Commentary on Recent Developments in the United States Social Security Program

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The phrase "Social Security" probably means different things in different countries, and it may even mean different things in the same country. My commentary on the U.S. Social Security program relates primarily to the Old-Age, Survivors, and Disability Insurance benefits (OASDI benefits) and the Hospital Insurance benefits (HI benefits). These benefits are financed principally by a payroll tax, paid by employers and employees, that is usually referred to as the Social Security tax (but is more accurately named the FICA tax, after the Federal Insurance Contributions Act).

There is another component of Social Security that is not financed by the Social Security payroll tax. It is the Supplementary Medical Insurance (SMI) program, which generally provides partial reimbursement for physicians' services. The SMI program is financed by premiums paid by the participants to the extent of about 25% of the total cost, with the remaining 75% of the cost paid by general taxes from the entire population. The Hospital Insurance program and the Supplementary Medical Insurance program are sometimes referred to collectively as the Medicare program.

In my commentary I shall use the various acronyms (OASDI, HI, SMI) in cases where precision seems advisable. Generally speaking, the phrase Social Security will refer to OASDI and HI benefits which are financed by the Social Security payroll tax and Medicare will refer to the HI and SMI programs.

Recent Developments

There have, indeed, been important developments in the U.S. Social Security program in the past ten years. There exist detailed, exhaustive

lists of amendments that have been made to the Social Security laws. I prefer not to duplicate those lists, but rather to provide an interpretation and perspective on recent developments, including changes in the law, and then offer speculation on the nature of future developments.

1. In the mid-1970s, it began to appear that future economic development might not be adequate to provide all the social benefits that had been promised during the relatively affluent and optimistic 1960s and early 1970s. National productivity was declining, as evidenced by wage increases not keeping pace with consumer price increases (which were unusually high). Unemployment was high with no significant reduction in sight. Fertility rates, which had been declining for some twenty years, showed no signs of increasing to prior levels; on the contrary, it appeared they would continue to drift downward. Lifespans among the older population continued to increase. To an impartial analyst, it was obvious that future Social Security taxes would be increased, that benefits would be reduced, and that retirement ages would be raised; but this was not a popular message to deliver in the mid-1970s, to which I can bear personal witness.

2. The unpopular message was delivered, however, for several years and eventually gained some credibility. In 1977, the formula for calculating Social Security benefits was revised to correct a "technical flaw" which prevented it from operating rationally in times of high inflation accompanied by relatively low productivity increases. Simultaneously, in a little-publicized change, benefits for future retirees were reduced by approximately ten percent. Social Security tax rates were increased and the taxable wage base was increased.

3. In 1981 and 1982, further benefit reductions were made. Minimum benefits and survivors' benefits were reduced and disability benefits began to be administered more strictly. Tighter controls were placed on Medicare reimbursements. These benefit reductions were relatively minor; nonetheless, they were beginning to establish a precedent for <u>curtailment</u> rather than <u>expansion</u> of benefits.

4. In April 1983, more changes were made, partly in response to the short-range, acute financial problems and partly in response to the predicted long-range, chronic financial problems. Newly hired Federal employees and all employees of nonprofit organizations were covered by Social Security, to expand the taxable wage base and thereby increase the net income to the system (at least in the short term), as well as to satisfy the public's belief that it is only "fair" that all workers pay Social Security taxes. Social Security taxes were increased. Cost-of-living adjustments to benefits were postponed for six months. Benefits were reduced by taxing a portion of the benefits, which had formerly been tax exempt, and channeling the taxes to the Social Security system. This new taxation of benefits, which affects approximately 15% of the currently-retired, higher-income beneficiaries and will affect an increasing percentage as time goes by, introduced two important concepts: the use of general revenue and the use of a "needs" test. The age at which full retirement benefits can be received, currently age 65, was increased by two years to age 67 for persons born in 1960 and later. For persons born between 1938 and 1959, inclusive, the full-benefit retirement age was increased by less than two years (the older the worker the less the increase); and for persons born prior to 1938, retirement age 65 was retained.

5. Finally, as a result of ten years of publicity generated by the system's financial problems, the public began to understand the true nature of Social Security. It is not an advance-funded system that accumulates employee/employer contributions until they are paid out in benefits that can be purchased with such contributions. It is a pay-as-you-go system, with relatively small trust funds that are currently equal, in the aggregate, to less than three months' benefit payments. It is an income redistribution system that provides benefits according to presumed need, not according to taxes paid by a particular individual. Past generations received benefits worth at least five times past employer and employee taxes; the majority of today's new entrants into the system can expect to receive less in benefits than can be provided by

combined employer and employee taxes. Based upon this new understanding, the public is becoming less willing to pay the ever-increasing taxes that are necessary to provide the benefits. The public once thought that they had "bought and paid for" their own benefits and that Social Security benefits were inviolable. The public had high regard for the institution of Social Security. Now that the public has learned that benefits can and will be reduced, and that the program does not operate as was once thought, erosion of confidence in the Social Security system has been added to the general erosion of confidence in all government programs. This change in attitude will probably have serious consequences that go far beyond the Social Security program itself.

Current Financial Outlook

After ten years of turmoil (unprecedented publicity, numerous national study commissions, and countless Congressional hearings) culminating in a series of legislative changes intended to restore Social Security's financial health, as well as public confidence, what is the situation now?

In April 1984, the Trustees of the Social Security program issued their annual financial reports[1/] and the news is not good. In the absence of significant recessions, and assuming the tax increases scheduled for 1985, 1986, 1988 and 1990 are tolerated by the taxpayer, the system will be able to pay its scheduled benefits for the next five years, and possibly for the next ten to twenty years (assuming some reallocation of the total Social Security tax among the component programs). During the first half of the next century, however, benefit outlays are projected to be as much as 40% to 100% greater than income, depending upon the degree of optimism employed in the projection assumptions.

The projected income and outgo for the Old-Age, Survivors and Disability Insurance (OASDI) and Hospital Insurance (HI) programs as a percentage of payroll that is subject to the Social Security tax may be summarized as follows:[2/]

OASDI and HI Income and Outgo

Year	Income	Outgo	Excess of Income Over Outgo
1984	14%	14%	-
1995	16	15	+ 1%
2010	16	16	-
2020	16	20	- 4
2040	16	25	- 9

The figures shown in this table are rounded to the nearest whole percentage in order to minimize any illusion of accuracy. The income is made up primarily of payroll taxes but is supplemented by small amounts of general revenue. For example, in 1984 the employer payroll tax is 7% and the employee tax is 6.7%, for a total of 13.7%; supplemented by general revenue equivalent to 0.5% of payroll. In 1990 and later the employer tax is 7.65% and the employee tax is 7.65%, for a total of 15.3%; supplemented by general revenue of less than one percent of payroll.

The Trustees' Reports include long-range projections based upon four alternative sets of assumptions to portray a range of costs that might materialize. The projections in the above table are based upon the Alternative II-B assumptions about future demographic and economic conditions—the so-called "intermediate" assumptions. Under the less optimistic Alternative III assumptions, projections (not all of which are published in the Trustees' Reports) indicate that OASDI and HI costs would eventually become about 40% to 45% of taxable payroll, while the scheduled income would still be only about 16% of payroll.

An analysis of all these figures indicates that employee Social Security taxes must rise to an ultimate level of about 12% of pay (under the Alternative II-B projections) and more than 20% of pay (under the Alternative III projections) during the lifetime of today's youth—unless the system is revised. Employer taxes would, of course, rise to the same

amount. This is considerably higher than the scheduled employee and employer taxes of 7.65% in 1990 and later.

Medicare Costs

HI benefits account for a large part of this cost overrun. The projected income and outgo for the HI program as a percentage of payroll that is subject to the Social Security tax may be summarized as follows (these figures are included in the projections in the preceding table):[3/]

HI Income and Outgo

Year	Income	Outgo	Excess of Income Over Outgo
1984	2.60%	2.71%	- 0.11%
1995	2.90	4.13	- 1.23
2010	2.90	5.65	- 2.75
2020	2.90	6.99	- 4.09
2040	2.90	9.37	- 6.47

The figures in this table are shown to two decimal places because of their relatively small size. The income represents the portion of the combined employer and employee Social Security tax rate that is allocated to the HI program. In addition, small amounts of investment income are available until about 1990, when the trust fund is projected to be exhausted.

The projections in the above table are based upon the Alternative II-B assumptions. Expenditures would be much higher under the less optimistic Alternative III assumptions, reaching a level of 15% of payroll or more by the year 2040.

None of the projected costs mentioned thus far cover Supplementary Medical Insurance (SMI) benefits, which are financed primarily by general revenue. The cost of SMI benefits, based upon the Alternative II-B

assumptions, will probably rise from the current level of approximately 1% of taxable payroll to between 4% and 6% of payroll during the projection period, depending upon how much the SMI "deductible" is increased as medical costs rise. Under the Alternative III assumptions, future SMI costs would be even higher.

The future cost of the Medicare portion of Social Security (HI and SMI benefits) poses a gigantic problem—a problem that cannot be resolved by the relatively minor changes being considered at this time.

Conclusion

What conclusions can be drawn from an examination of these projections of income and outgo and a consideration of the underlying assumptions on which they are based (in particular, continued low fertility rates and continued increases in life spans), as well as the mood of the public? The conclusions are about the same as they were prior to the various Social Security amendments that were enacted in the 1980s.[4/]

- Social Security taxes will continue to increase in the future. As the public balks at paying higher payroll taxes, less obvious taxes will be utilized such as general revenue or value-added taxes.

- Benefits will be reduced further, particularly for the less needy segment of the population. Pressure for the reduction of Medicare costs (as well as for medical care costs for the entire population) will be particularly intense and the national medical care system will be changed beyond recognition. Important elements of this change will probably include rationing of health care, more government intervention and control of the practice of medicine, and (if we are fortunate) less emphasis on curing illness after it develops and more emphasis on attaining and preserving good physical and mental health through proper regimens of diet and exercise and mental attitudes.

- Retirement ages will increase to age 70 or higher for persons now less than about age 35. With major breakthroughs in health care and further increases in lifespans, the predominant retirement age will be even higher. There will be less uniformity in the prevailing normal retirement age than exists now. Employees will provide for an increasing portion of their needs at the older ages by working part time, thus affecting the amount of savings and the type and level of pension benefits traditionally thought appropriate for retirement.

- There will be louder cries for "reform" as more of the public understands that Social Security is not a plan under which individuals save for their own retirement but that it is a massive income redistribution program. There is a very good chance that this changed perception, accompanied by relentlessly increasing tax rates, will result in major revisions in the Social Security system and thus in the related institutions that provide economic security, sometime before the end of this century.

There are troubled times ahead for the U.S. Social Security program and, of course, for the private systems of supplemental benefits that fill the voids left by Social Security. This entire combined system of providing economic security for the aged, disabled, and ill workers, together with their families and their survivors, is an important and integral part of our current social and economic structure; accordingly, one must conclude that there are troubled times ahead for our entire social and economic structure. I shall be greatly surprised if this turmoil that I anticipate for the United States does not also prevail, sooner or later, in most of the other countries represented here today at this Conference.

Footnotes

1. 1984 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds. Washington, D.C. April 5, 1984.

   1984 Annual Report of the Board of Trustees of the Federal Hospital Insurance Trust Fund. Washington, D.C. April 5, 1984.

   1984 Annual Report of the Board of Trustees of the Federal Supplementary Medical Insurance Trust Fund. Washington, D.C. April 5, 1984.

   Copies of these reports can be obtained by writing the Public Information Office of the Department of Health and Human Services, 200 Independence Avenue, S.W., Washington, D.C. 20201.

2. Extracted from Table F3 in Appendix F on page 131 of the 1984 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds.

3. Extracted from Table B1 of Appendix B on page 57 of the 1984 Annual Report of the Board of Trustees of the Federal Hospital Insurance Trust Fund.

4. For example, see The Coming Revolution in Social Security by A. Haeworth Robertson (Reston Publishing Company, Inc., Reston, Virginia, 1981), particularly Chapter 24: "What Is the Outlook for Social Security?"