

Comments of Karl Polzer - [Center on Capital & Social Equity](#)

U.S. Senate Finance Committee hearing:

“The President’s Fiscal Year 2025 Social Security Administration Budget”

March 20, 2024

Could long-term Treasury bonds and Fed financing help close Social Security’s funding gap?

Summary

Besides facing a major long-term funding shortfall, Social Security is putting increased pressure on federal spending and pushing up annual deficits. Spending down Social Security reserves requires the Treasury to sell bonds. As the program moves toward debt financing organically, the paper below explores the possibility of adding long-term public debt and assistance from the Federal Reserve Bank as tools to deal with Social Security’s financial shortfall. Experts differ widely on whether increased debt or general fund financing would be a positive change. Findings include:

- A related and deeper problem than how to structure Social Security’s funding is demographic. The U.S. is not producing enough children or allowing sufficient immigration to build the type of workforce needed to sustain Social Security’s current level of benefits.
- Bonds with longer terms than currently issued could help finance Social Security while benefiting private pension plans and insurance products under certain conditions. But the market for them may be limited.
- There are several ways Congress could provide liquidity or short-term funding for Social Security if needed.
- Increased levels of debt financing could affect legal and procedural protections for Social Security beneficiaries now receiving "entitlements" under the budget rules for mandatory spending.
- Proposals to channel Social Security funds into the stock market would significantly increase the amount of money Congress would have to raise through debt or taxes. One pot of funds would be needed to deal with the current Social Security shortfall, and another needed for stock purchases to fund the program in the future.
- The longer policymakers wait to deal with Social Security’s funding problem, the more likely some kind of debt financing may be needed to maintain the program in the future.

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Could long-term Treasury bonds and Fed financing help close Social Security's funding gap?

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The author would like to thank Stephen Goss, William Emmons, Henry Aaron, Desmond Lachman, John Lowell, and Rusty Toler for comments and suggestions. They are in no way responsible for the paper's shortcomings.

The upcoming annual 2024 Social Security Trustees Report will likely echo previous warnings. The trustees last [report](#), released almost a year ago, cautioned that, unless Congress changes the law, Social Security will only have enough money to pay about 80% of current benefits by 2034. That is when the program's reserves run dry, and it can only pay out what Social Security taxes bring in.

The program's actuaries calculate that long-term solvency will require raising Social Security tax revenues by one third or [reducing benefits](#) by one fourth -- or negotiating a combination of the two approaches. They project Social Security's 75-year deficit is about 1.3% of GDP. When the 2023 report was released, U.S. GDP was \$24 trillion, 1.3% of which equaled about \$388 billion. Multiply by 75 years and you get about \$30 trillion as a rough estimate of the long-term funding gap. Social Security's annual cost is forecast to increase from 5.2% of GDP in 2023 to 6.3% in 2076 -- after the [Baby Boom generation](#) has passed away -- and then decline to 6.0% by 2097.

This paper explores the possibility of adding long-term public debt and assistance from the Federal Reserve Bank as tools to deal with Social Security's financial shortfall for several reasons. Though falling "outside the box" of conventional policy analysis, long-term debt could lessen the short-run pain of payroll tax increases or benefit cuts otherwise needed to balance its books. This policy approach is not a [personal preference](#). I am not advocating for it. In order to evaluate it, I sought comments from experts in Social Security policy, actuarial science, economics, and the Fed and include some below.

One motivation for exploring debt financing was trying to push some of the cost of what is generally believed to be a "bulge" in Baby Boomer retirees to later generations. As discussed below, expert review of the article proved this assumption to be questionable at best. The number of Boomer births turns out to be more of a blip than a bulge.

Perhaps the strongest reason to explore debt financing is that it is already under way in an operational sense. As a result of the mechanics of spending down its reserves, Social Security already is moving toward financing its shortfall with bond sales. As I [pointed out](#) last year, after almost 40 years of rendering a surplus, Social Security's revenues dropped below expenditures in 2021. As a result, the federal government has had to raise an additional \$56 billion in 2021, \$22 billion in 2022, and an estimated \$53 billion in 2023 to pay promised benefits. Social Security's annual funding shortfall is projected to reach \$378 billion in 2032 (unadjusted for inflation) just before reserves run dry. (A thorough

description of trust fund's history and function can be found in [“Social Security Cash Flows and Reserves”](#) by David Pattison, and a brief one [here](#).)

Because the entire federal government is spending more than it takes in, drawing down Social Security reserves adds to current budget deficits. The government needs to raise additional funds to use Social Security reserves because they are, in effect, legally binding IOUs from one part of the government to another not backed up by marketable assets. Once the reserves are depleted, the government will need Congressional authority to tap new sources of revenue.

I hypothesized that long-term bonds might be able to help Social Security in many ways. If Congress, for some reason, waited until the last minute to act on the shortfall, they could help provide short-term funding and liquidity to prevent a sudden drop in benefits. Bonds could also be a significant part of a long-term financing solution.

For the sake of experiment, assuming U.S. GDP averages \$30 trillion over the next 75 years, Social Security would need roughly \$400 billion a year in additional funding. What would be the impact if the government financed about half of that amount (\$200 billion) a year through long-term debt?

While financing experts no doubt could come up with better ways to engineer this, I offered a couple of options. Congress could authorize the Treasury to sell special 50-year to 100-year bonds to raise \$200 billion (or whatever amount decided) each year and send the cash to the Social Security trust fund, which, in turn, would carry an obligation to repay the rest of the government when the bonds matured. In this way, the rest of the federal government would be loaning Social Security money, just as the social insurance program provided cheap financing to the rest of the government for decades as it generated a surplus during a period when the [ratio of workers to beneficiaries](#) was higher.

The longest-term US bond now issued by the US matures in 30 years. Already, [fourteen OECD countries](#), most with slowing population growth and increasing life spans, have issued sovereign debt with maturities ranging from 40 to 100 years. A handful of large private-sector organizations including wealthy U.S. universities and health care networks have issued century-long debt. Buyers include pension funds and insurance companies managing long-term risk. Could long-term Social Security debt financing dovetail with future needs of private-sector retirement funds?

The Federal Reserve Bank could play a role in this. Much as the Fed has helped salvage financially distressed and insolvent banks, hedge funds, airlines, and insurance companies, Congress could authorize and direct it to acquire long-term Treasury bonds providing cash to Social Security as assets on its balance sheet. Under the current [legal framework](#), the central bank cannot purchase Treasuries directly from the government. It can work with the Treasury to facilitate government spending. For example, through the 2020 [CARES Act](#), Congress authorized sending \$1,200 checks to individuals in families earning less than a certain amount while the Fed made sure that the government could

finance that spending on favorable terms by [buying large amounts of government bonds in the secondary market](#).

Asset purchases including these increased the Fed's balance sheet by [\\$7.8 trillion](#) between September 2008, just before the acute phase of the financial crisis, and the end of 2022 after the central bank stimulated the Covid-impaired economy, according to the St. Louis Fed. Would adding \$200 billion a year in Social Security debt to its balance sheet be on [a scale](#) to pose significant risk to bank and financial system? How much would not pose a risk? Social Security debt could be separated from other Fed assets to minimize the impact on other reserves and potential risk shouldered by Fed member banks. The Treasury could work with the Fed to buy and sell bonds in its Social Security account in a way that facilitated monetary and fiscal policy goals as needed.

As the US economy recovered from the effects of the Covid epidemic, the central bank began reducing its balance sheet gradually (quantitative tightening) in June 2022 by not reinvesting all the proceeds of maturing securities, according to the [Brookings Institute](#). By early January 2024, the Fed had reduced its assets from a peak of nearly \$9 trillion to \$7.7 trillion. Unless its reserves fall to much lower levels, their magnitude may have less of an impact on the economy than movements of assets on and off its balance sheet, which indirectly impact economic growth and interest rates.

One might argue that pumping billions of dollars in debt financing to Social Security beneficiaries each year instead of raising payroll taxes could have inflationary effects. On the other hand, macroeconomic effects might be muted because beneficiaries are expecting to receive benefits at that level. Most of the new money in the system would be used by low- and middle-income retirees and disabled persons to maintain current levels of consumption. Unlike loans to businesses, not much of it would be saved and invested in enterprises stimulating expansion of the money supply and resulting inflation. Minimizing the need to raise taxes could be helpful if there is risk of a recession.

While the Social Security trustees frame financial solvency in terms of pre-funding the program for 75 years, Social Security already is operating on a pay-as-you-go basis relying, along with the rest of the federal government, on increasing levels of debt financing. Though policymakers could [shore up Social Security financing](#) without it, long-term debt could be a useful tool in helping break deadlocks to reach compromise over a package of tax increases and benefit cuts.

If Congress does not act, in about 10 years benefits for more than eighty million people will drop by 20%. In 2023, Social Security payments averaged \$1,827 a month. The economic disruption of an average monthly cut of \$365 would be enormous, not only for tens of millions of elder and disabled people and family members who could no longer pay all their bills, but also for food stores, landlords, medical providers, nursing homes, and others receiving their money downstream.

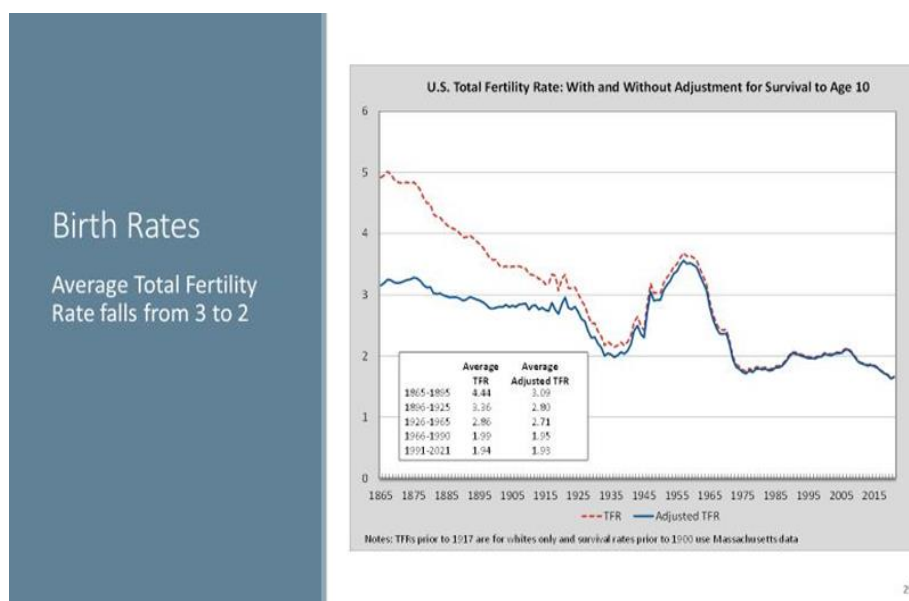
The longer policymakers temporize, the more jarring the economic and political impacts of re-financing the program are likely to be. So, why not use the leading institutions providing

capital to the international economic engine to help stabilize the nation's most valued social insurance program?

Reviewer Comments

Debt timing, birth rates, immigration, and size of the future work force

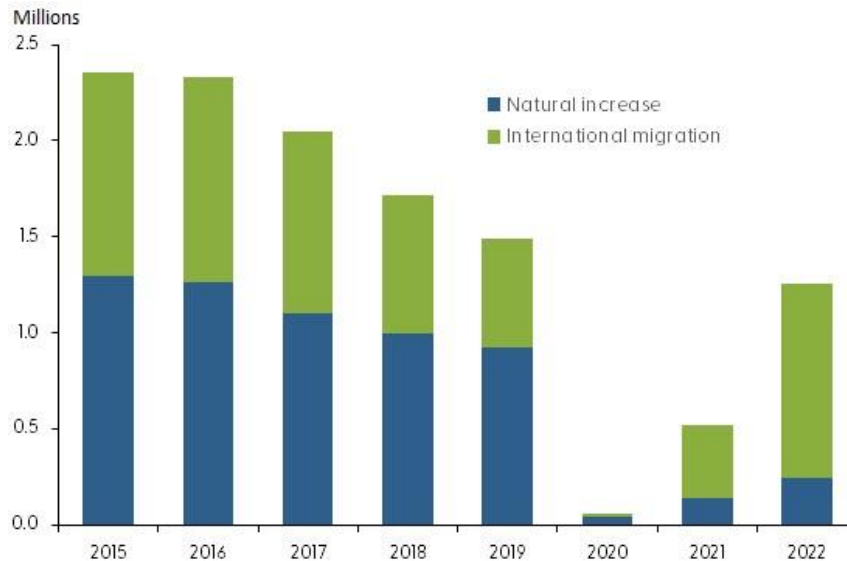
The most important criticism of the proposal is that its widely held assumption that the Baby Boomers constitute a generational “bulge” is incorrect. Social Security’s chief actuary pointed out: “Births in the boom period (1946-65) were not extraordinary as the birth rate (per woman) averaged 3.3 in that period versus about 3.0 prior. Those births are perceived as a boom only because that generation has since led to much lower birth rates (2.0 or lower). The change in the age distribution of the population starting in 2008 is an increasing level shift in the population age distribution, and not a transient bulge. Given this is an apparent permanent shift, borrowing will not be an effective answer.”



Source: SSA Office of the Chief Actuary

In light of this and other comments, it would make sense to decrease the amount of debt in this financing “experiment” from 50% of the shortfall to somewhere in the range of 10%-25%. Baby Boomer parents had about 10% more children than preceding generations. We cannot be sure that the US birth rate will remain below two in the future though government actuaries and economists may be building that rate into their models. A complementary variable contributing to the size of the future workforce is the rate (and type) of immigration, which recently has been driving US population growth, according to new [San Francisco Fed paper](#).

Annual U.S. population change, 2015–22



Source: Fed [analysis](#) using Census Bureau data.

Uncertainty about whether the workforce can grow sufficiently to provide the revenue to fund Social Security obligations may be the most significant finding in this exercise. To what degree can the native US population produce enough children, or its politics allow sufficient [inflow of workers](#), to get the job done?

Could long-term bonds help?

Assuming debt plays a future role in Social Security’s financing, one economist commented that long-term bonds might be helpful under certain conditions: “If the new bonds--call them SS bonds--were issued at maturities that overlap regular Treasury issuance, I suspect they would be expensive relative to simply issuing more Treasury debt. So your proposal would be a money-loser. If, however, SS bonds are issued only as super-long bonds, with 50 years to maturity or more, it becomes a question of whether their uniqueness would elicit sufficient specialized demand -- mostly from pension funds and insurance companies, I suspect -- to overcome their inevitable illiquidity and a hefty term premium. My intuition is that SS bonds of this type would be very expensive to issue. If there were a large demand for 50- to 100-year bonds, why wouldn't the Treasury have issued them already? In fact, the US Treasury has considered this and decided not to do it, even though some other countries have issued at those maturities.”

At a national retirement security [conference](#) in late February, I asked an actuary whose firm manages several pension plans to weigh in. He said that there is a market for debt instruments that can spread risk and manage cash flow over 75 years among pension plans, and that US bonds would offer more security than foreign issuance. However,

pension fund managers already have developed a work-around using “derivatives” as a substitute. It’s unclear whether they would turn away from existing products if the US Treasury were to offer new very-long-term bonds.

The Fed and other sources of relief

Social Security could borrow money from other federal trust funds to deal with liquidity issues as it did from Medicare’s beginning in 1982 as Congress worked on reforms establishing its current financing scheme. If a similar scenario recurred, it is unclear whether inter-trust-fund borrowing would be available or could provide the amount of money needed.

There is also precedent for Congress setting up a separate federal corporation to issue bonds to repay the debts of a trust fund. In 1989, [Congress enacted](#) such a scheme to bail out savings and loan (S&L) institutions that failed during the S&L crisis of the late 1980s and early 1990s. REFCORP issued bonds between 1989 and 1991. Over the course of more than six years, the Resolution Trust Corporation liquidated, bailed-out, or otherwise resolved, 747 insolvent S&Ls, and thrift institutions. This cost taxpayers almost \$500 billion.

Responding to a scenario involving the Federal Reserve as a potential market maker and long-term holder of Social Security bonds, a former Fed economist provided these comments:

“Even though this flies in the face of the Fed's preferred operating procedures -- hold only Treasury debt that mirrors the Treasury's outstanding issuance by maturity -- you should mention that there is precedent for what you propose. Large-scale asset purchases of federal agency debt and agency mortgage-backed securities made no sense from the traditional Fed perspective. But (former fed chairman) Ben Bernanke made the case that the Fed should prevent the mortgage market from collapsing, rather than waiting for Congress to do it. If a similar emergency occurred for Social Security beneficiaries, the Fed might well step in again. But a much better plan would be to pay for the shortfall out of government resources raised in regular Treasury auctions.”

Is debt financing of any kind a good idea for Social Security?

Reviewer reactions to using debt as a future funding source for Social Security ranged from strong objection to acceptance, in part stemming from the state of the federal budget writ large. According to an economist from a conservative think tank:

“My main reservation with your paper is that it is proposing added government debt financing to be bought by the Federal Reserve at a time when our public finances are already on a dangerously unsustainable path. At a time of cyclical strength and full employment, we are running a 6% of budget deficit. According to the Congressional Budget Office, on present policies we will continue to run deficits of that size for as

far as the eye can see. That will soon take our debt level to a higher level in relation to GDP than that which we reached in 1945. This would seem to be inviting both a dollar crisis and a move to higher inflation that would constitute an unfair tax on the poor. Rather than adding to the debt problem, I think that a more appropriate way to address the social security crisis is through an equitable way to increase social security revenues and reduce expenditures.”

Another economist predicted that Social Security would survive more or less intact with its shortfall covered by regular Treasury issuance. A third (from a left-to-center think tank) commented: “When you refer to long-term borrowing, that is simply general revenues by another name, but under whatever name it flies, some of it would be a good idea in my opinion. All good, but keep in mind that depositing funds borrowed today is nothing more than general revenues today rather than general revenues tomorrow.” In the current fiscal situation of recurring budget deficits, tapping into general revenues means generating more debt.

Funding Structure, Legal and Procedural Protections

Many economists characterize Social Security’s trust fund as a “fiction” obscuring that its benefit payments are “just another line item” in the federal budget. The trust fund, however, is part of a matrix of legal and procedural protections for Social Security beneficiaries receiving “[entitlements](#)” under the [budget rules for mandatory spending](#). Unlike federal discretionary programs where spending levels are determined annually through appropriations, mandatory spending for entitlements like Social Security is open-ended, guaranteeing that eligible individuals receive benefits according to a pre-set formula. The government must allocate funds to meet the needs of all qualified individuals, even if spending exceeds overall [budgetary limits](#) set by Congress and the President. (The Social Security Administration’s operating budget, however, is set by Congress in its annual appropriations process.)

If Congress includes general revenue in Social Security financing reforms, questions arise concerning whether, and to what extent, Social Security might retain its status as an entitlement and mandatory spending: Would the portion of benefits paid for by general funds retain this status? The portion covered by dedicated Social Security taxes? Could entitlement and mandatory spending status disappear altogether?

Could investing in equities help Social Security?

Over the years, there have been several proposals to invest trust fund dollars in the stock market in order to generate higher long-term gains than what lending to the rest of the government can yield. Sen. Bill Cassidy (R-LA) [recently presented](#) the latest iteration of a Senate study group proposal that would both close Social Security’s current financing gap while also setting up a separate equity fund to help finance Social Security decades in the future. Aside from the higher risk posed by equity value fluctuation, because trust fund outflow now exceeds inflow, this proposal would significantly increase the amount of money Congress would have to raise through taxes or borrow. One pot of funds would be

needed to deal with the current shortfall, and another needed for stock purchases to fund Social Security in the future. Pre-funding Social Security is more difficult than it has been in the past. Before putting Social Security funds at risk in the stock market, proponents might consider trying it with a dedicated funding stream of an agency with a much smaller budget. For example, what about a trial run with the [Securities and Exchange Commission](#)?

Final Observations

While I do not necessarily favor debt financing to help close Social Security's financing gap, the program's current structure is putting increased pressure on federal spending and pushing up annual federal deficits. The longer policy makers wait to deal with Social Security's funding problem, the more likely some kind of debt financing may be needed to maintain the program in the future. Long-term bonds could be part of that solution under certain conditions but probably could not play a major role. A related and deeper problem facing the US than how to structure Social Security's funding is demographic. The country is not producing enough children or allowing sufficient immigration to build the type of workforce needed to sustain Social Security's promised benefits.

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