reduces the on-budget balance. By changing the accounting rules, the Clinton administration's proposal prevents the transfer from improving the off-budget balance, thus reducing the unified budget surplus and preserving the surplus from being spent on other proposals.[20] The investment of some of the trust fund holdings in equity additionally seeks to improve the return of the Trust Funds. In addition to transfers from general funds to the Trust Funds, the President's plan includes several other provisions that use surplus money but do not affect the Trust Funds.

Feldstein's plan transfers money from general revenues into individual accounts and later adjusts social security benefits according to the balance in individual accounts. Initially, workers receive a tax credit that is paid into an individual account. At retirement, their social security benefit is reduced by 75 cents for every dollar withdrawn from individual accounts.

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[19] Feldstein (1999) explicitly discusses the financing needs of his proposal and puts the potential financing gap at 0.5 percent of gross domestic product if surpluses end in 2020.

[20] As discussed in Congressional Budget Office (1999b), the current budget projections do not reflect the change in accounting rules and thus do not record the intragovernmental transfer as a change in the unified budget balance because the change in rules has not been enacted by the U.S. Congress.

If the accounts are treated as non-budgetary, the tax credit reduces the unified budget surplus by the same amount and preserves the surplus money for future retirement income.[21]

Compared with current law, neither President Clinton's proposal nor Feldstein's plan would raise national saving. Compared with paying down the debt, both plans would likely reduce national saving. Under the president's plan, substantial amounts of the surplus are not allocated to the Trust Funds but allocated for other spending. National saving falls simply because overall government saving (including the amounts that are transferred to the Trust Funds but not recorded as receipts) is lower than otherwise. By allowing individuals to keep some of the money allocated to their individual accounts on top of their social security benefits, Feldstein's plan probably encourages people to reduce their other private saving, so that not every dollar transferred from general revenues into individual accounts is saved. Clearly, under which of the two proposals saving falls more compared with current law depends on how much of the projected surpluses are used up for other spending.

The evaluation changes if the proposals are compared with a benchmark under which surpluses are being spent. In that case, both President Clinton's plan and Feldstein's plan would raise national saving. The President's plan removes money from the unified budget and uses it to pay down the debt. Feldstein's plan removes money from the unified budget and increases private saving. Both clearly raise saving over a situation in which all money

[21] The budgetary treatment of Feldstein-type individual retirement accounts has not yet been considered by the U.S. Office of Management and Budget or the Congressional Budget Office. If the accounts are perceived as government assets, they could be treated as public rather than private wealth, making the tax credit an intragovernmental transfer. In that case, Feldstein's proposal would also necessitate a change in accounting rules to lower the unified budget surplus.

would be spent. Again, which of the two plans raises saving more depends on the specific amounts being preserved.

As a result, the essential differences between the preserving-the-surplus plans are how and how much of the surplus is being "walled off" from other use (and how any additional financing needs are met). For example, Feldstein (1999) argues forcefully that the private ownership of individual accounts is a better way to protect surplus money than increasing the holding of Trust Funds, because it would be much more difficult to undo the allocation of funds to private accounts than to change the accounting rules underlying the transfer to Trust Funds.

V. U.S. Social Security, National Saving, and the Sustainability of Fiscal Policy

The main reason why economists care about the saving response to different reform plans is because that response allows them to judge the extent to which a plan prepares the economy for an aging population and increasing budgetary pressures. Higher national saving is generally perceived as an indication that more resources are being set aside for the future and thus future pressures can be alleviated. That finding does not depend on whether higher saving takes place through more government saving, that is, paying down the federal debt, or through more private saving.[22]

[22] While raising national saving would improve the outlook for fiscal policy, improving fiscal sustainability is not necessarily accompanied by higher national saving. For example, if individuals offset higher government saving originating from a tax increase through lower private saving, the overall financial outlook of the government would increase although national saving remains unchanged.

In recent years, different models have been developed to evaluate the sustainability of fiscal policy. One of them is generational accounting, another is the long-term budget model of the Congressional Budget Office.[23] The message of those models is quite clear: continuing on the current path of fiscal policy is unsustainable. Even though the fiscal situation has recently improved in the short run and in the long run, current-law spending cannot be sustained indefinitely.

Because those models evaluate current law, that is, a benchmark under which projected surpluses would reduce federal debt, it can also be concluded that proposals, which do not increase overall government revenues or cut spending compared with current law, do not further improve the sustainability of fiscal policy. That outcome can be seen from the proposals that partially preserve the surplus. While those proposals may cut the fiscal burden compared with a policy that spends the surpluses, they simply shift a portion of already projected surpluses from general revenues into the Trust Funds. As a result, overall government revenue and spending do not change compared with current law, and long-term sustainability, as currently measured with generational accounts or the long-term budget model, would thus remain unchanged.

VI. Conclusion

In the current debate over adjusting or changing U.S. social security such that the system can be financed in the long run, much importance has been assigned to the question of national saving. Evaluating the response of national saving under different proposals is not an easy

[23] For recent results, see Gokhale, Page, and Sturrock (1999) and Congressional Budget Office (1998a).

task because it involves a clear judgment about the alternative path of saving. In particular, the questions of how the financing needs of the program would be met if the changes were not implemented, and of how surpluses would be spent make a great difference for the sign and magnitude of saving responses attributed to different proposals.

Among the three different types of proposals discussed in the paper—carve outs, add-ons, and preserving the surplus—the ranking of the saving response may change depending on the benchmark. Add-ons provide a clear-cut addition to national saving, compared with current law. They also have the disadvantage of not reducing the unified surplus, however, and therefore would not necessarily raise national saving if the surpluses were spent. Carve outs and proposals designed to preserve the surplus have the disadvantage of not improving national saving compared with current law unless they incorporate some additional tax increases or cuts in guaranteed benefits. At the same time, they may be powerful instruments to lock away money and commit future legislators to not spend the surplus, thus raising national saving compared with a situation in which surpluses are being spent. However, proposals that simply reallocate current-law government resources cannot improve the sustainability of fiscal policy over current law.

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