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Social Security's uncertain future

by A. Haeworth Robertson

The present institution of Social Security will not be viable 20 years from now when the first group of baby boomers expects to retire. Social Security has promised more benefits to the baby boomers than their children will be willing and able to pay for.

Social Security, including Medicare, now costs about 16% of the participant's covered, taxable payroll. Projections by the Social Security Administration and the Health Care Financing Administration indicate that these costs will rise by the middle of the next century to 34% of such payroll based on the intermediate set of demographic and economic assumptions and 52% of payroll based on the so-called pessimistic assumptions, which I consider to be the prudent assumptions to use in evaluating long-range benefit promises.

The projected cost of these benefit promises exceeds by far the Social Security income projected to result from the taxation promises. Social Security payroll tax rates of 15.3% of payroll (shared approximately equally by employees and employers) are not scheduled to increase in the future. General revenue earmarked for the Old-Age, Survivors, and Disability Insurance part of Social Security is projected to be about 1% of payroll. Most of the cost of the Supplementary Medical Insurance part of Medicare is financed by general revenue, although long-range projections of the need for such general revenue are not published.

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Insurance: From the Victorian age into the future

by James C. Hickman

Great fleas have little fleas
upon their backs to bit'm.
And little fleas have lesser fleas
and so ad infinitum.

This piece of doggerel, with the embedded lesson on limits stated in entomological terms, is by Augustus De Morgan (1806-1871). De Morgan was one of those remarkable Victorian scholars who generated ideas on almost every topic. He probably is best known to contemporary students for his contributions to formal logic, but he also was an articulate spokesperson for the subjective interpretation of probability. It is more important to us that he was a member of the Institute of Actuaries.

De Morgan was a frequent contributor to the first 14 volumes of the *Assurance Magazine* and later the *Journal, Institute of Actuaries.* He had unbounded enthusiasm for the idea of insurance solving human problems. He called insurance "the most enlightened and benevolent form which the projects of self-interest ever took. It is, in fact, in a limited sense and practicable method, the agreement of a community to consider the goals of its individual members as common."

Friendly societies and their potential for managing society's problems especially impressed De Morgan. He said these societies could "raise working men to an unknown degree of independence as the poor laws are removed."

Augustus De Morgan, we need you. Gallons of ink have been used in actuarial publications and hours of conversations have been spent on The Actuary of the Future/The Future of

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Under any reasonable set of assumptions, there will be a very large gap between projected income and outgo. Therefore, either the benefit promises or the taxation promises will have to be broken. It seems clear that both promises will be broken, since it will be virtually impossible to increase taxes enough to fulfill the benefit promises being made to the baby boomers.

Reasons for high cost

There are several well-publicized reasons for the high projected cost of Social Security:

- The baby boom followed by a baby bust
- Longer life expectancies
- Extraordinary increases in medical care costs
- The assumption of a continued pattern of retirement between ages 60 and 65

In 1930, the remaining life expectancy for a 65-year-old male was 11.8 years; for a female, 12.9 years. In 2030, the remaining life expectancy at age 65 is projected to be 16.8 years for a male and 20.8 years for a female.

In 1950, there were 16 Social Security taxpayers for every benefit recipient. Today the ratio is about 3.2 to 1, and in 2030 it will probably be less than 2 to 1, if present retirement patterns continue. All these factors have obvious implications for a pay-as-you-go Social Security system.

Fallacious trust funds

The government would have us believe that Social Security is accumulating huge trust funds that will be used in the 21st century to help finance the high cost of retirement benefits that will become payable. This simply is not true. The present trust funds, and probably the future trust funds, are mere window dressing and have no economic reality.

The government collects more Social Security taxes than are needed to pay current benefits. It spends the "excess" taxes on other government programs, and it issues an IOU (Treasury Bond) to the Social Security trust funds. This simply means that the government intends to collect general revenue in the future to redeem the bonds, plus interest thereon, when Social Security needs the money to pay benefits.

In other words, part of our Social Security taxes will be used to pay for other government programs during the trust fund "buildup." An equivalent amount of general revenue (enhanced by interest) will be used to pay Social Security benefits during the trust fund "liquidation" period.

It takes a fantastic imagination to believe that this process will strengthen the security of future benefits or that it will reduce the future tax burden (taking into account both general revenue and payroll taxes).

Ignore Medicare?

Some analysts who want to give a false sense of security about the future of Social Security try to ignore Medicare, an important component of Social Security's rising future cost. In 1989, the average cash annuity paid to a retired worker and spouse was $922 per month. The average monthly value of the "medical care annuity" provided such a couple was $304 for Hospital Insurance benefits and $200 for Supplementary Medical Insurance benefits. Thus, the value of the Medicare portion of Social Security was 55% of the value of the cash annuity portion.

It is misleading to state that Social Security is financially sound well into the future and thus imply that Social Security's currently scheduled taxes will be adequate in the future. This clearly is not true, since an important component of Social Security taxes is used to finance the Hospital Insurance part of Medicare.

In assessing the adequacy and the financial viability of retirement benefits provided by Social Security to the baby boom generation, we should consider the medical care annuity as well as the cash annuity. Even if Medicare is separated someday from what we now call Social Security, the question of its viability will remain.

Prescription for an uncertain future

Any reasonable analysis would indicate that Social Security has an uncertain future. It follows that the baby boom generation has an uncertain retirement future — not necessarily a bad future, just an uncertain one.

One thing seems certain, however. On average, the baby boomers will retire in their early 70s, not their early 60s. Although an increase in retirement age will help reduce the future cost of Social Security, this is only a by-product of the primary purpose of establishing an appropriately sized work force to produce all the goods and services required by the population. We can have improved education, a cleaner environment, improved and more widely available health care, a better maintained infrastructure of roads and bridges, and a generally improved material standard of living, but only if enough people are working to produce these things.

In other words, the formula for survival — now and in retirement — is the same as it has always been: work and save.

You should be saving personally and through employer-provided benefit plans, not only to supplement the Social Security benefits currently being promised, but also to make up for the shortfall that almost certainly will occur in such promised benefits.

You should do your utmost to find income-producing endeavors that you enjoy and can do well, because you will probably be doing them a lot longer than you think you will. Besides, wouldn't it be a sad commentary on our life and culture if we spent the majority of our healthy, active lives just looking forward to retirement?

A. Haeworth Robertson, former Social Security chief actuary, is president of the Retirement Policy Institute and author of the 1992 book, *Social Security: What Every Taxpayer Should Know.*

The October issue of *The Actuary* will include a book review by Robert J. Myers of A. Haeworth Robertson's book, *Social Security: What Every Taxpayer Should Know.*

ASA requirements cont'd

Education Policy Committee and the Administration and Finance Committee for their comments. The report will be discussed by the Executive Committee at its September meeting and by the Board at its October meeting. As always, the Board is very interested in membership input on this important issue. Letters may be sent to *The Actuary* or to the Board in care of the Society of Actuaries office in Schaumburg.

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