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Living Happily Ever After?

The Future of Social Security

Synopsis of the April 2005 WFS Washington DC Chapter dinner program presented by Dean Baker, Co-Director, Center for Economic and Policy Research; summarized by Darlow Botha

Social Security is one of the country's most important and successful social programs. It provides a large measure of economic security to the whole country, uniting the interests of the poor and the middle class. In addition, Social Security not only keeps tens of millions of retirees out of poverty but also provides disability and survivors' insurance to almost the entire working population.

But recent projections from some politicians and policymakers suggest that Social Security is in dire straits. Are they right? No, says Dr. Dean Baker, as he discussed the future of Social Security at the April 2005 dinner program of the US National Capital Chapter, where he provided details of the program history, management, and rationale through the years beginning in 1937. Asserts Baker, independent forecasts by the program trustees and the Congressional Budget Office (CBO) confirm that any shortfalls in individual year accounting are modest and can be accommodated as readily as adjustments made in the past. Furthermore, he continues, many of the factors used as scare tactics (such as baby boomers) have been considered in the accounting projections for decades, suggesting that the program will continue to be safe and solvent for ourselves, our children, and our grandchildren. A potentially greater problem is Medicare.

CAUSES FOR CONCERN – THEN AND NOW

Several factors have been cited as imperiling the financial health of Social Security, chief among which are the baby-boomer demographics. The number of workers supporting each retiree, at 45 in 1950, has been steadily decreasing since. Over the next 50 to 75 years, that number is projected to level off at slightly above a 2:1 ratio, according to current estimates. But from a historical standpoint, noted Baker, there have already been shortfalls in 1977 and again in 1983. Forty years ago, the projections would have looked even worse, even though increased longevity now increases the pressure on the budget. Thus, there would have been more cause for concern at any point between 1937 and 1980 than there is today.

However, as befitting the fiduciary nature of the program, the trustees' assumptions have been conservative, and they have already incorporated these factors and the necessary adjustments. Independently, the CBO has arrived at very similar conclusions about the soundness of the program.

Baker also stated that between 1977 and 1983, significant changes were made to accommodate changing demographics. The Social Security tax rate (employer and employee) was raised from 6% to 10.6%, well in excess of current benefit payments, with the surplus applied to building the trust fund.

PRESENT STATUS

The value of the Social Security Trust (SST), which is invested in US government bonds, is presently $1.7 trillion. The value peaks in 2015 at 500% of benefits payments projected for that year and is projected as completely drawn down in approximately 2043 (or 2052, according to the CBO), but with all scheduled payments paid up to that point. Beginning in 2018, interest on the bonds will be needed to pay the benefits, but selling the bonds themselves will not be necessary. Even if no changes are made, benefits that are presently scheduled can be paid through 2043, and the program will always pay a higher benefit than what present retirees receive, even after inflation adjustment. Reminded Baker, the benefits when this happens will be larger in comparable dollars than they are now because benefits are indexed to average income, and the ratio between average and median income is projected to continue increasing. Furthermore, notes Baker, if the future gross domestic product (GDP) growth is closer to historical levels, the shortfall will be even less than what the trustees project.

Dr. Baker presented additional facts of interest. In addition to being adjusted for inflation, SST projections account for the demographic changes including lifespan increases and changing workforce patterns. Real hourly compensation after Social Security taxes, referenced to 100 in 2000, will rise to 280 in 2080. This will decrease by 10 in 2043 when the trust fund is finally depleted. Also, if payroll taxes are increased as needed to continue paying full social security benefits, then in 2043, there will be a one-year decrease in hourly compensation – just a blip – according to the trustees' figures. The trustees' have identified the needed payroll tax increases as 1.3% per year, while the CBO has pegged the needed increase at 1.5%.

SO WHY THE CONCERN?

Returning to the dire predictions of various policymakers and politicians, Baker discussed why he regards these predictions as baseless. For example, he emphasized that expressing the shortfall in terms of trillions of dollars is misleading. A better measure, he proposes, is as a percentage of GDP, since nobody knows what a million dollars will mean decades from now. Returning to the demographic factors, Baker noted that the trustees' calculations factor in not only the aging baby-boomers but also immigration, the projected shortfall of labor – and the fact that in 2000, for example, there was an increase in employment among workers 55 and older but a decrease among workers below age 55. He further noted that according to most economists, productivity is increasing.

More sobering was Baker's statement that if the US health care system is not fixed, then the US will face an economic crisis, even if Medicare is discontinued immediately. Observed Baker, while the Social Security shortfall as a percent of GDP is 0.73%, the projected shortfall for Medicare is 2.0% of GDP.

PRIVATIZATION

Observed Baker, the administrative costs of Social Security as a percent of the annual benefits are 50 cents per $100. This is 0.6% of the Social Security budget (that is, the retirement, disability, and survivors' portions). In contrast, decentralized privatized systems in other countries have administrative costs that are 15% of the budgets of their Social Security equivalent systems, whereas for centralized privatized systems, the percent is 5% (a factor of 10 above the present US system).

Continued Baker, the reinvestment that a privatized system would involve depends on how stock returns are allocated between dividends and capital gains. Furthermore, the high price-to-earnings ratios (PEs) of recent years point to a slow growth rate, rendering it impossible for stocks to provide there historic rates of return.

CONCLUSION

Baker concluded that Social Security is a fundamentally sound program that is effective in fulfilling its mission, to provide a core retirement income. In Baker's view, the program must be protected. In addition, he stated the need for policy emphasis on a healthy environment and on global warming.

QUESTIONS, ANSWERS, AND COMMENTS (as best captured):

C: The recent rash of pension plan defaults is expected to result in more workers continuing on past previously planned retirement dates.

A: This is true. For this reason, Social Security is now more important to a larger number of people. Another reason for older workers returning to the workforce is to obtain healthcare coverage.

C: Business and the administration want to privatize Social Security to provide investment vehicles.

A: If economic growth slows, then it is difficult for the administration to sell the program – to tell people that the stock market will do well.

A (to a comment on the deficit): There are two sets of books. According to the "on-budget" figures, that deficit is $600 billion. The "unified budget" shows a deficit of $420 billion. The unified budget has its place, but if one asks how much the government has to repay, the answer is $600 billion.

Q: How valid are the projections for the solvency of Social Security in the far term – given the possibility of "wild cards" such as war, environmental disaster, resource exhaustion, or a precipitous decline in the value of the dollar? Expanding on the latter point, a massive sell-off of US securities can impact the US economy substantially – and with it, Social Security. Presently, other nations including China are buying US securities, but how sustainable is this – considering that on one hand, US securities may become less desirable to China at some point, while on the other hand, a massive sell-off will hurt China too by reducing the value of the US securities that they do have (in a manner analogous to a majority stockholder dumping his stock)?

A: Forecasting 75 years out or out to infinity really doesn't make sense, but a 10-20 year forecast is reasonable. We will be seeing a very different world in 2080. Presently, the rest of the world is letting the US be the biggest consumers, but this is not sustainable for 50 years. Furthermore, other countries buy our securities to help their export markets. That is, they are paying us to buy their goods. However, they can grow their economies in other ways. Therefore, the question becomes, how long will they pay us to buy their goods? Because of the strong dollar, we buy a lot of Chinese goods. The Chinese buy few American goods, since to them, American goods are more expensive. A modest increase in their standard of living may result in their buying fewer American goods, which will then need to be bought more and more by Americans to sustain the American economy. India is also developing, but it is a democracy, and as a result, its economy may not be as export-oriented.

Dr. Dean Baker *is Co-Director of the Center for Economic and Policy Research in Washington, DC (www.cepr.net). He previously worked as a senior economist at the Economic Policy Institute and was an assistant professor at Bucknell University. His prolific list of publications includes books and articles* *about Social Security, Medicare, the stock market bubble, pharmaceutical policy, globalization, the deficit, and the consumer price index. In addition, Dr. Baker reports on economics in major media outlets including the* Atlantic Monthly*, the* ***Washington*** Post*, the* London Financial Times*, and National Public Radio.*

POINTS FOR THE CLASSROOM *(send comments to forum@futuretakes.org):*

- *During the discussion, it was pointed out that more workers can be expected to continue working past previously planned retirement dates because of pension plan defaults and the need to maintain healthcare coverage. To what extent are under-funded pension plans the result of increased longevity vs. other factors? Also, how will next-generation healthcare impact healthcare costs (apart from extending longevity and thereby increasing demand)?*
- *How will (US) Social Security and other retirement and insurance plans be impacted by anticipated changes in work-education-retirement patterns?*
- *Finally, what developments might alter the symbiotic relationship between the US economy and that of China, and how will that change impact working and retirement patterns in both countries?*

FURTHER READING:

http://www.cepr.net/pages/dbbio.htm Professor Dean Baker, bio

http://www.rationalrevolution.net/articles/truth_about_social_security.htm history and data on Social Security

http://www.ssa.gov/OACT/ProgData/taxRates.html Government data