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Commentary

BUFFIN PARTNERS INC. ECONOMIC INVESTMENT AND ACTUARIAL RESEARCH

A View from the Treasury: Part Three

The latest Issue Briefs on Social Security from the U.S. Treasury include discussions of important topics. A specific question posed is whether attempted pre-funding is "real". Treasury concludes that this financing strategy is reasonable provided the surplus revenues are safeguarded in a way that allows them to be used in the future to pay for benefits. One way to accomplish this objective would be to invest surplus revenues in real assets such as marketable equity and fixed-income securities. Treasury maintains that if the surpluses are not truly saved, (in practice they are used to finance government deficit spending) and if it is not possible to put in place some other mechanism such as "lockbox" provisions, then "it would be reasonable to limit trust fund accumulations." This reasoning, being dependent on significant conditions, is controversial, both as to validity of the conditions and the logic of the conclusion. Treasury argues that inability to pre-fund Social Security benefits has an important effect on how large to make benefits. Treasury proceeds to a discussion of the merits of reducing benefit levels, claiming that this policy change "would have little effect on the well-being or retirement incomes of individuals who increase their private saving by the amount of their tax reductions." That might be a true if, in fact, the existing Social Security system were simply a savings plan and, importantly, if any reduction in the employer's payroll tax reverted to the worker. But in reality, these conditions do not hold; Social Security is an insurance system and there are significant differences between insurance systems and savings plans. Any reduction in benefits resulting from a reduction in Social Security payroll taxes would constitute a retrograde step for the beneficiaries of Social Security, particularly the elderly, the poor, the disabled and the children and widows who receive survivor income benefits. The Treasury also places a higher priority on intergenerational equity as a trade-off for lesser emphasis on adequacy of benefit provisions.

The third Treasury Issue Brief notes that "when considering that Social Security's net taxes should be progressive across birth cohorts as well as within birth cohorts, the ethics of progressive taxes between birth cohorts is different from the ethics of progressive taxes within birth cohorts, since future generations have no influence on the decision." Treasury discusses partial reforms that address projected revenue shortfalls over 75 years (the official projection period) rather than an infinite horizon (as advocated by Treasury). The Issue Brief notes that multi-stage approaches to achieving solvency have implications for the distribution of reform burdens across generations. Infinite-horizon projections are controversial and questionable as to their suitability for critical policymaking purposes. They are subject to increasing uncertainty and decreasing reliability as the term of the projection increases. Beyond 75 years the demographic and economic scenarios are virtually unknown and unpredictable. It is speculative to place a value on the difference between income and outgo cash-flows beyond 75 years all the way to infinity and then claim that the result represents a reliable metric upon which to base today's policy decisions. The latest Treasury Issue Brief claims that "the difference between Social Security's estimated infinite-horizon imbalance and its estimated 75-year imbalance is not due to speculative projections of the far-distant future; instead, the difference obtains because 75-year projections include relatively more of the taxes paid than the benefits received by the individuals who are in the 75-year calculation." This statement implicitly assumes that the infinite-horizon projections are not speculative. If a part of the difference is not due to the speculative projections of the far-distant future, then some key questions that should be addressed are: How reliable and meaningful are the infinite horizon projections? What is the degree of uncertainty associated with them? How valid are the demographic assumptions concerning birth rates, retirement ages and longevity and the economic assumptions regarding interest rates, inflation, and productivity growth when projected out to infinity? What is the range of plausible outcomes projected to infinity corresponding to the single figure utilized throughout the Treasury Issue Briefs? Can this single figure be regarded as an absolute and completely accurate metric that may be relied upon for important policymaking purposes? It is inevitable when assuming ever-increasing longevity and the same normal retirement age as under present law that infinite projections will produce unrealistically high deficits whereas in reality Social Security is dynamic, not static, and would be expected to change in a changing environment. No one is denying the existence of potential future requirements to strengthen the solvency and sustainability of the Social Security system; but whenever references are made to long-term Social Security financial projections, they need to be explained fully, carefully and rationally so as not to create public misunderstanding of the nature of the uncertainty associated with them.

Buffin Partners Inc.

P.O. Box 1255
Sparta, NJ 07871
Phone: (973) 579-6371
Fax: (973) 579-7067
Email: commentary@buffinpartners.com