SOCIETY OF ACTUARIES

Article from:

The Actuary

February 1970 – volume 4 - Issue 2

The Actuary

The Newsletter of the Society of Actuaries

VOLUME 4, NO. 2 FEBRUARY, 1970

ACTUARIES AND SOCIAL SECURITY

by K. Arne Eide

"Social Security: Perspectives for Reform" contains much that should be of interest to the actuary. However, one cannot obtain a clear understanding of the book by merely reading the authors' statements of objectives as cited in the review in the *Transactions*, by reading the review itself or the authors' letter to *The Actuary*. If one cannot find time to read the entire book, a reasonably accurate picture may be obtained through reading the summary at the end of each chapter.

There are many facets of the Pechman, Aaron and Taussig book that might provoke discussion. In commenting on some points that have arisen in the reviews and the authors' letter, I do so with the reservation that my few remarks can by no means cover all the basic issues. What might be written to *The Actuary* simply is not comprehensive enough to illumine to great depth a subject as complex as Social Security.

The authors, along with a growing number of others interested in the broad field of public welfare, express dissatisfaction with present welfare programs. Social assistance programs have grown over the years both in scope and magnitude of outlay without seemingly achieving desired objectives. Recently advocated programs encompassed by the Administration's proposal for welfare reform and the report of the Heineman Committee would attempt to provide benefits to those in poverty or near poverty levels, whether working or not working, in an attempt to raise their income and standard of living. Social Security (OASDI primarily) would, as heretofore, continue to provide basic economic support for most workers,

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THE RETIREMENT TEST UNDER SOCIAL SECURITY

by Harry E. Blagden

When the Social Security Act was first passed in 1935, it was during a depression and the psychology engendered thereby led to the provision that earning as little as $15 in covered employment *in any calendar month disqualified an* otherwise eligible recipient from receipt of Social Security old age benefits.

There is, of course, a need for some kind of retirement test because there seems little sense in paying *tax free* Social Security benefits to a person working full time after age 65 and earning as much as $50,000 a year.

Unfortunately, the philosophy which led to the kind of retirement test initially provided has, with some modifications, persisted, with significant changes in amounts involved and with the desirable change that earnings in any employment (not only covered employment) are taken into account.

Currently one can earn as much as $1,680 in a calendar year with no loss of benefits. For each dollar of the next $1,200 in excess of $1,680, fifty cents is lost in Social Security benefits. For each dollar earned (and subject to tax) in excess of $2,880 a dollar of tax free Social Security benefits is lost.

There is, however, an important exception to this — a loophole. An employee can earn as much as $140 in any calendar month without losing Social Security benefits for that month regardless of how much he earned in the calendar year in which such calendar month occurs. Furthermore, if a self employed person can demonstrate successfully that for any calendar month he does not "render substantial services," he is entitled to receive Social Security benefits for such calendar month re-

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FURTHER COMMENTS ON SOCIAL SECURITY

by Robert J. Myers

The December 1969 issue of *The Actuary* carries comments by Pechman, Aaron, and Taussig on the review of their Brookings Institution report "Social Security: Perspectives for Reform" made by Ray Peterson and me. I should like to make a rebuttal of some new points raised by the authors. I believe that the detailed comments that I made in my *TSA* review are still pertinent and accurate and have not been answered by the authors.

I disagree most thoroughly with the authors' contention that "the widespread habit of regarding social security as a form of insurance is misleading and harmful." The difficulty on the part of the authors is that they equate "insurance" only with individual insurance and that they do not have knowledge of the differences in concept and approach of group insurance and group pension plans as against individual insurance. In fact, I believe that it is fair to say that group insurance and pensions have more in common with OASDI (social insurance) than they do with individual insurance. The authors apparently never studied the financing principles of private pension plans.

I am convinced that the American public approves the insurance concept in the Social Security program and that this viewpoint is beneficial for the program and the nation. People want to feel that they and their employers are providing that part of their economic security which comes through this channel and that the Government has only the function of setting up the administrative machinery necessary therefor. People do not want a basis for the Social Security program that implies

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their dependents, or survivors who suffer loss of income through death, disability or retirement of the wage earner.

In their book, Messrs. Pechman, Aaron and Taussig suggest a two-tier Social Security benefit consisting of (1) a higher level minimum benefit than now provided in the OASDI formula and (2) a superimposed strictly wage-related benefit. The first would provide more adequately for workers with low earnings; the second would provide a greater degree of equity for workers with higher earnings.

A convincing argument may be advanced for this type of benefit structure but there may be strong disagreement among many concerning both level of benefits and qualifying rules. I believe that for those persons who have had little or no attachment to either the labor market or to covered employment under Social Security, a mechanism other than OASDI should provide a minimum benefit at a level high enough to keep the recipient (and spouse) at least above the poverty level. For the low-paid wage earner who has worked for many years under Social Security, there should be a higher level of benefits than that provided the aforementioned recipient.

Further, I can see scant justification for permitting someone who may have worked in employment which excluded Social Security coverage (but granted commensurately higher staff pensions) coming on the Social Security rolls through working the minimum required time either after retirement or otherwise and qualifying for minimum benefits that are not greatly different from those provided the low-paid long-term covered worker and spouse.

For the worker with higher earnings, the authors' suggestion of a strictly wage-related benefit has merit. I also agree with them that the level of the taxable wage base should continue to bear approximately the same relationship to average wage levels that it does at present. An ample area above the Social Security benefit level should still be retained in order that the individual might have free choice to invest a portion of his earnings as he sees fit to obtain optimum capital appreciation. If he desires to invest in pensions or profit-sharing plans, either as an individual or through his employer, he should be permitted to do so.

Perhaps one of the reasons the younger worker today appears to be disenchanted with the prospects of Social Security is that he does not wish to have an increasingly larger portion of his wages set aside to provide the *principal* portion of his retirement. As an individual he objects to paternalism whether it be by his employer or government. Although not objecting to providing a measure of social adequacy for those persons with lower earnings, he does not accept without serious question attempts to expand the taxable wage base to encompass his entire earnings.

The introduction of new mechanisms by the private sector offers increasingly attractive opportunities to the individual to provide for his own economic security. Projections over the next decade or more which have shown only a minor role for the private sector in providing economic security for the aged may well prove to be incorrect.

The concept of long-range estimates and forecasts is discussed in *Perspectives* and by both Mr. Peterson and Mr. Myers in their TSA review. This area seems to be particularly suited to employment of the actuary's talents. I am certain that every actuary working in the field of retirement benefits must have been confronted with the problem of explaining to laymen the long-range implications of various factors affecting plans. This expertise could well be applied to enhancing the knowledge of those who must determine the future course and outcome of Social Security.

The problem is real and acute. For example, members of the Congress, most of whom would not venture to embroil themselves in the technicalities of a bill to strengthen the Civil Service Retirement system, apparently feel no such constraint where Social Security is involved.

It is not Mr. Myers' forecasting methods or his presentation of the results that are at fault. Rather, it is the lack of background knowledge and familiarity with a very complex subject that causes policy makers and legislators of all persuasions to go astray. Fortunately, the Congressional Committees concerned with Social Security have over the years done a very creditable job in weighing the merits of proposals and developing reasonable legislation. Actuaries are aware the actuarial staff of the Social Security Administration has given consistently expert and unbiased advice in the course of Committee and other Congressional deliberations.

The role of interest rates in the OASDI program is discussed both in the book and the reviews and is magnified by authors and reviewers to proportions perhaps greater than merited. The role of interest in the trust funds has never been well understood by the public and many legislators. Although in aggregate the interest on funds is substantial, it is relatively small in relation to total payments.

If, as has been advocated by a number of those concerned with Social Security, the program is further directed toward closer adherence to a pay-as-you-go basis, the relative importance of interest will decline in the future. Some knowledgeable persons believe that interest should not even be considered in discussions of financing. There are few experts who attach great importance to the "return" from interest on the trust funds as it is increased or diminished by changes in interest rates. Increased interest rates on the trust funds imply higher taxes for the public who must pay such interest. It is difficult to impute a vested right to a certain rate of interest return for Social Security beneficiaries which differs from that of any other holder of government securities.

In the past, reluctance of qualified actuaries (with a few well-known exceptions) and others in the private sector to speak up on matters pertaining to Social Security has resulted in the growth of "experts" in government and the academic world who have tended to become the only advisors in the field. As such, they formulate opinion and undoubtedly influence much of the legislation. If, as actuaries, we were to provide a forum for discussion of principles and practices, lend what expertise we may have to discussion, or volunteer our services to those who seek it, we could provide guidance that is much needed in the field of Social Security.

It appears inconsistent to criticize what takes place in Social Security if we do not show enough interest to become at

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Comments by Myers

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that the Government is taking care of them—as is the approach in the Soviet Union and as the authors seem to propose.

The authors repeat their simple example, which is obvious without algebraic trappings, that if the rate of population growth and increase in earnings exceeds the interest rate, then the chain-letter situation of all generations getting more than their money's worth is present. The trouble is with the assumptions, not the mathematics. Population growth will not always be positive (i.e., increasing) and may well be negative at times and close to zero over the long run. Interest rates should generally exceed rates of increase in earnings. In fact, it is possible that, in some economically mature society, earnings rates may be level, and prices will be the variable (i.e., moving downward as productivity rises). In any event, I repeat, over the long run, everybody cannot get more than their money's worth from a social insurance plan!

My criticism of the authors' analysis of individual equity under OASDI should not have puzzled them. Calculations of this type are difficult, if not impossible, to make on a fair, equitable basis, taking into account all the variables under the complex OASDI system. I merely stated that I adversely criticize such attempts which "show" that *all* participants get a "bargain," just as I do those attempts which "show" that none "get their money's worth." The choice of assumptions and methodology can "prove" almost anything! The truth of the situation lies between the two extremes.

I criticized the authors for a lack of understanding of the cost estimates on the grounds of several specific points. One of these they deny—namely, the cost effect of a change in the interest-rate assumption—on the grounds that the data which I quote were published after they went to press. Specifically, they cite the 1968 OASDI Trustees Report, whereas they used the 1964 report as their source. Actually, the 1967 report (House Document No. 65, 90th Congress, page 42), which was published in February 1967, gave data indicating that a ½% increase in the interest rate "finances" only a 1% benefit increase.

The authors state that, when benefits are increased, the contribution rate and/or the earnings base are increased to maintained "actuarial balance" and that this is bad because it generates future surpluses, which start the cycle all over again. They continue to fail to realize the nature of the cost estimates and the underlying earnings assumptions. The use of level-earnings assumptions merely generates an actuarial surplus *after* earnings rise, and this can then be used to update the benefit structure (for both existing beneficiaries and active workers). The authors' statement is wrong in the light of history; benefit increases have not always been accompanied by changes in the financing provisions (note the 1969 amendments increasing benefits by 15%), while in other cases the benefit increase was financed by the available actuarial surplus and the "gain" from the desirable updating of the earnings base.

The authors apparently do not realize that the *ad hoc* method of increasing benefits in the past and the automatic-adjustment method proposed by President Nixon have the effect not only of increasing current benefits, but also of updating the average wage used for benefit purposes for active workers. Thus, one of the authors' criticisms—that benefits should be related to recent earnings—has already been answered in practice.

The most important flaw in OASDI, according to the authors, is the low level of the minimum benefit, which is so much below the so-called poverty line. The authors fail to realize that a significant portion of those getting minimum benefits are not primary workers, dependent on their covered earnings or their benefits for their living. Instead, this group includes government workers receiving substantial other pensions, women who worked only part time and are dependent economically on their husbands, etc. As a matter of fact, a low-earnings, full-time worker almost always qualifies for far more than the minimum benefit.

Concept or Poverty

In passing, I cannot avoid criticizing the concept of poverty, which the authors and many others nowadays use as though it were sacred and unquestionable. The main criticisms are that the base figures were, in fact, picked out of the air and are not the results of studies of what poverty really is and that, in measuring against the poverty line, no account is taken of the availability of assets and services furnished by others as offsets against "needed income." For example, home ownership and furnishing of room and board by relatives is completely ignored.

Finally, the authors renew their proposal that the payroll taxes paid by low-income workers and their employers should be refunded to such workers. I cannot see why social insurance contributions should be singled out for this special treatment. Why should not sales taxes, gasoline taxes, or other taxes be similarly treated? Or why should not low-income persons be refunded, out of the general treasury, part of the cost of the food, appliances, automobiles, life insurance, etc., that they purchase? If it is desired to give more income to this category, let it be done directly and forthrightly—and not by little subsidies hidden here and there. I insist that the "purchase" of social insurance should be considered in the same manner as any other purchase and, much more importantly, that this is how the average person considers the matter—and wants to consider it. □

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least concerned with its course and ultimate role. The private sector has a tremendous stake in the provision of income security and through its investments also makes a most important contribution to capital formation so greatly needed for future expansion of productive capacity. This in itself should provide sufficient reason for showing more than a cursory interest in Social Security. □