Remarks by the Commissioner

by Dorcas R. Hardy*

I am pleased and honored to be here today. The kind of public policy deliberation represented by this event and this organization is a valuable part of the process of governing ourselves—the wonderful, complex, complicated, and often tangled series of events by which we identify and define a problem and then work toward a solution.

Clearly, this organization recognizes the central facets of that process—information and debate. Without a clear understanding of the reality with which we are dealing, we cannot hope to engage in useful debate or be effective in resolving the issues at hand.

When I first became Commissioner of Social Security—and in fact during the confirmation process as I was asked what I believe is important in the administration of such a massive and far-reaching program—I identified five or six central priorities. One of these priorities is public information and education.

In my mind, public education goes beyond the usual definition of providing information about our processes and procedures. Not that that isn't important—if clients do not know how to participate in the system, we cannot carry out the purposes of the law. That type of education is directed toward the operation of our program as it is now. Equally important is the information necessary to deciding what the program will be tomorrow. That is basic to the process of public policy development.

Sometimes it seems that Social Security is moving from crisis to crisis. Commentators seem to be constantly predicting the bankruptcy or breakdown of the system. I know that the Old-Age, Survivors, and Disability Insurance program is strong and stable, but I am concerned about the effect of this continual alarm on our ability to steer a rational course toward the future. These commentators serve a useful purpose in keeping the public debate about Social Security alive. But if we are fostering public misperception about this program, we are hindering the development of effective public policy.

I believe that a survey of the American public would probably show that a large portion of the public believes that:

- Social Security is an insurance program. Your payroll taxes represent premiums paid for your policy.

- Payroll taxes are credited to individual accounts and invested toward that account. Individual accounts are fully funded and waiting to be drawn down when circumstances require.

Of course, the second statement is not true, and the first only partly so. At present, payroll taxes move through the system fairly rapidly—our reserve is only equal to 3½ months outgo. Whatever the "rollover" time involved, payroll taxes go toward the benefits of current beneficiaries, not for those currently paying the taxes.

The concept of investment in the future, however, is completely true. Not in the narrow sense of individual accounts managed by the Social Security Administration, but in the larger sense of investing in the stability and health of our society. A civilized society ensures that its elders receive a return on a lifetime of hard work, and today's workers are ensuring that happens by paying payroll taxes which are used to pay today's benefit checks. In the same way, today's beneficiaries invested in the generation before them.

The program, then, represents not so much individual insurance as what has been called "social insurance." Mr. Reinhard Hohaus, an actuary who recently died at age 90 and who was an important participant in the very early development of the Social Security program, perhaps best described this concept:

> Social insurance...aims primarily at providing society with some protection against one or more hazards which are sufficiently widespread throughout the population and far-reaching in effect to become "social" in scope and complexion. Usually these risks are not many in numbers. Yet, if not guarded against through some organized means, they produce large dependency problems that take their toll in terms not only of financial but of human values as well.[1]

*Commissioner of Social Security. This article is based on a speech delivered at the Ethics and Public Policy Center, Washington, D.C., on January 20, 1987.

[1] Reinhard A. Hohaus, "Equity, Adequacy, and Related Factors in Old-Age Security," The Record, American Institute of Actuaries, 1938, cited in a 1983 Congressional Research Service report.

This basic policy concept gives rise to the key choices by which benefits under such a program are to be distributed—whether according to need or according to individual tax payments. This choice is also often referred to as a choice between "adequacy" and "equity," or between the "welfare" and "insurance" elements of the program.

The uniqueness of the Social Security program is that it does both, and in fact can change the mix over time to respond to changing needs.

A 1983 Congressional Research Service report, prepared as part of that year's debate over the basic structure of Social Security, pointed out:

> There is no simple way of distinguishing the insurance, annuity, or private pension features of the Social Security program from its welfare features. Social insurance mixes these two types of income protection together in such a way that the end product takes on a distinct character of its own. Thus, the frequently mentioned idea of separating the program's insurance and related "private sector" features from its welfare features often leaves the mistaken impression that these elements can be easily identified.[2]

The predominance of one of these elements or another has changed over the life of the program. The Social Security program was developed at a time when we faced a social imperative—to respond immediately to the needs of a large segment of the Nation's older citizens during a deep-seated economic depression. We also needed to provide enough support to older workers to give them an incentive to retire and free badly needed jobs for younger workers.

Part of the development of the program was a debate over whether these needs should be met by a separate public assistance program, or by a program of universal flat pension payments regardless of need, or by a program of retirement insurance.

In fact, the new program started slowly and was supplemented with a Federal general revenue public assistance program—the program of Old-Age Assistance, now part of the Supplemental Security Income program.

With that immediate need answered, the young Social Security program could begin its slow development. It rested on some very basic principles: (1) People must qualify for benefits by making contributions; (2) having contributed, they are entitled to benefits as a matter of right; (3) benefits should be related to previous earnings; and (4) there must be no means test.

[2]David Koitz, in "Financing Work-Related Entitlement Programs," a report prepared by the Congressional Research Service for the Senate Committee on the Budget, April 1983.

In addition to these "principles," however, the program embodies some features related to the concept of "adequacy." (I consider this a better term than "welfare" because the point of this concept is **avoiding** dependency.) For one thing, while benefits are to a certain extent related to contributions, the benefit formula is very clearly weighted to ensure a basic minimum level of subsistence to steady low-income workers. Expressed in terms of replacement for lost earnings, this means that at the normal retirement age (currently, age 65; age 67 in the future) the replacement rate for a low-income worker would be about 60 percent; for an average-income worker about 41 percent; and for a high-income worker, around 26 percent. (These figures vary slightly depending on the year of retirement.)

An additional feature related to "adequacy" is the program of auxiliary benefits paid to members of a worker's family. While this means that a retired or disabled worker who is married or has children will receive more return on contributions than a single person, these benefits are tied to the goal of avoiding dependency by providing an adequate income.

Clearly, the program has been successful in terms of both concepts. People receive payments which are based on their own work and contributions to the system, and these payments are formulated to provide a "floor of protection" to which other benefit programs and private savings can be added. We have seen a significant decrease in the poverty rate among our Nation's elderly, and Social Security is the dominant source of income for more than half of the elderly population.

In looking at our ability to continue to do this in the future, we need to recognize the "maturity" of the program.

The "mature" stage of the program is generally defined as the point at which most of the people in the country have been covered for most or all of their working lives—more or less the point at which we are now. This means that the program has encompassed most of the revenue sources that are going to be available to it within the limits of wage increases and demographics. This in turn means that future generations will need to meet the costs more completely than was necessary in the past.

In the very earliest years of the program, full benefits were payable even to persons who had made very small contributions. Given the two concepts of benefits by right and adequacy of benefits, this was inevitable, for the early retirees had not had an opportunity to pay substantial amounts. An extreme example is our first beneficiary, Ida Fuller, who paid $22 in contributions and received more than $20,000 in Social Security payments.

Over time, beneficiaries have contributed larger and larger amounts to the system prior to retirement. At the same time, however, the growing system drew in other sources of revenue—workers previously not covered by the system, new workers just entering the system in large numbers—allowing a generous Government to make significant increases in benefits. Note that these increases were based on estimates of "adequacy" in relation to increases in the cost of living. (Although automatic periodic cost-of-living increases were not introduced to the program until 1972, increases were given before that at irregular intervals in response to perceived problems with adequacy.)

For most of the history of this program, there have been many more workers than beneficiaries. Benefits could be generous in spite of fairly low taxes, because the number of workers paying Social Security taxes has been so much greater than the number receiving benefits. Given the demographics of the "baby boom," that is still the case.

In the future, however, the demographics will be working against us. Starting in about 2010, the number of workers paying into the system for each beneficiary will decline dramatically, because of longer life spans, lower fertility rates, and of course the "baby boom" retirement years. Where we now see a ratio of about 3 workers to every 1 beneficiary, that ratio is expected to be about 2 to 1 around 2030.

An additional factor beyond retirement data is the disability program. We estimate that roughly 30 percent of all young workers today will be on the Disability Insurance rolls at some time before retirement, based on the intermediate assumptions of the 1986 Trustees' Report. This fairly rough estimate assumes about a 40-percent increase in incidence rates from recent levels.

To better understand the burden on the active workers, however, we should instead look at the **total** "dependency ratio," including children and youngsters under age 20, to get a better idea of the total number of people dependent on active earners. Currently, that number is about 7 "dependents" for each 10 active earners. By 2030, that ratio is estimated to rise to 8½ dependents for each 10 active earners. Thus, while the burden on active workers will increase substantially, the increase will not be as large as is indicated by looking at beneficiaries only.

Still, at the same time that the limits of revenue expansion for the system are being reached, the demographics are just beginning to make greater demands on the system than ever before, demands that are going to be moving upward for the next 50 years.

The 1983 amendments restored the financial soundness of the Old-Age, Survivors, and Disability Insurance program both in the short range and into the next century. In other words, we have answered the question of financing for today's generation of workers (assuming no large benefit increases that draw down on our expected resources for responding to this need and given that our actuarial assumptions about real earnings growth, fertility rate, and life expectancy are realistic). What we need to consider is how we will provide for the generation after us. Some changes will be needed, and this may vary depending on the particular trust fund program.

I will not cover here the Medicare Hospital Insurance Trust Fund, except to say that we should avoid the trap of using Old-Age, Survivors, and Disability Insurance funds to finance Hospital Insurance. Medicare has its own needs and problems, and should be dealt with separately. Any reallocation from the Social Security programs to the Hospital Insurance Trust Fund would push the Old-Age, Survivors, and Disability Insurance programs out of the close actuarial balance achieved by the 1983 amendments.

I believe Social Security **will** survive. The history of this program and the support for it embedded in our society make it clear that any other option does not appear at this time to be viable or politically acceptable (in the sense of the general public will). That may change. However, what is **not** clear is what price will have to be paid for its survival and who will pay it.

In a May 1977 **Washington Post** article, George Will wrote that Social Security "is so woven into the Nation's life that its difficulties jeopardize almost everything but itself." He went on to say that "unquestionably, Social Security's basic commitments will be met. The problem is the effect that this will have on the economy that makes Social Security—and everything else—possible."

There are several key issues that we will have to confront. The first is the balance of costs against benefits. Up to now, it has been possible to provide fairly generous benefits with relatively low taxes. But in 1988, the payroll tax is scheduled to increase to 7.51 percent, to be paid by the employer and the employee, for a total of 15.02 percent of each covered salary up to the earnings base, now $43,800. In 1990, the combined tax rate will rise again, to 15.3 percent of a covered salary base estimated at $50,400. (Of the total 15.3 percent, 12.4 percent goes to the OASDI Trust Funds and 2.9 percent is for the Hospital Insurance Trust Fund.)

Not only are these higher taxes than we have had before, but they have been thrown into sharp relief by the recent changes in the income tax law. At the same time that the income tax system has been reformed to reduce personal taxes and to respond more clearly to differences in income, the Social Security tax will continue to rise to its highest level yet. Through last summer and fall, as the final outlines of the tax bill became clear, I saw increasing numbers of articles and editorials on the extent of the Social Security tax burden, which is increasing as a percentage of all taxes.

Up to now the public has been generally tolerant of the payroll tax, thanks partly to its low levels and partly to the clearly visible evidence of the benefits to a member of virtually every family. I believe this tolerance has also reflected the basic humanity of our society, which has valued the income support for older and disabled citizens and has been willing to pay for it.

But there comes a point when it becomes as much a question of ability to pay as of willingness to pay. The higher the tax levels, the greater the burden on the individual's ability to meet immediate family support obligations. In a broader sense, the more social resources this one program consumes, the less there are for other social service resources. I agree with George Will—Social Security will not suffer, but our capacity to respond to other social needs in our country—whether in a public or private framework—will.

In recent years, we have seen that Social Security and the other programs— public and private—that provide income to retired persons have done so good a job that the poverty rate for the elderly is actually lower than that of the workers who, in part, support them. Moreover, the average wealth of retired families is, not surprisingly, substantially higher than that of the average working-age family. (However, we know that, based on a recent survey conducted by Louis Harris and Associates for the Commonwealth Fund's Commission on Elderly People, single women over 85 are a significant exception.)

Taking these facts into consideration, our society needs to examine whether the "right" level of resources is being transferred from the working population to the nonworking population. The right level, of course, is simply the level that has the greatest political acceptability. I am not suggesting that stories of "generational warfare" have any validity—few people begrudge the benefits that are currently payable to their parents and grandparents. In the future, however, I see a real potential for problems, as the nonworking population grows relative to the working population, causing the burden on the working population to grow.

Of course, no analysis can accurately reflect the many informal mechanisms that exist to transfer resources to those who need them. For example, if a Social Security beneficiary sees that his or her children need more money in order to support their own children, it is a simple matter to send a check. This happens every day. In fact, the recent Harris Survey stated that elderly persons are four times more likely to give regular financial assistance to their children than they are to receive it. These informal mechanisms also can work in the other direction, and do. But such transfers are beyond the scope of Government's responsibility. The question that we can address is whether the formal income-transfer mechanisms have gone too far, or will do so in the future.

Another issue that will have to be confronted is the extent of our reliance on Social Security for our retirement income needs. Social Security was never meant to be a full retirement system—as noted earlier, it was intended to provide only a "floor of protection." Unfortunately, the success of the program seems to have led to an exaggeration of its capabilities and to an over-reliance on the system that future retirees will not be able to afford.

We must as a society become more intensive in turning to private planning for retirement income. By this I **do not** mean disregarding future Social Security benefits in planning. Instead, Social Security benefits should be considered realistically in planning for retirement. Right now information on estimated future benefits is supplied on request to persons nearing retirement age, but it takes time and is often difficult to understand. This year we will be testing a program that will provide much more complete information about future benefits to those workers who request it. We hope that this will alert today's workers to consider whether that estimated amount will in fact allow them to have the retirement living standard they want, and, if not, to start to do something about it.

The philosophy of this administration in social service planning is based upon the principle that the well-being of the public is primarily a responsibility of individuals, families, and the communities in which they live. One of the most positive things about the Social Security program is that, Government-run though it may be, it is based on the efforts of the individual, and through the payroll tax, the individual's contributions to the well-being of the community.

But there are limits to what one program can and should be expected to do, in terms both of amounts and in responsiveness to individual needs. Social Security benefits are standardized to groups of people. In spite of the many (sometimes seemingly endless) clauses and subclauses in the law, it is not possible to tailor the program closely to individuals.

One of the many strengths of the American system has been the combination of public and private efforts. In terms of retirement income, I think we have spent too much time and emphasis on the public efforts, and it is time to recognize and articulate efforts in the private sector by individuals for their retirement planning.

A third very significant issue for our society is the question of just when we retire. We have moved away very substantially from enforced retirement. Last year amendments to the Age Discrimination in Employment Act made it illegal for private or public employers to establish a mandatory retirement age, with only very limited exceptions. The very positive purpose of that law, in the words of Representative Claude Pepper, one of the major sponsors of the bill, is "to protect human rights. That is, the right to work and make a living in an honorable way in a free country, and to allow the economic rewards to those who work to provide for their own security and sustenance."[3]

There are a great many people in this country who wish to work beyond the normal age of retirement for many reasons. Ironically, however, the average age of retirement has been steadily declining. For example, between 1950 and 1980 the percentage of men aged 65 in the labor force fell from 72 percent to 35 percent. Put another way, in 1950 it was not until age 70 that the participation rate of men fell below 50 percent. By 1970, average retirement age had fallen to age 65. By 1982, it was below 63.

This sharp decline is attributed to a number of reasons. These include the incentives provided in fairly generous employer pension programs as well as Social Security. Another theory is that the increasing affluence of our society has contributed to this trend, with leisure time equated with wealth (or made possible by wealth).

In fact, the Social Security system has also contained some very specific disincentives to working beyond one's early sixties. This includes such provisions as the retirement earnings test and the meager delayed retirement credit.

Changes have been made to respond to these disincentives. Exempt amounts under the retirement earnings test have increased, and, starting in 1990, the offset against earnings above the exempt amounts will increase from $1 for every $2 earned to $1 for every $3 earned. In addition, the delayed retirement credit is due to increase substantially from 3 percent per year of delay to 8 percent per year in 2009 and later. I am not convinced these efforts are enough—or at least not occurring soon enough.

In 1935, when Social Security was first enacted, it was a public policy goal to encourage retirement, so that younger workers would be able to find jobs. With the shift in demographics, we are likely to face exactly the opposite problem.

There are other factors which will vitally affect our program over which we will have very little control, but which we must be willing to confront as realistically as possible.

For one thing, we cannot predict what the Congress will do. There are strong pressures on elected officials to increase benefits. The Congress must resist those pressures. Increases in benefits are not paid for by today's beneficiaries; the price must be paid by today's workers, not only now, but in the future. For example, a 5-percent increase in the benefit levels would cost about $10 billion annually in the short term, and it would raise the long-range actuarial deficit by 0.67 percent of payroll (roughly doubling the deficit and taking the program out of close actuarial balance).

Another unpredictable factor is demographics. My earlier discussion of the effect of these elements was based on what we know now, and what we estimate. But we have been fooled before. Medical breakthroughs we cannot now foresee could cause life expectancy to increase much more than we expect. The average life expectancy at age 65 today is 14.5 years for men and 18.9 years for women, but we also know that the over-85 age group is the fastest growing segment of our population. On the other hand, we may also be premature in assuming that the baby boom generation has produced a "baby bust"—the great majority of that group is not yet past child-bearing age.

To refer to my earlier urgency about public education and awareness, we must be able to discuss these issues openly and honestly. We seem to have come to a point where Social Security is so sacrosanct as a program that to mention its problems becomes equated with criticizing or threatening the program. Those most involved in the public policy process seem to back off in alarm, as if to discuss it is to assume its demise. On the contrary, only a clear and comprehensive debate can ensure its survival.

We also hear a lot of talk about making Social Security "independent" in order to remove the program from the taint of "politics." I do not think that is possible, however the program might be structured. As Martha Derthick noted in her book **Policymaking for Social Security**, "Policy choices made for Social Security are important choices for the society. To make them is to exercise power and distribute things of value—and that is politics. The question is not whether there will be politics in this process, but what sort of politics it will be."

This program is the major means by which we as a people have chosen to ensure that older citizens in our society will have income security after a lifetime of work. We must be prepared to protect it by being willing to raise those issues which are the cause of its greatest vulnerability.

I hope you will all join the debates.

[3] Joint hearing, March 12, 1986, Subcommittee on Employment Opportunities of the House Committee on Education and Labor and the Subcommittee on Health and Long-Term Care of the House Select Committee on Aging.