Against False Choices:
True Intergenerational Equity in Social Insurance

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Abstract

This paper questions conventional rhetoric surrounding entitlement reform, challenging the notion that social insurance represents a zero-sum distribution of resources between the young and the old. I begin by outlining a framework for intergenerational equity that considers an individual's entire life course and then apply this perspective to the current intergenerational contract in the United States, highlighting the importance of social insurance programs such as Social Security and Medicare for Americans of all ages. I then assess the fiscal outlook for reform, demonstrating that intergenerational investment could provide potent economic stimulus, and that the current debt level should not pose an impediment to short-term expansions to the social insurance system. I conclude by analyzing options for reforming our current social insurance system to benefit all generations and discussing potential revenue sources for ensuring long-run fiscal sustainability.

Keywords

Social Security, Medicare, Fiscal Policy

Introduction

Today the rhetoric of intergenerational equity is most frequently invoked to decry current levels of social spending, particularly spending on the elderly, and the debt they have generated[1]. While there is reason to seriously consider how to ensure the long-term sustainability of American fiscal policy, this discussion should not come at the expense of our broader values of shared security and opportunity. In this paper I outline a framework for conceptualizing equitable resource distribution between and across generations—drawing a sharp contrast with much of the prevailing political rhetoric on entitlement reform—and then apply it to the current intergenerational contract in the United States. I conclude by assessing the fiscal outlook for reform, arguing that there are economic imperatives, as well as the necessary resources, to finance intergenerational expansion of our social insurance system.

A Framework for Intergenerational Equity

When I refer to intergenerational equity, I mean the pursuit of a fair distribution of social risk, resources, and outcomes between different age groups. Thus conceived, intergenerational equity ought not preclude other forms of equity, both within and between generations—such as equality of gender, socioeconomic status, race, and ethnicity. Furthermore, I adopt a perspective that considers equity across an individual's full life course rather than a single point in time. It is the latter two additions—multiple spheres of equity and a vision of a complete life course—that distinguish my perspective of intergenerational equity from the current debate on entitlement reform (see also Myles, 2002).

[1] See for example the statement of principles proposed by the Brookings-Heritage Fiscal Seminar (http://www.concordcoalition.org/files/uploaded_for_nodes/Taking_Back_Our_Fiscal_Future.pdf).

Proponents of the current perspective of generational fairness claim that excess amounts of public resources are directed at the elderly and the retired through the United States' largest social insurance programs—Medicare and Social Security—and that these outlays crowd out spending on government programs for younger generations (e.g: Sawhill & Monea, 2008). They cite that the share of children's spending in the federal budget is just 2.6 percent of GDP, compared to seven percent for the elderly (Carasso, Steurle, Reynolds, Vericker, & Macomber, 2008). This situation, they contend, is considerably worsened by our nation's aging population—starting with the baby boomers—and will only exacerbate the generational inequities we currently face.

The second component of this argument notes that the material and health *outcomes* of the elderly have dramatically improved while those of children has stagnated and worsened. For example, the median income of those 65 and over has increased 79 percent since 1979, and their poverty rate fallen by a third to nine percent over the same period[2]. In contrast, the number of children under 18 living in poverty has held relatively constant at 17 percent[3].

In sum, the advocates of this current framework believe that we spend too much on the elderly and not enough on the non-elderly, and that the solution to this is to be found in increased generational self-sufficiency. Many of the policy prescriptions that flow from this philosophy thus involve mechanisms for private saving and investment, an end to the automatic funding of Social Security and Medicare, and a move away from universal to targeted and means-tested social initiatives—all in opposition to these programs' historical social insurance-based logic.

[2] Author's calculations based on Current Population Survey.
[3] Author's calculations based on Current Population Survey.

While I do agree that we are not spending nearly enough public resources on children, I must take issue with the argument that our current social insurance programs *actively crowd out* spending on our youth, or represent a zero-sum distribution. Such a perspective isolates each generation from the other and overlooks the multiplicity of contributions that the elderly and retired can offer to other groups of society, particularly children. For example, nearly four million children are being raised by their grandparents and a third of older Americans report providing some childcare for their immediate family members (Hayslip & Kaminski, 2005).

In addition to directly contributing to children's welfare, childcare offered by the elderly often provide the deciding factor for young parents' labor force participation, especially in the case of low-income mothers (Fuller-Thomson & Minkler, 2001; Hayslip & Kaminski, 2005). Conversely, the economic independence generated for the elderly by social insurance programs such as Social Security and Medicare relieves families of much of the economic cost of supporting their elderly relatives, permitting parents and guardians to invest resources in their children—old age pensions have provided security against the risk of financial strain for *both* the elderly and the young throughout history (Haber & Gratton, 1994). This is but one representation of a crucial intergenerational interaction that fosters economic productivity and growth, and one that is lost by adopting a static and zero-sum perspective of generational spending.

Additionally, I contend that we cannot abandon other forms of equality in the pursuit of generational equity. While the elderly and retired have enjoyed significant material and health gains— largely due to the success of Social Security and Medicare—on average, a significant portion still remain at or below the poverty line—nearly 14 million at last count, with minorities

and women starkly overrepresented[4]. Thus while the reduction in the elderly poverty rate over the past century is certainly cause for celebration of effective government action, much work still remains to be done.

Given the precarious state of many elderly and retired Americans, we cannot afford to shift more risk onto their already burdened shoulders, nor cut benefits, as has been previously proposed. A framework for true intergenerational equity would call for measures that maintain and strengthen social insurance safety nets for the elderly, particularly in ways that would reinforce existing positive cross-generational effects and reduce *intra*-generational disparities. It would also increase spending on children through existing and new social insurance programs. Such spending could provide an extraordinarily valuable investment in human capital, which would likely pay for itself over time as these children and young adults become more productive members of society.

For example, a universal voluntary high-quality pre-kindergarten program—a policy with well-documented lifelong social and educational benefits for enrolled students—would require just six years before its net benefits began to exceed its costs, and then would provide rapidly growing excess benefits with each following year (Lynch, 2007). Direct fiscal benefits include a net reduction in elementary and high school costs due to higher performance and lower special education needs (ultimately reflected in a lower burden for tax payers), reduction in criminal justice costs due to lower youth crime rates, reduced welfare and child services costs due to lower incidence teenage pregnancy and child abuse, and higher tax revenue due to increased lifetime earnings. Though more difficult to identify and quantify, indirect social benefits from a

[4] Author's calculations based on Current Population Survey, including populations up to 200% of the federal poverty line.

universal pre-kindergarten program are no less important and include improved health, reduced crime, higher earnings, and increased global competitiveness.

Aside from their fiscal and social benefits, high-quality investments in childhood programs form one of most effective interventions for *future retirement security*. The best way we can ensure that our children and youth have sufficient savings for a comfortable retirement is to ensure that they receive the education they require for a successful and rewarding tenure in the labor market.

The Fiscal Outlook for Intergenerational Investment

Despite the compelling case for increased cross-generational social investment, we are frequently warned of dangers of a growing federal deficit generating astronomical levels of public debt. While we must indeed be wary of the level of the debt we generate, we must be equally mindful of the composition of that debt, and its potential role as a tool for meaningful economic investment. Indeed, the rapidly worsening labor market demands bold stimulus in the form of intergenerational investment.

Looking at federal outlays over the past half-century, we see no explosion in government spending—it has fluctuated between 15 to 20 percent of GDP over the entire period. What *has* changed is the *composition* of this spending, and the levels of debt that have accompanied it—with tax exclusions and tax cuts, largely aimed at upper-middle class and wealthy households, occupying an increasing share of our public spending. For example, nearly half of the projected deterioration in the federal deficit between 2001 and 2011 is due the 2001 and 2003 tax cuts (Aron-Dine, 2008; Kogan & Brunet, 2008). The other single largest driver of long-term fiscal imbalance is our failing health care system, which extracts a heavy toll on our public coffers—all

told, our federal government spends nearly twice as much on health care as it is does on defense each year. Thus the main factors behind our increasing unsustainable fiscal obligations are specific policy choices, policies that can be reformed and reversed.

In spite of the changing composition of our fiscal obligations, federal debt as a share of the economy is approximately 40 percent, below both the average of the past 65 years and the average share in the 1990s. Based on these levels, and historical experience, it would appear that additional modest increases in the debt level would not cause excessive economic instability, particularly if additional spending is used to generate investment in human capital with clear returns.

Intergenerational investment through social insurance could form a potent component of an economic stimulus package. To give one example, by increasing and expanding Social Security benefits, legislators could, in one fell swoop, efficiently help our nation's most vulnerable populations of all ages, while making permanent investments in our economy. An expansion, such as raising the minimum benefit as recently proposed by economist James Galbraith, would help alleviate the shocking erosion of retirement savings that has occurred in the current recession—$2 trillion over the past 15 months, according to the Congressional Budget Office—ensuring that those that have worked their whole lives do not descend into poverty at the whims of the stock market (Orszag, 2008). Furthermore, a rise in the minimum benefit would also reach Social Security's other beneficiaries, including low-income widowed spouses and their children.

Policymakers could also use the *political* aperture created by a Social Security stimulus to begin consideration of long-term reform, with an eye towards intergenerational equity and sustainability. Financing these temporary benefit increases with general revenue would open the

political dialogue on Social Security to discussion of additional sources of revenue for the program beyond the payroll contribution system. It would also raise the possibility of other important expansions—such as restoring benefits to children of deceased Social Security recipients who want to pursue higher education, whether college or vocational school.

The Social Security student benefit is a clear example of how a social insurance program can effectively support both children *and* the elderly by making long-run investments in the nation's future economic productivity. Such a reform could reach up to four million children, largely from low-income and minority households, and would provide them with an incentive and the resources to pursue higher education, an increasingly important requirement for participation in a competitive global economy. Expanding the Social Security program to younger Americans would also produce important political effects. Prior research has shown that senior citizens have become much more politically invested and engaged by virtue of the benefits afforded by Social Security (Campbell, 2005). Restoring the student benefit could produce similar political empowerment amongst largely poor and minority young adults, and would also strengthen the constituency dedicated to Social Security's continuity.

Ensuring Long-Run Fiscal Balance

While large short-term stimulus spending on social benefits ought to be financed with deficit-spending, our government will require increased levels of tax revenue to restore fiscal balance and provide adequate intergenerational investments. Such revenue could be raised by increasing the progressivity of the federal income tax, which has deteriorated over the past quarter-century due to skyrocketing inequality of income and wealth (Furman, Summers, & Bordoff, 2007). Although all income groups have experienced a decline in effective tax rates

since the 1980s, these reductions have been the greatest for the highest earners. For example, the average tax rate for the top 0.1 percent of households (representing those earning over $1.3 million in 2005) has fallen from 60 percent in 1960 to 34 percent in 2004 while the rest of the top one percent has seen their average rates decline only moderately from 34 to 38 percent (Piketty & Saez, 2007). The 2001 and 2003 tax cuts have only exacerbated this trend, lowing rates for top earners at the expense of the majority of households (Gale, Orszag, & Shapiro, 2004).

Federal income tax enforcement, especially for top-earners, has eroded as well, with an increasing share of resources shifting towards audits of middle class households and low-income workers receiving the Earned Income Tax Credit (Johnston, 2003). For example, the share of unverified income of the top five percent of earners has doubled from 19 to 38 percent over the past 20 years while that of the bottom 95 percent of earners has risen only from six to eight percent across the same period (Bloomquist, 2003). The Internal Revenue Service estimates that the lost revenue from the federal income tax totaled $290 billion in 2001, accounting for the costs associated with enforcement (IRS, 2006). Proper enforcement of the income levy for high-income earners has the potential to restore progressivity and fairness to our tax system and provide increased funds for expanding investment in social programs.

Another option for financing social program expansion is through the creation of a value-added tax (VAT), either as a replacement to the federal income tax and as a dedicated source for specific benefits, such as a universal health insurance system (Emanuel & Fuchs, 2007; Graetz, 2002). Similar to a national sales tax, the VAT would be collected at each stage of the production of a good, rather than just at the point of sale. It is currently the primary method of raising revenue for social spending across the majority of advanced, post-industrial European economies. A VAT could provide a relatively effective—and if coupled with corresponding

increases in social spending—progressive source of significant public revenue that could incentivize saving by taxing only consumption.

A wide body of research suggests that financing increased social spending with modest increases in levels of taxation would not result in adverse economic outcomes. Contrary to received wisdom that assumes a clear trade-off between social spending and economic growth, there is no statistical correlation between social transfers as a share of GDP and economic growth among OECD nations over any time period in the past century (Lindert, 2004). Labor market rigidities found in generous social states—such as high payroll taxes, employment protections, widespread unionization, and generous unemployment benefits—are often assumed to contribute to high levels of unemployment, and in turn, slower economic growth. However, an expansive economic literature has indicated that these labor market features largely do not, in themselves, cause high levels of unemployment (Nickell, 1995). Even when such elements are associated with higher unemployment, they are not linked to lower levels (or growth) of GDP (Hall & Soskice, 2001; Lindert, 2004; Pontusson, 2005).

Committing to Intergenerational Investment

All the evidence suggests that we need to update our intergenerational contract given the changing nature of family, economy, and society, but we certainly should not abandon it entirely by dismantling our system of social insurance. In this time of recession, now more than ever, we need policies that share risk and resources broadly across diverse groups of society. Ensuring true intergenerational equity in these policies—both in the distribution of their taxes and benefits—requires a perspective that does not supplant other forms of *intra*-generational equity,

one that adopts a life-course perspective, and above all, recognizes the multiplicity of connections and interdependence between generations.

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