STRENGTHEN SOCIAL SECURITY

...don't cut it.

Ensuring Social Security Is In Long-Term Actuarial Balance

- To coherently discuss Social Security's long-term actuarial balance, there must be agreement about how to define the long term.

- Over its 80-year history, Social Security has used valuation periods as short as thirty-five years and as long as eighty years.

- Social Security's actuaries currently use a valuation period of three-quarters of a century for determining the long-term actuarial status of Social Security and the impact on that status of proposals to amend Social Security.

- Since 2003, the Social Security's Board of Trustees has also included, in its annual Trustees' Report to Congress, a valuation period of infinity.

    - The infinite time horizon is often used to argue that Social Security is in poor financial shape.

    - In response to the Warren-Manchin amendment to expand Social Security, offered on March 27, 2015 as part of the debate over the Senate Budget Resolution, Senator Mike Enzi stated:

        "At the present time, Social Security has an unfunded liability of $25 trillion over the infinite horizon. There is a problem. It is not to scare seniors, it is to preserve and make the program sustainable."

    - The infinite time horizon was given heightened prominence in the 2014 Trustees Report, by moving it into its own appendix and therefore being listed, for the first time, in the table of contents, making it easier to find.

- The Infinite time horizon is highly misleading.

    - When the infinite time horizon first appeared in the trustees report (together with the so-called closed funding method – also a highly misleading mechanism which distorts Social Security's actual financial health), the American Academy of Actuaries[i] wrote a letter to the Board of Trustees stating that those methods

        "provide little if any useful information about the program's long-range finances and indeed are likely to mislead anyone lacking

technical expertise in the demographic, economic and actuarial aspects of the program's finances into believing that the program is in far worse financial condition than is actually indicated. Thus, we believe that including these values in the Trustees Report is unnecessary and is, on balance, a detriment to the Trustees' charge to provide a meaningful and balanced presentation of the financial status of the program."[ii]

- Requiring that Social Security be projected to be in balance for infinity simply undermines confidence by showing extremely large dollar values representing shortfalls. Only half-jokingly, we point out that our sun is projected to only last another 4.5 billion years, not infinitely!

- Using absolute dollar amounts, rather than percentage of taxable payroll or percentage of GDP is also highly misleading, confusing, and seems intended only to undermine confidence.

    - As a technical matter, Social Security never has an unfunded liability, because it can only pay scheduled benefits if it has sufficient revenue to cover the costs of those benefits plus the cost of administering the program.
    - Using billions or trillions, – numbers no human has concrete experience with – is meaningless, simply sounding overwhelmingly and frighteningly large, without any reference point that allows comparison.
    - The problem is compounded in the case of Social Security, because the numbers are compared over decades, where the face amount changes over time as the result of nothing but simple inflation.
        - Seventy years from now, a loaf of bread is projected to cost around $35, average homes, around $12 million, and the lowest level jobs will pay hundreds of thousands of dollars a year. [iii] Similarly, today's prices would sound astronomically high to people in 1935, when a loaf of bread cost 8 cents, the average home price was $6,300 and the average salary was $1500 a year. [iv]
        - Would you rather earn $1,500 in 1935 dollars, $24,000 in today's dollars, or $50,000 in 2085 dollars? [v] (If you want to earn the most, check the endnote for which one that would be.)
        - It is for this reason that policymakers and analysts have traditionally used percent of taxable payroll or percent of GDP to express Social Security's long range surpluses or deficits.

- Like the infinite time horizon (and the use of absolute dollar amounts), the current estimation period of seventy-five years is much longer than can be made accurately and is likely to distort public policymaking.

    - In that same letter quoted above, the Academy of Actuaries stated about 75 year valuations:

"With regard to the infinite-time-period estimates, the Committee begins its analysis by noting that the results of the 75-year statutory valuation are themselves subject to extreme uncertainty. Consider the situation of actuaries or economists in the year 1928 attempting to project demographic and economic parameters 75 years into the future - to 2003. They likely would have missed the Great Depression, World War II, the baby boom, the influx of women into the labor force, etc. Nobody, no matter how intelligent or educated, could have anticipated these very significant events.

"Although methods of demographic, economic and actuarial analysis have improved greatly over the years, the sources of error in past valuations of OASDI have been unforeseen — and really unforeseeable — large-scale changes in the U.S. society and economy. We see no reason to believe that similar, unforseeable large-scale changes will not occur in the future."

- The 75-year valuation period is much longer than most other industrialized countries use.[vi]
  - The 28 European Union Member States -- : Austria, Belgium, Bulgaria, Croatia, Republic of Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovak Republic, Slovenia, Spain, Sweden and the UK -- use a 45-year valuation period in their regular pension reports to the European Commission.
  - Germany relies on a 15 year valuation period for its own internal purposes.
  - France also uses shorter valuation periods than that prescribed by the EU. In its 2012 report, it included for example, valuations eight years out, to 2020, and twenty-eight years out, to 2040.
  - Among the respondents to a recent survey covering 30 advanced countries, only Sweden and Canada, which follows the United States' lead, use valuation periods of 75 years; and only Japan uses a longer valuation period than the United States. (Japan uses 95 years, the result of a reform in 2004, which *decreased* the projection period from "in perpetuity.")

- In addition to the 75 year and infinite time horizons employed in the annual Social Security Trustees Reports to Congress, 25 year and 50 year valuation periods, which are much more reliable and more in keeping with what most other industrialized nations use, are also included in the annual reports. According to the 2014 Trustees Report::

  - Over the next 10 years, Social Security is in complete actuarial balance
  - Over the next 25 years, Social Security has a shortfall of 1.5 percent of taxable payroll, which is equal to .54 percent of GDP.

- Over the next 50 years, Social Security has a shortfall of 2.42 percent of taxable payroll, which is equal to .87 percent of GDP.[vii]

It is crucial for effective stewardship of Social Security, that Congress and the President use the same valuation period and a common set of numbers.

- Starting in 1934, actuaries employed by the Social Security Administration (or its predecessors[viii]) have developed the short and long range projections, including projections about the program under current law, and projections of the costs or savings of proposals changing current law, which have guided policy.
- For only a little more than a decade, economists at the Congressional Budget Office have made Social Security long-range forecasts as well,[ix] which are instructive but should not provide the baseline used by policymakers.
- Projections are just that – projections, not crystal balls. To be as accurate as possible, they should be made by those most trained at making them.
    - In projecting out fifteen or twenty years, economic assumptions are the primary determiner of the projections about the Social Security system. Both actuaries and economists are trained in these projections so either SSA's or CBO's numbers are appropriate and can be compared for accuracy, since they should be relatively identical.
    - In projecting out more than twenty years, however, demographic factors are the primary determiner of the projections. Actuaries are well trained in demographic projections; economists have no training in this complicated field. Consequently, SSA's numbers should be the baseline. CBO's numbers should be treated simply as instructive, used to seek the actuaries' explanation when the two sets of numbers vary.

BOTTOM LINE: Balanced reporting and policymaking should give the most weight to the more realistic valuation periods of ten, twenty-five and fifty years. The projections of the actuaries at the Social Security Administration should provide the baseline for policymaking for any projections extending beyond 20 years. In order not to mislead, forecasts should be discussed in terms of percent of taxable payroll and percent of Gross Domestic Product, not in terms of dollars, which simply serve to alarm and provide no context in which to evaluate the sums.

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[i] The American Academy of Actuaries describes itself as "the public policy organization for actuaries of all specialties within the United States. In addition to setting qualification standards and standards of actuarial practice, a major purpose of the Academy is to act as the public information organization for the profession. The Academy is nonpartisan and assists the public policy process through the presentation of clear actuarial analysis. ..The Academy also develops and upholds actuarial standards of conduct, qualifications and practice, and the Code of Professional Conduct for all actuaries practicing in the United States."

[ii] American Academy of Actuaries, Letter to Social Security Trusties and Social Security Advisory Board, December 19, 2003. http://www.actuary.org/pdf/socialsecurity/tech_dec03.pdf

[iii] Grant McArther, "The World 70 years from now," News.com.au, (August 19, 2013) http://www.news.com.au/finance/real-estate/the-world-70-years-from-now/story-fncq3gat-1226699742008

[iv] Television History – The First 75 Years, "What Things Cost in 1935,", http://www.tvhistory.tv/1935%20QF.htm, last viewed, 2/21/14

[v] If you want to earn the most, you should pick $1,500 in 1935 dollars. Inflation has caused $1,500 in 1935 to have inflated to over $25,000 in today's dollars. Bureau of Labor Statistics, "CPI Inflation Calculator," (January 2014). http://www.bls.gov/data/inflation_calculator.htm Assuming the average annual rate of inflation is a low 2.8 percent

– it was 3.9 percent over the last seventy years – then in today's dollars, that $50,000 is worth only $7,038. **"CPI Calculator to Calculate Future or Historical Inflation," at http://www.free-online-calculator-use.com/cpi-calculator.html#calculator. (Accessed June 2, 2014)** If the inflation rate turns out to be closer to the historical average, the dollar amount would be worth less. For example, if the rate were to be 3.5 percent, that $50,000 in today's dollars is worth only $4,500. **Bureau of Labor Statistics, "CPI Inflation Calculator," (January 2014). http://www.bls.gov/data/inflation_calculator.htm**

[vi] Email survey carried out by Elaine Fultz, Social Security Department, International Labor Organization (retired). during December 2014 – January 2015

[vii] Social Security Trustees, *The 2014 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, Tables IV.B4 and VI.G4, July 28, 2014. http://www.ssa.gov/oact/tr/2014/tr2014.pdf

[viii] Prior to a reorganization plan enacted in 1946 [DOUBLE CHECK DATE], the Social Security Administration was the Social Security Board, which was established by the Social Security Act of 1935. The Board hired much of the staff, including actuaries, who had worked for the Committee on Economic Security, the interagency taskforce that developed the legislation in 1934).

[ix] In 2003, CBO, for the first time, calculated long-term projections for Social Security, but they were very limited. CBO made more detailed projections in 2004.