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SOCIAL SECURITY: FUTURE FINANCIAL VIABILITY

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o Debate on the future of the Social Security Program.

MR. WILLIAM DAVID SMITH: This afternoon's session is a debate on the future financial viability of the United States Social Security system. Social Security and its related programs, such as Medicare, are widely considered the signal triumph of Federal domestic policy in this century. It is, in truth, a major accomplishment in that a floor of financial dignity has been built for almost everyone in this country over age 65. However, on the way to accomplishment it has become something of a political sacred cow. In part, that is caused by the natural human tendency toward reverence for our parents and consequently toward all the elderly. But in some part, it is also the result of a conscious political decision to provide titles for certain sections of the system. Those titles are mere words, but they are words like "contribution", "insurance", "trust fund", and "earned right". Those words have created a wrong impression on the public.

The program is mainly a straightforward tax distributed immediately to the retiree. I don't say that as a criticism, because I honestly can't conceive of how else such a program could be structured and run. But it has created a misunderstanding. That misunderstanding is an advantage and a disadvantage. The advantage is that the program is hard to change. The disadvantage is that the program is hard to change. Whether you view that characteristic as an advantage or a disadvantage is purely a function of your viewpoint.

There are some economic facts that have created some fairly significant changes. I am going to give you some facts taken from a newspaper article, so I can't attest to their validity. It is possible that one or both of our panelists might have an idea how valid these points are. There are four. The first is that since 1970, in real terms (that is, after adjustment for inflation), while Social Security benefits have increased 46%, wages and salaries have decreased 7%. Social Security, of course, touches the retiree, and salaries and wages touch the active part of our population. The second point is that major forms of Federal aid to children have decreased in real terms in the last five years. Third, in 1970 an elderly person was more likely to be impoverished than a child. In 1985, a child was six times more likely to be impoverished than an elderly person. The fourth point is that young adults have fewer financial resources and a stiffer tax penalty than their parents had at the same age. That violates an article of faith that each generation ought to be better off than the preceding generation.

Some of what has happened may be temporary. Part of it may be the result of an era of high inflation, low real wage growth, and runaway housing costs. All of these have tended to hurt the young working member of our society. But some of what has happened is directly related to Federal programs of which Social Security is a major part. So, we are suddenly facing the possibility (and there have been statements to this effect by various members of Congress) that we have enriched our elderly by impoverishing our youth, and Social Security has played a significant role in that. If that is so, some changes are needed. I believe it is naive to think that Social Security (or for that matter, any other tax or Federal program) is finished and will not need further adjustment. All such programs must be adjusted for ever-changing economic conditions. That follows directly from the immediate transfer of tax from the producer to the consumer. The question is how, when, and whether Social Security can be adjusted appropriately.

Our speakers today have much in common. They are both Fellows of the Society of Actuaries; they are both senior members, and very influential members, of our Society of Actuaries. Bob Myers is a past president of the Society; Haeworth Robertson is currently a vice president. Perhaps most important, they have both been, as part of their careers, chief actuaries of the Social

Security system. Both have written many books and articles on the subject of Social Security. Both currently spend a major part of their time on the problems of the Social Security system. Despite this common background and knowledge, they have different viewpoints on how Social Security can be changed, and whether it is politically possible to save the fundamentals of the system. Bob Myers, professor emeritus at Temple University, is going to lead off.

MR. ROBERT J. MYERS: I am sorry that I must break one of the rules of debates. The debaters are supposed to debate each other, and not the moderator. Some things which Bill said were quite correct, but I take strong exception to several others. I argue that benefits have not increased by 46% in real terms since 1970. Likewise, I think that the figures on poverty which he quoted are not correct. I think that poverty figures are not too meaningful, but if the government's poverty figures are considered, the poverty level of the aged is about the same as the average for everybody else and is not a small fraction of the overall average.

Now let me get on with my prepared debate. I've included two appendixes. Appendix 1 is a fun job I had for the House Committee on Aging -- preparing a report card for Social Security on its 50th birthday, which occurred last year. Appendix 2 is an advertisement that appeared in the *New York Times* and the *Washington Post*, signed by about a hundred private pension professionals (including me). It is a declaration of confidence and support of the Social Security system, which supports my position. A number of prominent actuaries were also signers, including Jim Swenson.

As a background for my remarks, I would like to discuss what I consider three philosophies of Social Security, so that it can be seen which philosophy I adhere to. Then perhaps, there can be detected any bias in the following remarks.

At the one extreme is the expansionist philosophy, which believes that governmental programs should provide almost complete economic security for everybody, so that only the very highest-paid, highest-income people should do anything for themselves. At the moment, with all the budget cutbacks and the general feeling in the country, the expansionists are quite willing just to maintain the status quo until some later day, when there will be an opportunity to expand the program.

The other extreme is the contractionist philosophy. In essence, it says, let us do away with Social Security by phasing it out gradually. Let us introduce means tests into the program, or let us make it a voluntary program. The difficulty with this latter procedure is the matter of anti-selection. If people opt out individually, the low-cost, low-risk groups will do so. The high-risk, high-cost groups will stay in. As a result, program costs will snowball. The problem with introducing a means test (or a needs test) into Social Security is that, then, many people will not bother to save at all. Those who might get a small pension from their employer would rather have more current money in wages because their pension will be a deduction against their needs-tested Social Security benefit. Thus, any such approach would really do the converse of what the people who support it want -- that is, to put more economic-security efforts into the private sector.

Obviously, between these two extreme approaches, there is what I call the moderate approach. It holds that Social Security should be a basic floor of protection on top of which people can, should, and will build various private-sector economic activities such as pension plans, private savings, insurance, and so forth. I suppose that it is obvious by this time which philosophy I believe in -- namely, the moderate one. I strongly support Social Security, but at the same time I think that it should provide only a floor of protection, and that most people in the country, in one way or another, should build on top of it to provide the necessary economic security when the risks of old age, premature death, or disability occur.

A basic question is, "What does the phrase 'Social Security' mean?" Unfortunately, words have different meanings for different people. If the average person on the street in the United States were asked what Social Security means, he or she would describe, more or less, the Old-Age, Survivors, and Disability Insurance program (OASDI) -- in other words, our national pension system.

Other people use this term more broadly and say that it includes Medicare as well -- because Medicare is one of the titles of the Social Security Act. I noticed our distinguished moderator used the phrase "Social Security" about five out of six times to mean only the OASDI program, but once he used it to include Medicare.

Still other people, particularly internationally, would use the term "Social Security" even more broadly -- to include any types of governmental programs that protect people in this industrial, urbanized world against the various economic risks that might befall them (thus including unemployment insurance, health insurance, complete health care, and so forth).

From this point on, I will cease using the phrase "Social Security" because of its ambiguous meaning. I will use the Washington alphabetese of "OASDI" and "Medicare." I think that consideration of these two programs must be done separately. They are two distinct types of programs. One essentially provides services, while the other provides cash benefits. Although there is some linkage between the two programs, because the same payroll tax supports both programs, I believe that they should and must be considered separately.

When the National Commission on Social Security Reform was given its assignment in late 1981, it was told that the problem which it should look at was the OASDI program, and not the Medicare program. The Commission did recognize that the Hospital Insurance (HI) portion of Medicare will have financing problems in the future, but the immediate problem was what to do about the OASDI program and its impending bankruptcy.

Now, let us look at each of these programs separately. As for OASDI -- and this point is widely misunderstood, at least by some in the press -- when the reform legislation was passed in 1983, it was decided that the financing established should be such as to make the system viable during the 1980's even under rather adverse economic conditions and not merely under intermediate or "most likely" conditions. It was recognized that it is not possible to assure that the system would be viable under any and all economic conditions, because one could always dream up even worse conditions -- much worse, say, than in 1933.

Accordingly, the financing was based on quite pessimistic economic assumptions during the 1980's, although many people believe that it was based on the intermediate assumptions. The latter procedure was followed in 1977, with rather disastrous results. So, some people have said, "We'll have another financing crisis in three or four years. You just can't believe government officials when they say that the system is now adequately financed. They're basing the financing once again on the intermediate assumptions, but suppose conditions get worse?"

You may recall that the National Commission said that to solve the problem in this way would require providing $150 to $200 billion more of either increased income or decreased outgo in the 1980's. That, the Commission believe, should insulate the system against very pessimistic economic conditions. As to the actual package which was enacted, it was stated that $168 billion of additional resources would be available in the 1980's. One might criticize that by saying that $168 billion was not even in the middle of the range.

Once again, there was a problem of public understanding because the two sets of estimates, perhaps unfortunately, were based on different economic assumptions. The estimate of $150 to $200 billion was made under the assumption there would be relatively high inflation during the rest of the 1980's, with CPI increases of around 8 percent per year. By the end of 1982, the economists had "discovered" that now they knew the answer: there was going to be 4 or 5 percent inflation, such as we are currently having. So, at the moment, they are on track, but I would not bet that this will happen in the rest of the 1980's.

At any rate, the new estimate of $168 billion, as the additional resources needed to be made available in the 1980's, was based on these lower inflation assumptions. If it were converted on the basis of the previous assumptions, it would have been around $185 billion. So thereby, I draw the conclusion that the 1983 Act did finance OASDI on a very conservative basis in the 1980's by assuming quite pessimistic future economic conditions then.

In the long range, the intermediate assumptions were used, as they always have been. They seem fairly reasonable. There is no reason to believe that any real reason for changes in them should now be made. The system was shown to be in close actuarial balance over the long-range, 75-year period. Of course, estimates were made using both optimistic and pessimistic conditions, which yielded quite different results.

When the long-range cost estimates presented in the latest trustees' report are considered, under the intermediate estimate, the HI program contributes 87% of the long-range deficit, and only 13% is due to OASDI. If the pessimistic estimate is used, the corresponding proportions are 62% of the deficit due to HI and 38% due to OASDI.

The experience to date following the 1983 legislation has been very favorable. So far, the experience has been better than even the intermediate estimate -- let alone the pessimistic estimates on which the financing was based. The OASDI Trust Funds at the end of 1985 were $18 billion higher than the original pessimistic estimate, and $10 billion higher than the intermediate estimate. In fact, the OASDI Trust Fund has grown to such a size that complete repayment of the loan from the Hospital Insurance Trust Fund was made last January, which was far ahead of schedule.

In the 1990's, if present law remains unchanged, it is likely that there will be a huge buildup of the fund, because then demographic conditions will be very favorable as far as OASDI is concerned. The numbers of annual births in 1925-39 were relatively low, and therefore the number of people reaching retirement age each year in the 1990's and early 2000's will be lower than those presently occurring. So, as a result not only of that trend, but also of the buildup in the labor force and the scheduled increases in the tax rates in 1988 and 1990, the financing problems will be much less in the 1990's, and the scheduled income will greatly exceed the outgo each year. Some may question, and I certainly do, whether it is desirable to build up such large funds. However, at least this is a safety factor, because it is always much easier to cut back on taxes than to try to raise them.

Now, this brings me to what changes should be made in the OASDI program to assure that it is on a sound financial basis. What I would do first would be to change the present funding method, which I consider to be most undesirable.

The system ostensibly is financed on a pay-as-you-go basis, but one can hardly call it that, because of this huge buildup in the trust funds in the 1990's and early 2000's. The OASDI trust funds combined will peak at a level of about 5 times the annual outgo, which will be a very high figure both in current dollars and in nominal dollars. If the fund were that large today, it would be almost $1 trillion. That would result in the trust fund's owning a very substantial part of the national debt if it were invested in government bonds, which is the only appropriate way of investing it. But then, this fund will be used up following about 2030, and eventually it will be exhausted, around 2050.

I contend that this is no way to finance a social insurance system or a pension fund. Building up the fund, only to use it up will create a financing problem. I propose that beginning in 1990, after the fund has been built up to a reasonable size -- because it is now still rather low -- automatic adjustments be made in the tax rates to keep the fund balance at a level of about half a year's outgo.

If the fund builds up beyond that point, the tax rates would be lowered, and vice versa. What this would mean would be a real pay-as-you-go tax schedule. Of course, it would mean higher tax rates in the second half of the 75-year valuation period, because there would be lower ones in the early and middle years. The higher ultimate rate would, according to the intermediate estimate, have to be something like 1 percent more for the employer and 1 percent more for the employee.

Furthermore, such an increase would eventually (after the 75-year valuation period) have to be put in, anyhow, after the fund is exhausted. Therefore, I think that it is much better to set the tax rates on an automatic basis.

The other major change that should be made is to put a more effective fail-safe device into the system. At present, there is a moderate stabilizer in that, if the OASDI trust funds are relatively low (even lower than at present), and if wages go up less than prices, then the cost-of-living adjustments (COLA) will be the lower of the wage increase or the price increase. This is a very desirable thing. The weakness is that the trigger point is too low, and by the time it has been reached, the trust funds would probably be well on the way to exhaustion. I would provide that the lesser of wage or price increases should be used for the COLA at almost any level of the fund, so as to prevent the happening of what occurred in 1979-81 when the economic experience was so bad. Further, I would introduce a real failsafe device by providing for complete elimination of the COLA when the fund balance is very low.

Next, let us consider the Medicare program, which has two parts. One part is Supplementary Medical Insurance (SMI), which primarily covers physician services. It is not financed by payroll taxes,but rather by the enrollees paying monthly premiums, which meet roughly 25 percent of the costs, with the other 75 percent coming from general revenues. I view this as a term-insurance program, just as are most health insurance plans for active employees. Consequently, it can be changed from time to time, and such has been the case over the years.

If SMI is viewed as term insurance, the program is actuarially sound by anybody's definition. If the program were wound up today, enough money is in the SMI Trust Fund, some $10 billion, to meet all benefit obligations that have been accrued but not yet paid.

The only problem with SMI, which is also a problem related to the Hospital Insurance program (which I will discuss next), is its rising cost over the years, as both utilization of physician services and physician fees have increased. But this is a problem that faces the whole country, not merely the governmental program under Medicare.

Next, let us consider the Hospital Insurance program. At the moment, it is in very good financial condition insofar as the amount of its assets is concerned. At the end of January 1985, it had assets of $31 billion (or about 62 percent of a year's outgo). This is $13 billion higher than the pessimistic estimate made in 1983 (including the loan to the OASDI Trust Fund as an asset) and $8 billion higher than the corresponding intermediate estimate.

The relatively favorable current status of the HI system will not last forever, because the cost curve is continually rising, and doing so more rapidly than the income curve. Thus, at some point in the future, the HI program will have a financing problem of a cash-flow nature.

In 1983, it was thought that, by 1986 or 1987, the HI Trust Fund would run out of money. But as time has gone by, both because of changes in the experience and because of legislative changes (such as requiring the self-employed to pay the full HI tax rate, covering non-profit employees compulsorily, covering all federal employees and establishing a new reimbursement procedure), the problem has been pushed further and further off into the future.

It was thought that, when the 1983 Amendments were passed, another national commission would have to be formed in a year or two to deal with the problems of HI. Now, it does not look as though these problems are at all imminent. Although I think that it would be desirable to contend with them more fully by prompt legislative action, at the moment it does not seem likely that this will be done. The 1986 Trustees report shows that under the intermediate assumptions, the bankruptcy point will not occur until 1997 (after taking into account legislation enacted shortly after the Trustees Report was issued). According to some estimates, it will be much further off than that. Of course, I am trying not to be too optimistic. It is not an ideal situation when one says that the system is certainly going to go bankrupt at some time in the future. However, because it will not occur quite so soon as previously expected, enough breathing space to make any changes is present.

The financial problems of HI are not confined to this governmentally operated program alone. In the private sector, the cost of health insurance is a big problem for employers. In the past, it has been an ever-mounting cost. This whole problem must be faced by the entire nation.

A new system of hospital reimbursement under HI, through the so-called diagnosis related groups, was created by the 1983 Amendments and is being gradually phased-in. Apparently, this will help to lessen the financing problems of HI. Under this approach, hospitals get reimbursed a flat amount per case, and not on a cost basis.

In the last year, hospital usage has dropped sharply. As a result, hospital costs have not risen very rapidly in the past year, and the situation seems to be quite under control at the moment. Whether this will last or not is impossible to say. I think that the HI Trustees Report is probably a little too optimistic, because as these controls tighten up, people may begin to find ways to get around them. It has been said that people will be admitted to the hospital and then discharged and readmitted, so that the hospital will get two DRG payments instead of one. Still another response that might be tried is to shift costs from the Medicare population to the remainder of the population. In the macro-economic sense, this does not solve the problem, but rather glosses over it.

Then, too, there is the possibility that people will not receive sufficient medical care. Specifically, hospitals may not have adequate nursing care, or they may discharge patients too soon, and eventually people might rebel. Whether or not this is now happening is debatable. Some people claim that it is already beginning to happen, but others disagree.

Finally, let me turn to the matter of whether the ultimately higher costs shown for the OASDI and Medicare programs can be met. Are the programs financially viable? I think that the answer is "yes." As to OASDI, if the intermediate estimate is too optimistic, if the experience is worse, what can be done about it? One solution would be to increase the tax rates slightly. Another solution, and in my mind a more preferable one, would be to have higher retirement ages. The breach was opened by the 1983 Amendments, when the normal retirement age, which had been 65 for almost 50 years, was raised. This process begins in the year 2003, and the normal retirement age gradually increases to 67 in 2027. So, if the experience of OASDI is more costly than estimated, it will probably be due to beneficiaries having longer life expectancies than currently projected. Consequently, the way to solve that demographic problem is through demographic means, increasing the normal retirement age.

Another thing that causes the very high cost in the pessimistic estimate for the OASDI program is the very low fertility assumed. I do not think that a fertility rate as low as in that estimate could possibly occur. But if it did, there is a cure for it, and this cure will automatically follow. If we have very low fertility in this country, we will have greatly increased immigration, either legal or illegal. People will come into this country if there is a vacuum because of a relatively small working-age population.

Hospital Insurance has much greater problems. Some persons feel that those in hospitals are over-using hospitalization. Most people, I think, desire extensive and comprehensive medical care. In any event, if one desires such care, it must be paid for.

The whole country has to face this predicament. I believe that the country really does want more hospital care, just as it wants a better living standard. Extensive hospital care is really part of a better living standard. So what can be done about it? The only solution, really, is to have higher tax rates. I am not generally in favor of higher tax rates, but if a government service is needed and wanted, it must be paid for. If more cost-sharing provisions are introduced, people are going to have to pay for the services in that way. If we are to have complete and up-to-date hospitalization protection for the population of the United States, and utilize new scientific developments, it will cost more money. There is no "free lunch" in this world; you must pay for it!

Based on the Trustees Reports, OASDI and HI together might possibly cost 40 percent of payroll, based on the pessimistic cost estimate -- but I seriously doubt that it will have that high a cost. This is a very scary figure, particularly if it is considered in terms of what the tax rate will be next year. I claim that 40 percent of payroll -- 20 percent from the employer and 20 percent from the employee -- is economically possible over the long range. This is viable because of increasing productivity, and increases in real wages. Over the years, wages have increased more than the prices by 1-1/2 to 2 percent a year, and that has resulted in the rise of living standards, including much more expensive medical care.

Therefore, I say that a contribution or tax rate of as much as 40 percent for OASDI and HI together is economically viable -- although I doubt that much will be needed. For one thing, an increase in the Normal Retirement Age for OASDI further than now scheduled and increasing the minimum eligibility age for Medicare so as to be the same as for OASDI would certainly hold the cost well below 40 percent. If the increase is made gradually over the years, people would still have a rising standard of living. For example, let us take the pessimistic view that real wages increase only one percent a year (i.e., wages increase more than prices by one percent each year). Then, if there is a tax rate of 40 percent of payroll ultimately, split equally between the employer and the employee (and we should recognize that, on the average, the employer tax is really passed on to the employee, as so many economists point out), people would still, some 45 years from now, have real take-home wages that are 30 percent higher than at present. In other words, my view is that people could pay those higher tax rates (which I do not think will happen) and yet have a real rising standard of living, including much more costly medical care and hospitalization.

Last year, as is well known, was the fiftieth anniversary of the signing of the Social Security Act, so let us look ahead. I predict that 50 years from now, we will have OASDI and Medicare programs very much like the ones we have today. The dollar amounts of the benefits and taxes will be different, because of the continual rise in wages and prices, and the retirement age may be higher than now scheduled, but the program will have the same general structure as today.

At the present time, there is a considerable lack of public confidence that the system will actually be there when younger people retire. It is interesting, too, that in surveys in which people are asked whether they want a different kind of system -- for example, abolish the present system and have a system of individual IRA's -- the answer is strong support for the present system.

I believe that public confidence in the OASDI system will gradually be restored over the next few years. It took a long time to destroy public confidence. Likewise, it will take a long time to rebuild it. I think that confidence will be rebuilt as the OASDI trust funds build up, and people see that a large amount of money is there. The size of the trust fund will not be large in terms of liability, but in terms of dollars, it will be very large.

I hope that the program committee of the Society will have another meeting like this 50 years from now. I hope to be able to come to it with Haeworth, discuss the matter, and tell him, "See, I told you so. The system is still here, it is viable, and it is healthy."

MR. A. HAEWORTH ROBERTSON: Is the Current Social Security Program Financially Feasible in the Long Run?

In my opinion, the answer is *no* for the following three reasons, any one of which is sufficient:

First, if Social Security is not changed significantly, it will eventually cost more than the taxpayer will be *able* to pay. It is entirely possible that the cost of Social Security will be equivalent to as much as 40% to 50% of taxable payroll during the lifetime of the younger members of this audience.

Second, even if taxpayers are *able* to pay for high future taxes needed to support the program, they will not be *willing* to pay those taxes. Taxpayers enthusiastically supported Social Security during its first 40 years of existence largely because of its low cost and a misunderstanding about how it works. As taxes have risen dramatically, and as people have begun to better understand Social Security, this support has diminished and will continue to do so.

Third, even if the present Social Security program were appropriate for the conditions that existed in the past, it will not be appropriate for conditions that are likely to exist in the future when the young working population of today is ready to retire. A social insurance program is a reflection of a country's social and economic environment, and Social Security has not changed as rapidly as this environment has changed. Rapid future changes will make the program even less appropriate.

For these reasons, I believe the current Social Security program is *not* financially feasible in the long run.

Social Security Defined

First, it is probably a good idea to define Social Security. I think most people believe it is the program of benefits they can expect to receive in exchange for paying their Social Security, or FICA, taxes: old-age benefits, survivor benefits, disability benefits, and hospital insurance benefits provided under the Medicare portion of Social Security. These benefits are frequently referred to as OASDI and HI benefits. I believe it also includes the Medicare Supplementary Medical Insurance (SMI) program, even though these benefits are financed by general revenue and premiums paid by participants, and not by the FICA taxes.

It may be instructive to think of the retirement benefits provided by Social Security as follows:

A person who retires at age 65 receives monthly benefits under the Social Security program, which is made up of two parts:

- A cash annuity, payable monthly for life, adjusted explicitly to reflect changes in the Consumer Price Index (CPI).

- A medical-care annuity, payable monthly for life, the value of which increases implicitly as the cost of medical care increases.

The medical-care annuity is not paid in cash, it is paid in kind; that is, in the form of medical care *insurance protection.* The approximate monthly value of this insurance protection for HI benefits and SMI benefits can be determined from the annual Trustees Reports.

Here are some examples of average monthly annuities paid in 1985:

	Retired Worker Over Age 65	*Retired Worker and Spouse*
Cash Annuity	$ 472	$ 780
Medical Care Annuity		
HI	$ 128	$ 256
SMI	62	124
Total	$ 662	$1,160

For the retired worker alone, the medical care annuity of $190 is 29% of the total annuity of $662. For the retired worker and spouse, the medical care annuity of $380 is 33% of the total annuity of $1,160. (These examples are estimates based on averages and ignore the differences in male and female per capita medical care costs.)

Thus, Medicare is a very important part of every retired person's benefits. A reduction in Medicare benefits may be even more burdensome to the beneficiary than a reduction in cash benefits, since it may be more difficult to replace benefits lost as a result of Medicare cuts than it is to replace reductions in cash benefits.

The Cost of Social Security and Our Inability to Pay

On March 31, 1986, the annual reports on the financial condition of Social Security were released by the program's Trustees. In the past, there have been three Trustees: the Secretary of the Treasury, the Secretary of Labor, and the Secretary of Health and Human Services. Since 1985, there have also been two *public* Trustees (appointed for four-year terms by the President and confirmed by the Senate).

It is obviously impossible to predict with certainty all the factors that will determine the ultimate cost of Social Security: inflation, fertility or birth rates, unemployment, changes in productivity, etc. Therefore, the Trustees Reports include long-range projections of income and outgo for the program. These projections use four alternative sets of assumptions about future economic and demographic conditions in order to portray a general range within which income and outgo might reasonably be expected to fall.

One way to analyze the results of the 1986 Trustees Reports is to compare the projected benefits (including administrative expenses) with the projected tax income (the scheduled FICA payroll tax payable by employers and employees combined, plus small amounts of earmarked general revenue). Table 1 makes this comparison for OASDI and HI benefits combined, i.e., the portion of Social Security that is financed primarily by the Social Security (FICA) taxes. It shows the proportion of benefits that can be financed by scheduled tax income under each of the four alternative sets of assumptions for three 25-year time periods beginning in 1986, as well as for the entire 75-year projection period. The comparisons are only approximate since they are based upon the arithmetical average of the tax income and benefit outlays during each year in the period under study.

Table 1

*Proportion of OASDI and HI Benefits That Can Be Financed by Scheduled Tax Income**

	Alternative Assumptions			
Time Period	*I*	*II-A*	*II-B*	*III*
25-Year Averages:				
1986-2010	126%	114%	109%	95%
2011-2035	110	84	79	55
2036-2060	105	73	68	41
75-Year Average:				
1986-2060	113%	87%	82%	56%

*Derived from Table E3 of Appendix E of the 1986 OASDI Trustees Report.

These figures indicate that under the Alternative I assumptions, there would be more than enough tax income to pay the promised benefits throughout the 75-year projection period. That is, tax income would average about 113% of benefits. As one might expect, these are usually referred to as "optimistic" assumptions.

Under the Alternative II-B assumptions, tax income would average about 109% of benefits during the next 25 years, creating a surplus that would be needed to offset the deficits in ensuing years. Over the entire 75-year projection period, tax income would average only 82% of benefits. This set of assumptions, sometimes called the "intermediate" set, is customarily used by policymakers as the benchmark against which to measure the system's financial health.

Under the Alternative III assumptions, tax income would be sufficient to pay only 95% of the promised benefits during the next 25 years (projected taxes are approximately equal to projected benefits during the first 10 years or so of this period). During the following 25-year period from 2011-2035 (when the baby-boomers reach age 65), tax income would be sufficient to pay only 55% of the promised benefits. During the period when the children of the baby-boomers reach age 65 (2036-2060), scheduled tax income would pay for only 41% of the promised benefits. Some observers refer to these as "pessimistic" assumptions.

Another way to compare projected income and outgo over the years ahead is illustrated in Table 2. It indicates the pattern of increased taxes necessary to support benefit payments under the various alternative projections. With regard to the income column: combined employee and employer tax rates amount to 14.3% in 1986, and are scheduled to increase to 15.3% by 1990. The remainder of the projected income is accounted for by general revenue, including that generated by taxing a portion of Social Security benefits.

Table 2

Projected Income and Outgo Under the OASDI and HI Program Expressed as a Percentage of Taxable Social Security Earnings

		Outgo			
Year	*Income*	*Alt. I*	*Alt. II-A*	*Alt. II-B*	*Alt. III*
1986	15%	14%	14%	14%	14%
1995	16	13	14	14	16
2010	16	12	14	15	19
2020	16	14	18	19	27
2030	16	16	21	23	35
2040	16	16	22	24	38
2050	16*	15	22	24	40
2060	16*	15	22	24	42

* Under Alt. III assumption, the income for these years would be 17%.

The figures in Tables 1 and 2 do not include Supplementary Medical Insurance benefits, which are financed largely by general revenue. Unfortunately, official cost estimates of the SMI program are made by the Trustees for only three years. Presumably this is done on the theory that general revenue represents a bottomless well from which we can draw to pay for SMI, no matter how much it costs.

The cost of SMI benefits is currently equivalent to about 1.3% of taxable payroll (i.e., 50% of the cost of the HI program). Assuming this cost relationship continues, the SMI cost will rise to between 2% and 8% of payroll during the projection period, depending upon the particular assumptions used.

Which Assumptions are Proper?

Of course, no one can know in advance which of the four alternative projections best depicts the future. An indication of the relative degree of optimism or pessimism in the various projections can be determined by examining the economic and demographic assumptions illustrated in Table 3. These assumptions are key in determining the size of the beneficiary population relative to the size and productive capacity of the taxpaying population. Most of the assumptions vary for the next several years, reaching their ultimate level by the year 2010.

Table 3

Key Economic and Demographic Assumptions after the Year 2010

	Alt. I	*Alt. II-A*	*Alt. II-B*	*Alt. III*
Total Fertility Rate (1.86 in 1985)	2.3	2.0	2.0	1.6
Productivity (annual real increase)	2.7%	2.4%	2.1%	1.8%
Consumer Price Index (annual increase)	2.0%	3.0%	4.0%	5.0%
Mortality Rate (annual decrease)	0.3%	0.6%	0.6%	1.2%

The total fertility rate may be defined roughly as the average number of children that would be born to a woman in her lifetime based upon the birth rates prevalent during the year under consideration. Fertility rates have fluctuated widely in the past, but the long-term trend has been downward. During this century the rate has ranged from a high of 3.7 in 1957, to a low of 1.7 in 1976. The average rate during the 10-year period 1976-1985 has been 1.81.

According to the 1986 Trustees Reports, the past "variations in fertility rates have resulted from changes in social attitudes, economic conditions, and the use of birth-control methods. Future fertility rates may exceed the present low level, because such a low level has never been experienced in the U.S. for a long period, and because such a level is well below that needed to maintain the size of the population, in the absence of increased net immigration. *The recent historical and projected trends in certain population characteristics, however, are consistent with a continued relatively low fertility rate* [emphasis added]. These trends include the rising percentages of women who have never married, of women who are divorced, and of young women who are in the labor force." These next figures came out of a newspaper, like Bill Smith's did, so I am not sure they are accurate. Two days ago the *Washington Post* said that in 1983 the fertility rate was 1.3 in West Germany and Denmark and 1.5 in Italy and the Netherlands. Our fertility rates can go below their present level of 1.8. It is imprudent not to assume that they will, based on the long-term trends (not to mention the underlying factors causing those long-term trends).

A review of these points suggests to me that the long-term fertility rate will probably be lower, not higher, than the current rate of 1.86. Accordingly, the Alternative III rate of 1.6 does not seem to be pessimistic; on the contrary, it is probably realistic and it may even be optimistic (the higher the fertility rate, the lower the long-range Social Security cost expressed as a percentage of payroll during the 75-year projection period).

The productivity increase, together with the Consumer Price Index increase, is an important determinant of future payroll, which in turn affects future tax income.

According to the 1986 Trustees Reports, "For the 30 years 1955-1984, annual increases in productivity for the total U.S. economy averaged 2.0%, the result of average annual increases of 2.7, 1.9, and 1.3% for the 10-year periods 1955-64, 1965-74, and 1975-84, respectively." According to experience of the past 20 years, the Alternative III productivity assumption is not pessimistic. On the contrary, it is optimistic (the higher the productivity increase and thus the higher the payroll, the lower the Social Security cost expressed as a percentage of payroll during the 75-year projection period).

Although the CPI assumption is shown as a point of reference, it is not by itself a determinant of future costs. The future cost of the Social Security program, expressed as a percentage of payroll, depends upon the relationship between program cost increases and taxable payroll increases (both of which are affected by changes in the CPI).

The average annual decrease in the mortality rate (more precisely, the age-sex-adjusted death rate) that was assumed for the period from 1984-2060 ranges from 0.3% under Alternative I to 1.2% under Alternative III. Historically, the average annual decrease was 1.3% during the period 1900-1983, and 1.5% during the more recent period 1940-1983. The relative effect on the long-range cost of the system moving from one illustrative alternative to another is approximately the same for the mortality rate as it is for the fertility rate. The various assumptions about mortality improvement are based upon steady annual changes, and not upon one or more major breakthroughs (which are probably not out of the question, and which would materially increase long range costs, all other factors remaining constant).

A factor not illustrated explicitly in Table 3, that has a very important effect on projected costs of the Medicare part of Social Security, is the rate of increase in the unit cost of hospital and physician services as well as other institutional and ambulatory care. Of course, these increases are partially related to changes in the CPI and average wage levels. As already noted, changes in average wage levels are normally a function of changes in both the CPI and productivity, although economic history of the past 10 years indicates this relationship is not always predictable during any given short time span. Under all four alternatives it was assumed that, ultimately, the costs per unit of service would increase at the same rate as average wage levels. Somewhat higher rates of increase were assumed in the interim. (Reference should be made to Appendix A ofthe *1986 Hospital Insurance Trustees Report* for more specific information about these assumptions.)

In deciding which set of economic and demographic assumptions to rely upon, it is not a question of selecting the "correct assumptions," since that is clearly impossible. The question is this: For the Social Security program (which makes promises about benefits payable as much as 50 to 75 years in the future), which set of assumptions should be used to determine whether or not it seems reasonable to expect that future income will be approximately equal to future outgo and that benefit promises can be fulfilled?

In making this test, it seems to me that the Alternative III assumptions are the most appropriate of the four sets of assumptions shown in the Trustees Reports -- and even they may be somewhat optimistic. Based upon these assumptions, it is clear that we have promised substantially more in benefits than can be provided by the scheduled taxes. It is true that taxpayers will be able to pay taxes well above the projected level of 16% of pay. They will not be able to pay taxes equivalent to 40% to 50% of pay, however, since there are many other programs that must be supported by federal, state, and local taxes.

It is understandable that these Alternative III projections are not popular. They indicate that today's youth can expect to receive less than half of the benefits the present system has promised them (unless, of course, the children of the baby boomers are willing to pay twice the rate of Social Security taxes scheduled). But that's not even the whole story. We've got an SMI program financed primarily by general revenue. Under the Alternative III assumptions the cost of SMI benefits will rise to the equivalent of about 8% of payroll during the lifetime of today's youth. This is more than the entire Social Security cost during the first 30 years of its existence. Let's be honest with our children. Advocates of the expansion of Social Security, and even some advocates of the status quo, use every imaginable subterfuge and semantic trick to hide the program's high future cost from the public. Said in a less flattering way, older people are hiding the high future cost of Social Security from their children and their grandchildren.

Therefore, major changes will have to be made in the current Social Security program, sometime before the turn of the century, because of the sheer inability of taxpayers to pay the taxes that will be necessary to support the program as well as the other mandatory government programs.

Our Unwillingness to Pay Substantially Higher Taxes

One might argue that the public *will be able* to pay Social Security taxes of 40% to 50% of pay (for employees and employers combined) because productivity will continue to increase. The resulting gain in income could then just as well be spent on social insurance benefits for the inactive population as on a higher standard of living for the active working population.

It is a very questionable assumption that the government (or well-meaning social planners) will be able to convince the public that a significant portion of gains in income (because of group or individual productivity increases) should be diverted from the immediate enjoyment by the worker to be used for the benefit of someone else in either a contemporaneous period, or some future period.

Moreover, there are numerous programs other than Social Security that will be competing for the taxpayers' future earnings, including any productivity gains: e.g., improvements in our educational system; rebuilding our decaying roads and bridges and other key elements in our national infrastructure; maintenance of a cleaner environment, including preservation of an adequate supply of clean water; and the provision of increasingly sophisticated and costly health care, before as well as after retirement.

In any event, a significant redistribution of future gains in income will not be easy to accomplish in this country as long as we retain our present degree of economic freedom.

Another important point that has a bearing on our willingness to pay higher Social Security taxes is the public's increasing understanding (and past misunderstanding) of how Social Security works.

In explaining Social Security over the years, the government employed certain rhetoric that contributed to the past misunderstanding. The use of words and phrases like "insurance," "trust fund," "account," "contributions," and "earned right," while not necessarily wrong, has frequently conveyed the wrong impression. After 40 years of this rhetoric, people began to believe that they were buying and paying for their own benefits. This was not true for either individuals or generations of people. In fact, during the first 50 years of Social Security's existence, the total taxes paid by employees and employers combined have amounted to less than 20% of the value of the benefits that have been paid or promised in that period of participation. In other words, during the past 50 years, Social Security tax rates would have to have been at least five times what they were to be adequate to pay for benefits that were "earned" during that period.

No wonder the public liked Social Security. They were paying ridiculously low "contributions," yet they thought they were saving for their own retirement without a significant subsidy from others.

President Franklin D, Roosevelt, himself, set the tone for this rhetoric when he responded to a visitor who complained about the economic effect of the Social Security payroll tax: "I guess you're right on the economics, but those taxes were never a problem of economics. They are politics all the way through. We put those payroll contributions there so as to give the contributors a legal, moral, and political right to collect their pensions. . . .With those taxes in there, no damn politician can ever scrap my Social Security program."

Beginning in the mid-1970's, the public began to understand that they were really paying taxes, not so-called "contributions." They learned the so-called "trust funds" were about to run dry, and there wasn't any money in their so-called "account." They learned that their so-called "insurance" was really "social insurance." It was not the kind of insurance where premiums were commensurate with the benefits. In other words, they learned that their taxes bore virtually no relationship to their benefits. And finally, in the past few years, they learned they didn't have any "earned rights" to *anything*. Congress effectively cut retirement benefits for some 15% of the retired population by taxing them, eliminated students' benefits even though the deceased parent had satisfied all conditions for their payment, reneged on promised inflation projection, increased the normal retirement age for persons now under age 46, and so on.

SOCIAL SECURITY: FUTURE FINANCIAL VIABILITY

The mere mention of phrases like "income transfer" or "income redistribution" is enough to make a social planner's eyes light up. It might even light up the eyes of the beneficiaries of such redistributions. The informed taxpayer whose income is being redistributed sometimes reacts differently.

During the past 10 years, enthusiasm has waned as taxes have risen. People have begun to understand that Social Security is a gigantic income redistribution program with plenty of social adequacy but very little individual equity. Fewer and fewer people believe the Social Security program to be fair, and if a program -- any program -- is not considered fair by most of its participants, it cannot survive in a democratic society.

Therefore, major changes will have to be made in the current Social Security program sometime before the turn of the century. A tax increase of the magnitude that will be required to maintain the current Social Security system is more than the taxpayer will tolerate, even if it appears to a social planner to be affordable.

The Inappropriateness of the Current Social Security Program

The development of a system like the Social Security program is a continuing evolutionary process. A program that was appropriate for yesterday is not appropriate for today. A program that is appropriate for today will not be appropriate for tomorrow.

The present Social Security program is a product of decisions made by past generations of policymakers who lived in a different social and economic environment. They were trying to resolve problems different from those that will exist in the future. When Social Security was enacted some 50 years ago, the nation had been in a serious depression for almost six years. The social and economic conditions existing at that time included the following:

More workers than jobs and a consequent high unemployment rate;

A small elderly population relative to the younger potential working population;

Relatively undeveloped reliable institutions through which an individual could invest and save for the future;

An almost completely undeveloped system of private pensions and other employee benefits provided by employers.

When the bulk of today's population approaches retirement some 25 to 50 years in the future, social and economic conditions can be expected to be quite different from what they are now, or were 50 years in the past. Accordingly, the nation need not and should not be forever influenced by past decisions made to solve past problems.

More specifically, Social Security should be viewed as more than just a retirement program. It is, in effect, a rigid mechanism for dividing the population into two groups: those who work and produce goods and services, and those who are inactive but still share in such production. The particular division fostered by Social Security may have been appropriate in the past, but it will not be appropriate for tomorrow. The early 60's will not be a proper age to divide the active from the inactive population as the baby boom of yesterday becomes the senior boom of tomorrow. A flexible system is needed that will permit this separation into active and inactive groups of persons to be self-adjusting with the changing times: changing proportions of old and young, improved health at older ages, longer lifetimes, more women in the paid work force, and so on. (The projected high future costs of Social Security are simply an indicator of this inappropriate division of the population into two groups.)

The only way to bring about a rational change in Social Security is to examine the characteristics of the younger segment of our population, together with the social and economic environment that it now seems reasonable to assume will prevail throughout their lifetime, and then design a new social insurance system that is appropriate for these suppositions. (The system for today's elderly has already been designed and should be considered virtually inviolable.)

One way or another, by means of rational analysis or demagogically-inspired turmoil, major changes will be made in the current Social Security program. If we are fortunate, the program will be reformed through rational analysis, so that it more nearly reflects the evolving social and economic environment.

Conclusion

Senator Russell Long has served in the Senate since 1948. He was Chairman of the Senate Finance Committee for 14 years and is generally considered the most influential Democrat in the Senate. Not all Congressmen fully understand Social Security, but Senator Long probably does. In a speech last year to the annual meeting of members of the Association of Private Pension and Welfare Plans, he characterized Social Security as follows:

> "Social Security is nothing more than a promise to a group of people that their children will be taxed for that group's benefit."

Is this really true? I believe it is. Is this a sound basis on which you can base your retirement planning? This is not a rhetorical question; it is a question that each of you should answer. When you make financial plans for your retirement, is it prudent to assume that your children and the children of your friends and neighbors (and the children of people you don't even know) will be willing to pay the taxes needed to pay benefits promised by the current Social Security system -- a system that may require combined employee and employer taxes, including general revenue, equivalent to as much as 40% to 50% of payroll; a system that is becoming increasingly unpopular?

I believe it is reasonable to assume that our children (and in some cases our grandchildren) will be willing to pay *some* taxes to provide *some kind* of "social insurance" benefits. I do *not* believe it is reasonable to assume that our children will be both *able* and *willing* to pay the high taxes that will be necessary to provide the benefits promised by the present Social Security system. Furthermore, I do not believe that the current system will be appropriate for the social and economic environment of tomorrow.

There is no reason for this country to continue with a social insurance system that is controversial, constantly on the verge of financial collapse, out of phase with the times, and -- in my opinion -- doomed to ultimate failure. Living with such a system is an unnecessary drain on our collective productivity and psyche. It is eminently more sensible for us to design a social insurance system, understood and perceived as fair and reasonable by the majority of the citizens, that will be considered an aid, rather than a hindrance, to the attainment of a healthy and productive national economy.

MR. MYERS: There are many points which I would obviously like to take up, but I can only deal with a few of them. Haeworth has said that he thinks the Alternative III, or pessimistic, assumptions are the most likely, and the intermediate ones (the II-B assumptions) are not very likely. I would like to say, in defense of the government actuaries, that both the Social Security Administration and HCFA actuaries have selected the assumptions which they thought were the most reasonable for the intermediate estimate. They were never put under any political pressure to do so, or to make the program look good. I think that everyone believes that they have done a good, capable, professional job over the years in turning out the best possible estimates that they could.

I very definitely favor full consideration and disclosure of the costs of all parts of the OASDI and Medicare programs. But I think we should make it clear to the public what we are talking about when we use the words "social security" and mean OASDI plus Medicare, when the public thinks that we are talking only about OASDI. I say that is perpetrating a serious misconception if we do not do so. We should be specific, and not use the words "social security" if they have these two meanings; we should instead use different words for each separately. The fact is that "Social Security" is used by the public as meaning OASDI. One piece of good evidence of that is that President Reagan uses it that way when he talks about only the OASDI program, when he set up the National Commission, and so forth. I think that it is up to us to use words in the way that the public uses them, rather than the way we think they ought to be used. For example, if OASDI does not have financing problems, but HI does, then obviously the combination of OASDI and HI does have such problems. If we use "Social Security" as meaning OASDI plus HI and say that problems are present, this will seriously mislead and alarm the general public, who will think that OASDI is being referred to -- after they have been assured that the 1983 legislation did solve the problem.

I think that if we do have these very high costs of 40% of payroll, most of this is going to be due to health care costs, rather than OASDI ones. If we cannot bear those costs, what are we going to do? Are we not going to provide the medical care? Will that apply across the board to people of working age as well as those at the retirement ages? I think that the country wants to go on spending for health care if it is certain that it is getting its money's worth and that health care is delivered in an efficient manner. It must be paid for in one way or another, whether by payroll taxes or otherwise.

As to my report card, I want to emphasize that what I said there (and I think that I did speak as an actuary -- at least I always try to do so!) was solely about the OASDI system. It used the phrase "Social Security" because that is what the public that it was addressed to means by "Social Security".

As to SMI, I continue to believe that it is term insurance, as do the actuaries at HCFA. It cannot be evaluated over the long run by examining its benefits, costs, and financing, because the financing is based on premium rates that change annually. As I understand health insurance as sold by insurance companies, projection ahead for 20 or 30 years is not made as to what the premium rates will be when selling health insurance on a renewable term insurance basis. The soundness of it is measured by only considering the accrued but unpaid claims.

Finally, I think that Haeworth, in criticizing OASDI and Medicare programs by saying that the country cannot afford them (which I think it can), that the country does not want them (which I think it does), and that the system is not appropriate, does not suggest (at least in his remarks here) any feasible specific solutions. At times, he has suggested one thing that I support -- raise the retirement age (although he thinks the age ought to be raised much higher than I do.) I think that, if he is going to criticize the system, and say that it is not feasible and that it is not appropriate, he should suggest a specific plan that would take the place of OASDI and Medicare.

PANEL DISCUSSION

MR. ROBERTSON: I believe that Bob Myers has clouded the issue by talking about the favorable experience of the past year or two; by talking about trust funds with billions more than projected under the pessimistic assumptions; by talking about potential trillion dollar trust funds in the years ahead (a false issue, in my opinion); and by introducing ambiguity into the definition of Social Security.

I believe his Appendixes 1 and 2:

- A 50-Year Report Card on Social Security, and
- A Declaration of Confidence and Support by Private Pension Professionals

are extremely misleading to an uninformed, unsuspecting public.

The Report Card gives Social Security an A+ in Financial Soundness and states it "is in excellent financial condition, both in the short run and over the long range."

The Report Card gives Social Security an A in Money's-worth for Participants and states that "All participants will receive good actuarial value for their own contributions."

In my opinion neither of these statements would survive informed scrutiny. This appears to be a report card prepared by an advocate of the present system, not by an actuary.

The National Commission on Social Security Reform, of which Bob Myers was Executive Director, may have done a commendable job under the circumstances, in resolving Social Security's OASDI problems -- at least for the next 25 years. That is not the question at hand. The question is whether the current Social Security program is financially feasible in the long run.

Many of Bob's earlier statements are irrelevant to the question at hand. It is irrelevant to state that medical costs would still be there if the HI benefits were reduced; or that the same problems confronting Medicare's retired population confront the active population; or that HI is responsible for 87% of the total OASDI/HI deficit; or that a prominent politician has stated that the "Social Security system must be preserved." It has become axiomatic that if you want to remain a politician you must make such statements.

We cannot separate the Social Security program into its components (OASDI and HI and SMI) and resolve each component's problems independently and without regard to the other components. The various benefits are intimately inter-related, differing principally in that some of them are annuities paid in cash and some of them are annuities paid in kind.

The SMI program is not actuarially sound. It is ridiculous to state that the SMI program is like one-year term insurance and therefore actuarially sound if its trust fund balance equals the amount needed to pay incurred claims.

The least rigorous definition of actuarial soundness that can properly be applied to an ongoing program of long-range promises, like SMI, is whether "expected future benefit outlays are equivalent to expected future tax income, determined over the lifetime of the program based upon a reasonable set of actuarial, economic, and demographic assumptions about the future."

The Social Security Trustees make official projections of income and outgo for only three years under the SMI program. Accordingly, they do not have the faintest idea about SMI's future cost, much less whether it is actuarially sound.

It does not mislead the public to announce that "Social Security" still has future financial problems, even if those problems may be greater in one of the components (like the HI component) than in another component.

On the contrary, it grossly misleads the public to announce that "Social Security" is in "excellent financial condition both in the short run and over the long range" as Bob does in his Report Card when, in fact:

(1) the OASDI financial problems have been resolved for only about 25 years (i.e., until the 75 million baby-boomers begin reaching age

65), taking into account the reality that the surplus funds projected to accumulate during the next 25 years will not materialize because excess OASDI taxes will not actually be assessed except to the extent necessary to cover HI deficits;

(2) the HI financial problems have been resolved for only about 10 years; and

(3) the SMI financial problems have not even been quantified, much less resolved.

I consider it gross negligence, if not sheer demagoguery, to take advantage of the public's confusion and lack of understanding about Social Security, and to give them repeated false assurances about the program's financial stability.

How can we say that Social Security's financial problems have been resolved when:

(1) the combined employer and employee Social Security tax rate is scheduled to rise to 15.3% in 1990 and remain level thereafter; yet

(2) the Social Security benefit outlays financed by those *same taxes* are projected to increase to 24% of payroll under the optimistic Alternative II-B assumptions, and to more than 40% under the more realistic Alternative III assumptions; and when

(3) we have not even assessed the future financial viability of the SMI program?

If we repeatedly assure the public that Social Security's financial problems have been resolved for the next 50 to 75 years, what excuse will we give to the taxpayer a few years down the road when we must increase *Social Security taxes* significantly to finance the Hospital Insurance program?

Will we say, "It is a problem of semantics," and that the taxpayer should have realized that when we referred to Social Security *taxes* we meant OASDI and HI taxes, but when we referred to Social Security *benefits* we meant only OASDI benefits?

Or should we tell them the truth: namely, that the people who gave them all those false assurances about the financial stability of Social Security did so because it was their opinion that the Social Security program (OASDI, HI, and SMI) that existed in the mid-1980's was good for the public; that it should be continued in the future no matter what it costs; and that it was thought inappropriate to burden the public with details about the program's high future cost because, after all, the public might have rebelled and demanded a change in the program's design?

As to the actuarial assumptions and whether I question the integrity of the actuaries at SSA and HCFA: No, I don't question their integrity.

Those actuaries associated themselves with four sets of assumptions designed to portray a range within which future costs might reasonably be expected to fall. I accept the range, but I believe the Alternative III projections are more likely to materialize than the Alternative II-B projections. I also believe the Alternative III projections are the appropriate ones to use in assessing the actuarial soundness of the program: that is, whether there is a reasonable chance that future income will be equal to future outgo, and whether we can give reasonable assurance to today's taxpayers that they will receive the benefits we are promising them.

Although I don't question the SSA and HCFA actuaries' integrity, I do question their judgment and the judgment of the Trustees, if they endorse the Alternative II-B projections as the yardstick by which to measure Social Security's actuarial soundness.

I question their judgment if they pronounce the SMI program to be actuarially sound on the basis of projections of income and outgo for only a three-year period. If they persist in making projections for only three years, they should issue a statement to the public as follows:

> "The Trustees, who are responsible for reporting annually on the financial condition of Social Security, have not reviewed the long-range cost of the SMI benefits that are currently being promised. The Trustees are therefore unable to say with any degree of certainty that the benefit promises now being made to millions of today's taxpayers, particularly the 80% of the non-retired population that is currently less than age 45, will in fact be honored."

If the Trustees are not willing to examine thoroughly the cost implications of Social Security's promises to ensure that they are reasonable, they have no right to endorse those promises.

I do not agree that there is no effort by groups outside of SSA and HCFA to influence the cost estimates and the assumptions on which they are based. Hosts of outsiders attempt to influence the Trustees and their staffs, who in turn try to influence the actuaries; this is understandable since the annual reports are Trustee Reports. Of course, I cannot say the extent to which the actuaries succumb to those pressures at the present time--perhaps it is not at all.

During the period ending in 1970, when Bob Myers was Chief Actuary of SSA, there was probably no pressure about the assumptions, particularly the economic assumptions. Since the system was not automatically indexed during that period, it was assumed the CPI increase would be zero, the rate of salary increase would be zero, the rate of productivity increase would be zero, and the increase in the taxable wage base would be zero. These were very conservative assumptions, to say the least, and they consistently produced lower costs than actually materialized. Wages did increase, of course, and the resulting gain from increased tax income was offset by periodically increasing benefits by an appropriate amount.

A cynic could easily conclude that the public has been duped by the Social Security expansionists and those who advocate a total welfare state because:

(1) Social Security's financing has been rearranged so that things will be just good enough for the next 20 to 25 years to avoid major changes in the program.

(2) The public has been assured that Social Security's financial problems have been resolved well into the next century, even through the retirement years of the baby-boomers.

(3) This assurance is false, but some 15 years hence when the financial situation begins to deteriorate rapidly and the baby-boomers realize the true cost of continuing the present program, they will be so close to retirement they will not be willing to accept significant change.

(4) But the baby-boomers' children will not be willing to pay the exorbitant taxes necessary to continue the program. *Unbelievable turmoil will ensue.*

I don't know what the outcome will be. All I know is that we could avoid, or at least minimize, that future turmoil by abiding by the creed of the Society of Actuaries, and beginning *today* "to substitute facts for appearances and demonstrations for impressions."

True, this level of honesty would result in increased turmoil *now*, but it would obviate the turmoil that will occur later if we continue this game of obfuscation.

After all, that is the basic principle of insurance with which actuaries are trained to be conversant: the substitution of a small, certain loss now for a large uncertain loss in the future.

MR. JAMES LAWS: Haeworth, could you answer the question "If Social Security was by some fashion, just terminated, what would you propose to replace it with?"

MR. ROBERTSON: I don't propose terminating the system just because I don't believe we can afford the present promises we've made. But I would say there are two general kinds of changes that have to be made in the system. People 45 and under are going to have to plan to retire under Social Security in their early 70's instead of their early 60's. Second, no matter what program we have, it is going to cost a lot in the future. In order for that to be acceptable to the public I think there has to be a closer relationship between what you pay in taxes and what you get in benefits. There has to be more individual equity and less social adequacy. Bob thinks the individual equity and social adequacy mix is okay, but I don't think it is.

MR. MYERS: That is one thing on which I agree with Haeworth -- namely, what he thinks that I think about the mixture of individual equity and social adequacy!

MR. ROLAND E. (GUY) KING: I am gratified to see both of you agree that the hospital insurance program does have a very severe financing problem. I also think we can agree that one of the problems we face in educating the Congress is that the earlier the action (whatever it might be) is taken to do something about it, the less disruptive it will be. We will have more chance of keeping what I call "intergenerational equity" in the system; a term we tried to use in the Trustees' Report. We were successful in using it in the 1985 Trustees' Report, and then the Trustees decided in 1986 that the term was political dynamite and they wanted it out. They took it out, but I wonder if both of you could comment on intergenerational equity either in the hospital insurance program or the OASDI program or both.

MR. MYERS: I think that intergenerational equity is something like the American flag and apple pie. Everybody is in favor of it. In fact, actuaries are the original experts on intergenerational equity, by setting appropriate insurance premium rates that are fair to everybody regardless of age. I think that it is not necessary to have complete individual equity in OASDI in order to have intergenerational equity, any more than this is necessary in private pension plans. When a private pension plan is established, the people who retire in the early years get far more of the employer's money (relatively) than those who retire after many years of service in the future. I think that we have a good mix of individual equity and social adequacy in OASDI. I think that there is intergenerational equity present, particularly considering the fact that many younger people today no longer have to support their aged parents in the way that they would otherwise have had to do if there had not been an OASDI system.

MR. ROBERTSON: I'd like to take this opportunity to congratulate the HCFA actuaries, headed by Guy King, for showing last year, for the first time, the 75-year cost projections for the hospital insurance program (instead of only the 25-year projections). As soon as they do that for SMI, I'll congratulate them again. On the question of intergenerational equity, the best I can do in a few seconds is to recommend that you read chapter 11 (pages 132-134) on equity among generations, in the book entitled *The Coming Revolution on Social Security* by A. Haeworth Robertson.

MR. GERALD G. TOY: This being my 62nd birthday, I wonder, Haeworth, if you are going to reverse the trend toward early retirement in this country. Your scheme, I think, would be fraught with peril: talking people into doing something contrary to what they are doing, which seems to be retiring earlier rather than later.

MR. ROBERTSON: No, it's not fraught with peril, Gerry. I am not talking about you and me and Bob Myers. I am talking about people aged 45 and under. They are the ones who are going to work later and retire later. They may not like it, but they are. Some thirty years from now life expectancy measured from age 65 is going to be longer than it is now, and much longer than it was in the 1930's when the retirement age was set at age 65. It will be a natural thing for today's youth to work longer since they will be living so much longer.

APPENDIX 1

Select Committee on Aging

Aging Info

U.S. House of Representatives

Edward R. Roybal, Chairman — January 1, 1986 — Matthew J. Rinaldo, Ranking Minority Member

SOCIAL SECURITY: A 50-YEAR REPORT CARD

GRADE	SUBJECT	COMMENTS
A+	Meeting Historical Goals	Has well fulfilled goals established in 1935 report of House Committee on Ways and Means.
A	Meeting Economic Needs	Has brought living standards of the aged up to a more satisfactory level.
A+	Financial Soundness	Is in excellent financial condition, both in the short run and over the long range.
A-	Public Support	Solid support but could be more enthusiastic if public confidence were restored.
C	Public Confidence	Needs improvement, which can be accomplished by better dissemination of the facts.
A	Money's-worth for Participants	All participants will receive good actuarial value for their own contributions.
A-	Administration	Very economical, but service to beneficiaries could be improved with more effort (and funds).

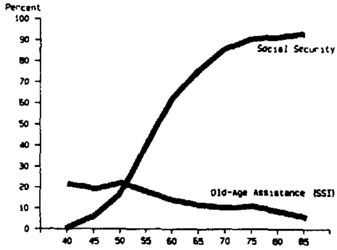
GOALS*	ACHIEVEMENTS
1. Providing old-age security as a right, rather than as public charity.	1. Currently, 26.5 million persons aged 65 or over receive Social Security benefits (about 93 percent of all persons of that age).
2. Benefits related to wages earned, but favoring the lower paid.	2. For retirees aged 65 in 1985, monthly benefit (before any benefit for spouse and children) of $548 for average earner, $370 for minimum-wage worker, and $717 for maximum earner.
3. Benefits will provide something more than merely subsistence.	3. Foregoing benefit amounts, plus any pensions, retirement income, earnings, home ownership and other assets achieve this in the overwhelming majority of cases.
4. Old-age assistance continued because not all will be eligible for old-age benefits.	4. Proportion of population aged 65 or over receiving such assistance decreased from 22 percent in 1940 to 6 percent currently.
5. In view of growing number of aged, old-age assistance would have great cost to Federal Government if no old-age benefits system.	5. Total cost of Supplemental Security Income program is only about $9 billion per year currently (versus Social Security payments of $190 billion).

*Goals taken virtually verbatim from Report of House Committee on Ways and Means on the original Social Security bill, April 5, 1935 (Report No. 615, 74th Congress).

APPENDIX 1 (continued)

PROVIDING OLD-AGE SECURITY AS A RIGHT, NOT CHARITY

Percent of Persons Age 65+ Receiving Social Security and Old-Age Assistance/SSI 1940 - 1985



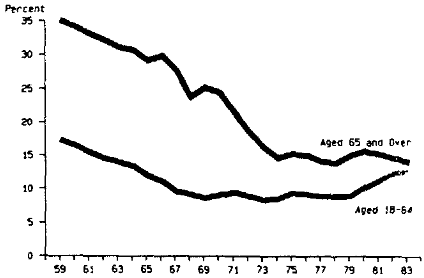
Source: Social Security Administration

The proportion of those aged 65 or over receiving Social Security benefits as a matter of statutory right increased steadily following the first payment of benefits in 1940 and now is 93%. The vast majority of the remaining 7% are substantially employed (or the spouse of such a person). At the same time, and as a result, the proportion of the aging who receive old-age assistance (Supplemental Security Income after 1973) fell from 22% to 6%. About 70% of those receiving such assistance also have Social Security benefits.

MEETING ECONOMIC NEEDS

Poverty Rates of Persons: Aged 18-64 and Aged 65 or over 1959 - 1983

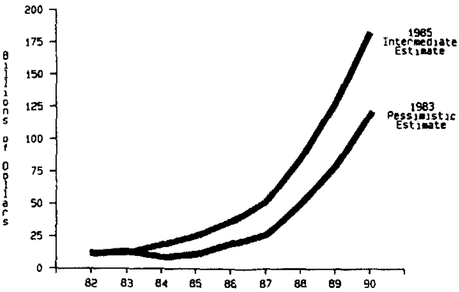
The governmentally-defined poverty rate for persons aged 65 or over decreased significantly over the past 25 years and is now only about 10 percent higher relatively than for persons aged 18-64. In the 1960s, it was about 2½ times as high. The availability of Social Security benefits for the population aged 65 and over was the major factor in this trend. Without Social Security, the poverty rate for those aged 65 and over would now be at least 30 percent, instead of about 14 percent.



Source: U.S. Bureau of Census (Current Population Survey) and Social Security Administration

SHORT-RUN FINANCIAL SOUNDNESS, 1982 - 1990

Estimated Balance in Social Security Trust Funds at End of Year*



*Assets in Old Age, Survivors and Disability Funds less debt, if any, to Medicare Hospital Fund

Source: 1985 Trustees Report and Social Security Administration

Due to severe financing problems in 1978-1982 caused in part by poor economic performance, the 1983 Act was designed to keep the system solvent under a so-called "worst case" scenario. The 1985 Trustees' estimate is based on the much more favorable experience to date and on intermediate assumptions for the future.

The Trust Fund balances under the 1983 estimate would be relatively low in 1985, but would grow to $120 billion in 1990. Because actual experience has been much more favorable than estimated, the 1985 fund balance is $13 billion higher than the 1983 estimate and is estimated to grow to $180 billion in 1990, or $60 billion higher than the 1983 estimate. Such favorable experience should restore public confidence.

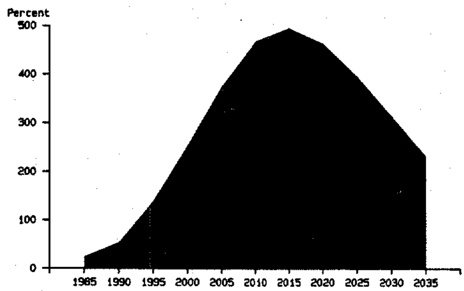
APPENDIX 1 (continued)

The long-range financial status of the program is best shown by the fund ratio. This ratio is the outgo for the year as a percentage of the assets at the beginning of the year. For the next 30 years, the fund ratio, according to intermediate estimates, will increase steadily and peak at about 500% (5 years' outgo). Then, the ratio decreases until the fund is exhausted in about 2050, when additional financing would be required.

Even if a higher tax rate is needed in about 50 years, this would not be onerous due to a rise in "real" wages and productivity. For example, even if the employee tax is increased by two percentage points in 2035, real take-home pay will more than double if, as expected, wage increases average 1½% more than inflation.

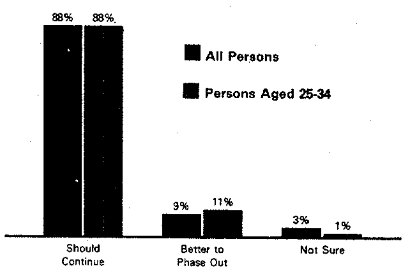
LONG-RANGE FINANCIAL SOUNDNESS, 1985 - 2035

Estimated Trust Fund Ratios at End of Year



Source: 1985 Trustees Report.

PUBLIC SUPPORT FOR SOCIAL SECURITY



Source: American Association of Retired Persons

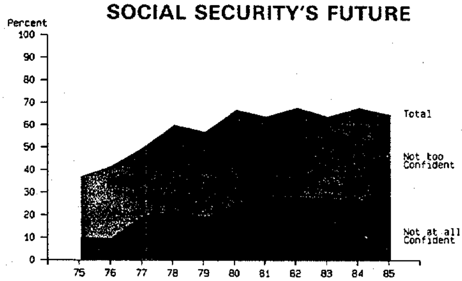
In 1985, the American Association of Retired Persons (AARP) made an opinion survey about various aspects of the program. About 88% percent of the respondents expressed basic support of the program and opposed terminating it. The support among persons aged 25-34 was virtually as high as among all ages. Although the vast majority support the program, the survey also showed that there remains a significant lack of confidence that it will fulfill its commitments. The task ahead is thus to convince the public that the financing of the program really is sound.

In a 1975 survey, 37% of respondents were either "not at all confident" or "not too confident" in Social Security's future. By 1982, this had risen to 67%. Despite the 1983 Act, this proportion remains high through 1985.

The 1985 AARP survey showed 53% were "not at all confident" or "not too confident." Although lower than the other survey, lack of confidence among persons aged 25-34 was higher, 67%.

As the charts on Social Security's sound financial condition show, confidence should rebound, but more dissemination of this information is needed.

LACK OF CONFIDENCE IN SOCIAL SECURITY'S FUTURE



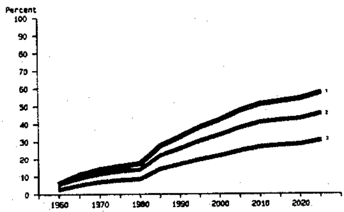
Source: American Council of Life Insurance

APPENDIX 1 (continued)

MONEY'S WORTH FOR PARTICIPANTS

Proportion of Benefits "Purchased" By
Average 65 Year Old Retirees: 1960 - 2025

1 Working Man 2 Working Woman 3 One-Earner Couple



Source: Computed by Robert J. Myers.

Whether people get their money's worth from the employee taxes which they pay can be analyzed by comparing the taxes paid up to age 65 (plus appropriate interest) with the "actuarial" value of future benefits.

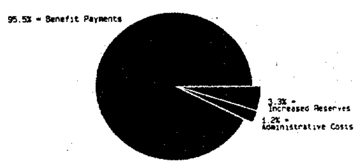
Those retiring in 1960 after a career of average earnings "purchased" less than 10% of the benefits they can expect to receive. This proportion increased steadily over the years. In 1985, it is 28% for working men, 22% for working women, and 15% for one-earner, married couples. In the future, these proportions will continue to rise steadily, but they will never reach 100%.

Despite what some might believe, young people will get their money's worth — and considerably more — from the Social Security taxes that they pay as an employee. Even today's highly paid young men (the lowest-cost category) will receive retirement benefits slightly in excess of the amounts "purchaseable" by their employee taxes. The secret of this apparently "magical" result is that the matching employer taxes are pooled over the years to provide the relatively more favorable benefits for "high-cost" groups such as those near retirement age when the program was first applicable, those with low earnings, and those with dependents.

Some people believe that a very sizeable portion of Social Security taxes are used to administer the program. This is by no means the case. In 1984, only 1.2 cents of every dollar collected went to pay operating costs, and the remainder was used either to pay current benefits or was set aside for the future. In fact, the program is being very inexpensively run.

However, services furnished to taxpayers and beneficiaries could, and should, be improved by having more funds allocated for administration. For example, record-keeping still lags too much, visitors to district offices do not receive prompt service, recomputations of benefits to reflect recent earnings are too much in arrears, and written communications are both incomplete and overly complex. Yet, high marks must be given for getting about 37 million benefit checks out on time each month and maintaining accurate records for about 125 million active workers each year.

HOW SOCIAL SECURITY INCOME WAS USED IN 1984



Source: 1985 Trustees Report.

About the Author

This 50-Year Report Card was prepared for the Committee by Robert J. Myers. Mr. Myers is the distinguished former Chief Actuary of the Social Security Administration (1947 to 1970) and the Executive Director of the 1983 National Commission on Social Security Reform, which produced the compromise that restored Social Security's financial health. His association with Social Security began in 1934 when he was hired as a Junior Actuary to analyze the various plans being proposed. Mr. Myers currently is a consultant on Social Security to the National Association of Life Underwriters and the American Association of Retired Persons. He is often asked to testify before the Congress and provide expert assistance in perfecting Social Security law.

Robert J. Myers, author of the "50-Year Report Card on Social Security" discusses the accomplishments and future of the Social Security system with Chairman Edward R. Roybal (r), and the Committee's senior Republican member, Matthew J. Rinaldo (l).

APPENDIX 2

THE WASHINGTON POST NATIONAL WEEKLY EDITION 8/26/85

SOCIAL SECURITY

A Declaration of Confidence and Support by Private Pension Professionals

In recognition of the Fiftieth Anniversary of Social Security, we the undersigned wish to pay tribute to its indispensable role in providing economic security.

Social Security provides the bedrock of America's income security programs. That is our message to America as private sector pension professionals.

As attorneys, actuaries, accountants, consultants, administrators, and other professionals, we serve employers, unions, and plan trustees in providing retirement income programs, almost all of which are supplementary to Social Security. We know from experience that all private pension programs build upon the foundation of Social Security. America needs the private programs which we design and help operate. Those private programs in turn need Social Security.

Social Security covers almost all American workers except certain government employees. It provides American families with basic income security when death, disablement and retirement end the flow of earned income, no matter how often workers have changed jobs. Social Security can and does provide steady income insulated from the shocks of inflation.

Social Security protects all generations today. And it will in the future. It shields young families from the financial devastation of the death or disability of a working parent. And by assuring young workers that their basic needs will be met when they grow older, Social Security enables these younger workers to meet more adequately today's needs of themselves, their parents and their families. When their time finally comes, as indeed it must, those currently at work and supporting Social Security with their taxes will harvest their own rewards.

The Social Security system operates soundly. The trust funds and scheduled future taxes have been designed to assure that Social Security will be able to pay its promised benefits in the future, just as it has always done in the past. They and the broad support of the electorate insure that Social Security is secure now—and for the future. Social Security works. We have complete confidence in Social Security.

The Study Group on Social Security
544 E. 86th St.
New York, N.Y. 10028

(We sign as individuals. Affiliations are indicated for purposes of identification only.)

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