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Editorial

A proposal for an independent actuarial committee to review Social Security and Medicare

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If the United States is to have a successful Social Security and Medicare system long term, one that blends needs with financial capacity, it is necessary to protect the actuarial process from being overwhelmed by the political process. While some assistance is provided already under existing law, additional protection would enhance public confidence in the estimates made by government actuaries. The best approach would be regular, ongoing public reviews by an independent board of actuaries from the private sector.

Review process

Social Security and Medicare directly affect about 150 million Americans, either as taxpayers, beneficiaries or both. Each year, the Board of Trustees of these programs reports to Congress on their financial status. The board is composed of three cabinet secretaries (Treasury, Labor, and Health & Human Services) and two members of the public, one Democrat and one Republican, appointed by the President. The financial estimates are made by government actuaries, using assumptions approved by the board. The two chief actuaries – Social Security and Medicare – are required to certify whether or not the assumptions are reasonable. The developing financial experience of the programs has sometimes been quite different from the official estimates. The two most notable examples relate to major legislation enacted in 1972 and in 1977.

1972

On November 27, 1972, *The New York Times* printed an article entitled "Social Security Now Seen Stable." The article identified the following reasons for that stability, almost all related to the 1972 legislation: retirement pensions had risen to a respectable level; future automatic cost-of-living adjustments based on the CPI would keep them there; the payroll tax rate was at a point where there would be stiff public resistance to further increases; the actuaries were using new financing assumptions that included future wage increases, permitting a reduction in the recommended contingency fund from 100% to 75% of one year's outgo.

Of course, we soon learned that the program was very sensitive to economic conditions. Under the high-inflation conditions of the mid-1970s, Social Security benefit levels rose without constraint, dooming the program to bankruptcy in the absence of corrective legislation. Such legislation was enacted in 1977.

1977

The 1977 amendments provided a new benefit formula, called the "wage-indexed" or "decoupled" formula. It also provided for much higher taxes, through both higher payroll tax rates and several ad hoc increases in the taxable earnings base, which rose almost 70% in three years. On signing this legislation, President Carter announced that it had restored the program's financial soundness for 50 years. By 1979, a return to adverse economic conditions of high inflation and low wage growth led to another looming bankruptcy for Social Security.

1980-81

Corrective legislation in 1980 and 1981 delayed the inevitable until 1983, when another major piece of corrective legislation was enacted. The 1983 legislation was designed to allow the program to operate satisfactorily even under adverse economic conditions. Because the economic experience since 1983 actually has been quite favorable in most respects, the Social Security and Medicare trust funds have grown large, and they are expected to continue to grow for many years. But was the legislation's reliance on pessimistic assumptions an indication that confidence in the "best estimate" assumptions had declined to the point that Congress would not use them for policymaking? Was Congress gun-shy after its unpleasant experiences after 1972 and 1977 legislation? Can confidence be restored in the intermediate assumptions? Can one set of assumptions fairly portray the likely future condition of these very important government programs, or should they always be presented as a range of costs (optimistic/pessimistic) together with a public review by an independent board of actuaries?

Actuarial Board of Review

Social Security and Medicare need a systematic review by a committee of independent, professional actuaries. The major U.S. actuarial organizations should be encouraged to form such a committee to respond to Social Security and Medicare issues by publishing and distributing papers that show not only the majority point of view but also other points of view where no consensus exists.

Actuaries are uniquely qualified to advise on Social Security and Medicare issues. The significance of actuarial assumptions, for example, can best be reviewed by actuaries. Congress relies on actuarial reports and recommendations in committing billions of dollars of public monies.

Conclusion

From 1937, when the Social Security program began operations, through 1972, the Social Security trust funds increased in all but four years. During the same period, the program was regarded as being in long-range actuarial balance. After the enactment of the 1972 law, the program's financial experience reversed. Beginning with 1974, the Social Security trust funds declined for seven consecutive years, dropping from $46 billion almost to zero. The long-range deficit grew during this period, although it was reduced substantially by the 1977 law.

Since 1983, the Social Security funds have increased to all-time high levels, reaching $110 billion at the end of 1988, and are estimated to approach $170 billion by the end of 1989. At the same time, the long-range deficit has grown, from zero in 1983 to 0.70% of taxable payroll in the Trustees' 1989 report, released on April 24. The long-range deficit is now one-third of what it was before the 1983 law. The Medicare trust funds have grown steadily since that program began in 1986, but bankruptcy of the Hospital Insurance program is predicted to occur just after the turn of the century.

Social Security and Medicare are too important to let uneasiness continue.