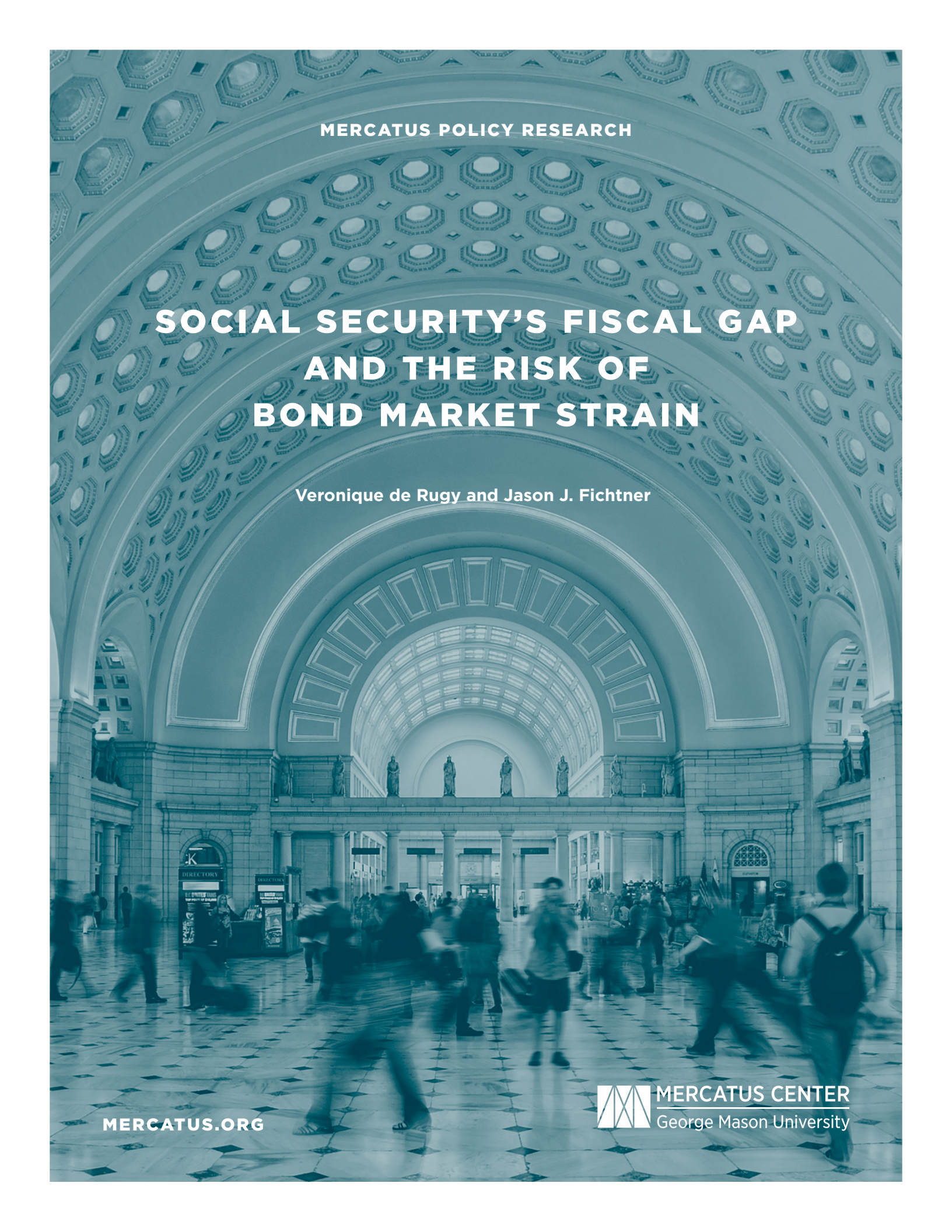




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SOCIAL SECURITY'S FISCAL GAP AND THE RISK OF BOND MARKET STRAIN

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Abstract

This paper examines how the impending depletion of the Social Security Old-Age and Survivors Insurance (OASI) Trust Fund could affect US Treasury financing, bond markets, and broader economic stability. The authors argue that Social Security’s long-term financing shortfall, combined with already rising federal deficits and debt, may become a critical fiscal inflection point in the early 2030s. Using both conventional bond-market analysis and the Fiscal Theory of the Price Level (FTPL), the paper explores how delayed reform could lead either to higher interest rates and borrowing costs or to inflationary adjustments that erode the real value of government liabilities. The authors contend that trust fund depletion is likely to prompt additional federal borrowing unless policymakers enact reforms beforehand. They identify potential early-warning indicators of market stress and conclude that earlier action would reduce fiscal risks, strengthen market confidence, and lessen the likelihood of disruptive economic and financial adjustments.

JEL codes: H55, H61, H62, H63

Keywords: Social Security, federal budget, deficits, debt

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The views expressed are the authors’ own and do not reflect the official positions of the Mercatus Center or George Mason University.

Introduction

For almost two decades, we have written about the unsustainable fiscal path of the United States and how the continued increase in deficit spending and federal debt is leading to a fiscal reckoning.¹ A growing body of policy research has recently assessed the rising costs of US debt and the potential impact on the bond market and the broader economy. While the US 10-year Treasury bond interest rate has generally remained within 4 to 5 percent post-COVID, over the past several months, market events have led to disruptions in the auctions for Treasury securities. These disruptions may be a harbinger of things to come, underscoring the importance of addressing major long-term fiscal challenges, such as the approaching depletion of the Social Security Old-Age and Survivors Insurance (OASI) Trust Fund and its current \$29.6 trillion unfunded liability through 2100.²

This paper examines how the approaching depletion of the Social Security OASI Trust Fund could interact with US Treasury financing conditions and broader bond-market functioning. Social Security's long-term cash-flow imbalance implies rising fiscal pressure. Because Social Security does not have its own borrowing authority, Trust Fund depletion would automatically reduce benefits to the level supported by current revenue unless legislative action is taken. To avoid an automatic reduction in benefits, policymakers must choose among benefit adjustments, revenue increases, or transfers from general revenues, which, given the current US fiscal position, would lead to increased federal borrowing. Because Treasury markets transmit fiscal stress through interest rates, inflation expectations, and financial conditions, with consequences for household budgets, this paper evaluates how a sustained Social Security financing shortfall—on the order of hundreds of billions of dollars per year—could

1. For overviews of the national debt, see Bipartisan Policy Center, "Our National Debt Visualized," May 17, 2023; and Veronique de Rugy, "Politicians Want to Avoid Reforming Social Security and Medicare. You Will Pay the Price," *Reason*, February 12, 2026.

2. Social Security Administration, 2026 OASDI Trustees Report, "F. Infinite Horizon Projections," last accessed June 17, 2026, https://www.ssa.gov/oact/TR/2026/VL_F_infinite.html.

change Treasury-issuance patterns, investor demand, and Federal Reserve (Fed) responses.

A “fiscal crisis” is often considered as a rapid deterioration in a government’s fiscal position, in which it can no longer pay its bills, outlays exceed revenues, and access to credit markets becomes impaired, eventually leading to a default of government debt or a “debt crisis.” Notable examples include Greece, Venezuela, and Argentina.³ Governments in the United States are also not immune to fiscal crises,⁴ as demonstrated by the bankruptcies of the City of Detroit and the Commonwealth of Puerto Rico.⁵ While a US default on the federal debt is highly unlikely, a fiscal crisis can take two forms: one in which a collapse in Treasury demand drives yields sharply higher, raising borrowing costs across the economy; and one, arguably more insidious, in which investors lose confidence that future government surpluses will be sufficient to back outstanding debt, causing the price level to rise as the market writes down the real value of government liabilities through inflation rather than through formal default.

We view the impending depletion of the Social Security OASI trust fund in the early 2030s as the inflection point that could lead to a fiscal crisis if legislative action is not taken beforehand.⁶ The central argument of this paper is that delaying reform increases fiscal risk and raises the likelihood that policymakers will resort to additional borrowing, thereby increasing strains on Treasury markets and the broader economy. We highlight potential early-warning indicators of market strain and discuss policy options that reduce fiscal risk while supporting market stability.

This paper examines the risks of fiscal inaction through two complementary analytical lenses. The first is the conventional view, which draws on bond-market dynamics. Under this view, sustained deficit spending crowds out and reduces private sector investment, while a debt-sustainability problem emerges

3. Dorothy Neufeld, “Ranked: The Largest Sovereign Debt Defaults in Modern History,” *Visual Capitalist*, August 12, 2024.

4. Christopher Migliaccio, “How Many US Cities Have Declared Bankruptcies? What We Can Learn,” Warren & Migliaccio, L.L.P., October 9, 2024 (last updated November 20, 2025), <https://www.wmtxlaw.com/cities-declared-bankruptcy/>.

5. Gene Amromin and Benjamin Chabot, “Detroit’s Bankruptcy: The Uncharted Waters of Chapter 9,” Chicago Fed Letter, No. 316, November 2013, Federal Reserve Bank of Chicago; and Financial Oversight and Management Board for Puerto Rico, “About Us,” last accessed June 17, 2026, <https://oversightboard.pr.gov/about-us/>.

6. According to the 2026 Trustees Report, the OASI trust fund depletion date is projected in 2032. If combined with the Disability Insurance (DI) trust fund, the hypothetical OASDI Trust Funds are projected to be depleted around 2034. See Social Security Administration, *The 2026 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, June 9, 2026, <https://www.ssa.gov/oact/TR/2026/tr2026.pdf>.

when interest rates exceed economic growth, making it increasingly difficult to stabilize the debt-to-GDP ratio because interest costs grow faster than the economy's capacity to support them. Rising deficits increase Treasury supply, push yields higher, raise borrowing costs across the economy, and over time erode the private capital stock and long-run growth. The second view, the Fiscal Theory of the Price Level (FTPL), offers a different mechanism. Under this view, when investors lose confidence that future surpluses will be sufficient to back outstanding government debt, the adjustment arrives primarily through a rising price level that erodes the real value of government liabilities. Bond prices may react as well, but a decline in bond prices is not required for the adjustment to occur. We present both frameworks because the evidence is alarming under either one and because both point to the same conclusion: Delay makes the eventual adjustment larger, harder to reverse, and more regressive, falling hardest on the fixed-income households Social Security is designed to protect.

Understanding the risks associated with Social Security's financing shortfall requires first understanding why debt matters and how fiscal stress can emerge through either higher borrowing costs or a rising price level.

Why Debt Matters

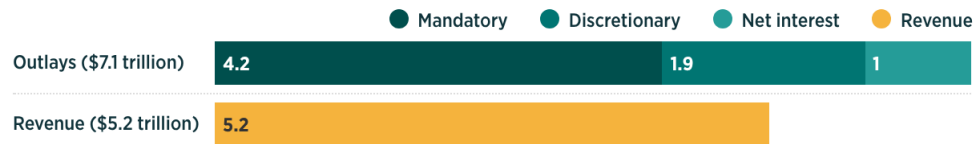
Debt matters for many reasons,⁷ but debt in and of itself is not a bad thing. Like individuals and families, governments borrow money to finance critical public services, infrastructure, and investment, and to respond to economic recessions through social safety net programs and economic stimulus policies. Borrowing allows for the funding of certain projects without having to raise taxes immediately to cover their costs. Taxes or fees can then be assessed to stretch out payment of the debt over the useful life of the project. For example, governments may issue debt to finance transit projects that have useful lives spanning decades.

A household analogy, though imperfect in important ways, can illustrate some dynamics of government borrowing.⁸ People borrow money to buy a house or a car, or to finance an education. While individuals also borrow money to finance consumption (for example, through the use of credit cards), it is generally not considered a good idea to borrow money for everyday expenses. Financial professionals make a distinction between “good debt” and “bad debt,” where

7. “Top 10 Reasons Why the National Debt Matters,” Peter G. Peterson Foundation, last updated February 27, 2026, <https://www.pgpf.org/article/top-10-reasons-why-the-national-debt-matters/>.

8. Tamara Keith, “How the Federal Budget Is Just Like Your Family Budget (Or Not),” *NPR: It's All Politics*, March 19, 2013.

FIGURE 1. The federal budget deficit in fiscal year 2025 (\$1.8 trillion)



Source: Congressional Budget Office, “The federal budget in fiscal year 2025: An Infographic,” March 30, 2026, <https://www.cbo.gov/publication/61950>.

good debt helps people increase their financial position (home) or generate future income (education), while bad debt decreases their net worth and does not generate future income (vacations, daily consumption expenses, clothes).⁹ When households rely on credit cards to finance too much spending in excess of their income, the resulting debt can lead to financial difficulty, crowd out other necessary expenditures, and, for some people, ultimately end in bankruptcy.

In the context of government budgets, when government spending exceeds revenue, governments can run a deficit and borrow to fill the gap. But if borrowing becomes too excessive and is considered “bad debt” because it is used primarily to finance current consumption rather than long-term investment, debt-financing costs can become so large that they crowd out funding for other public priorities, lead to tax increases, or require further borrowing. This can create a vicious cycle in which additional debt is used to fund past expenditures and increasing interest payments. Net interest on US debt is now the third-largest item in the budget (figure 1) and, under current policy, interest costs are projected to rise dramatically over the next decade (figure 2).¹⁰ Today, the US spends more on interest payments than on national defense (see figure 8, p. 12).¹¹

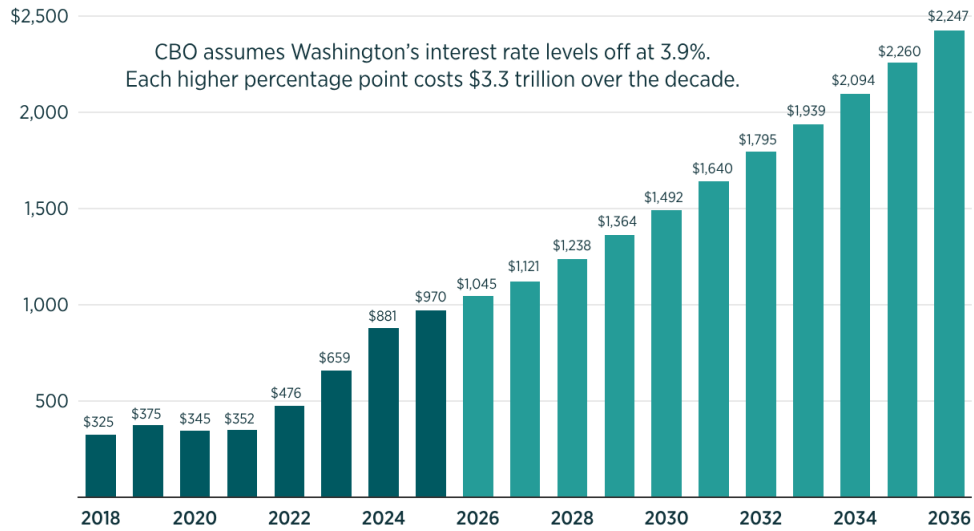
The federal government has run deficits in most years since the late 1970s, with recent deficits remaining well above their historical average (figure 3). Recent deficits have been historically large, and current policy projections

9. Fidelity Investments, “Good Debt vs. Bad Debt,” *Smart Money* (Learning Center), October 16, 2025, last accessed June 17, 2026, <https://www.fidelity.com/learning-center/smart-money/good-debt-vs-bad-debt>

10. “10 Largest Budget Functions,” Peter G. Peterson Foundation, last updated June 16, 2026, <https://www.pgpf.org/article/top-10-largest-budget-functions/>. <https://www.pgpf.org/article/top-10-largest-budget-functions/>

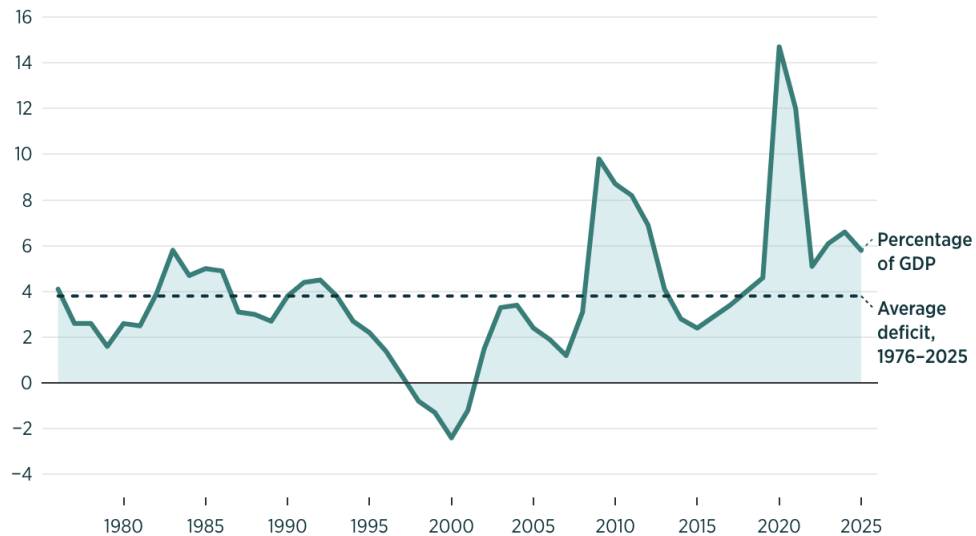
11. “What Is the National Debt Costing Us?,” Peter G. Peterson Foundation, updated February 12, 2026, <https://www.pgpf.org/article/what-is-the-national-debt-costing-us/>.

FIGURE 2. Projected interest costs on US debts in the next decade (nominal \$billions)



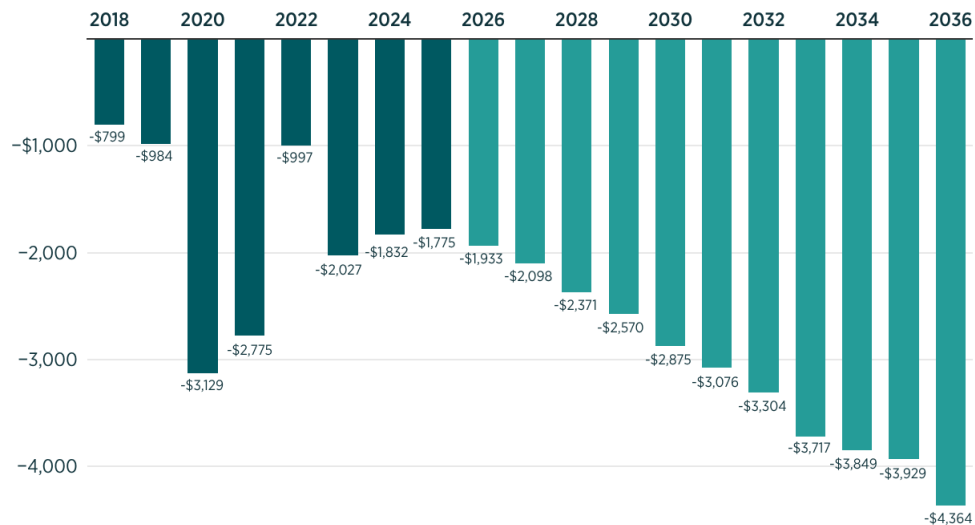
Source: Jessica Riedl, "Spending, Taxes, and Deficits: A Book of Charts" (The Brookings Institution, April 2026), slide 8, <https://www.brookings.edu/wp-content/uploads/2026/04/BudgetChartBook-2026.pdf>.

FIGURE 3. Federal deficit or surpluses, 1976–2025



Source: Congressional Budget Office, "The federal budget in fiscal year 2025: An Infographic," March 30, 2026, <https://www.cbo.gov/publication/61950>.

FIGURE 4. Predicted US federal budget deficits in the next decade (nominal \$billions)



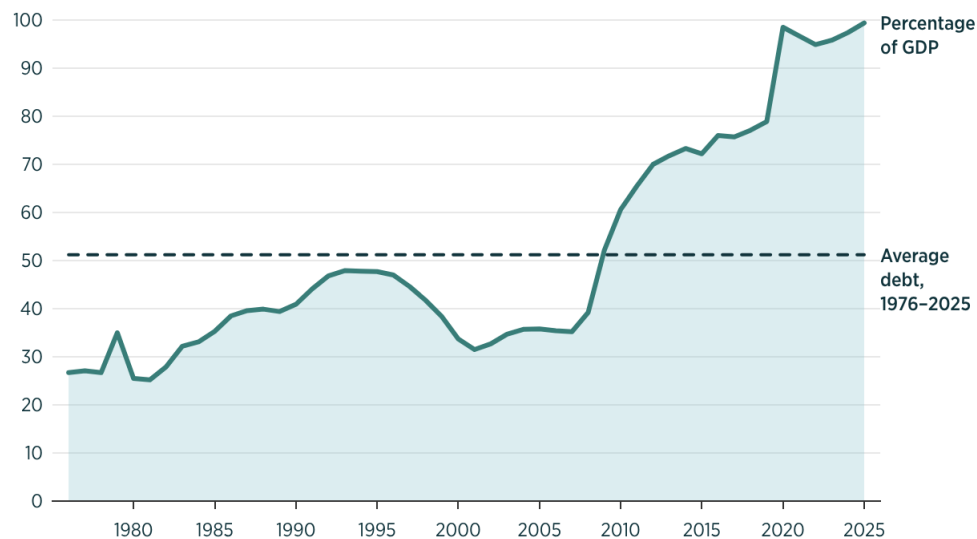
Source: Jessica Riedl, “Spending, Taxes, and Deficits: A Book of Charts” (The Brookings Institution, April 2026), slide 7, <https://www.brookings.edu/wp-content/uploads/2026/04/BudgetChartBook-2026.pdf>.

suggest they will continue to grow substantially over the coming decade (figure 4). Federal debt held by the public has also risen dramatically over the past several decades, reaching nearly 100 percent of GDP in 2025 (figure 5).

The household analogy captures the conventional concern well, but it has an important limitation. Unlike a household, the federal government issues the currency in which its debts are denominated. This means the adjustment to excessive borrowing need not take the form of default or bankruptcy. Instead, if investors come to doubt that future fiscal surpluses will be sufficient to back the outstanding stock of government debt, the market can write down the real value of those liabilities through a rising price level. In this sense, inflation can function as an unlegislated tax, one that reduces the real burden of government debt while simultaneously eroding the purchasing power of every household holding dollars, earning wages, or depending on fixed benefit payments. The analogy to a household that maxes out its credit cards and declares bankruptcy is therefore incomplete: For a currency-issuing government, the more troubling scenario is not that creditors cut off access to borrowing, but that the currency itself quietly loses its purchasing power while the debt remains nominally intact.

There is a legitimate discussion about how we frame the nation’s debt, whether we should be worried about a debt crisis, and what such a crisis might

FIGURE 5. Federal debt held by the public, 1976–2025



Source: Congressional Budget Office, “The federal budget in fiscal year 2025: An Infographic,” March 30, 2026, <https://www.cbo.gov/publication/61950>.

look like. For example, scholars at the Brookings Institution write that increasing debt levels are unlikely to “spark a fiscal crisis” while noting that “increases in federal debt will manifest as a slow and steady erosion of our capital stock and national wealth that will ultimately impair living standards.”¹² The Committee for a Responsible Federal Budget lists six forms of crisis (Financial Crisis, Inflation Crisis, Austerity Crisis, Currency Crisis, Default Crisis, and Gradual Crisis), all of which could be “sparked by a variety of factors.”¹³ All six possible crises are worrisome.

Too often, the likelihood of a debt crisis is framed as a binary event: Either there is no crisis, or markets panic, yields spike, and the government formally defaults. Some observers argue because there are no current signs of market panic attributable to the debt, nor a spike in interest rates, we are therefore still in the zone of calm fiscal waters.¹⁴

12. Wendy Edelberg, Benjamin Harris, and Louise Sheiner, “Assessing the Risks and Costs of the Rising US Federal Debt,” Brookings Institution, February 2025.

13. Committee for a Responsible Federal Budget, “What Would a Fiscal Crisis Look Like?” January 22, 2026.

14. Veronique de Rugy and Jack Salmon, “A Friendly Response to Alex and Tyler’s Discussion About the Debt,” *The Unseen and the Unsaid*, December 9, 2025, <https://www.theunseenandtheunsaid.com/p/a-friendly-response-to-alex-and-tylers>.

But this is an upside-down way of thinking about a debt crisis, and it misses the main reasons we worry about and fight against the continued accumulation of the national debt. Greece could borrow at reasonable rates until the day it could not,¹⁵ and by the time yields spiked, the window for orderly adjustment had closed. In other cases, inflation expectations were well anchored, as in the United States until 2021, until they were not.¹⁶ In neither case does the market provide a smooth, gradual warning, and it may not do so the next time fiscal risks emerge.¹⁷ In one scenario, yields gap up overnight. In the other, the price level shifts before policymakers recognize the problem. Waiting for a visible signal before acting is therefore a dangerous strategy under either framework. In the context of federal budgeting more generally, countries should curb spending during periods of economic growth and reduce debt in order to have the fiscal space needed to expand deficit spending during economic recessions. Now is the time to implement meaningful and thoughtful reforms that place the country on a sound financial track before bond-market pressures force changes that may be more immediate and inequitable.

This paper does not take a position on which Social Security reforms should be adopted. There are many Social Security reform proposals in the public domain that would achieve fiscal solvency.¹⁸ Instead, we are guided by the old proverb that one should “fix the roof when the sun is shining.” While we are not arguing that everything is sunny, we do foresee stormy times ahead. The Social Security trust funds are projected to become depleted within six short years (figure 6). The time is now to act and place Social Security back on sound financial footing.

The conventional and FTPL frameworks described above both point to the importance of addressing large fiscal imbalances early, and the projected depletion of the Social Security trust funds represents one of the most immediate challenges to long-term fiscal sustainability.

Social Security’s Financing Challenges

Social Security’s retirement and disability programs are financed largely on a pay-as-you-go basis: Today’s workers fund today’s beneficiaries, with trust-fund

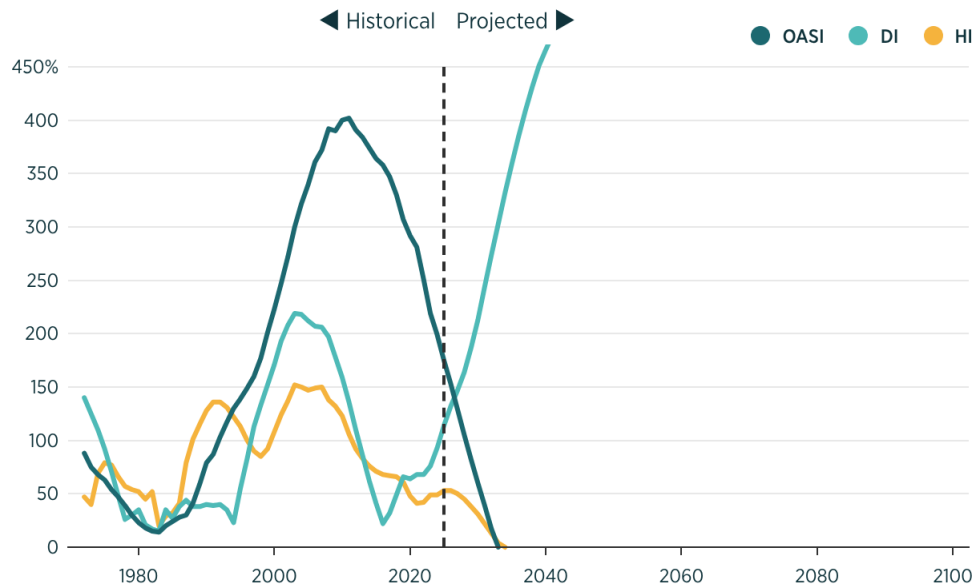
15. De Rugy and Salmon, “A Friendly Response.”

16. Ben S. Bernanke and Olivier Blanchard, “What Caused the US Pandemic-Era Inflation?” Hutchins Center on Fiscal and Monetary Policy, The Brookings Institution, June 2023.

17. “Markets Crisis,” *The New York Times*, February 13, 2026.

18. The Social Security Administration’s Office of the Chief Actuary scores and evaluates many proposals, which can be viewed here: <https://www.ssa.gov/OACT/solvency/index.html>.

FIGURE 6. The Old-Age and Survivors Insurance (OASI), Disability Insurance (DI), and Hospital Insurance (HI) trust fund ratios, 1972–2034



Source: Social Security Administration: A Summary of the 2026 Annual Reports," Chart D, last accessed June 17, 2026, <https://www.ssa.gov/oact/trsum/>.

accounting helping to smooth differences in the timing of inflows and scheduled outflows. Demographic change is the central challenge. As the baby-boom generation retires and life expectancy remains high relative to earlier decades, the ratio of workers to beneficiaries falls, reducing the tax base per dollar of promised benefits. Figure 7 highlights the importance of payroll-tax revenue to the federal fiscal system and underscores why slower growth in the payroll-tax base presents a challenge for Social Security financing. At the same time, real wage growth and productivity trends shape payroll-tax collections, while disability incidence, claiming behavior, and mortality trends influence outlays.

FIGURE 7. Total revenues FY 2025 (\$5.2 trillion)



Source: Congressional Budget Office, "The federal budget in fiscal year 2025: An Infographic," March 30, 2026, <https://www.cbo.gov/publication/61950>.

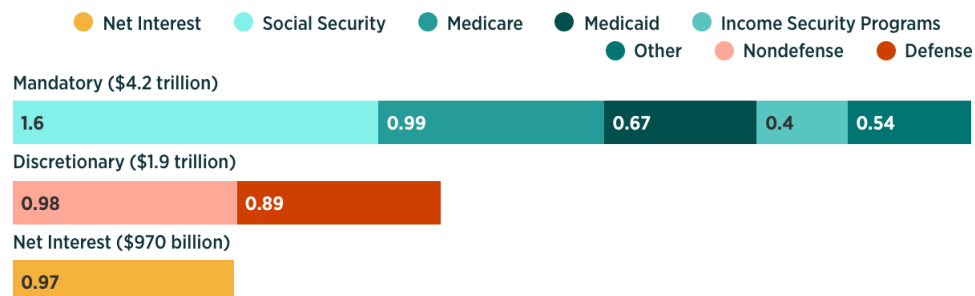
When payroll-tax revenue and other dedicated inflows fall short, the trust fund is drawn down through the redemption of Treasury securities it holds. Those redemptions do not create “new money”; they require the Treasury to obtain cash from the public—via taxes, spending reductions elsewhere, or new borrowing. Thus, as trust-fund balances decline, Social Security financing becomes increasingly intertwined with the government’s unified budget and the Treasury’s market-facing financing operations.

In most discussions, Social Security is framed as a distributional and inter-generational policy challenge. But it is also a macro-financial challenge because the program’s deficits can translate into sizable and persistent funding needs. Social Security is already one of the largest components of federal spending, alongside Medicare and Medicaid, while net interest has grown into one of the largest federal budget obligations (figure 8). Treasury securities are the world’s primary safe asset, widely used as collateral in repo markets—short-term lending markets—and held by banks, pensions, insurers, mutual funds, and foreign official institutions. If the supply of Treasuries rises rapidly, or if the composition of issuance shifts toward longer maturities, markets may require higher yields to clear, especially if private balance sheets are constrained or if foreign official demand slows.

These dynamics can create feedback loops: Higher yields raise federal interest costs, further worsening deficits and increasing issuance; higher discount rates can depress asset prices; and tighter financial conditions can slow growth, thereby reducing payroll-tax revenue.

Social Security’s structural deficit is not merely a challenge for bond market operations; it is a potential source of persistent fiscal inflation. The program’s

FIGURE 8. Total outlays FY 2025 (\$7.1 trillion)



Source: Congressional Budget Office, “The federal budget in fiscal year 2025: An Infographic,” March 30, 2026, <https://www.cbo.gov/publication/61950>.

long-run imbalance reduces the expected path of future primary surpluses available to back the existing stock of nominal government liabilities. When investors assess whether those liabilities are backed by sufficient credible future revenues, the answer shapes not just yields but the price level itself. A fiscal trajectory that appears unsustainable does not simply push yields higher; it erodes confidence in the real value of outstanding debt, creating inflationary pressure as the price level adjusts to equilibrate the government's intertemporal budget constraint. Seen through this lens, the Social Security shortfall is not a problem that can be deferred without consequence: Each year of delay increases the size of the fiscal correction required and reduces the credibility that such a correction will be delivered, thereby raising the probability of a price-level adjustment.

A feedback dynamic also operates through the price level. If the fiscal trajectory loses credibility, the price level adjusts upward. This reduces the real value of outstanding nominal debt, but the relief is neither chosen nor benign: The same inflation that writes down the government's real liabilities simultaneously erodes the purchasing power of fixed-income retirees, wage earners, and savers. It is an unlegislated tax on households least able to absorb it. And it is self-undermining: If inflation reduces real economic activity and future tax revenues, the expected surplus path deteriorates further, requiring another round of price-level adjustment. Each cycle leaves the fiscal position harder to stabilize. Evaluating these channels is essential for policymakers who aim to preserve both retirement security and financial stability.

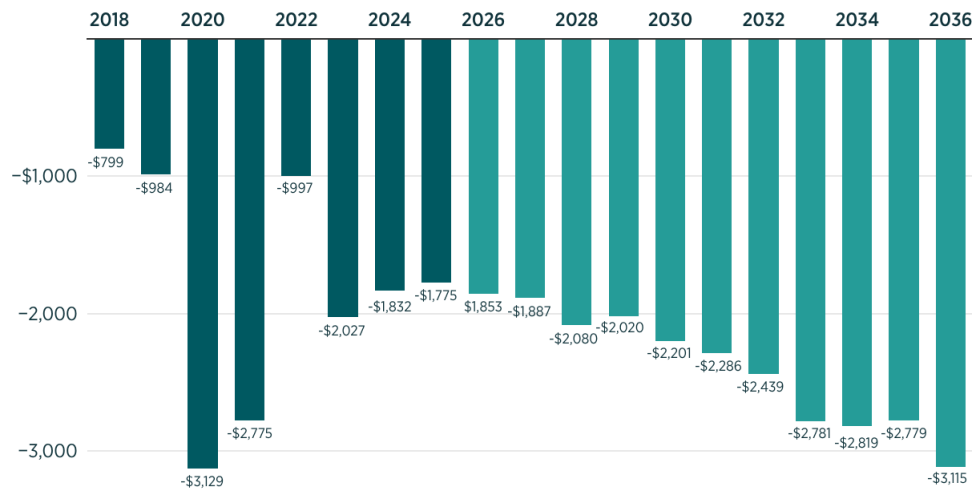
Trust fund depletion is often misunderstood. It is important to note that Social Security is not going “bankrupt.” The Social Security trust funds hold special-issue Treasury securities, which represent a legal claim on the Treasury but are not marketable assets that can be sold to the public.¹⁹ When the program runs a cash deficit, the trust funds redeem these securities, and the Treasury must provide cash by raising revenue or borrowing from the public. Once the trust fund balance reaches zero, Social Security is prohibited from paying benefits in excess of current dedicated income under current law, absent congressional action.

In a way, Social Security is technically “solvent” because benefit payments cannot exceed existing revenue, which means that, without congressional action, benefits will be reduced by approximately 22 percent when the OASI trust fund is depleted.²⁰ It is hard to believe, however, that Congress will allow

19. Social Security Administration, Office of the Chief Actuary, “Investment Holdings of the OASI and DI Trust Funds,” last accessed June 17, 2026, <https://www.ssa.gov/oact/progdata/investheld.html>.

20. Social Security Administration, *2026 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, <https://www.ssa.gov/oact/TR/2026/tr2026.pdf>.

FIGURE 9. CBO current-law baseline shows rising deficits (nominal \$billions)



Source: Jessica Riedl, “Spending, Taxes, and Deficits: A Book of Charts” (The Brookings Institution, April 2026), slide 6, <https://www.brookings.edu/wp-content/uploads/2026/04/BudgetChartBook-2026.pdf>.

approximately 70 million Social Security recipients to experience a roughly 20 percent reduction in benefits overnight.²¹ Rather, when the OASI Trust Fund is depleted, Congress is more likely to turn to borrowing to cover the shortfall, either temporarily to allow time for more deliberate reform or permanently as an ongoing source of financing.

Social Security’s financing challenge is occurring against a backdrop of already-rising federal deficits under current law (figure 9). Even before accounting for any congressional response to trust fund depletion, CBO projects deficits to grow substantially over the coming decade. Any decision to finance Social Security shortfalls through additional borrowing would therefore be layered onto an already deteriorating fiscal outlook.

By one estimate, the shortfall between 2032 and 2036 will total approximately \$2.8 trillion.²² In 2033 alone, the annual shortfall is approximately \$600 billion, and by 2036 the annual gap grows to around \$700 billion. This additional

21. Social Security Administration, Office of the Chief Actuary, “OASDI Beneficiary Statistics,” last accessed June 17, 2026, <https://www.ssa.gov/oact/STATS/OASDIbenies.html>.

22. Jonathan Schwabisch, “Social Security Is Running Out of Money—And Congress Might Count It as Savings,” *Urban Wire*, February 16, 2026.

amount of borrowing would be on top of the estimated \$2.7 trillion deficit and US national debt of \$46.5 trillion in 2033 (118 percent of GDP).²³

Financing Social Security's shortfall ultimately comes down to combinations of (1) benefit changes, (2) revenue increases, and (3) borrowing, whether through explicit debt issuance for the program or general-revenue transfers that are themselves deficit-financed. Each approach has distinct economic and distributional implications, and each interacts differently with financial markets. Benefit reductions can lower government outlays but may reduce consumption among retirees, while revenue increases can affect labor supply and disposable income. Under the conventional framework, borrowing can smooth near-term impacts but may raise interest costs and increase exposure to market sentiment, thereby contributing to higher inflation costs for American households and furthering the current affordability crisis.²⁴ Under the FTPL framework, borrowing without credible fiscal backing can trigger a price-level adjustment with all the consequences of inflation on beneficiaries and the economy.

Market Effects of Social Security Borrowing

The channels through which Social Security-related borrowing affects financial conditions differ across the two frameworks developed in this paper, and each deserves attention.

Treasury supply and investor demand

Under the conventional view, as Social Security redeems trust-fund securities and the unified deficit widens, the Treasury must increase net issuance to the public. The market impact depends not only on the size of additional borrowing but also on maturity choices. Greater reliance on Treasury bills can reduce near-term interest costs but increases rollover risk and sensitivity to short-term rate volatility. Shifting issuance toward longer maturities can lock in funding but may lead to increased long-term interest rates if investors demand additional compensation for duration risk, especially in periods when inflation uncertainty is elevated and investors believe fiscal restraint will not be forthcoming.

23. Congressional Budget Office, *The Budget and Economic Outlook: 2023 to 2033*, Visual Summary Handout, February 2023; and Congressional Budget Office, *The Budget and Economic Outlook: 2023 to 2033*, February 2023.

24. Hannah Stephens and Andre M. Perry, "In Every Corner of the Country, the Middle Class Struggles with Affordability," Brookings Institution, December 2, 2025.

Treasury securities are purchased by a diverse set of investors: households indirectly through mutual funds, banks and dealers for liquidity and regulatory needs, pensions and insurers for duration matching, foreign private investors seeking safe assets, and foreign official institutions managing reserves. The question is not whether Treasuries will be “saleable,” but at what price and under what conditions. Higher supply generally requires either higher yields or a shift in who holds the marginal security.

Investor capacity depends on both preferences and constraints. Banks may hold Treasuries for liquidity but are constrained by capital requirements, leverage ratios, and interest-rate risk management. Money market funds prefer short maturities and are influenced by the level of short-term rates and the size of the Federal Reserve’s overnight reverse repo facility.²⁵ Pensions and insurers value long-duration assets but must manage funded status, solvency rules, and asset-liability matching. Foreign demand depends on reserve-management objectives, exchange-rate policy, geopolitical considerations,²⁶ and relative yields versus other sovereign debt.

When the marginal buyer shifts from price-insensitive holders, such as some foreign reserve managers, to more price-sensitive private investors, the yield required to clear auctions may rise. This shift can show up as higher term premia (the extra yield investors demand to hold longer-term debt),²⁷ steeper yield curves, and more volatile auction outcomes, especially if primary dealers are forced to temporarily warehouse supply and balance-sheet constraints limit their intermediation capacity.²⁸

Treasury auctions provide real-time information on demand.²⁹ Common indicators include bid-to-cover ratios, “tails” (the difference between the stop-out yield and the pre-auction when-issued yield), the share awarded to indirect bidders, and the fraction taken by primary dealers.³⁰ Episodes of Treasury market stress illustrate that even the deepest sovereign bond market can experience

25. Federal Reserve Bank of New York, “Repo and Reverse Repo Agreements,” Markets & Policy Implementation, <https://www.newyorkfed.org/markets/desk-operations/repo>.

26. Reuters, “US Equity Funds See Biggest Outflows in Eight Weeks on Geopolitical Worries,” March 6, 2026.

27. Federal Reserve Bank of St. Louis, “The Term Premium,” *FRED Blog*, May 12, 2025.

28. Federal Reserve Bank of New York, “Primary Dealers,” Markets & Policy Implementation, <https://www.newyorkfed.org/markets/primarydealers>.

29. US Department of the Treasury, “Treasury Securities Auction Results,” Treasury Direct, <https://www.treasurydirect.gov/auctions/>.

30. Caleb Quakenbush, Upamanyu Lahiri, and Aaron Till, “Tracking the Bond Market and US Fiscal Health,” Bipartisan Policy Center, September 23, 2025.

temporary dislocations when leverage constraints bind or risk appetite shifts quickly. Persistent fiscal deterioration raises the probability that such episodes will become more frequent or more severe.

Borrowing, interest rates, and household costs

Higher Social Security–related borrowing will contribute to rising interest rates through several channels. First, increased Treasury supply can push up yields directly if demand is not perfectly elastic. Empirical research over the past two decades has found a consistent relationship between rising public debt and higher long-term interest rates, with estimates typically ranging from three to six basis points for each percentage-point increase in the debt-to-GDP ratio.³¹ Second, larger deficits may raise inflation expectations or uncertainty about future fiscal adjustments, increasing term premia. Third, if higher government borrowing coincides with strong private credit demand, crowding-out effects may emerge as borrowers compete for funds. Over time, sustained government borrowing that displaces private investment reduces the capital stock, lowers productivity growth, and shrinks the tax base, making Social Security’s structural deficit worse than currently projected.

These yield increases ripple directly into household budgets. Mortgage rates tend to move with intermediate and long-term Treasury yields, and even modest increases can materially change monthly payments and housing affordability. Auto loans and other types of consumer credit are sensitive to interest rates, while student borrowing costs can also be influenced by Treasury yields. For example, the Committee for a Responsible Federal Budget notes that “if the current neutral rate on ten-year Treasury bonds is 4.0%, general funding for Social Security could push it up to 6.6%. If the average rate for a 30-year fixed rate mortgage is around 6.3%, general funding for Social Security could push it to near 9.0%.”³² Any additional increase in interest rates would act as a tax on consumers and the economy, exacerbating the current affordability challenges facing Americans.³³

31. Jack Salmon, “The Impact of Public Debt on Interest Rates” (Mercatus Policy Brief, Mercatus Center at George Mason University, May 2025).

32. “Social Security General Revenue Funding Would be a Costly Mistake,” The Committee for a Responsible Federal Budget, November 17, 2025.

33. For an overview of “affordability,” see Urban Institute, “The American Affordability Tracker,” updated April 2, 2026, and accessed April 30, 2026, <https://www.urban.org/data-tools/american-affordability-tracker>.

Higher interest rates also raise the government's own net interest costs as maturing debt is rolled over at higher yields and new deficits add to the existing stock of debt. This creates a vicious cycle: Deficits increase debt, debt increases interest payments, and interest payments widen deficits further. The case for early reform is straightforward under the conventional view. The sooner reforms occur, the more gradually adjustments can be implemented; the longer they are delayed, the more likely policymakers are to face abrupt changes forced upon them by the bond market.

Inflation and fiscal dominance

Meanwhile, unlike the conventional yield channel, an FTPL-style adjustment can occur while auction metrics remain orderly. This means conventional bond-market indicators may provide little warning of a fiscal crisis operating through the price level rather than through yields. Deep global demand for Treasuries, sustained by the dollar's reserve currency status, may suppress the yield signal even further and may also delay the price-level adjustment by sustaining demand for dollar-denominated assets even as fiscal fundamentals deteriorate. But reserve currency status does not eliminate the adjustment; it may simply defer it, potentially allowing the gap between fiscal fundamentals and market signals to widen until the correction arrives more abruptly. If global investors revise down their expectation of future primary surpluses backing dollar-denominated liabilities, the primary FTPL adjustment occurs through a rising domestic price level that erodes the real value of outstanding nominal debt. Dollar depreciation may accompany that adjustment, but it operates through a distinct channel and should not be conflated with the price-level mechanism itself.

The Federal Reserve sits at the center of this dynamic. If the Fed attempts to resist the price-level adjustment by tightening monetary policy without a corresponding fiscal correction, it risks raising debt-service costs, worsening the surplus path, and accelerating the very dynamic it is attempting to contain. If instead the Fed accommodates fiscal pressures, it allows inflation to substitute for the legislative correction that should have occurred. That is fiscal dominance, a situation in which fiscal pressures limit the Fed's ability to control inflation without worsening debt dynamics, and it is the terminal condition this paper argues Social Security reform is necessary to avoid.

The case we are making is that the sooner reforms occur, the more gradually adjustments can be implemented, while the longer reforms are delayed, the more likely policymakers will face the need to make abrupt changes that are

forced upon them by the bond market.³⁴ Time is running out, as Social Security’s impending OASI trust fund depletion in about six years will be a forcing event.³⁵

Early Warning Signs

Under neither the conventional view nor the Fiscal Theory of the Price Level does a crisis announce its arrival clearly. Under the conventional view, stress builds gradually in auction metrics and yield dynamics before it becomes acute. Under FTPL, the adjustment can arrive through inflation before any conventional bond-market indicator flashes red. While both frameworks point to the risks of fiscal deterioration, they imply different early-warning indicators and different channels through which those risks become visible.

Under the conventional view, early-warning indicators can help distinguish routine market fluctuations from emerging structural strain. No single metric is conclusive or predictive. However, by monitoring several indicators—including auction outcomes, secondary-market liquidity, repo market conditions, volatility, and measures of risk compensation such as term premia—one might be able to gain a sense of whether bond-market health is deteriorating and a crisis is at hand. Persistent deterioration across multiple indicators may signal that the marginal cost of financing is rising and that market health is declining.³⁶

The Bipartisan Policy Center recently began publishing a series of graphs and metrics to monitor the bond market and Treasury auctions (figures 10 and 11).³⁷ Recent auctions have occasionally featured larger tails, softer bid-to-cover ratios at certain maturities, and periods of heavier primary dealer coverage—often coinciding with heightened rate volatility and changes in Federal Reserve balance-sheet policy.

It is important to note the role that primary dealers play in Treasury auctions. Primary dealers are supposed to buy up any debt issuance that is not purchased in an auction. Primary dealers are a backstop and, if they play their role, an auction can never technically fail. The number of primary dealers, however, has recently declined, and the Treasury Department is experiencing difficulty

34. Heather Long, “Welcome to the New Era of US Debt, Where the Bond Market Is King,” *Expert Views: Lessons from History for America Today*, Peter G. Peterson Foundation, November 2025.

35. Veronique de Rugy, “When the Trust Funds Run Dry: The Price Level May Do the Adjusting If Congress Doesn’t,” *The Unseen and the Unsaid*, November 19, 2025.

36. David Wessel, “How to Tell If the US Treasury Is Having Trouble Borrowing in the Bond Market,” Hutchins Center on Fiscal and Monetary Policy, The Brookings Institution, July 23, 2024.

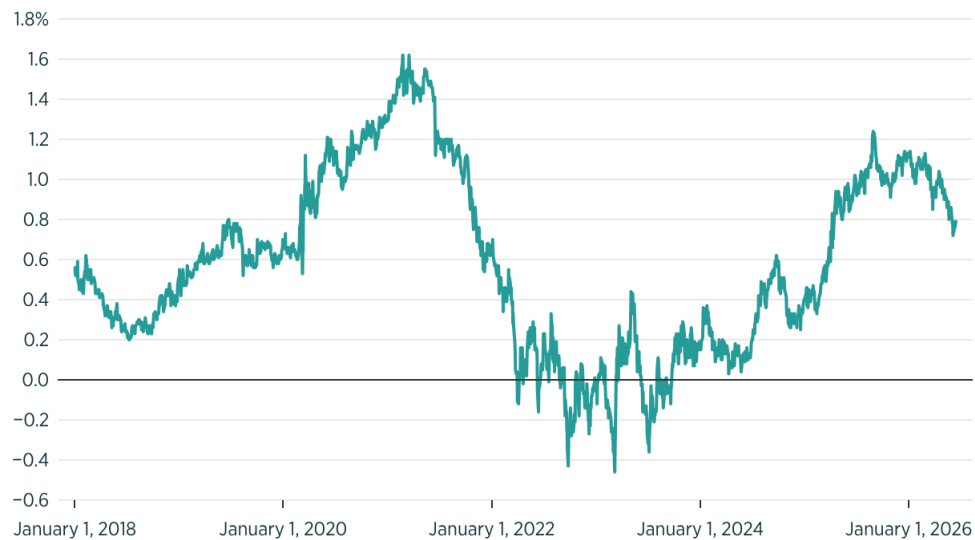
37. Quakenbush et al., “Tracking the Bond Market and US Fiscal Health.”

FIGURE 10. 10-year Treasury security yields



Source: Caleb Quakenbush, Upamanyu Lahiri, and Aaron Till, "Tracking the Bond Market and US Fiscal Health," Bipartisan Policy Center, September 23, 2025.

FIGURE 11. Difference in market yields between US Treasury securities at 30-year and 5-year maturity



Source: Caleb Quakenbush, Upamanyu Lahiri, and Aaron Till, "Tracking the Bond Market and US Fiscal Health," Bipartisan Policy Center, September 23, 2025.

recruiting new ones.³⁸ This could reduce the capacity of primary dealers to support future Treasury auctions.³⁹

It is also worth asking whether some of these warning signs are already present. The 2021–2023 inflation surge has not fully resolved to the Fed’s 2 percent target. It may be ticking back up. Long-run survey-based inflation expectations have drifted modestly but persistently above target. TIPS (Treasury Inflation-Protected Securities) breakeven rates on longer maturities suggest markets are not fully convinced that inflation will remain anchored over the coming decade. In other words, what looks like a post-pandemic normalization may instead be unfinished fiscal reckoning.

But there is another way to look at the relative calm in Treasury markets, and it is one that explains why we should not take it as evidence that investors have already priced in the Social Security borrowing scenario. It could be that markets are, for now, assigning a meaningful probability to Congress adopting a fiscally responsible resolution, some combination of benefit adjustments and revenue increases that avoids large-scale unfunded borrowing. If Congress instead resolves the shortfall primarily through borrowing without credible fiscal backing, the market’s revision will not be gradual, nor will the adjustment of the price level that follows.

We are not predicting imminent crisis. But an honest reading of both frameworks is that the early warning signs may not just be approaching. They may already be here, in nascent form, across multiple indicators simultaneously. The case for acting now on Social Security reform does not rest on a forecast of future stress. Rather, it rests on the observation that the stress has already begun, and that the OASI trust fund depletion in 2032 will convert a manageable deterioration into a forcing event that arrives with or without congressional preparation.

Conclusion

This paper argues that the longer Congress waits to reform the program, the larger the required adjustment becomes. The larger the required adjustment, the more politically painful explicit reform becomes. The more politically painful explicit reform becomes, the more likely Congress is to reach for the easiest

38. “Monetary Policy Task Force Examines the Primary Dealers and Balance Sheet Constraints,” House Committee on Financial Services, press release, December 2, 2025.

39. Paul Cochran, Lubomir Petrask, Zack Saravay, Mary Tian, and Edward Wu, “Assessment of Dealer Capacity to Intermediate in Treasury and Agency MBS Markets,” *FEDS Notes*, Federal Reserve Board, October 22, 2024.

option, which is borrowing. Borrowing is precisely the option that activates both crisis channels.

Framing a fiscal crisis as a binary all-or-nothing event provides a false sense of calm. The two frameworks developed in this paper differ substantially in their mechanics, but they agree on this: The adjustment, when it comes, may not announce itself with sufficient warning for an orderly legislative response.

From a fiscal and financial perspective, earlier reform can reduce expected future debt issuance, stabilize long-run debt dynamics, provide some certainty to markets, and lower the risk that the Treasury market must digest sharply higher supply during an adverse macroeconomic environment. Social Security reform is therefore not only a retirement policy imperative but also a fiscal and market-stability and imperative.

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