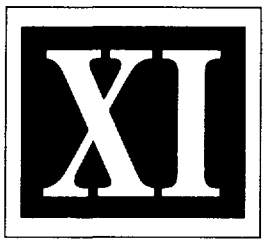

OASDI and the Future Economic and Social Environment

by Howard Young

Much has been written and said in recent years about the intergenerational effects of OASDI. This has caused me to reexamine my view of the program, as well as its relation to and interactions with the larger economic and social environment. The focus of this presentation is on certain responsibilities that successive generations have to themselves and to other generations.

The term "generations" is used here in a generic way, since it is not at all clear how many annual cohorts (20?) constitute a generation, or how to determine which calendar years should be used to separate generations. Nevertheless, it seems useful to think about each generation's responsibility:

- To share output with prior generations
- To recognize the "burden" that will result from its own goals for retirement and leisure
- To maintain—and preferably increase—the ability of subsequent generations to produce output.

Furthermore, the responsibilities to prior and subsequent generations are conceptually symmetric, so it is convenient to consider them together.

To a large extent, I agree with the concept that national output is used during a relatively short time period after it is produced, so generally it is impractical for a generation literally to "save" goods or services in order to consume them during its own retirement. However, actions that support future output levels are a way to "save" for retirement; that is well understood when the investment process is explicit, but often ignored with regard to implicit actions. For example, providing free public education to most children enhances their ability to utilize production facilities in the future, even after allowing for various shortcomings of our mass education system.

Therefore, the usual conclusion—that altruism was involved in covering, and providing so-called windfalls to, people who have collected OASDI benefits well in excess of their own money's worth—ignores the implicit economic and social inheritance provided by those people. In addition to financing physical infrastructure and activities like free public education, prior generations defended and maintained a political and social stability that enhances the well-being—as well as the productive capability—of the nation. Despite the philosophical differences among us, our national structure has not suffered the wrenching and often violent disruptions that have occurred in many other countries.

In fact, the implicit inheritance is so important that I suggest the trust fund, although not irrelevant, is primarily a historical record of explicit financial actions related to providing for future economic capability. Ignoring the implicit actions, which benefit subsequent generations, produces an inadequate evaluation of each generation's valid claims on subsequent output. A larger trust fund balance could have been recorded, without changing the overall fiscal status of the nation—although there probably would have been distributional effects—if the FICA tax rate had been higher, but offset by an equivalent decrease in income tax or other federal revenue.

With a larger current and projected trust fund it would appear that FICA taxpayers were behaving more responsibly with respect to their own retirement costs, but their benefits still would have to be paid by subsequent generations through some combination of taxes and repayment for investments. Similarly, various current proposals—to invest portions of the trust fund in private-sector securities—will not eliminate the need

for future generations to provide repayments on those investments as they become due.

Contentions that government bonds are only IOUs or "authorizations for future federal expenditure" do not make the trust fund any less substantial than it would be with other types of investment-generated claims. Of course, there are valid issues regarding the ultimate use of investable funds, but—unless one is totally committed to the belief that economic market forces never fail to maximize social utility—it must be recognized that there are important social goals that could be financed by the trust fund in ways that would explicitly relate the investment and subsequent repayments to preparation for future retirement costs.

For example, the trust funds might finance loans for postsecondary education and retraining, with repayments collected from future earnings. Such a proposal is more fully described in "Generational Alliance: Social Security as a Bank for Education," by Bluestone, Clayton-Matthews, Havens, and Young in the summer 1990 issue of *The American Prospect.*

It also is important to recognize that output capability is affected by demographic, as well as economic, investment. Past and projected decreases in the active-to-retired ratio largely reflect decisions about the number of children produced by each generation. More children presumably produce more output when they are in the active worker age range. However, that ignores the effect that a larger workforce has on the availability of jobs and their pay levels and assumes that there is adequate economic investment for the required production capital. Furthermore, limiting examination to the OASDI effects of the demographic projections ignores important concerns about environmental and other impacts of population pressure.

The partial substitutability of demographic and economic investment is also significant when considering the third category of a generation's responsibilities: recognition of the "burden" that will result from its own goals for retirement and leisure. If a generation produces relatively few children and is unwilling to offset its own increasing longevity fully with adjustments in retirement eligibility or benefits, then that generation has an even greater responsibility to make productivity-enhancing economic investments. Here again, implicit investments should be considered, along with the explicit actions reflected in the trust fund; however, the latter has another important function; the FICA rate provides a price tag to help communicate the cost of retirement benefits.

An unfortunate aspect of FICA financing is that it emphasizes the portion of current earnings used for payment of Social Security benefits, with little (if any) recognition of the affordability of that arrangement. Even with relatively modest average productivity increases, the cumulative effect between generations is substantial. For example, much of the discussion about the OASDI Trustees Report emphasizes that the cost rate, on the intermediate basis, goes from its current 12% of covered payroll to almost 19% at the end of the 75-year projection period; however, the same projections imply that, even after deducting the increased FICA rate, the average real wage would almost double during that time period. (Additional data are in the Appendix. For further details on this analysis, see "Another Look at the Affordability of U.S. Social Security Cash Benefits (OASDI)," in *Actuarial Research Clearing House* 1995, no. 1.)

Another interesting relationship can be found between increased productivity and retirement benefits. Advocates of increases in the full-benefit retirement age (and possibly in the earliest retirement age) often argue that such increases should at least proportionately offset longevity gains, by maintaining about the same ratio of adult lifetime before and after retirement. Although that adjustment is described as an equitable approach, that is, "it doesn't postpone the full-benefit retirement age by the total additional longevity period," it implies that all productivity gains should go to increases in material output or preretirement leisure. Otherwise, if some of the productivity gains were allocated toward postretirement leisure, each year of employment could support a longer period of retirement than today; thus, the ratio of pre- to postretirement age lifetimes would decrease.

Furthermore, the debate about when retirement should be permitted—with full or adjusted benefits—obscures the importance of facilitating additional flexibility in lifetime allocations of employment and leisure. Individuals always have had varying desires about the ratio of employment-to-leisure time, even after allowing for their material goals. The changing nature of employment relationships may further amplify that variation. Therefore, considerable effort should be made to recognize and accommodate alternative employment patterns (especially at older ages, for example, phased retirement or other active-to-retired transitions) and increases in preretirement leisure. As an interesting example of the latter, Yves Guerard has suggested (for Canada, but the idea is also useful for U.S. Social

Security) that sabbaticals—for midlife retraining or otherwise—could be financed by delays in the individual's full-benefit age.

In conclusion, I recommend a "macroview" of the Social Security program that is related to the broader economic and social environment now and in the future. OASDI is not simply a private-sector pension plan writ large; instead, it provides socially determined claims on the future economy. Demography cannot be ignored, but it is not the sole determinant of what is desirable or affordable.

Of course, there will continue to be significant political and psychological issues, for example, about the "reality" of the trust fund, about how to verify the intergenerational effect of public investment, and—perhaps most important of all—about whether future generations will be willing to share their output with a larger proportion of retirees even when they clearly can afford to do that. Nevertheless, I will close with two quotes that strike me as providing the correct outlook even if they sometimes appear overly optimistic:

> The Nation's future has probably never been less constrained by the cost of natural resources or the limits of human strength, dexterity or memory. Much less depends on physical limits to what can be done and much more on what Americans choose to do. (OTA, former agency of the U.S. Congress)

> The future does not just happen to us; it is created by what we do and what we fail to do. It is we who shape the future and we who make tomorrow what tomorrow will be. Thus we need to think less in terms of predicting the future and more in terms of what we want the future to be. . . .The years immediately ahead are a legacy from the past that we will have to deal with, but the more distant future remains ours to shape according to our dreams of what we want the world to be. (E. Cornish, futurist)

Appendix

Each of the trustees' annual reports for the Social Security trust funds is a cornucopia of data. The Office of the Actuary publishes much additional material and is very cooperative in providing supplementary data and interpretive comments. However, it is not implied that my conclusions are endorsed by the trustees or the actuarial staff.

In the Trustees Report the major focus is on projections expressed as a percentage of payroll. That indicates how available income is to be shared, but it doesn't show affordability. This analysis—which addresses only the cash benefits (OASDI) program—suggests that additional measures be considered to supplement, rather than replace, the percentage of payroll data.

	Alternatives		
Summary of Results[a]	**I**	**II**	**III**
Ratio of real average wage less the employee's share (i.e., 50%) of payroll cost for then-current OASDI benefits			
Year 2030/Year 1996	1.62	1.33	1.08
Year 2070/Year 1996	2.90	1.93	1.26
Ratio of real (GDP-OASDI) per worker			
Year 2030/Year 1996	1.70	1.42	1.22
Year 2070/Year 1996	3.16	2.25	1.64
OASI real benefits per beneficiary Ratios for years indicated:			
Year 2030/Year 1996	1.44	1.24	1.07
Year 2070/Year 1996	2.51	1.77	1.27
$ annually, per billion GDP			
1996	1.07	1.08	1.11
2030	0.74	0.80	0.86
2070	0.55	0.68	0.86

[a]Using 1996 Report.

Source: Table II.F.13: Comparison of Estimated Income Rates and Cost Rates by Trust Fund and Alternative, Calendar Years 1996–2070. Table II.F.17: Components of Annual Income Rates by Trust Fund and Alternative, Calendar Years 1996–2070. Table II.F.19: Comparison of OASDI Covered Workers and Beneficiaries by Alternative, Calendar Years 1945–2070. Table III.B.1: Selected Economic Variables by Alternative, Calendar Years 1995–2070. Table III.B.4: Estimated OASDI and HI Income Excluding Interest, Outgo, and Balance in Current Dollars by Alternative, Calendar Years 1996–2070.