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Social Security and Medicare—What Does the Future Hold?

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Moderator: BRUCE D. SCHOBEL
Panelist: A. HAEWORTH ROBERTSON
Recorder: BRUCE D. SCHOBEL

Summary: The press continues to report on the uncertain financial status of Social Security and Medicare. What is truth and what is "hype?" In this session, Social Security and Medicare experts separate fact from fiction to give you insight into the solvency of the systems and proposals for change.

Mr. Bruce D. Schobel: I work for New York Life Insurance Company. Before that, in an earlier life, I worked for the Social Security Administration for nine years, from 1979 to 1988. During that time, I held various actuarial and policy development jobs, ending with my last two years as Senior Policy Advisor to the Commissioner of Social Security. Since then, I've been active writing and speaking on Social Security to various groups. I haven't been quite as active as our other panelist, however.

Haeworth Robertson was Chief Actuary of Social Security from 1975 to 1978. He was there before I was. We didn't actually overlap, but we've known each other quite well for the last, roughly, 20 years. Haeworth, interestingly, left Social Security, as you will learn from his book, if you haven't already read it, because he felt that the people there really didn't want to hear what he had to say. Being in that situation, he didn't particularly want to stay. So he left. I know how that feels because I left under fairly similar circumstances. Since Haeworth left the government, he has been very active speaking and writing about Social Security. He's written several books, including his most recent called *The Big Lie*. Haeworth is also President of the Retirement Policy Institute, which is his own think tank. Haeworth, unlike many people, speaks and writes very passionately about this subject. I think that's refreshing.

Mr. A. Haeworth Robertson: Before I start, I want to supplement some things that Bruce said about my past. You're entitled to know the perspective that I have on Social Security and how I got it. I was, basically, a pension consultant for about ten years when I first started in the business. Then, I spent about five years as an organizer and manager of a small life insurance company. Then, I spent about five years with the International Labor Office, consulting on social insurance to developing countries. Now, the point to all that is I don't want to appear to pass judgment on government employees or career bureaucrats. I don't know whether it's good or bad that people are career bureaucrats. But I'm not one of them.

I come from the outside. I was Chief Actuary of Social Security for three years from 1975 to 1978 when I left. About two months after I left Social Security, it instituted a program of outside speakers to get other viewpoints from those who had insights. I was the first person hired. I think I received $200 to come back and conduct a seminar. So I was always kind of an outsider.

I'll summarize the things I'm going to say with a few sentences. There are six major points. Number one. Social Security and Medicare promise more in future benefits than future taxpayers will be willing and able to pay. It may seem obvious to most of you, but I'm not sure it is. I should say one other thing. This session is designed for people who have had no experience in this issue, as I read the program, but I won't make it quite that basic. If everything I say you think is right and you already knew it, then why did you come here? Maybe you might get some other ideas on how to explain this to the public. Because that's what we really need, and I can't think of a more appropriate group than this. So the first point is, we've promised more than future taxpayers will be willing and able to pay.

Number two. In order to close the gap between projected income and outgo, significant changes have to be made in benefits or taxes or both.

Number three. The public will be very reluctant to accept these changes because they do not understand the true nature of Social Security nor its long-range financing problems.

Number four. There's good reason for this misunderstanding. The public has been lied to for 60 years about the nature of the program and how it works. Five to 15 years ago, when I was writing books, I said the public has allowed itself to be misled. But I'm getting bolder now. The public has been lied to about how these programs work.

Number five. The public must stop voting for politicians who lie about Social Security and Medicare. Every voter must demand that politicians tell the truth about

Social Security and Medicare and then begin to redesign it so that it will meet our needs at a price that our children can afford to pay—assuming that we continue with a pay-as-you-go system.

Number six. You, as actuaries, should get involved in this education process.

Now that's really the whole thing. But I'll go on and explain my views in a little bit more detail on some of those items.

I'm going to refer to pages from my book. It's always a problem talking about Social Security. What do you mean by Social Security? Well, I always thought Social Security meant Medicare, too, when I worked there. But now 20 years later they've managed to change the ground rules of the debate. Some people seem to think Social Security and Medicare are separate things. And maybe they are. But I want to point out to you, if we take the retired workers and spouses over age 65, the average cash annuity they're receiving is $1,215. But they also get insurance protection. I call it a medical care annuity.

The value of the hospital insurance (HI) and the supplementary medical insurance (SMI) medical care annuity is $822 a month. That's 40% of the total benefit that's being paid to retired people. So if we're taking a look at the future to see what kind of benefits are being provided to people over age 65, we really need to look at the cash and the medical care annuity. Very often people will separate those and particularly they leave Medicare over to the side. And they say, "Well, that's such a big problem. Somebody else will solve that." But I'm not willing to talk about it in those terms.

The trustees put out a report every year. They made a summary of it this year. There are two public trustees. I was so proud of them, I wrote each one of them a letter for putting language in here like I think should be in. There are four trustees who are trustees by virtue of their office: the Secretaries of the Treasury, Labor, and Health and Human Services, and the Commissioner of Social Security. And then there are two more public trustees. They are appointed, somewhat politically, but they are public trustees.

These public trustees said, in their summary, "The aging of the baby boom generation will place heavy demands on both Social Security and Medicare requiring substantial changes and sacrifices by some or all Americans. A key point to remember"—and if they had asked me to write this paragraph, this is what I would have said if I'd been capable of doing it—"a key point to remember as the debate goes forward, is that while Social Security and Medicare are large and complicated programs, which are usually considered separately, they are clearly interrelated. Together, these programs form the foundation that Americans depend upon in retirement." I've underlined this: "Both of these programs are vying for the same limited resources and in the long run, the shape of both programs will be driven by the same demographic forces that are leading us to an aging society." Then they go on to say about SMI, Part B of Medicare, which is probably the most overlooked and ignored program in history: "Continued SMI growth at current rates will ultimately lead to costs which exceed the capacity of the funding sources, Federal general revenues, and beneficiary premiums."

We've promised more than we can pay for. Therefore, even major legislation this year cannot fully resolve the issues of health care costs. We should expect that further legislative action will be needed even before taxing the increase in Medicare costs that will occur when the baby boom generation begins to retire. So the trustees seem to be taking up this call. But, if you noticed, I didn't say all the trustees; I said the two public trustees. The four *ex officio* trustees decided to remain silent on these problems.

On Table 1 I've taken the period of time that most of you will be in your retirement years, 2010–2060. I don't think most of you really care, personally, what happens to Social Security in the next ten years. It's when you retire that you're concerned about it. I took the projected expenditures and projected income, all from the trustees' report. As you can see, on the left side, OASDI, we're scheduled to collect in taxes 80% of what we need to pay benefits. Another 15% we haven't made provisions to collect. I don't know how we will get it. There's much talk about the trust funds. Of course, I'm going to maintain, later and now, that there isn't anything there. So it's going to be irrelevant to put it on this table. But assume there is something there. The value of the trust funds is enough to pay 5% of the benefits over that 75 years. So the trust funds are not a significant element in financing this program.

You move to HI and you see we've made provisions to collect only 39% of what we need. If we combine the two, we've made provisions to collect 64% of what we need. And SMI is financed by premiums to the extent of about 25% of current costs, but in the future, if there are no changes in the law, the SMI cost will be financed only about 7% or 8% by premiums and the rest by general revenue. It's really easy to get general revenue. That just flows out of the heavens. So nobody has been worried about that.

The Social Security trustees make projections based on three scenarios. Three sets of assumptions. They call one of them intermediate, one high cost, and one low cost. The ones that I've just been talking about are the intermediate assumptions. I don't believe the intermediate assumptions. I think the range will be somewhere between the intermediate and the high-cost assumptions. The assumptions you make in making any projections should bear some relationship to the reason you are making the projections. If the American public thinks that Social Security guarantees certain benefits to them, and it seems to me that most of them think that, I think we ought to be assessing the viability of this program in the future based on the so-called high-cost assumptions. Now that I've brought up the high-cost assumptions, look at Table 2. You can see there we are in deeper trouble during the retired lifetime of all you young people.

TABLE 1
COMPARISON OF PROJECTED EXPENDITURES AND INCOME,
DURING THE PERIOD 2010-2060, FOR EACH PART OF SOCIAL SECURITY,
BASED ON INTERMEDIATE ASSUMPTIONS

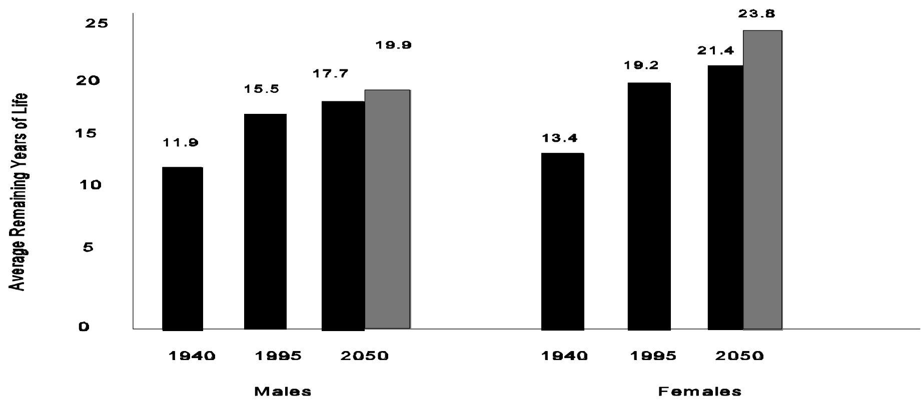
	OASDI	HI	OASDI & HI	SMI
No earmarked source of income available under present law to meet these expenditures	15%	61%	36%	92%
Expenditures met by liquidation of trust funds and interest on trust funds	5%			
Expenditures met by earmarked income (payroll taxes, income taxes on OASDI benefits, and SMI premiums)	80%	39%	64%	8%

TABLE 2
COMPARISON OF PROJECTED EXPENDITURES AND INCOME,
DURING THE PERIOD 2010-2060, FOR EACH PART OF SOCIAL SECURITY,
BASED ON HIGH-COST ASSUMPTIONS

	OASDI	HI	OASDI & HI	SMI
No earmarked source of income available under present law to meet these expenditures	32%	77%	55%	93%
Expenditures met by liquidation of trust funds, and interest on trust funds	2%			
Expenditures met by earmarked income (payroll taxes, income taxes on OASDI benefits, and SMI premiums)	66%	23%	45%	7%

If you go to Chart 1, I'll start showing charts that you've seen lots about. I compare life expectancies measured from age 65 in the past, currently, and in the future. If you look at females, they used to live 13 years beyond 65 in 1940. When you read that maybe they'll be living 21–24 years once they reach age 65, you just might get an idea that some kind of changes have to be made in our society.

CHART 1
REMAINING LIFE EXPECTANCY FOR PERSONS
REACHING AGE 65 IN SELECTED CALENDAR YEARS



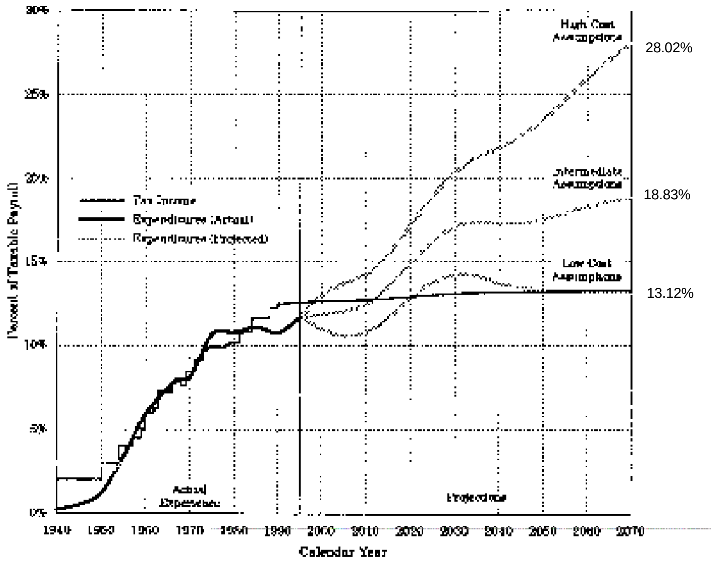
Note: Two projections are shown for 2050, based on the "intermediate" and "high-cost" assumptions, respectively.

Source: *1996 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*.

I'll just point out that on Charts 2,3, and 4, I've shown the projected income and outgo separately for the OASDI program, the HI program, and the SMI program under all three sets of assumptions that the trustees use. So, I say, the public has never really been told the whole truth about Social Security nor about Medicare. This has created a monster Catch 22 for us.

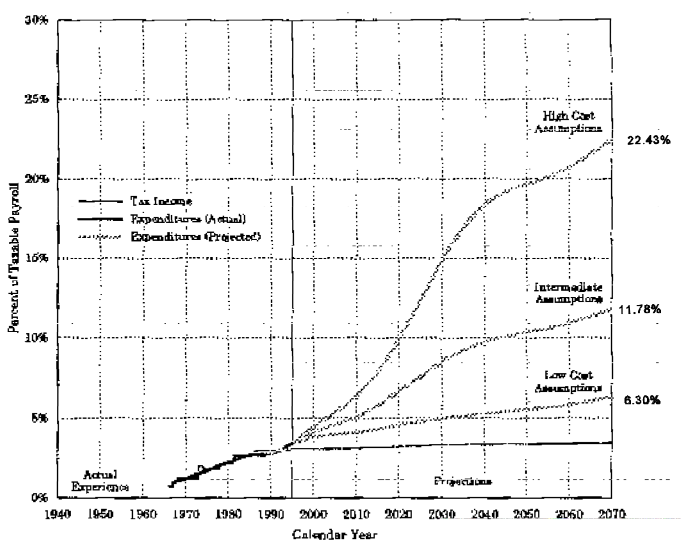
The pay-as-you-go financial structure of Social Security requires that periodic changes be made in either benefits or taxes. You can't freeze benefits and taxes and have it work forever under a pay-as-you-go system. If you analyze it, it's hard for me to find the difference between a pay-as-you-go system and a Ponzi scheme. All of these lies must be stopped. Every citizen should insist on full disclosure of the truth about Social Security.

CHART 2
PROJECTED EXPENDITURES AND TAX INCOME FOR OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE PROGRAM UNDER ALTERNATIVE DEMOGRAPHIC AND ECONOMIC ASSUMPTIONS
(AS A PERCENTAGE OF TAXABLE PAYROLL)



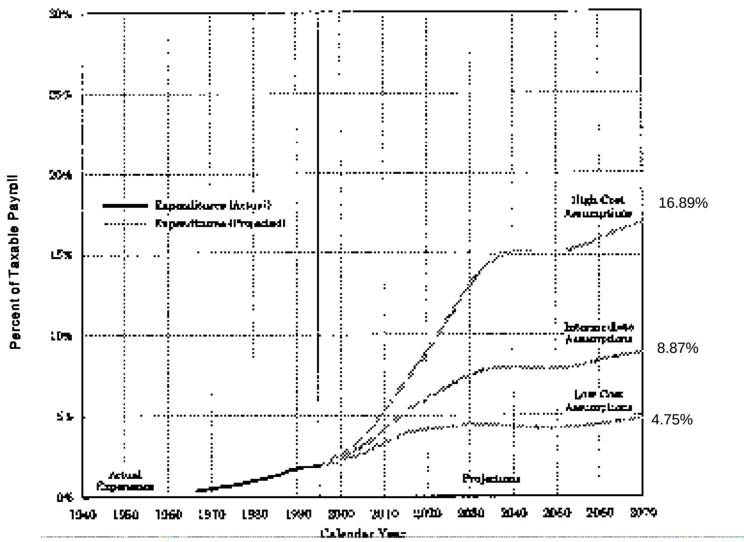
Source: *1996 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds* .

CHART 3
PROJECTED EXPENDITURES AND TAX INCOME FOR HOSPITAL INSURANCE PROGRAM UNDER ALTERNATIVE DEMOGRAPHIC AND ECONOMIC ASSUMPTIONS
(AS A PERCENTAGE OF TAXABLE PAYROLL)



Source: *1996 Annual Report of the Board of Trustees of the Hospital Insurance Trust Fund.*

CHART 4
PROJECTED EXPENDITURES FOR SUPPLEMENTARY
MEDICAL INSURANCE PROGRAM
UNDER ALTERNATIVE DEMOGRAPHIC AND ECONOMIC ASSUMPTIONS
(AS A PERCENTAGE OF TAXABLE PAYROLL
FOR HOSPITAL INSURANCE PROGRAM)



Note: Projected SMI income is not shown. By law, income from beneficiary premiums and government general revenue contributions are automatically increased each year to meet projected expenditures.

Source: *1996 Annual Report of the Board of Trustees of the Federal Supplementary Medical Insurance Trust Fund* and unpublished data from the Office of the Actuary, Health Care Financing Administration.

I'm going to summarize very briefly some of those truths as I see them. Number one: benefits and taxes. The system is not designed to pay benefits to an individual that can be provided by his own taxes. In other words, an individual should not expect to receive his money's worth from his taxes, at least measured by personal benefits received. Instead, Social Security was designed to be a complex system of income redistribution.

Remember that term, income redistribution, because I'm going to come back to that. On the average, persons retiring during the past 60 years have received much more in benefits than their taxes together with the employer taxes could provide. Actually, they've received (or accrued) as of now about two times as much in benefits. No wonder we like this system. We misunderstood it. We thought we were getting what we paid for. We weren't paying very much and we were getting a lot. Yes, we liked that. But the current generations coming into the work force aren't under those same circumstances. So they're not so sure they like it. And I think that concern will grow and grow.

Number two: the financing methods. Social Security is financed on a pay-as-you-go basis, with no advance accumulation of funds to pay benefits due in the future.

Number three: financial condition. Current Social Security tax income is adequate to pay benefits except under Medicare. Based on projections made by the Social Security trustees, however, outgo will soon begin to exceed tax income under each part of the Social Security program. This deficit is not a temporary phenomenon. It will continue and grow rapidly in the future.

Number four: retirement age. Currently, most Americans retire in their early 60s. Persons born after 1945, that's most of you, should expect to retire in your early 70s, although you might only work part time after your 60s. This is a very important point. A later retirement age will reduce many of Social Security's financial problems; however, this is not the principal reason for increasing the retirement age. The primary reason for a later retirement age is to maintain, approximately, the present ratio of workers to non-working adults and, thus, have a large enough and productive enough work force in order to produce all the goods and services that all of us want. But we become aware of this problem in the future with Social Security because that's the only big program that I know of where we make long-range projections. If we made long-range projections on every other aspect of the economy, then we could blame the needs for a higher retirement age on something else. We wouldn't have to blame it on Social Security anymore. But, it's kind of hard to get people to take that broad look at the system.

Number five: Medicare benefits. Medicare is out of control. Major reforms must be enacted. Continued debate about whether changes should be made is ridiculous. The only justifiable debate is about what kinds of change should be made. The present half-hearted efforts at medical care reform are nothing compared to the frenzied efforts that lie ahead. During the coming months and years, we will be debating national health insurance; the moral and ethical questions of rationing medical care; euthanasia; federal control of hospital costs; physician salaries; government-provided vouchers with which to buy health insurance; payment by beneficiaries of a larger share of the health insurance costs; forcing hospitals to close, consolidate; luring—I use that word advisedly—more retirees into HMOs and managed-care plans. All those items that we're going to be discussing are going to result in a very painful dialogue in the future. But as painful as it may be to discuss that, it would be even more painful to continue to ignore the problem and hope that some act from heaven solves all these problems.

I've received some fan mail. Not too much. I go to a hairdresser. Her name is Latitia. She wanted one of these books. I gave it to her. The next time I went in for a haircut, she handed me this card. Somebody had written on the back of Latitia's card, "Just wanted to let you know that a general accounting office employee who works on Medicare issues really enjoyed this book, particularly its clarity." That's one of my favorite testimonials so far.

I got another one. In the book, I give some anecdotes about ways I've seen the program misrepresented. A couple of years ago, there was a fairly important official, an Assistant Secretary of Treasury, who gave a speech to a group of people at the National Academy of Social Insurance. The topic they were discussing was income redistribution. This person was a founder and a former President of the Academy to which she was directing her comments. She made the lunch-time address and said, "We should be less explicit in explaining the degree of income redistribution in Social Security if we are interested in low-income persons. Too much clarity is not a good idea. The redistribution element in Social Security should not be transparent." Did you get all that? This person was proposed, at least considered, fleetingly, to be Commissioner of Social Security. So I used that along with a number of other examples to add some concreteness to this idea that it's not completely the public's fault that they don't understand this program. That there are some people who deliberately try to spin the facts to meet their needs.

This is just the opposite of the letter from Latitia's client. This is from somebody I used to work with at Social Security 20 years ago. This ought to make you want to read this book. He says, "I just finished your new book, *The Big Lie*. It makes me sad that a policy debate has degenerated into name calling. You employed personal attacks, intemperate language, and rumors." So if you want any of those three things, I guess they are in this book. I didn't realize it. Then he goes on and says, "You criticize some remarks made at the National Academy of Social Insurance, remarks to the effect that the public should not be told too much about how Social Security works." Yes, I did criticize that. Then he said, "Would it be wise to emphasize to the general public how the banking system works? How our nuclear defense attack plans work? The tolerances the IRS uses? Most of this information is available to the press, scholars, etc., but the public at large can't be experts on every government policy or program." Well, that seems like a pretty flimsy excuse for not explaining the income redistribution effects of Social Security. But this fellow believed that. Of course, I wrote back and told him if he really believed that, that justified my writing this book. That, in my view, is not the right belief.

I just wanted to give you a couple of examples of my fan mail. I expect much more bad fan mail. I think people are a little more reluctant to write you nasty letters. But I'll have been gone four days when I get back, and I'm sure I'll have something.

I'll summarize some of the things I'm saying. During the past 20 years or so, Americans have devoted a great deal of time and energy to studying and worrying about Social Security. I would have had to do something else if they'd solved all these problems. But the concerns are real, not artificial, and they indicate that serious problems are underlying the design of Social Security. The public can no longer be tranquilized by the big lie or by public information campaigns about how good Social Security is. It's time to develop solutions to the problem. There is no reason for this country to continue with a social insurance system that is so controversial and unpopular and whose financial status must constantly be debated. Let's fix it up and we won't have to keep worrying about this. Living with such a system is an unnecessary drain on the nation's collective productivity and psyche. It is eminently more sensible for us to develop a social insurance system that is understood and perceived as fair and reasonable by the majority of the citizens. One that will support rather than hinder the attainment of a healthy and productive national economy.

Mr. Schobel: I'm going to point out some areas where Haeworth and I take somewhat different views, but I must say that overall, I tend to agree with Haeworth more than I disagree. The way that I like to describe it is, Haeworth and I take the same body of facts and we jump on the back of those facts and see how far they'll carry us. The facts seem to carry Haeworth a little further than they carry me, even though he is bigger than I am! They sort of throw me off about halfway down the road. They carry Haeworth all the way down the road. I really do want to emphasize that with regard to probably 75% of what Haeworth says, I don't disagree at all. That being the case, I'm not going to simply repeat what he said because you've already heard it. I'm going to focus on the areas where we disagree instead.

A couple of really quick observations, first. The program for the meeting says this is for people who have no experience with the subject matter. I don't think there are any people who have no experience with this subject matter. If you're an American and unless you're Amish or a couple of other very, very tiny groups, you are covered by Social Security. You're paying these taxes, you have an interest, and you care. The Social Security tax is a quite big piece of change for most of us.

By the way, just a very quick aside, when I worked for the Social Security Administration, one of the things that I did was talk to the press and respond to letters from the public. It was amazing how many letters we got from people and how many questions we got from the press. But, in particular, the letters from people who very sincerely tell you that they really wish that they could have had their taxes back because they paid $250,000 in lifetime taxes or $500,000. Huge amounts of money. Far more than anyone in the history of the program has paid. If you add up all the maximum taxes back to 1937, nobody has paid that much. But there are people out there who believe they have, and they are convinced that they are not getting anything close to their money's worth. The fact of the matter is, the people retiring up until about now are getting their money's worth from their taxes. They're getting it largely at our expense because we are paying the money that is going into their pockets. I don't begrudge them that money at all. Those are our parents and our grandparents, for the most part and they're quite nice people. If it weren't for them, we wouldn't be here. But when those people say they're not getting their money's worth, they're wrong. They are.

Another item I'll just mention for Haeworth's benefit, the figures in his book are almost entirely based on the 1996 Trustees Report, and just in case you're wondering, there was a new Trustees Report recently. They come out every year. They are required by law to be issued by April 1. They haven't been on time since the early 80s. But this year's Trustees Report came out April 24, which was exactly 29 days ago. Every critical number in the 1997 Trustees Report is exactly the same as in the 1996 Trustees Report. And that's by design, actually. Those were the marching orders. And the 1997 Trustees Report is identical in every important respect to the 1996 Trustees Report. There are changes in assumptions and so forth, but the bottom line results are identical. So in case you're wondering whether Haeworth's book is in any way out of date, it isn't.

Haeworth makes the observation that we've been lied to by the government for 60 years. You know, there's truth to that statement. It's also fair to observe that the lies were really quite flagrant in the 1930s, for example, when the program began and they built this whole nomenclature around insurance terminology when it's really not an insurance program. But that has cooled off quite a bit in the last 20 years or so. I think that the word "lie" might be a little strong for what's been coming out of the government over the last 10 or 20 years. But it's not far from the truth. The government has certainly attempted to be very, very reassuring about Social Security when it probably would have been better for them to be somewhat less reassuring and let some of the truth out.

Haeworth makes the point—and it's a good question—what's Social Security? Years ago I used to think of Social Security as OASDI and HI. I never really thought about SMI too much, for all the reasons that Haeworth mentioned earlier and also mentions in his book. I think that what I might think or what actuaries in general might think could be somewhat different from what the public thinks. But in 1992, as most of you know, and if you don't know, you can go home and verify, the IRS changed the W-2 Form to separate what used to be called Federal Insurance Contributions Act (FICA) taxes into something that's now called Social Security taxes and Medicare taxes. They did that on purpose. The IRS does everything thoughtfully. It did that because it believed that the perception was that Social Security and Medicare are really separate programs and combining the taxes into one was just not helpful. Also, nobody knew what FICA stood for and the IRS got many letters from people saying, "What's this FICA stuff?" So, it said, let's have Social Security and Medicare taxes. And it separated them.

The IRS didn't do it, as some people believe, because the Medicare tax had a different earnings base, which actually was effective in 1991. If it had done it for that reason, it should have done it in 1991. It did it in 1992 because it really thought that it was just more accurate and in keeping with the public perception to separate the taxes because people regard the programs as being separate.

I think that if you combine Social Security and Medicare, you get a somewhat worse picture of the financial status of Social Security—the cash benefits programs—than is really appropriate. As Haeworth says, Medicare is out of control. It's supposed to be bankrupt in the first few days of 2001. It will take place in the Clinton Administration if all the assumptions come to pass, which probably does not please Mr. Clinton one bit. He gets out of town January 20, 2001. The Medicare Trust Fund is supposed to be broke a little bit before that. He'll get about a week of Medicare bankruptcy before he gets to leave.

The situation with Social Security and Medicare is a little like having two cars. One of your cars is totally broken down and doesn't run, and the other car is not too bad. It still gets you around. You say on the average your cars are in terrible condition. Well, that's so. But I think that when you merge the programs like that, I think you really lose information about the separate programs.

I think it is reasonable to point out that the Social Security cash benefits program is running cash-flow surpluses. I'm not talking about the trust funds at all now. I'm just talking about the cash flow. Cash flow surpluses continue until the year 2012 under the intermediate assumptions. I'm going to talk about the intermediate assumptions also in a moment. So until the year 2012 Social Security is not going to have any problems.

That could all change when they solve Medicare's problems. We don't really know what they're going to do about Medicare. We know one thing because it's part of the balanced budget agreement. Actually, President Clinton proposed this about two years ago. He suggested moving home health care expenses from Medicare Part A to Medicare Part B. Part A, as you know, is financed by the payroll tax almost entirely, and Part B is financed three-quarters by general revenue. So when you shift the home health care expenses, you basically draw general revenues into the Medicare program that otherwise wouldn't go to Medicare. When President

Clinton proposed this during the 1996 presidential debates, he was roundly booed by all sorts of newspaper editorials and everything else. All kinds of people said, “This is a sham. This is ridiculous." And the Republicans they would never do such a thing. Yet it is part of the balanced budget agreement, which has sailed through the Congress this week and will undoubtedly be enacted into law. So that sham is about to become the law of the land, whether we like it or not.

Now that buys you an extra six years or so on the Medicare HI Trust Fund because it takes expenses out of the HI program. The revenue to HI doesn’t change, while the expenditures drop by approximately $20 billion a year. The program gets to go for several more years until the remaining outgo exceeds the income, because the income is not scheduled to grow except as the economy grows. And the outgo grows faster. So eventually the HI program will start going broke again, in any event.

Ultimately, they may solve the HI program’s long-term problems by reallocating the tax rates. That’s happened so many times in the past that it’s not in any way farfetched. They’ve passed laws that did nothing but reallocate the tax rate. In 1980 they did that, for example. They also reallocated the tax rate in 1983 and they did it again in 1990. They’ve reallocated the tax rate many, many times and they can do it again. It’s a very simple way to prop up the HI program while OASDI is running cash-flow surpluses. You can make an argument that the OASDI program doesn’t need the money, at least not at the moment. And so why not reallocate it? If they do something like that, then obviously, Social Security will start to run cash-flow deficits a little bit earlier. We won’t have until 2012.

In any event, the point that I’m trying to make in a long-winded way is that I prefer to evaluate the program separately. Haeworth would rather evaluate the programs together. I think that there are arguments that can be made on both sides of that issue. I just think you get more information when you look at them separately. If you want to combine them, you can do that later. But if you look at them separately, I think, you can possibly learn a little bit more about them.

One point on which Haeworth and I agree 100% is the nature of the trust fund and the reality of the trust fund investments. As most people in this room undoubtedly know, Social Security surpluses are all invested in U.S. Government bonds. They’re not the ordinary U.S. Government bonds you and I can buy from our stockbrokers or from the Federal Reserve Bank. They’re special-issue U.S. Government obligations that are sold only to the trust funds that can’t be traded, and have special conditions attached to them. They have an interest rate set by law, for example, instead of by the marketplace. The interest rate is not tied to the maturity date. They can be redeemed at par at any time. They’re very, very peculiar securities. If you could buy them, you would. But you can't. Only the trust funds can buy them. One day they're going to want to redeem these bonds, and they can't sell them on the open market to the public. They're going to have to take them back to the Treasury—about $3 trillion worth of them over about ten years. That's going to put unbelievable burdens on the Treasury.

Even now, Social Security is holding $600 billion in these government bonds. If they went down to the Treasury Department and said, "Can we redeem these bonds?" Secretary Robert Rubin would have to jump out the window. Because he doesn't have $600 billion, and he has no realistic way of getting it. And nobody is going to give him $600 billion. They could print it, but I think the consequences of that would be so negative that nobody would dare to do such a thing. So having all these government bonds piling up in a big stack, I fail to see how that relieves the burden of the baby boomers' imminent retirement. I don't see how, when we baby boomers start retiring in the year 2008 and later, having a big stack of these government bonds is going to help to somehow relieve that burden. If anyone in the audience can explain it to me, I'm all ears, as Ross Perot once said. And carrying this logic a little bit further, I think you have to ask yourself a question: I don't really understand where the government feels justified in taking approximately $35 billion a year out of the pockets of working Americans and their employers in order to accumulate this big pile of government bonds. What are they going to do with them? What's the point?

On to the actuarial assumptions. This is another area where Haeworth and I disagree, and this is a true disagreement that runs deep. I think here, and Haeworth can respond, Haeworth's information is a little bit obsolete. There was a very long period of time, at least 20 years, during which Social Security's intermediate actuarial assumptions were much too optimistic. The Trustees were wearing rose-colored glasses and seeing the future as being very wonderful and bright. And every year when the actual experience came out, we found that it wasn't as good as the assumptions. This happened for about 20 years in a row.

Many people, like Haeworth, were saying, "Stop looking at these intermediate assumptions. They're just too optimistic. You ought to look at the high-cost estimates." And Haeworth was absolutely right. But in between when Haeworth was saying that and now, something happened. In 1990, the last Advisory Council on Social Security, not the most recent one that just issued its report with the three privatization proposals, but the previous quadrennial advisory council, had a panel of actuaries and economists. In September 1990, that panel issued a report recommending a number of changes in the actuarial assumptions for Social Security. All of them, I'm tempted to say, and I think that's true, literally 100% of their recommendations were for more conservative assumptions. Over the next two years, the Trustees actually adopted those recommendations. Virtually 100%. All of the significant recommendations were adopted by the 1992 Trustees Report.

Since that time, the intermediate actuarial assumptions have been quite a bit more conservative than they were during the period 1970–91. The criticism of the intermediate assumptions is just not as appropriate as it was when we first heard it. It was very appropriate 20 years ago. It was even appropriate six or seven years ago. But it's really not appropriate any longer. I think the intermediate assumptions are really quite reasonable. And, in fact, most recently, they lowered the real wage growth assumption one more tenth of a percent, the sixth reduction since 1983. The assumption they're now using is actually even lower than was recommended in 1990.

The high-cost estimates, on the other hand, are supposed to represent sort of the outer limit of what's plausible. And I think it does. Haeworth said that he thinks reality lies somewhere between the intermediate and the high-cost estimates. I think reality is probably very close to the intermediate assumptions. I've been very comfortable with them since 1992, and I think that they represent the mainstream view.

Another point worth taking up is this notion that because the government has made promises to individuals, somehow we have to forecast the cost of Social Security in a conservative manner using the high-cost estimates, for instance. I think that's sort of a trap that actuaries are very prone to fall into. Many of us, possibly not at this meeting, but many actuaries generally work for insurance companies. I do. And I know that insurance companies calculate their liabilities using very conservative assumptions on their annual statements. They have to do that because the regulators make them do that. And the regulators make them do that because if they have understated their liabilities, the company might go broke. If the company goes broke, then you have all these citizens out there saying, "Who's going to pay my claim?" Very nasty situation. Regulators don't like to have thousands of unpaid citizens running around. So they force insurance companies to use very conservative assumptions. And it makes perfect sense. No criticism there. But it's a little different if the government does that, isn't it?

From the Floor: No.

Mr. Schobel: Well, here's why I say it's a little different. If the government estimates the cost for Social Security using high-cost assumptions, they will recommend, in keeping with those estimates, higher tax rates. Right? One follows the other as the night follows the day. If you estimate the cost to be higher, you're going to demand more financing to cover those costs. Where does that financing come from? It comes from you and me. They're going to reach into our pockets and say, "We're estimating costs using these high-cost assumptions. As a result, we have to impose higher FICA taxes. We're going to take more money than we probably need. And we're going to build up a big stack of these government IOUs." Which I don't think are real and which don't relieve the burden on future generations in any way that I can discern.

I think there's a real danger there. If you want to balance the interests of the taxpayers and the beneficiaries, you want to use intermediate assumptions. This is the government, after all. It can't go broke in the same manner as an insurance company. We've seen governments go broke around the world, but it's a little bit different when a government goes broke, as compared to when an insurance company goes broke.

Last point: This is one that I'm making in honor of my good friend, Bob Myers, who is a name that probably all of you know. Bob gets very, very upset, I think rightly so, when Haeworth refers to Social Security as a Ponzi scheme. Bob makes the point, and I think it's a valid one, that Ponzi schemes require ever increasing numbers of participants. If you don't have more and more people coming in all the time, then the Ponzi scheme goes broke. It's a pyramid scheme like they had in Albania. Ponzi schemes can't survive because, obviously, there's a finite number of people on the planet. Social Security, on the other hand, would be all right if it just had stable numbers of participants. If the ratio of workers to beneficiaries was just stable, it would be OK. But it's not stable; it's declining. And it's declining rather precipitously. That's going to be a problem. There's not too much we can do about it, except import a lot of people from other countries or something like that. Which may well be the answer. On that note, I'm going to stop because I promised to leave time for questions and answers.

Mr. Bradford E. Klinck: First, Haeworth, you made a statement that people generally don't have a bad feeling about Social Security. They don't understand that it's a lie, and yet an oft-cited study said that more young Americans believe in UFOs than believe that they'll ever receive a dime from Social Security. So do you believe that there's actually a bifurcation by age as to whether or not people believe that Social Security is, in fact, a valid program? And second, as was mentioned, the Social Security Advisory Council came out with three different possible alternatives to the current strategy of funding Social Security. I was wondering what each of your beliefs is with regard to whether any of these is, in fact, a viable alternative that you support. Or whether there is another alternative that, in fact, you support.

Mr. Robertson: Yes, I think the older you are, the more you believe that Social Security is a good thing and that it will continue. The younger you are, the more you believe in flying saucers and no Social Security. So confidence is definitely related to age. I think there's a great deal of misunderstanding, and sometimes I get confused because I live on the East Coast among a bunch of people who all say, "Well, we knew that all the time. Why do you even want to talk about these myths about Social Security? We know that." But the rest of the U.S. does not.

On the other question, I asked Bruce if he would comment on any question that came up on the three Advisory Council proposals. One is he is more familiar with them. Second, I have a perfectly good proposal in the book, which isn't one of those three. It's chapter nine. So I refer you to that.

Mr. Schobel: Let me first of all say there is actually a good reason for older people to have more confidence in Social Security. If you're really old and don't expect to be alive after 2012, then you've got nothing to worry about. If you're 15, you have much to worry about.

As far as the Advisory Council proposals are concerned, all three would bring the program back into actuarial balance. They all include the usual laundry list of things we've seen before. They would bring into coverage noncovered state and local employees, for example. There are about 2.5 million of them. That gives the system revenue before they have to pay benefits to those people. Increasing retirement ages in two out of the three proposals. Reduced cost of living adjustments to some extent. Taking into account some of the changes made in the consumer price index by the Labor Department last year. They anticipated that. Many of the things we're all used to seeing. I don't have to enumerate it all. Those things are all reasonable. Increased taxation of benefits may be somewhat less reasonable. But they would tax Social Security in the same manner private pensions are taxed.

But the big change, which I haven't discussed so far and the thing which is actually very innovative, is they all rely to a greater or lesser extent on private sector investment of Social Security assets. In one case, the assets are still owned by the government, so to speak. The government would invest in the private-sector equity markets. In the other two cases, individuals would control their accounts. In all three cases, really, the goal is to not have a big pile of government bonds, but to have real assets that can be redeemed in the future and also earn higher rates of return, by the way, which is not a minor element here.

Some people have said, "Don't we have the same problem? Here you, Bruce, have been saying that it's going to be impossible to redeem these government bonds in the future. It's going to put an intolerable burden on the Treasury. Isn't the same true of private sector equities? How are you going to redeem them? Isn't it the same problem?" No, it's not the same problem. You have lots of buyers and sellers and a much broader market. All of the burden isn't falling on the government. You have world-wide markets—a much different situation. I acknowledge that all of the food the baby boomers are going to want to eat in their retirement years can't be saved. Much of that food is going to have to be grown when they're retired. The ham sandwich I eat when I'm 80 is likely going to be created when I'm about 79 and not tomorrow. If it's created tomorrow, I'm not sure I'd be willing to eat it when I'm 80.

Mr. Frederick W. Kilbourne: The first question has to do with the assumptions. I understand, Haeworth, that you're saying that your best estimate is sort of halfway between the intermediate and the high-cost assumptions. Bruce, I understand what you're saying, and it's a valid point that there has been an improvement of the intermediate so that maybe those are, from today's perspective, the best. But I would suggest that maybe Haeworth is being optimistic if we include one other thing. That is, if the Social Security and Medicare problem is not solved and is left until we get closer and closer to the brink, that is going to have an adverse effect on those underlying assumptions such that I would suggest that maybe even the high-cost assumptions may be optimistic. Adverse not only in the economic sense, but possibly even in the demographic sense. Let's assume that we do not fix this in the next five or ten years, are we then going to have an adverse affect on the assumptions themselves so that the intermediate ones are going to be hopelessly optimistic?

Mr. Robertson: I think the two most critical assumptions are real wage gains and productivity. Of course, there are others that are not as critical. Are you saying those facts might change?

Mr. Kilbourne: Absolutely. I was born in the mid-30s. How many people were born in the mid-30s? Practically nobody. Why? Because of the economic conditions. The real wage gains are going to be very importantly impacted by the willingness of people to work and pay the kind of taxes that are going to be required.

Mr. Robertson: That's a very good point. I hadn't really thought about that, but that's good.

Mr. Schobel: I agree with the theory, but I would say, without having really thought about it very hard, that the impact of a bankrupt Medicare program, for example, is probably not big enough in the grand scheme of things to, for example, throw us into a great depression like we had in the 1930s. It's just not that bad. I think that if we had a situation like the 1930s, you're right. The fertility rate would drop and people wouldn't have children and, obviously, real wage growth would be terrible. But the Medicare program going bankrupt is probably not enough to trigger such events. It's an interesting question.

Mr. Kilbourne: My second question is related because it has to do with the political willingness to get something done. What's happened over, especially, the last year, is just a disgusting example of the ability of the politicians and the media to lie to the people. My question really has to do with this trust fund and the so-called bonds that are there. I see a parallel with what's happened on Medicare moving home health care out of HI and into SMI. Which is nothing more than just saying, Well, we don't want the spotlight to be on it, so we'll put it over here. It doesn't save a dime. It's just money coming from somewhere else. And so is the redemption of the trust fund bonds. That just puts them out into the market. If they don't sell, we'll just print more money.

Mr. Schobel: With regard to the bonds, as I said, we have about $600 billion right now in the OASDI Trust Funds. That's expected to grow to about approximately five times that number, three trillion, between now and about 2019. At that point, the bonds will have to be drawn down. Now, how is the government going to redeem these bonds? They don't have a lot of choices. They can raise taxes in order to get the money to redeem the bonds. They can sell other bonds to the public in order to get the money to redeem the bonds held by Social Security. Or they can print money. There aren't any other options. If anyone else has another option, I'd love to hear it. All three of the options I just described put the burden on the workers then, in the year 2019 and later.

In the year 2029, all the bonds are gone, in any event. So even if you believe the bonds are real, even if you believe that somehow those bonds can be redeemed, you still fall off a cliff in the year 2029. So the issue of whether the trust funds are real is sort of a ten-year issue. Either you have the horrible situation in 2019 or you have the horrible situation in 2029. I think, by the way, what will really happen in 2019 is the politicians in the 2019 or the year 2012, depending on how you look at it, they will say something along these lines: "Sure we can redeem the bonds. What do you mean? We're the U.S. Government. We've always made good on our obligations. Obviously we can redeem the bonds. But it would be wrong. We need to keep those bonds. We need to save them for posterity. If we redeem those bonds, the program wouldn't be financially sound. We need to carry them forward. We need even more bonds, so that our children and our grandchildren can know that the Social Security program is secure." And they'll change the program then, never acknowledging that they couldn't redeem the bonds. They'll just pretend it was a bad idea.

Mr. Kilbourne: All of those, the three solutions, plus what you suggest, come back in and affect the assumptions. The intermediate or high-cost or whatever.

My anecdote is supportive of the Big Lie concept. I think it's even worse than yours, Haeworth. It involved a member of the Advisory Council who said the following things: "We can do a little bit here and a little bit there and a little bit over here and then as we look at it from now, our gap will only be about so much." I forget what it was. You're only talking about a percentage point or something of total wages—I mean, a huge, huge sum still. And he said, "We could get rid of that if we would just do our long-term projections for 50 years instead of 75 years."

I tried to get up to talk, but the session ended on this note. I wanted to say, "What you're telling me"—and actuaries should be horrified that a person in this kind of a position should be saying such an actuarial lie—"is that I am supposed to go home to my five-year-old daughter and tell her that my profession and the people of this country have gotten together and solved the Social Security problem. We have brought it into actuarial balance for her contributions, not for her benefits." And that is exactly what that would say. That to me is the worst part of the Big Lie.

Mr. Steven J. Fenic: I wanted to touch a little bit upon the question regarding the UFO example, which I thought was excellent. Many of the younger generation have become jaded to the point where they would say, "Just take what I was giving to Social Security, let me have half of it back, you can have the other half. I'll keep giving it." I liken it to the story, "The Emperor's New Clothes." We're told about the emperor's fine clothes and we see a naked man walking past us. It's not as big a problem because we recognize that the Big Lie is a lie. It will be very interesting to see what personal savings rates do over the next 10–15 years, especially among people planning not to have Social Security. I know that really hasn't happened to date, but I think that really could be the answer to all this, "Will we have to work into our 70s? Or can we continue to retire at the same age?"

Mr. Schobel: Sure, maybe the country could raise the national savings rate by simply being more honest about Social Security's financial condition. Maybe that's happening already.

Mr. Robertson: I'll make a quick comment. You haven't read my book yet, have you? Well, I've got the Emperor's New Clothes anecdote in there. And my proposed plan to solve all this is to give everybody his or her money back, plus interest, plus inflation.

Mr. Michael I. Wiesner: In the scenario where the government owns the private-sector equities, what percentage of all equities does the government wind up owning?

Mr. Schobel: It's estimated to be about 10%, if it's all invested in the U.S.

Mr. Wiesner: And the other question I had is what does the rate of influx of folks from other countries have to do with these projections? How do we account for immigration? And what happens if that increases dramatically?

Mr. Schobel: Immigration is a good thing. One of the key assumptions underlying the Social Security projections is the fertility rate. The current assumption is that in the long run we will have 1.9 children per woman, per lifetime. We're actually running somewhat above that right now. We've been above two for something approaching a decade, but not by much. Either figure is less than zero population growth, and it's obviously bad for the program's finances.

At the same time, the Trustees assume a certain level of immigration: 600,000 net legal immigrants a year and 300,000 other than legal. And those immigrants take the place of some of the babies that American women are not having. But immigration, by and large, is a good thing for Social Security because normally they pay taxes for a while before they can get benefits. If you admit someone to the country who is very old, they don't qualify for benefits because they've never worked under the program. When you admit young people—normally they're young anyway—they work and pay taxes for a number of years before they can get any benefits. So the finite valuation period helps you out financially. It also helps the cash flow.

If we had higher immigration it would help the program significantly. Just to put the numbers into perspective, we have about 4,000,000 babies born every year. We're assuming about 900,000 net immigrants. By the way, some people leave the country every year; about 50,000–100,000 leave. But the net number is assumed to be 900,000 positive. If the number went up to 2,000,000 a year, 2,000,000 immigrants plus 4,000,000 babies, I think maybe Social Security's financial problems would go away. I'm not sure the country would tolerate 2,000,000 immigrants a year. But if we put ads in newspapers around the world saying, "We're looking for 2,000,000 immigrants," we'd have no shortage.

Mr. Robertson: Immigration may or may not be a good thing, but I think it's ludicrous to propose that our immigration policy be determined based on whether Social Security is having financial problems.

And you gave an answer of 10% to a question I didn't understand, and I believe it was misleading. Those three proposals of the Advisory Council all contemplate a different level of investment—so 10% is not the answer.

Mr. Schobel: He was asking about Plan Number One, the so-called Maintain Benefits plan, where the government owns the assets and invests in the equity markets itself. The maximum investment would be about 40% of the Trust Fund assets. That is expected at its peak to be about 10% of the U.S. equity market.

From the Floor: Haeworth, you indicated that most of the public doesn't understand the nature of Social Security benefits and redistribution of wealth. Would you make the same comment about members of Congress to any extent?

Mr. Robertson: There are many members of Congress who really don't understand this. There are quite a few members who do understand it but know that if they admit it, we won't vote for them anymore. And that's one of the purposes of this book: To try to make you all aware enough and angry enough that you'll quit voting for those congressmen who tell you lies. Don't vote for somebody unless he or she tells you the truth. And it's not that hard to find the truth, if you want it.