

program an implicit rate of return in a currently financed social security system, even if tax rates are fixed. If generation 1 pays t percent of its earnings Y_1 , to support retirement benefits under OASDI, then its tax burden is tY_1 . Generation 2 similarly pays the same t percent of its earnings, Y_2 , to support retirement benefits equal to tY_2 for generation 1. If population and the labor force grow at $100i$ percent a year and per capita earnings grow at $100j$ percent a year, then after a generation of n years, $tY_2 = tY_1(1+i)^n(1+j)^n$. The implicit interest rate that generation 1 receives on its OASDI taxes under the above assumptions is $100(i+j)$ percent, or the sum of the rates of growth of population and per capita earnings. Generation 2 and all future generations will receive the same implicit return on their taxes as long as population and per capita earnings continue to grow at the same rates.¹⁹

Thus, the analogy of an individual paying for his own insurance policy with contributions based on earnings is not applicable to social security. Unlike a private insurance firm, OASDI does not have to accumulate large reserve funds to meet its future financial commitments. When benefits promised to current workers come due, the funds will be provided out of tax revenues as of that future date. The financial soundness of the social security program does not depend as it does for a private insurance firm, on prudent financial management of present premium income, but rather on the Government's effective power of taxation. The Government's ability to collect taxes sufficient to provide adequate social security benefits in the future depends critically on the maintenance of a sound Federal tax system in a healthy, growing economy. The faster the rate of economic growth, other things equal, the lighter the burden of taxation that will be required to finance any given level of future social security benefits.

If social security taxes were increased enough to result in surpluses in the Government budget that were used to create a reserve fund, the consequences for the "financial soundness" of the program would hinge on whether the process affected the rate of growth of the economy. If the economy were at, or below, a full employment level of income when social security taxes were increased, and if the Government did not take some offsetting action, the result would be a fall in the level of income and a lower rate of growth. If, on the other hand, the Government offset the surpluses by expansionary monetary policy or by increased Government capital formation, the result would be a higher rate of growth. The point is that the creation of a social security reserve fund is, in the first instance, only a transfer of monetary claims from the private sector to the Government. The ultimate effect of this initial monetary transfer depends on a great many factors; it is certainly incorrect to assume that there is a mechanism that automatically transforms a Government reserve fund into increased stock of productive capital and, therefore, increases the rate of eco-

¹⁹ This point has been made many times, dating back to the basic article by Paul A. Samuelson, "An Exact Consumption-Loan Model of Interest With or Without the Social Contrivance of Money," *Journal of Political Economy*, vol. 66, No. 6 (December 1958), pp. 467-482. (See also Peter Diamond, "National Debt in a Neoclassical Growth Model," *American Economic Review*, vol. 60, No. 5 (December 1965), pp. 1126-1150; and Henry J. Aaron, "The Social Insurance Paradox," *Canadian Journal of Economics and Political Science*, vol. 32, No. 3 (August 1966), pp. 371-374.)