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Letter to the Editor

Projecting Social Security's Costs: Actuarial Science or Politics?

As I noted in prior Letters, the Intermediate Cost assumptions used by the Social Security trustees for making 75-year financial projections are unsatisfactory for two reasons: asset projections over the 10-year period 1992-2002 were grossly inaccurate, and asset projections to decennial years (e.g., 2030) were markedly diverse.[1] Is it possible politics caused the odd results, given the intersection in Washington of professionals and politicians, that the trustees are all presidential political appointees, and the enormous stakes involved? In addition, these trustees have the power to make the final actuarial decisions, such as on assumptions.

For your consideration, Figure 1 presents 75-year projection results from the trustees' annual reports, 1984-1998 (official Intermediate Cost basis). Does this deficit stream warrant our confidence sufficiently to declare Social Security to be in serious trouble, as many have done?

Figure 1

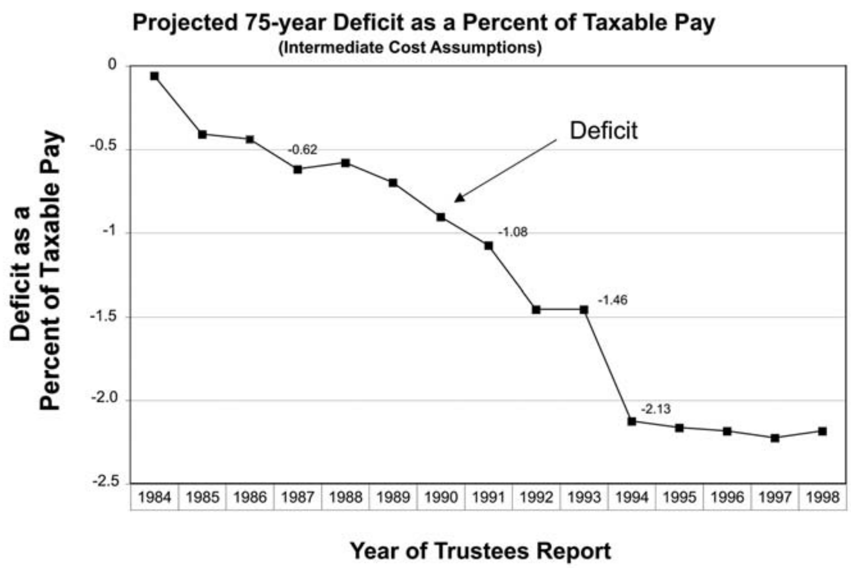

Figure 1 reveals persistently increasing deficits resulting from the trustees' changes in methods and assumptions. The range is from a surplus of 0.02 percent of taxable payroll in 1984 down to a 2.23 percent deficit in 1998. This deficit leap would call for a more than 15 percent increase in the payroll tax for each employer and worker, and it represents an increase in projected costs of over $100 billion a year and more than $10 trillion in benefits over the 75-year projection period.

In particular, there was the 0.67 percent increase reported in 1994, which raised the deficit from -1.46 percent to -2.13 percent, a 46 percent one year jump. The -2.13 percent is what the 1994 Social Security Advisory Council was faced with at its first meeting, and was a key reason for seven of the 13 members of the Council to call for some form of privatization to "protect" Social Security.

(continued on back cover)

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Politics or Actuarial Science?

The period between 1984-1998 is politically significant. The year 1984 represents the start of a resourceful drive fostered by the Heritage Foundation and the Cato Institute, explicitly intended to build up a privatized system of individual investment accounts to replace Social Security. These groups knew the deficits could be manipulated actuarially, that the trustees had the power to do this, and the cooperation of the actuaries would be needed.

After an acute political embarrassment to the Reagan Administration following a brash attempt in the early 1980s to sharply cut early retirement benefits, including those already in payment status, it appears the decision was made to blacken Social Security's eye financially by gradually raising the deficit over a period of many years so as to attract little notice. The drive peaked in 1994 when the Social Security Advisory Council came into being, a prime topic being privatization.

In reading through the trustees' reports, I found no satisfactory explanation for the plunging deficit phenomenon. I also don't recall hearing the chief actuary or a deputy ever dispute blatant assertions that the system was going kaput, or any explanation that the projections were subject to too great an error to be relied on, or advise the public that a 2 percent deficit should not even be regarded as significant over 75 years.[2]

Finally, in the process of accommodating the trustees, the chief actuary has apparently violated two actuarial standards of practice published by the American Academy of Actuaries. My 1999analysis of the Gross Domestic Product (GDP) economic assumptions revealed a failure to take into account either substantial past or recent experience, thus giving the trustees carte blanche to set the level wherever desired. The average future GDP chosen by them was less than half of the long-term actual average (3.3 percent vs. 1.5 percent), and served to make Social Security future finances look dismal indeed.[2]

Secondly, the chief actuary has consistently failed to report as required in his actuarial certification at the end of the trustees' reports, the influence and input of the trustees. Readers can easily err in believing that the chief actuary has total professional control.

It is reasonable to conclude the trustees had the motive and the means and ran with the opportunity to worry the public about the financial health of Social Security. True trustees they are not. Unfortunately, the reputation of the actuarial profession is involved. ◆

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[2] See my 1999 *Contingencies* article analysis on my Web site at *www.davidlanger.com*, "Social Securities Finances are in Fine Shape."

An Overview of Retiree Health Aging Curves • from page 17

a valuation several times. Actuaries with a solid basis for their current aging factors will find the paper to be a reminder that there are other opinions, there are important variances by medical services, and there are dynamics driving changes in the relative values between ages. It might also encourage them to share their own findings through publication. For instance, there are now many actuaries interested in the aging curve for primary and secondary prescription drug coverage. Is this an appropriate area for practice section research?

In the larger world there are also implications. In the United States and other developed countries, the population is gradually but inevitably becoming older. A health cost aging curve such as those discussed in the paper implies that, due to the older average population, spending for medical goods and services will increase as a portion of national expenditure, crowding out other needs. This seems to have been the case in at least the last 30 years. While productivity gains in the economy have taken care of some needs, there is a significant portion of the population for whom medical care has become a substantial economic problem. Much of this is due to demand and supply variables that may be separate from the aging effect. Nonetheless, it is worth considering that if the aging curve is not static but sufficiently dynamic, there is a greater chance that the efforts at health care cost control—that many of us have been involved with—will be successful. ◆

Based on the research mentioned above, The SOA Health Section is sponsoring a webcast based on Jeff's research. The webcast is scheduled February 15, 2006, for complete details go to http://www.soa.org/ccm/content/?category ID=33504.

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