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SOCIAL SECURITY COST TRENDS

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- o Reasonableness of cost projections in the 1986 Old-Age, Survivors and Disability Insurance (OASDI) Trustees Report
- o Possible policy alternatives in response to the higher cost projected for years after 2020
- o How to reduce the variability in cost trends due to economic and demographic changes
- o Financing implications of differences and similarities in cost trends between Social Security pensions and private plan pensions
- o Introduction of paper, "Components of Trends in Social Security Costs" by Francisco R. Bayo, Milton P. Glanz and Charles L. Trowbridge

MR. FRANCISCO BAYO: I would like to present the paper, "Components of Trends in Social Security Costs," which was offered by Milton P. Glanz, Charles L. Trowbridge and myself. The panelists are free to comment about the paper if they wish.

The Old-Age, Survivors, and Disability Insurance (OASDI) program is the most important pension system in the United States of America. Ninety percent of all employment is covered by this program. Over 95% of those turning age 65

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are eligible to draw retirement benefits. Its cost is about 25% of the overall federal budget and Social Security is about 5% of the Gross National Product (GNP). Without any doubt, the cost trends of the OASDI program are of significance in our country, both with respect to its social structure as well as to its economic development. The paper tries to analyze the principal factors that for the last 30 years have been affecting the cost of the program. The paper also attempts to analyze what is expected to influence the cost trends for the next 65 years. The procedures followed in the analysis of the paper are rather simple and straightforward. However, I must indicate that the procedure is not unique and that other researchers may prefer to break down the cost into other, different factors. The ones used in the paper are based on the authors' preferences as well as on the availability of data. In the interest of saving time for the panelists, since we are all interested in hearing what they have to say, I will try to summarize the paper and not present it section by section. Instead, I will give you what I consider the salient points.

First, the rapid increase in the OASDI costs in the last 30 years has been due mostly to increases in the proportion of the aged population that is eligible for benefits. In the 1970s and early 1980s, however, the relative value of benefits, when compared to average wages, also increased significantly.

For the future, the relative benefits are projected to decline by about 20%. The most important factor for the future will be the aging of the population. The demographic load that this aging would involve represents about an 80% increase in the cost. The projected increase in cost will be below 80% because other factors tend to decrease the cost. This combination of future trends, that is, decreasing average relative benefits and increasing demographic load, points toward the need for a reduction in the number of beneficiaries; possibly a further increase in the retirement age beyond that enacted in 1983. This will conclude my brief presentation. I would like now to ask Bob Myers to give us his comments.

MR. ROBERT J. MYERS: First, I would like to make a few comments on the Bayo, Glanz, and Trowbridge paper "Components of Trends in Social Security Costs." In brief, I think this is an excellent, interesting, really intriguing

analysis and one that bears close study and should be something that people should read if they want to see what is affecting, what is driving the OASDI system from a cost standpoint. There is one place in their analysis where I took some objection and I've submitted a formal discussion of the paper to the *Transactions* which I hope will be published, and I hope the editors won't massacre it out of all accuracy. This point was on the effect of the maximum taxable earnings base. The way I see what has been done over the years since 1951 is that while the base was adjusted on an ad hoc basis in 1951-72 it resulted in a relatively constant factor. In other words, the proportion of the total earnings of persons in covered employment, that were taxable was relatively constant at about 80% during the entire period except for the fact that in between the time that changes were made that proportion tended to drop as wages were rising so there was a sort of saw-tooth effect. Then when the earnings base was changed in the 1972 Act, it was supposed to be on an automatic adjustment basis beginning in 1975 and once again stability was introduced but at a somewhat higher level -- namely, that about 85% of the total payroll was made taxable. Because the adjustments were made annually it would have really held that same proportion and not had that saw-tooth effect. However in the 1977 Act, ad hoc increases of a more than proportionate nature were adopted for 1979-81. Then, the automatic provisions took effect for 1982 and later. So that what we have had since then and what we will have in the future as long as this provision is not changed is that the proportion of payroll that is taxable will be around 89 or 90%. This means that there's been a real increase in the coverage over the years from the 80%-level that prevailed during the period 1951-72 until what's going to happen in the future when its going to remain relatively level at about 90%.

Now turning to items that are on our agenda, as listed in the program. The first one is the reasonableness of the assumptions. By and large, I think that the assumptions both in the intermediate estimate and in the various alternatives are reasonable. I certainly don't want at this stage of my career to play Monday-morning quarterback to the actuaries at SSA who work so hard on this and so thoroughly. I do have a few views, however, as to the assumptions. Let me give them to you; but before I do, I do want to emphasize that these are not meant to be adverse criticisms but just, hopefully, slight differences in view and something that perhaps they'll take into account and maybe make

changes in the future along the lines I suggest. First is the fertility, which we all know is a very difficult subject to project. I have the belief that there is a relationship between fertility and immigration that is not being recognized as much in the assumptions for the future as I think it might be. In other words, I believe that if this country has low or decreasing fertility from the present level, as is occurring in some countries in Western Europe, I think this will be made up at least in part by immigration which I think is just another form of fertility. Therefore, if I were assuming in the pessimistic estimate very low fertility, I'd have much higher immigration. The two are intimately connected.

Next item is mortality. I think that the projections made by the Office of the Actuary, both present and past, are good. I think they're excellent. I don't see that anybody can really improve on them much. The actuaries at SSA have studied this intensively for years. I think they well recognize, as I think other actuaries do too, that this is not merely a matter of science in projecting these rates, it's a matter of art. There's some feeling in there in addition to a knowledge of the data. Just recently there have been some new entrants into this area. One of them is Mrs. Crimmins, in the Office of Management and Budget, but there are several others. I've read a paper that's being submitted to a journal by a person like this who just has come into the field and who has decided that you can do great mathematical, statistical things by fitting curves, running things through computers, regression analysis, etc. Then, by picking the right period, you can end up using data only from when mortality rates decrease sharply so you project those decreases ahead without remembering that mortality rates have already tended to level off. As a result, they get much lower mortality rates or much higher expectations of life in the year 2000 than the Office of the Actuary has in its projections and, therefore, they proclaim there's going to be another Social Security financing crisis. I don't think they realize that even if there were these improvements, they would come about so gradually that they really have their effect not in the year 2000 but some years later.

Another topic is the disability rate. This is again another tough one to project, particularly if we look at the swings that we've had in the past 10 or 15 years when the disability incidence rates were first high and then dropped

way off and now again are rising. To some extent it's a political matter as to what the disability policy is going to be as compared to the language in the law. But looking at it from the very long range, I believe that there should be some connection shown between the disability rates and mortality rates. If you have decreasing mortality rates in the future by age you should also have decreasing disability rates. I go by the simplistic theory that if in the future somebody age 60, from a mortality standpoint, is what today might be equivalent to somebody age 55 or 56, then the same relationship should apply to the disability rates.

The last assumption that I want to talk about is the retirement rate assumptions. Here again I think it's rather difficult to predict. In the past, the retirement rates have been very high, such a large portion of people retiring at so-called early retirement ages, between 62 and 65. I think that in the future when the changes made by the 1983 Amendments to raise the normal retirement age start taking hold and people realize this, there will be a change in the psychology of people who now think that 65 is the last year they ought to work. They'll begin to realize they ought to work longer and that they're able to work longer. I think the retirement rates in the future will be somewhat lower than they are now. In other words, I'd introduce more of a secular element into it than I think the official estimates do. However, I do recognize, and it's most important for us to know that after about 20 or 25 years from now retirement rates won't make much difference cost-wise. It may on a cash-flow basis, but on a long-range cost basis it will have little effect because the delayed retirement credits are being gradually increased to 8% by the year 2009 for people reaching the normal retirement age then, and that's very close to the actuarial equivalent. So, then if you have early retirement rates and deferred retirement rates that are actuarially equivalent, from a long-range cost standpoint, you don't care much when people retire. It doesn't affect the cost. Of course, I would like to see those DRCs being increased right away to the 8%. I think that's another matter. I think the earnings test now creates great unfairness for some people in the middle earnings levels, where there's so little incentive to work. For very high-income people like lawyers and dentists and actuaries and economists, they'll go on working anyhow. But there's a lot of people in the average earnings range where the

earnings test is just unfair and in essence should just be eliminated by giving actuarial equivalent DRCs as soon as possible.

Next let me turn to the subject of policy alternatives in response to higher costs and combine this with the other topic -- how to reduce the variability due to demographic/economic changes. But first before getting into this, I think there's one thing that's essential. I don't believe in changing the program much after the massive changes that were done in 1983. However, I think there should be something done in the next few years to prevent the huge buildup in the trust fund balances for OASDI that will occur in and after 1990. I believe this should be done by lowering the tax rates in 1990 to 2010 by 1% each on the employer and employee, or something of that order. Then after 2010 when the baby boom comes along with its accompanying high cost, the tax rate should be increased back to what is now scheduled to be the ultimate rate. By about 2020 there will have to be higher tax rates than the present ultimately scheduled one; and, beginning in 2030, the rate should be increased by about 1 1/4% each on the employer and employee.

I'm not a believer in higher and higher taxes, but you have to recognize that under the present laws, assuming that the intermediate estimate holds true, you would have to have that rate increase that I mentioned of about 1 1/4% each around the year 2050 anyhow, after the trust fund has been used up. So I don't see that rate as a rate that is impossible for the country to bear. I just think it is better to have an incidence of lower taxes for maybe the next 20 years or so and then slightly higher ones at what will be the real ultimate level. And perhaps, as I've advocated elsewhere, I would like to see these tax rate changes go in by automatic adjustment. When the fund ratio gets to be over a certain level the tax rate would drop a little bit until the fund ratio goes down and vice versa.

Now getting back to alternative higher costs in 2020 and afterwards. I suggest raising the normal retirement age even more than the 1983 Amendments did. I think that the normal retirement age might well be 68 to 70, eventually. But, I think that this need not be done now. This is something that should be talked about. Get people used to it. I think that what was done in 1983 was right. The delay in increasing the age for some 15 years gives people a chance

to realize this and to get away from this notion that age 65 is sort of sacrosanct. In the same way, when the age starts to be increased, I would just let it keep increasing a little faster than present law. That, I think, is the real element that affects what is coming as the higher cost, ultimately, as Frank's paper's analyses show.

About the increase in the normal retirement age, this could be done again by automatic adjustment methods. This has been talked a lot about in the past and, in fact, Senate Bill 1 in 1983 did incorporate automatic adjustments. It was not adopted, but rather the ad hoc increases to age 67 that are now in the law were done instead. Probably, the automatic adjustment method seemed too complicated to members of Congress. I thought it was a very nice approach. I'd like to see indexing done although increasing the normal retirement age can be done either way.

Another element that I think would take out a lot of the variability is one that the National Commission on Social Security Reform talked a lot about. Most of the members were favorable but at the last minute it wasn't recommended when the compromise was hammered together. It would be good if something could be done, eventually, to index the benefits in course of payment in the same way that you index the earnings record for pre-retirement. Two different indexes that we now have, of course, can produce instability. With this type of proposal, instead of indexing benefits generally by the Consumer Price Index, you would index by something based on wage increases, such as the increase in wages, minus 1.5% points. The wage increase, minus 1.5% is a close proxy at least according to the economic assumptions in the intermediate cost estimate for the increase in the CPI. If things go wrong in the economy and the CPI and wages don't move together, as happened in the early 1980s, an indexing method of this type would keep the situation under control.

Finally, I think there ought to be an effective fail-safe device put in place rather than having everybody disturbed thinking the program is going to go bankrupt and destroying public confidence. There was a little fail-safe device put into law in 1983, to serve as a warning, in that the Trustees have to tell Congress that there's trouble coming. But I don't view that as being much. I want to see something that really does something.

There was also passed into law something we call a stabilizing device which means really a partial fail-safe device. That device requires that benefits in course of payment will be indexed, not by the CPI, but by the increase in wages if that's lower, if the trust fund ratio is very low. The trust fund ratio is defined as the balance in the fund at the beginning of the year as a percentage of the benefit payments in the year during which the promulgation is made for the COLA at the end of the year. In other words, in December you make a promulgation for the COLA that goes into effect for January that's based on the fund ratio at the beginning of the year to benefit payments during the year, most of which is actual experience and can be well estimated. That's a pretty good stabilizing device, but the one in present law is far too weak. It only goes into effect if the trust fund is below 15% for years up through December 1988, then it goes to 20%. That's too low. I would put this lesser of wages or prices into effect unless the fund ratio were very, very high, say over 100%. You'll recall, there is also a payback provision. Later when the fund builds up you give the remainder of the COLA back to people, not retroactively but prospectively.

I would put a real fail-safe device in the COLA and say that if the fund ratio was low, and I would define it much higher than the present law does, you should then cut the COLA out for that year. The COLA is a very powerful cost-driving force and if you are having bad times, that can make all the difference.

There is a 3% trigger in the law. You don't pay the COLA unless the CPI goes up 3%. That is going to be eliminated, and there's going to be a COLA, regardless. It's in both versions of a bill, both the House and Senate have passed it, everybody is in favor of it, it's just a matter of getting it through sometime either this week or next week. I think it's a certainty because there's an election coming up in November and the COLA calculation is going to yield something like 1.2%, which means with the 3% trigger there will be no COLA. The politicians want to say "look what we did; we saw to it that you got this small COLA." I'm in favor of eliminating this trigger, but that's another subject. I think there are good reasons for doing it.

Another thing that I would do is a proposal that's been talked about for some years. If it's decided that the trust fund is getting dangerously low and that

next year there's going to be a great deficit that may even put it into bankruptcy, then automatically provide for sufficient income to be brought in next year to keep the fund up. Half of it would come from contributions, by raising the contribution rate, and half of it would come from reduction in the general level of benefits, including the COLA. In other words, if it was a serious enough situation, you might not only have to eliminate the COLA but in addition actually cut benefits back some. Well, I think if you had an automatic device as harsh as this is, it would at least assure the system's viability and people could be told that they are going to get 98% of their benefit and that they are certain to get them.

In any event, I believe that despite all these ideas about what you ought to do in case very drastic things happen, I think that the OASDI system is viable and, as President Reagan said when he signed the 1983 Act, what was done there was a compromise of a number of things, a number of parties giving up a little bit. If there's ever trouble with the system again, the same thing can be done. The American people can be assured the OASDI system is viable in the future.

Ms. Alicia Munnell is the Senior Vice President and Director of Research for the Federal Reserve Bank in Boston. She has had significant ongoing interest in the Social Security program and its financing for many years. She has written several articles about it. Today she will be helping us by giving us her insight from the perspective of her knowledge on economic and Social Security matters.

MS. ALICIA H. MUNNELL: This panel has been asked to address four issues relating to Social Security cost trends: (1) the reasonableness of the OASDI cost projections; (2) possible responses to the higher costs projected after 2020; (3) possibilities for reducing the variability in costs due to economic and demographic changes; and (4) the relationship between the cost trends for Social Security and those for private pension plans.

Let me start with the reasonableness of the OASDI cost projections. On this issue I would like to make two points. First, I am delighted that the request for comment was limited to OASDI and did not include hospital insurance (HI). For while future costs for the retirement and disability programs can be fairly

well bracketed, the financing requirements of HI are extremely difficult to predict, as they depend on future health care costs and the way medical and hospital practices are organized. Lumping together projections of the long run costs for hospital insurance with those for the cash benefit programs produces nothing but confusion.

Second, in my view the OASDI cost estimates are reasonable. The assumptions underlying the intermediate II-B option are more or less consistent with available rates and trends, and the optimistic and pessimistic projections seem to incorporate realistic alternatives. This endorsement of the overall picture, however, does not preclude some concerns with individual assumptions. As it turns out, these concerns, both on the demographic front and the economic front, tend to cancel out, and the proposed changes would have little impact on future cost estimates. Nevertheless, they may be worth mentioning.

The first pertains to the central assumption for the fertility rate, which is projected to rise gradually from its current level of 1.86 to an ultimate rate of 2.00 by the year 2010. This figure can be justified on the basis that it is not that much higher than the 1985 rate and it is consistent with the fertility expectations of American women, who continue to plan to have slightly more than two children over their lifetimes. [1]

On the other hand, the fertility rate has hovered around 1.8 for the last decade and some experts characterize the current figure of 1.86 as nothing more than an upward blip around this basically stable level. Moreover they point out that fertility rates in many European countries have already fallen below those assumed in the pessimistic projections (Table 1). It is too soon to determine which view is correct, but if the U.S. fertility rate falls back towards 1.8 in the next few years, serious thought should be given to lowering the long run assumption to 1.9. This number would coincide with the central assumptions used by the Bureau of the Census and would appear to be more con- sistent with a stable current rate. Such a change, however, would have only a minor impact on costs, reducing the long run actuarial balance by 0.25% of taxable payroll

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[1] U.S. Department of Commerce, Bureau of the Census, *Fertility of American Women: June 1985*, Series P-20, No. 406 (June 1986), Table 5, p. 26.

Table 1. Recent Fertility Rates for Selected European Countries

Country	Total Fertility Rate[a]	(Year)[b]
Denmark	1.38	1983
West Germany	1.41	1982
Luxembourg	1.45	1983
Netherlands	1.50	1982
Italy	1.51	1982
Belgium	1.67	1981
United Kingdom	1.78	1982
France	1.91	1982
Greece	1.94	1983
Portugal	2.19	1980
Spain	2.34	1979
Ireland	2.74	1983
United States	1.86	1985

[a] Defined as the average number of children that would be born per woman if all women lived to the end of their childbearing years and bore children according to a given set of age-specific fertility rates.

[b] Indicates date of latest available study.

Sources: European Economic Community, *Demographic Statistics*, 1985, Table 9; and Social Security Administration, Office of the Actuary, *1986 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds* (GPO, 1986), Table 11, p. 35.

The future number of workers to support the retiring baby boom generation depends, however, on more than just domestic population growth. The pattern of immigration also plays an important role. Currently, the Social Security actuaries assume that immigration will remain constant at its current level of 500,000 persons per year. This is a very conservative estimate, since it ignores the large number of people who enter this country illegally. To reflect this previously uncounted influx of people, the Census Bureau began this year to assume that illegal immigration produces a net increase in population of 200,000 per year.[2] If the actuaries increased their net immigration

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[2] Using data from the 1980 Census and subsequent surveys, the Census Bureau has estimated illegal immigration to be between 100,000 and 300,000 per year. Other studies have placed this number as high as 500,000. See Jeffrey S. Passel and Karen A. Woodrow, "Change in the Undocumented Alien Population in the United States, 1979-1983," (U.S. Bureau of the Census, 1986), unpublished.

assumption for II-B by a similar amount, the long run costs of the OASDI program would fall by about 0.2% of taxable payroll. Hence, lowering the fertility assumption and raising the net immigration assumption would roughly offset each other in terms of the long run costs of the system, but such a shift would provide a more easily defensible projection.

Similarly, the productivity assumption underlying the real wage differential may well be a little high. For the 1986 projections, the actuaries have assumed that productivity in the U.S. economy, defined as production per hour paid, will rise at a rate slightly in excess of that experienced over the entire postwar period. (That is, the ultimate productivity growth assumption under II-B is 2.05 as compared with 1.85 for the period 1955-1985.) While it would be totally misleading to simply extrapolate the very low level of productivity growth that occurred during the 1970s, something less than the postwar average would be appropriate in view of the significant shift from manufacturing to services in this economy.

Projecting productivity growth, however, is only the first step in calculating the real wage differential. A series of linkages relates productivity to the increase in real covered wages. Key among these is the ratio of taxable earnings to total compensation. This ratio is assumed to decline by 0.3% per year, so that cash wages will fall from their current level of 83% of total compensation to 75% in the year 2020 and then to 66% by 2060. This assumption of continued rapid growth in nontaxable fringe benefits now appears unduly conservative. Coverage for any of the three major benefits -- pensions, health insurance, and life insurance -- is unlikely to expand much further. The percentage of civilian workforce covered by these plans has remained almost constant since 1970 and a recent study by the Bureau of Labor Statistics showed that coverage in medium and large firms was nearly universal -- 96% of employees in these firms had health insurance, 96% had life insurance, and 91% had retirement pensions.[3] Moreover, the shifting industrial structure in the United

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[3] U.S. Department of Labor, Bureau of Labor Statistics, *Employee Benefits in Medium and Large Firms, 1985*, July 1986, Table 1, p. 3.

States tends to make further major increases in coverage unlikely. Industries with traditionally higher benefit coverage, such as manufacturing, are expected to employ a declining share of workers, while employment in industries with low benefit coverage, such as retail trade and services, is projected to increase. All these trends already seem evident in the data which show that the ratio of fringe benefit to total compensation has remained constant since 1983. (See Table 2.)

Table 2. Growth of Employee Benefits, 1960-85

Compensation	1960	1970	1980 (billions)	1983	1985
Total Compensation [1]	$294.9	$612.0	$1,599.6	$2,004.4	$2,350.7
Wages and Salaries	271.9	548.7	1,356.6	1,676.2	1,965.8
Nonwage Compensation	23.0	63.3	243.0	328.2	384.9
	(As Percent of Total Compensation)				
Nonwage Compensation	7.8	10.3	15.2	16.2	16.4
Legally Required	3.6	4.4	6.4	6.7	7.0
OASDHI	1.9	3.0	4.2	4.6	4.9
Unemployment Compensation	1.0	0.6	1.0	1.1	1.1
Workers' Compensation	0.7	0.8	1.2	1.0	1.0
Agreed-Upon	4.4	6.0	8.9	9.5	9.3
Government Pensions [2]	1.2	1.3	1.8	1.8	1.8
Private Pensions and Profit Sharing	1.6	2.1	3.5	2.8	2.6
Group Health	1.1	2.0	3.1	4.5	4.5
Group Life	0.4	0.5	0.4	0.4	0.3
Other	0.1	0.1	0.1	0.1	0.1

Note: Totals may not add due to rounding.

[1] Does not include military pensions.

[2] Includes Federal Civilian Retirement System, state and local retirement systems, and the Railroad Retirement System.

Sources: U.S. Department of Commerce, *National Income and Product Accounts, 1929-76, Statistical Tables*, supplement to the *Survey of Current Business*, September 1981, Tables 1.11, 2.1, 6.15; *National Income and Product Accounts, 1976-79*, supplement to the *Survey of Current Business*, July 1981, Tables 1.11, 8.4; and *Survey of Current Business*, July 1986, Tables 1.14, 8.5.

Not only is coverage unlikely to expand, but Congress also seems bent on keeping relative benefit levels in check by limiting contributions and benefits under traditional pension plans. A movement has also emerged to limit deferred savings vehicles solely to those that will be used for retirement saving. Moreover, the new lower marginal income tax rates resulting from the Tax Reform Act of 1986 will lessen incentives to receive compensation in nontaxable forms. In short, cash wages are likely to remain a relatively stable portion of total compensation and this has important implications for Social Security costs. If the wage compensation ratio stayed at current levels, productivity growth would only have to amount to 1.7% as opposed to 2.0% to produce a real wage differential of 1.5%. Alternatively, if productivity growth did turn out to be 2.0%, then the real wage differential would be considerably higher than assumed in the II-B projections.

In short, while it is possible to quibble with the individual assumptions underlying the OASDI cost estimates, the proposed changes, adopted as a group, would not significantly alter the overall picture. Hence, the projections for OASDI financing should be taken seriously, and thought should be given to the best ways to pay for future benefits. This brings us to the second and third issues posed to this panel -- namely, how to meet the higher costs projected after 2020, and how to reduce the variability of those costs due to demographic and economic fluctuations. In this regard I would like to make two brief points before turning to the important issue of the desirability of building up trust fund reserves as scheduled under current law.

First, the costs of the OASDI program are manageable even if they are financed on a pay-as-you-go basis. According to the II-B projections, the required combined employee-employer tax rate would have to rise from its present rate of 11.4% to roughly 14% in 2020 and then gradually to 16% by 2060. This means employees and employers would each have to pay 2.5% more; this is roughly equivalent to the magnitude of the increase the workers and their employers have faced over the last 20 years. Moreover, measured as a percentage of GNP, the burden of supporting the elderly after 2020 will rise only slightly, from 5% in 1986 to 6% by 2030, after which it would remain relatively constant. Finally, it is important to remember that the reason for the increase in costs involves no mystery; the number of elderly persons in our society is projected

to rise from 12% to 22% of the total population and a large elderly population dependent on fewer workers will require a greater share of resources regardless of whether the support is provided directly by children to parents or through the Social Security program.

The second point pertains to possibilities for stabilizing the system against economic fluctuations. In this regard, a clever, albeit not perfect, idea was floated about during the deliberations of the National Commission on Social Security Reform. The proposal was to adjust the retirement and disability benefits by the increase in wages minus 1.5% rather than by the change in the consumer price index. The 1.5% is the assumed differential between prices and wages in the intermediate II-B cost estimates, so if the II-B economic assumptions were borne out, the two indexing approaches would produce identical results. On the other hand, in the event of unanticipated variations in the rate of wage growth and rate of price increases, the wages-minus-1.5% approach would totally protect the system and ensure that the long run costs would be in line with the intermediate assumptions. The problem, of course, is that stable long run costs would be achieved at the expense of potentially significant fluctuations in the welfare of beneficiaries. Periods of low or negative real wage growth, such as that experienced during the 1970s, would reduce real benefits. For example, if prices increased at a rate of 4% and wages at 3%, nominal benefits (linked to wages minus 1.5%) would rise by only 1.5%, resulting in a 2.5% annual decline in their real value. While there is no reason to advocate such a procedure at this time, it is an idea to keep in mind should excessive nervousness about future OASDI costs ever endanger important program provisions.

Finally, let me turn to what is surely the most important policy issue regarding Social Security -- namely, how should the OASDI program be financed over the next 30 years? The demographics are extremely favorable; the low birth rates of the late 1920s and 1930s will be reflected in a considerable reduction in the rate of increase in the population 65 and over during the 1990s and the first decade of the 21st century. At the same time, the baby boom generation will continue to swell the labor force. As a result, the ratio of beneficiaries to workers, which has increased continually since 1940, is estimated to remain stable for the next 20 to 30 years. With a stable ratio of

beneficiaries to workers, even modest productivity gains will reduce the required Social Security tax rate. Under the intermediate assumptions, the rate is projected to decline from 11% in 1986 to 10% in 2005 and then start to rise gradually, reaching its present level again by 2015.

At the same time that costs are projected to decline, revenues are scheduled to increase, since a combined employee-employer tax increase of 1.0% over current levels is slated to take effect by 1990. With lower costs and higher revenues, the retirement and disability programs are scheduled to run substantial annual surpluses through 2025. The projected accumulations are staggering -- $12 trillion by 2025. Even if measured in terms of today's dollars, Social Security reserves will exceed $2 trillion. These accumulated surpluses are then scheduled to be drawn down to cover the annual deficits that arise as the baby boom generation retires, placing the system in rough actuarial balance for the next 75 years.

The major policy issue for the 1990s will be how these reserves should be used. Should they be saved to finance future Social Security benefits, as implied under current financing arrangements? Should they be used to pay off the large deficits amassed in the non-Social Security portion of the federal budget? Should they be used to cover projected shortfalls or finance new initiatives in the Medicare program? Or should payroll tax rates be reduced in order to return the Social Security program to its traditional pay-as-you-go form of financing?

In the past, my tentative opinion on this issue has been that, once an adequate contingency reserve (roughly 150% of annual outlays) has been accumulated, a return to pay-as-you-go financing would probably be the best course to follow. This conclusion rested on the belief that it would be very difficult in this country, as a practical matter, to stockpile real resources in anticipation of future benefit payments. It is more likely that Congress would divert surpluses in the trust fund to finance other parts of the federal budget. In that case, the only effect would be the use of payroll revenues to cover general government outlays in the first half of the period and the employment of general revenues to finance Social Security benefits in the latter part of the period.

This opinion was formulated, however, before the full impact of continued federal deficits was evident. Current projections now suggest that the nation will have accumulated at least $2 trillion of outstanding government obligations in the hands of the public by 1990. The likely result is that investment in government bonds will begin to crowd out private real investment to a significant extent, so that future generations will end up with a smaller capital stock and lower consumption. In this setting, it is probably desirable on the grounds of intergenerational equity to raise money in any way feasible to reduce the deficits and alleviate the debt burden. Using the surpluses in the trust funds to close the deficit gap and to begin redeeming outstanding government bonds will help increase private investment (provided the economy is kept at full employment). Hence, at this time I think that a buildup of surpluses in the Social Security trust funds would be desirable national policy.

Let me conclude with the fourth item on the list of issues -- namely, the differences and similarities between the cost trends for Social Security and those for private pension plans. In my view, the effects of demographic changes depend crucially on the way in which the plans are financed. If plans are financed on a current cost or a pay-as-you-go basis like Social Security, they will be extremely sensitive to changes in the age structure of the population, since that affects the ratio of beneficiaries to contributors. On the other hand, if plans are fully funded and monies are put aside each year in anticipation of future benefits, then demographic shifts have little impact on pension costs. In my view, any debate on this issue would need to center on the degree to which the benefit obligations of private plans are prefunded, but this particular issue I will defer to the experts.

MR. A. HAEWORTH ROBERTSON: Because of time limitations, my oral commentary today will be an abbreviated version of the written text that I am submitting for publication in the *Record*. I shall comment in turn on the four items listed in the program beginning with the reasonableness of the cost projections in the 1986 OASDI Trustees Report. It is obviously impossible to predict with certainty all the factors that will determine the ultimate cost of Social Security: inflation, fertility rates, unemployment, changes in productivity, etc. Therefore, the Trustees Reports include long range

projections of income and outgo for the program under 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.

The range of assumptions in the 1986 OASDI Trustees Report is certainly broad enough with respect to the long term, portraying OASDI costs in the mid-21st century of between 11% of taxable payroll under the Alternative I assumptions and 24% under the Alternative III assumptions. In my opinion, the entire range is too optimistic.

The Alternative I assumptions strain one's credulity by postulating that (1) the total fertility rate, which has averaged 1.8 children per woman for the past 10 years, will reverse its historic long range downward trend and increase to 2.3, and (2) the annual productivity increase will average 2.7% over the next 75 years, even though it has averaged only 2.0% for the past 30 years (1955-84) and 1.6% for the past 20 years (1965-84).

The 1986 OASDI Trustees Report, itself, in discussing the fertility rate states:

> The recent historical and projected trends in certain population characteristics, however, are consistent with a continued relatively low fertility rate. These trends include the rising percentage of women who have never married, of women who are divorced, and of young women who are in the labor force.

In the same paragraph, the Trustees Report, as if desperately grasping for a rationale to assume a higher rather than lower future fertility rate, states:

> 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.

West Germany has learned that this is a shaky rationale since their number of births per thousand inhabitants has fallen each successive year since 1964 resulting in the fewest per capita births of any country in the world and, perhaps, the lowest birthrate recorded in modern history. Since 1975 the West German population has fallen by about one million, the first example ever of a

population decline caused solely by low fertility. (This information is taken from the September 10, 1986 issue of the *Wall Street Journal.*)

With respect to the long term cost projections, I believe the entire range of assumptions should be made less optimistic and the central assumptions used for planning purposes should be closer to the current Alternative III assumptions than to the Alternative II-B assumptions.

With respect to the short term cost projections, I believe the entire range of assumptions should be made less optimistic. It would seem reasonable for the so-called pessimistic scenario to be at least as unfavorable as actual recessions that have occurred during the past 10 years.

Furthermore, I consider it grossly inappropriate, in assessing the reasonableness of the cost projections, to look solely at the OASDI program and ignore the HI portion of the Medicare program. Social Security taxes (i.e., FICA taxes) are used to finance the HI program, as well as the OASDI programs, and it has been traditional to reallocate total FICA taxes among the OASI, DI, and HI programs as necessary to keep each program solvent. Under current allocation schedules, the HI portion of the FICA taxes is sufficient to provide 49% of the promised HI benefits during the next 75 years under the Alternative II-B assumptions and only 27% of the benefits under the Alternative III assumptions. When it is so clear that the financial health of the HI program will require a reduction of the share of the FICA taxes that is available for the OASDI program (and/or a substantial increase in the total FICA tax), I would consider it negligent for an actuary to pronounce that the OASDI program is financially sound without making some reference to the HI program. To avoid this negligence is probably why the OASDI Trustees Reports, have, in recent years, included a summary of cost projections for the HI program -- although there is no explicit commentary on the questionable sufficiency of the OASDI tax rate considering that it comprises only part of the total FICA tax rate which is insufficient and is subject to reallocation. To make pronouncements that Social Security is in good financial condition and that scheduled Social Security taxes are sufficient is, it seems to me, analagous to a medical doctor's telling a patient that the patient's heart is strong enough to last 25 more years but failing to announce that his kidneys will stop functioning in

the next 6 months. The patient is interested in his overall health, not just selected parts of it. The Social Security participant is interested in the financial reliability of all the benefits supported by his Social Security taxes, not just selected portions of it.

Finally, on this subject, even to the extent that the projections may be reasonable, the commentary and the conclusions drawn from those projections and presented in the Trustees Reports leaves something to be desired. For example, the significance of accumulating surpluses during the next 25 years to be used to meet deficits in ensuing years is not discussed in the Reports.

Dwight Bartlett comments on this in *The Actuary* (September 1986) as follows:

> The Trust Funds which are invested in U.S. Government bonds are not in the same nature as private pension funds. The Trust Funds do not represent any real economic asset other than a commitment by the Federal Government to redeem the Bonds, presumably from general revenues, if and when that becomes necessary. Increases in the Trust Fund balances by the same token represent merely funds becoming available to the Federal Government to meet its current operating expenses. The consequences are that the large amounts in the somewhat fictional Trust Funds, which will accumulate over the next 25 years, obscure the fact that the program may be running at a substantial deficit when the baby boom generation retires.

As will be noted later, this is an oversimplified account of the consequences of investing federal pension funds in government securities, but it does make the valid point that surpluses may sometimes be more apparent than real and may obscure future deficits.

The substantial future deficits are obscured further by spreading them over a 75-year period and then concluding that they are small enough to be manageable. The reality is that little, if anything, will be done to resolve the future deficits until they begin to occur and by then they will not be as manageable as when they were spread over 75 years.

In summary, the traditional method of assessing the financial soundness of Social Security (by comparing income and outgo on the average over a period of

years) may not be appropriate except when income approximately matches outgo and there are thus no significant periods of advance funding.

The next two items listed in the program for discussion today seem to me to be interrelated: Possible policy alternatives in response to the high cost projected for years after 2020 and how to reduce the variability in cost trends due to economic and demographic changes.

I would suggest that it is not appropriate to address these OASDI issues in a vacuum. In other words, to propose changes in the OASDI program just because it has a high projected future cost or just because the costs vary with economic and demographic changes is to approach these problems from too narrow a point of view.

The OASDI program is not a national program of retirement benefits even though it is often characterized in that way to sell it to the public. Rather, it is an integral part of the social and economic structure of the nation. It is a vital factor in answering two basic economic questions: (1) What segment of the population is going to produce the nation's goods and services and (2) to whom are those goods and services going to be allocated?

Our efforts should be directed toward ensuring that these two questions are answered appropriately because, if they are, the OASDI problems will be resolved automatically. Of course, my opinion is that, with respect to the baby boomers, we need to redefine the age at which people can no longer be expected to be productive as the early 70s, not the early 60s. We need to do this so there will be a socially acceptable ratio between the active and inactive segments of the population; and, perhaps more importantly, so the nation will be capable of producing a sufficient quantity of goods and services to satisfy the needs and desires of the entire population, active and inactive alike.

The projected high, long range costs of the OASDI program are just an indicator that these basic economic questions must be addressed. The problem is not primarily a Social Security problem. The government does not make long range projections in areas other than Social Security. If it did, then Social

Security would not have to take all the blame for impending higher retirement ages and numerous other changes (such as the future rationing of medical care) that will have to be imposed on the baby boomers and their children.

In summary then, the fact that Social Security costs are projected to increase in the future and that such costs will vary with economic and demographic changes indicates that some action should be taken, but it would be a mistake to conclude that the action should be confined to, or even centered upon, changes in the Social Security system.

The last point listed is the financing implications of differences and similarities in cost trends between Social Security pensions and private pension plans.

I am not sure that the relative cost trends of private and public pension systems are as relevant to "financing implications" as are two other factors:

1. The mortality of private businesses as compared with the presumed immortality -- not to mention the presumed unlimited taxing power -- of the federal government. This difference is less, in my opinion, than it is presumed to be. The taxing power is not unlimited and it is possible for a government to promise more in benefits payable in the distant future than the taxpayers will be willing and able to support. (Not only is it possible, we have done it with regard to the portion of the Social Security program that is financed by FICA taxes.)

2. The traditional investment practices in which private pensions are invested outside the sponsoring company and federal pension funds are invested in government securities. The economic consequences of investing federal pension funds in government securities is frequently oversimplified. The real consequences depend on the effect that excess Social Security taxes have on other taxes (they could be unchanged or reduced) and the related question of whether excess Social Security taxes are spent or invested (and if they are invested, how wisely they are invested). In other words, the financial consequences of the advance funding of Social

Security will vary depending upon a chain of events that can be somewhat difficult to trace and assess.

I have not attempted to discuss thoroughly all four items on the agenda; rather, I have tried to make a few comments that may provide a different perspective on these issues. I would urge each of you to study the matters we are discussing today and to become more involved in the discourse. It would be wrong for you to assume that some superior power is analyzing these questions and resolving them in the most favorable manner for the nation as a whole.

MR. HOWARD YOUNG: When Mr. Bayo told me that due to the timing of my birth and my name I was going to be the last speaker, I thought about the quality of our speakers and the range of what they would say and I must say they've even exceeded my expectations. It occurred to me that maybe I ought to try to get you to look at the issue from a little different point of view, although I must admit that Mr. Robertson has already opened that door and to some extent the other speakers did too. I would really like to make a few points to just get you to broaden your thinking.

First of all, if you look at the Trustees Report and if you do some construction of the numbers, it appears to me that the so-called pessimistic assumptions tell us that by the year 2060 the gross national product (GNP) per capita will be about 2.88 times the current level; that's pessimistic. The assumption for II-B gets up to almost 3.6 times the current level, and the optimistic assumptions are almost 6 times the current level. These are per capita figures, not total gross national product. Although I'm not trying to suggest that Haeworth would come to the same conclusions that I do, I think these figures fit in with Haeworth's point that we should not look at the Social Security system all by itself. I also agree with Haeworth in that Social Security is the only entity for which we look forward 75 years and try to put both quantifiable and qualifiable ideas together. If we did that for the whole society, we might have a different point of view.

Trying to do that, I also feel that we should separate looking at OASDI versus HI because they are two totally different problems. I think Haeworth is right, we have a serious problem with HI. I think some movement has started with the

effort to have cost containment. But the reason I think they should be discussed separately is that they require two different types of analysis.

To find the kind of figures I am going to cite to you, I used the II-B assumptions, because I think they're reasonable. I don't argue that they're right; none of us knows what the world is going to be like over the next 75 years, given all the unknowns. At the World Future Society meeting this summer it was pointed out that we ought to pay more attention to events that have low probability but high impact; for example, nuclear disaster. In that regard, I would suggest that unless we do something about nuclear weapons we may be worrying about all of this for nothing. The other thing is that I chose numbers comparing the end points, 2060 versus now, simply as illustrations. I know that you can get different results by picking different end points. I'm not arguing whether these are representative averages. I'm not arguing that the specific numbers I cite, such as the GNP per capita, are important. As numbers, I think they're important in a sense that they convey a type of conclusion that we ought to think about.

If you're not inclined to read the Trustees Report in all its detail, I would suggest you look carefully at things like tables 1, 28, 30, A1, and F1. They have very interesting numbers to look at and think about. For example, can the total economy afford the program as it's now structured? As was indicated, in terms of percent of GNP, the increase is relatively small -- 4.39% of GNP goes to the program in 1986, by 2060 that's projected to be 5.15% (a relatively small increase over that period of time). I mentioned the GNP per capita, but aggregate GNP, of which these are percentages, goes up under the II-B assumptions 4 3/4 times, and giving 1 additional percentage point of GNP to this program has an insignificant effect on the amount of the GNP that is available for all other purposes in the society.

Furthermore, the share of GNP that is going to the population that this program is targeted at grows much less quickly than the population itself. The growth from 4.39% to 5.15% is a 17% increase in the share of the GNP that is going to the program. At the same time, the population in the target range grows by 60%, relative to the total population. So the relative per capita share

shrinks by about a quarter. We're certainly not being overly generous towards older people and other people who will be on Social Security.

If we can afford it in the aggregate, can we afford it as individuals? If you assume the 1.5% annual increase in real earnings, average real earnings by 2060 goes up 3 times from the current level. Currently, we have 94.3% of our cash pay left after Social Security taxes (5.7% goes into OASDI). If one looks at the 2060 rate and goes to current funding, such as has been suggested here, and if all of that were taken out of FICA, some employees would be paying 8%, half of roughly 16%. Even if you take the assumption that employees bear the total cost, i.e., the employee and employer shares, the net result is that the annual growth rate is cut by about 1/20. Instead of looking at 1.5%, you would be somewhere in the 1.43% range. None of these are trivial results but my point is, we certainly can afford it.

I don't deny that you reach a point where there's a psychological objection to paying a lot of payroll taxes. There's a psychological objection to paying taxes in general. I think we ought to put things in perspective. I personally favor, and have argued for, general revenue funding as a significant portion of the financing of Social Security. I'm one of those people that Bob Myers has characterized as an expansionist because I desire improvements in the program. My point is that even if we don't do that, we certainly can afford higher FICA if that's the route we choose to go. If that is the route, I would favor small, periodic increases in the FICA rate, but not annually -- I think that's too disruptive. I don't favor the kind of automatic fluctuation that has been suggested, and I would not suggest that we decrease the overall rate when the costs drop in the 1995-2010 period.

Now, what happens with the large trust fund? I certainly do share Mr. Robertson's view that if we don't solve the HI problem some other way, or at least mitigate it, we will use some of the money that is in the OASDI trust funds to finance HI. It's got to be paid from somewhere. Hopefully, we'll get the costs under control. If we're foolish enough not to do that, we'll just have to pay for it.

I think that if we, in fact, can deal with the HI problem in another way, then one of the things we ought to do is provide FICA relief to lower income people. In fact, I think we ought to integrate into the FICA system what is now the earned income credit under the income tax system and in other ways prevent the program from being such a large burden on people with lower incomes.

I haven't run out of things which I think we ought to do to make the program more desirable. We do face a significant problem in the way working and nonworking spouses are treated under the program. I share the view that postretirement indexing ought to some extent reflect wage indexing so that retirees could share in some of the real growth of the economy as well as simply protect them against cost of living increases. I'm suggesting that we look at some kind of an average of the wage growth and the CPI in order to develop an index for retirees. I think that there are arguments to say that people on limited budgets should be more protected against fluctuations in wage levels and the cost of living so that they shouldn't simply have benefits raised with a wage index. But neither should they be prohibited from sharing in the growth of the society.

What I really objected to is that they should get the lesser of the wage indexing or the CPI and eventually end up with the worst of all worlds. I think it would be perfectly appropriate for retirees to have shared in the fact that our economy was retrogressing in the early 1980s if, in fact, they had been told that they could share in good times. I think that we all ought to be in this together.

Benefit levels are not overly liberal from my point of view and the retirement age question is open. I think that the question of an appropriate retirement age ultimately will tie in with patterns of work in our economy. I think that if, in fact, we have more people who spend less time at work, then there will be less urgency to retire. The people I come into contact with most often in my professional life aren't all anxious to continue to work into their late 60s and early 70s. Their view of work isn't getting a consulting assignment, or it isn't spending a day like we are spending here today. They see it much differently and I don't see any indication that they're interested in raising the retirement age any higher than it has to be. Furthermore, I doubt if work

effort by 60 to 70-year olds is going to be the critical determinant of national output in the future. The assumptions in any of the range of alternatives in the Trustees Reports still contemplate substantial unemployment on the order of 5% to 7% among the entire workforce. Certainly, if there is some kind of a so-called worker shortage, we can handle it in some way other than moving up the retirement age any higher than people want it to be.

I have a few comments on the relationship to private plans, which really is a very different situation. It has always seemed strange to me that the so-called contractual claim on output that we develop because we're in a private plan has some kind of a promise which is going to return investment income, payment of capital, or something, and somehow that's a more legitimate claim than the transfer payments that we're promised under Social Security. Even characterizing a government payment as a government bond which comes out of general revenue financing in the future somehow has greater legitimacy in everybody's eyes than the transfer payment. Maybe we ought to issue Social Security certificates to people and everybody would feel more comfortable about paying off on those certificates when they come due.

The only other point I'd like to make relative to private plans is that they have a fairly destabilizing effect. When one company gets into trouble relative to another, because of demographic reasons, one shouldn't have competing labor costs between companies because one happens to have an older work force or happens to have a greater ratio of retirees. And yet that's what happens under private pension financing. Social Security, to the extent that it provides a certain benefit for everyone at a fixed cost for all employers, has a leveling effect across the economy that is useful.

As a final perspective on this whole discussion, if you look at the report, the 1985 population was 247 million people; by the year 2060 under projection II-B there will be 335 million people and under the optimistic assumption I there will be 413 million people. Will we really be better off as a society if we have 413 million people in the country instead of 335 million? What may be good from the point of view of OASDI financing may not be good for society as a whole.

PANEL DISCUSSION

MR. BAYO: Do any of the panelists have any questions, comments or remarks for the other panelists?

MR. MYERS: Since I was either honored or handicapped by going first, I couldn't work into my remarks what I anticipated others to say. I would like to make a few remarks quickly. I was a little dismayed at my good friend, Alicia Munnell, changing her mind about whether the big fund should be built up in 1990 and I hope tomorrow she'll change it back to where it was before. I think it's a defeatist attitude to say that this country is going to let these huge budget deficits build up and the best way to fund them is through building up the Social Security trust fund based on payroll taxes. I think we ought to face the problem right out. If we can't cut the deficit one way, we have to cut another way through direct taxes where the people know they're paying for that purpose and not fool them into thinking they're paying it for their own social insurance.

As to Mr. Robertson, the point about the productivity increases in the cost estimates being too optimistic, I think that, although that may be so, this is offset by the element that Alicia mentioned, namely, I don't think it will turn out that a higher and higher proportion of gross remuneration will be used up for fringe benefits. I think that both through actual experience and through congressional pressure, the proportion of compensation going into fringe benefits will not increase nearly as much as in the cost estimates.

Mr. Robertson objects to saying that HI is going to borrow money from OASDI so you really aren't going to have these funds. That's another reason for my argument that the OASDI tax rates in the future should be lower, should approximate the current cost rates, then there isn't anything to borrow. And if HI needs the money, it will have to have higher tax rates directly so the people will know what is going on. Now if it happens by chance that OASDI rates are cut and HI rates are raised, it may come out the same in balance but at least it's clear what's going on.

With respect to what Howard Young said when he referred to the GNP estimates and to how the relative burden isn't going to be so large if you compare it to GNP, I would only say that SSA shouldn't make estimates of what the GNP is

going to be. I see no need for them and you're just getting into another area of controversy. I don't like the idea, as Howard well knows, of using the general revenues to finance OASDI. I want to see it all out in the open -- direct, visible payroll taxes. People can have as much social insurance as they want, but let them see what they're paying for it. I think that will tend to balance whereas with money coming in from the general revenues, many people think that's just manna that falls from the heavens -- the other guy pays for it. It's like what Russell Long has often said about taxes, he's against taxing himself, he's against taxing you, let's put the taxes on that other guy over there hiding behind the tree.

As far as FICA relief for low income people, I think the present way of doing it indirectly through the earned income credit for married couples is the best way to do it. Let low income people have the dignity of saying they're buying their social insurance. They're paying the same rate for it as do other people. I would rather give them relief for their low income through the income-tax procedure, not through bargain rate OASDI taxes.

Finally, as to the patterns of work versus the retirement age that Howard mentions, I think that having the normal retirement age at 65 has the psychological effect of getting people to think that's when they're supposed to retire. I think that we've broken that myth. I think people will work longer and realize that 65 isn't the limit but rather it's a flexible thing depending on people's health and the general condition of the country.

MS. MUNNELL: I just have one comment and one question. I think that the idea of extending the retirement age as a solution to the higher cost in the 21st century is not as simple as it sounds. If you look at current retirement patterns, most people retire before age 65. In fact, there's a temptation to retire as soon as benefits are available. If you extend the age at which full benefits are available, all that means is that they are not going to change their retirement behavior, they're going to end up with lower benefits. The people who retire early generally tend to be the disadvantaged people in our society so that what it amounts to is a benefit cut, and pretty much a benefit cut on the low-income, unhealthy portion of our population. My question is, there are no business cycles built into these long run projections and I think

that sounds like a good point -- do you do some simulations that have business cycles in them and, if so, does it have much effect on the cost?

MR. BAYO: We do not include business cycles in the long range projections. It would be almost impossible to design a set that would be fully acceptable. We have had simulations of business cycles for short periods of times -- 10-15 years -- following patterns similar to the ones we have had in the United States during the 1960s and 1970s; that is, cycles that would last somewhere between 3 and 4 years. The results are fairly similar to the long range projections after you finish all the cycles. Naturally, you have lower levels of trust fund accumulations during the downturn of the business cycle and higher levels during the period of boom. On the average, they do turn out to provide similar but slightly lower trust funds. Generally, in the upswing you do not gain everything you lost in the downswing.

I would like to take the opportunity to comment on the fourth question that was in your program. It is my view that when one looks at pension plans in general, from the point of view of the total economy, we will be referring to the same group of people that Social Security is referring to: the same citizens, the same beneficiaries, and the same workers. The type of problems that we are going to see in Social Security will also be prevalent for private pension plans when taken as a whole. I would agree very much with what Mr. Robertson said. We need to look at Social Security not as Social Security per se but as a part of the total economy of the United States, as a part of the total social structure of the United States. The same thing is true with respect to private pension plans. The idea that we can save and invest is valid when talking about one group or another group, but not when talking about the total United States. As Mr. Robertson indicated to us, we will be speaking about who is going to consume in the year 2050 and who is going to produce it. The remainder is just a matter of bookkeeping. It is proper for me to keep a book on how much my neighbor owes me but it doesn't seem proper to keep a book on myself. The latter would be the situation under a macroeconomic point of view. The only difference that I can see is the need for capital information. We might be able to have a bigger pie to distribute in the year 2050 -- if we have a higher level of capital formation, and better investment of that capital -- but that is something that is related to the total economy of the United

States and does not necessarily apply solely to Social Security. If this nation needs more capital formation, then we should be prepared to develop higher levels of capital. If Social Security is selected as a vehicle to accumulate the necessary capital, it should be clearly known that it is being used as a vehicle not because Social Security needs it, but because the nation needs it.

MR. MICHAEL O. KHALIL: You mentioned that the retirement age is going to be 67 sometime between 2015 and 2025. I think it grades up to that. Was a higher age discussed by the president's bipartisan commission, and how did they arrive at age 67 as opposed to a higher age?

MR. MYERS: The facts are that age 67 will be applicable to persons who attain that age in the year 2027 and after. As to the national commission, this was a point on which there was not consensus but rather, there were two options. When the Congress decided to go for raising the retirement age instead of raising the ultimate tax rate, they picked a figure and a way of getting to that figure, that would just about show actuarial balance under the intermediate estimate. In our discussions before the national commission, there was consideration given to higher ages than 67 and, in fact, the recommendation of the group on the national commission who favored solving the problem through raising the normal retirement age would have gone above 67 -- their recommendation actually was to do this indexing method that I described earlier. But when Congress actually legislated it, they wanted to put in specific ages.

MR. JOHN C. WILKIN: If I may be so bold as to summarize what all of the panelists have said here, the consensus seems to be that over the next 75 years there is going to be a substantial increase in the demographic load placed on the OASDI and Medicare systems. The expected size of this load, according to each panelist, depends upon what demographic assumptions (fertility, mortality, and immigration) he considers to be most reasonable. Also, there seems to be a consensus that to a certain extent, this demographic load will be offset by increases in productivity. The expected size of this offset, according to each panelist, depends upon what economic assumptions (productivity, fringe benefits, average real wages) he considers most reasonable. To those on the

panel who claim that the demographic load will be mostly offset by the increases in productivity, and therefore there is no need to worry about the financial condition of the OASDI program, I think that the force of your arguments are muted whenever you leave the HI program out of your analysis, because the HI program has a much bigger deficit than the OASDI program.

Turning just to the question of the demographic load, Mr. Myers, you mentioned that a good way to lessen the demographic load is by raising the normal retirement age to an age even greater than the age 67 to which it was raised in the 1983 Amendments. Ms. Munnell has mentioned in her presentation that although the 1983 Amendments raised the normal retirement age, the earliest age of eligibility, which is age 62, was not changed, thus increasing the actuarial reduction at any given age. In effect, what was actually done was not so much to raise the retirement age as to lower average benefits. Mr. Myers, I wonder if you would clarify your suggestion; when you were thinking of raising the normal retirement age, were you also thinking of raising the earliest age of eligibility?

MR. MYERS: My own personal preference would have been to keep the ages in tandem. In other words, we should have gone from 62 and 65 to 64 and 67 instead of the other way of keeping 62 but cutting the benefits. I'd have preferred it that way although what was done I think is alright. I just think we've got to get out of this fix of mind that 65 is the age at which we're going to retire. As Mr. Young said, different types of workers have different concepts, different problems, but I just take the very dynamic view that the world's going to be different 15, 20, 30 years from now and that chronological age isn't going to mean the same thing. For instance, when I go to Saudi Arabia on a consulting assignment, which I've had for a number of years, they use a different calendar year there. Suddenly I get 3 years older there. Well, I'm not. Chronological age isn't going to count, it's how people are going to be able to work in the future. I would quite agree with Mr. Young, if we just stay the same way we are now in our physical make up, then it's going to be a real problem to force people on, say, the automobile production line to go on and work longer. But, I think that people are just going to be different physiologically than the chronological age that they happen to have then as compared with what it is now.

MR. YOUNG: I have no quarrel with the idea that if people want to work longer we should facilitate that. The problem is, and that's why I don't agree with raising the lower age, that if a lot of people don't or can't work longer, then something has to be done. The other thing is, in the same way that age 65 presumably has shaped people's thinking about the issue, talking about the demographic load only in terms of numbers of people shapes the way you think about the problem. What I'm suggesting is that the real load is the combination of the demography and the economics. The real load is, what portion of our output will go to older people, and will we be able to afford it? Whether that involves fewer or more people relative to the number who are working is a secondary question, unless there's a problem of people perceiving it as being unfair. That gets back into this idea that somehow it's unfair to stay home and draw transfer payments but it's not unfair to stay home and withdraw a private pension. I'm not sure that I see those as such different situations.

MR. BAYO: I would like to add a comment to John Wilkin's observation. I think that to a large extent we feel that since we're going to have higher levels of productivity -- 2%, 1.5% -- whatever the assumption, by the year 2050 or 2040 we will be able to afford to pay these higher taxes. I think human beings think in relative terms and whether or not we should be able to afford it will be determined by the people who will be living then -- not those living now. I certainly would not like to live the way that my grandparents lived. To me, a second car is a necessity, not a luxury. What is going to happen between now and 2050 is very difficult to determine. I can give you another example. Most people in the Central American countries believe that because of our higher income in the United States we should be able to afford paying even higher taxes than we are now paying. I doubt very much that most of us would agree with them. I also believe that the idea of a fair distribution of income, or of goods and services, is something that cannot be determined in the year 1986 to be applicable in the year 2050 or 2060.

MR. YOUNG: But people in other countries do have substantially higher tax rates than we do and are willing to use them in order to provide social benefits.

MR. BAYO: I agree. But as I stated before, I am willing to spend 25% of my income on just transportation; however, my father would roll over in his grave because of that.

MR. JACQUES R. GAGNE*: First, I'd like to congratulate Mr. Bayo for his paper and his colleagues as well. I think it presents a simple method of valuing some of the factors that go into Social Security, and we will in the near future try to use it in valuing the Quebec pension plan. Mr. Robertson, you mentioned that we have promised more benefits than future generations may be willing to pay. I think it's a possibility, but when you look at it that way do you think that the actuarial reports that we prepare on Social Security present that side of the picture? If we wanted to at least give the people who read those reports a chance to find out that there is a possibility that things will not go as we seem to promise that they will go, how should we present our reports or what type of information would you like to see in those reports?

MR. ROBERTSON: Well, I really do believe that we've promised more than we're going to be able to deliver if we look at OASDI, HI, and supplemental medical insurance (SMI). In the Trustees Reports, the long range projections are not presented in such a way that the entire costs of all those programs is brought to anybody's attention. As you saw from the panel today, whoever figured out the subject of this program decided it should be OASDI only and not the other parts. And Ms. Munnell was delighted that that's all we were looking at. Howard Young says that they are different problems and they require different solutions. Well, all those things are true. But if we're looking at it from an actuary's standpoint or an economist's standpoint, or the standpoint of anybody who wonders what the financial consequences are of what we've promised in the future, we have to look at HI and SMI also. There's been such reluctance to look at these other benefits and we've got to get over that. So, even though Medicare is a benefit paid in kind instead of in cash, it's still a life annuity. It's the equivalent of a life annuity from an analyst's viewpoint. It's difficult to predict the cost, but I don't think that means the costs are going to be lower than we like them to be. I think it means that

* Mr. Gagne, not a member of the Society, is with La Regie des Rentes du Quebec in Quebec City, Quebec.

they're going to be higher. We need to look at all the programs of benefits that we've promised to people when they're no longer active and the Trustees Reports have made some strides in those directions. Howard Young gave you some tables to look at in the Trustees Reports and I'll give you one, table E3 in Appendix E of the OASDI Trustees Report.

MR. CHARLES M. SCHNEEBERGER: What is the current status of the Medicare problem? Is a commission established on studying the hospital income deficit at this time?

MR. MYERS: Back in 1983, when the OASDI problem was the one that was addressed, this is what President Reagan asked the national commission to look at. The national commission recognized there was an HI problem but said this is not in our scope of responsibility. Back then, 3 years ago, it looked as though there was going to have to be another national commission about this time, or in the next year or two. However, since then, in large part due to the favorable economic performance and the decreases in hospital utilization, the HI problem now doesn't seem to be imminent at the end of the 1980s but rather more nearly towards the middle 1990s or later. As a result, without that immediate pressure, the political people, the Congress and the Administration, have not worried about having a national commission look at the matter. Instead it's just a sword hanging over our heads.

I don't agree with Mr. Robertson that you have to look at these two together and only together. I think you should look at them both and look at them separately. HI is a real problem, but so are health insurance costs for the country as a whole. There was a crisis coming before that now is alleviated some. The whole thing has to be solved sometime. I think we should never lose track of it but we shouldn't, at the same time, scare the public by saying Social Security has a crisis when we mean OASDI plus HI. The public uses that term to mean OASDI. We should define our terms.

MR. ROBERTSON: Let's look at HI separately. Let's look at SMI separately. Come back to figures I quoted a while ago. Over this projection period -- people think 75 years is a long time but if you're a 20-year old kid entering the work force, you ought to wonder about it because that's probably the period

of time over which you're going to be getting these promises delivered or not getting them -- the HI program has some scheduled taxes, it has some projected benefits and under the alternative II-B assumptions the taxes are enough to pay about 50% of the benefits. And under the alternative III assumptions the taxes are enough to pay about 25% of the benefits. Now that ought to make you think. Then look at the SMI program. The SMI program, Part B of Medicare, now costs about 50% of the cost of the HI program. How long into the future do we make cost projections for that program -- 3 years. So nobody is even concerned about the SMI program which is going to cost half as much as HI, and HI is woefully underfinanced. Somebody needs to be worrying about these problems and Bob Myers said there's no political concern now. Nobody is really studying it. Of course, we are making big changes in medical care, in general, but it's going to take even bigger changes or we're going to have to figure out some way to make a bigger pie so that when we slice out the medical care part, everybody is happy with what is left. We need more illumination of the problems, a more heightened awareness of these future problems. We won't get it if we keep setting it aside and saying, "Well it's not our responsibility, somebody else will do that, or we'll study that later, or another commission will do it, or somebody else should do it."

MR. BAYO: I would like to add to that comment with respect to the SMI program. When it started, it was financed on a 50-50 basis: enrollee and the government. Since then the proportion payable by the government has increased, and yet it has been characterized as a voluntary program. It's getting to the point, in my opinion, where the proportion that is financed by the government is so high that you have to have your head examined if you drop your enrollment in that program. This really is, to a large extent, a compulsory program, and it is a compulsory program for which the government is responsible. This kind of promise and the resulting cost need to be kept track of, projected, and studied. We should have projections for SMI costs for as long as we have them for HI and OASDI. They are the same group of people involved and the government should have an understanding and knowledge of their problems and their cost implications.