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Commentary

BUFFIN PARTNERS INC. ECONOMIC INVESTMENT AND ACTUARIAL RESEARCH

A View from the Treasury: Part One

The U.S. Treasury is publishing a series of Issue Briefs on Social Security. The first Brief *Social Security Reform: The Nature of the Problem* begins with four Treasury premises: (1) Social Security faces a shortfall over the indefinite future of $13.6 trillion in present-value terms, equal to 3.5 percent of future taxable payrolls; (2) Social Security can be made permanently solvent only by reducing the present value of scheduled benefits and/or increasing the present value of scheduled tax revenues; (3) Delaying changes to Social Security reduces the number of cohorts over which the burden of reform can be spread; (4) Faster economic growth will not solve Social Security's financial imbalance.

While the future financial condition of Social Security will require careful and continuous review to ensure that the purposes and objectives of the System are met in terms of providing the scheduled benefits under the present law, there are diverse opinions among policymakers and commentators as to the extent that financial assessments of solvency, sustainability and affordability should drive the debate on the future amounts and incidence of benefit payments to current and future beneficiaries. Issues such as social adequacy, social priorities, and national economic policy are of importance, in addition to the fine-tuning of distant actuarial balances. It is, therefore, instructive to take each Treasury premise and assess it in terms of importance and impact relating to public policy on Social Security.

The reference to a shortfall over the indefinite future of $13.6 trillion requires some explanation in terms of the assumptions underlying the projection and the degree of confidence that may be accorded to it in terms of reliability and range of potential error. The Social Security Trustees, who have responsibility for the financial integrity of the system, state in every annual report that "the future is inherently uncertain" and "greater confidence can be placed in the assumptions and estimates for earlier projection years than for later years." This degree of confidence declines as the length of the projection period is extended. The degree of confidence associated with infinite projections is somewhat problematic according to leading technical experts and it is debatable as to whether the quoted shortfall over the indefinite future provides a reliable and rational basis for public policy decisions regarding future Social Security entitlements. According to some leading technical experts, the amount of $13.6 trillion, if it is to be used for policy purposes as though absolutely accurate and reliable, should be clearly qualified with a measure of its degree of confidence and might also be quoted with a plus or minus degree of potential error, consistent with the ranges for low-cost and high-cost estimates published for 25, 50 and 75-year projections.

The second premise regarding permanent solvency raises the question of whether permanent solvency is an essential objective. Gradually improving projected solvency for 50 or 75 years would be a more rational objective for public policy according to some observers. A gradual process of adjustment to improve solvency based on credible financial projections would seem to offer more flexibility than seeking permanent solvency based on uncertain financial projections over the infinite horizon. Parametric changes to the system or modifying the types of permissible investments for the trust fund are possible routes to improving long-term solvency over the foreseeable future.

Continuous monitoring of the financial condition of Social Security is essential to ensure its evolution to meet the needs of society in a financially responsible manner based on reliable metrics and sound public policy. Affordability is a relevant consideration since scheduled benefits may impose a strain on the future level, incidence and sources of revenues. Revenues may need to be increased to support a reasonably adequate level of Social Security benefits to the elderly, disabled, and survivors, including children. Inter-generational fairness is a topic for review and assessment in this context, but may not be completely attainable or absolutely essential to the viability of the system.

The premise that faster economic growth will not solve Social Security's financial imbalance and that there is no way to grow out of the situation contains some degree of validity, but merits closer examination and analysis. The word "faster" is implicitly in comparison to a specific benchmark. Faster economic growth than that implicit in the assumptions utilized in developing the long-range actuarial projections will have a beneficial effect on the degree of solvency, and is a relevant topic for consideration in the mission to protect and strengthen Social Security. One of the reasons that the trustees publish projections on three alternative sets of assumptions, explain the sensitivity of the projections to changes in the assumptions, and present the results of complex stochastic modeling, is to demonstrate the range of plausible variability in projected outcomes, including the implicit effect of faster economic growth.

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