The Future of Social Security

by Dorcas R. Hardy*

Social Security and justice are inextricably linked. It can be said that society's capacity for justice makes our Social Security system possible. Some might also argue that it is society's capacity for injustice that makes Social Security necessary.

For more than 50 years, Social Security has been a necessary and vital element in America's social and economic well-being. It has provided economic security to generations of workers and their families, and it promises the same security to future generations. Yet, many of today's workers wonder if the Government can, or will, keep that promise. More than ever before, young people are concerned about the future of Social Security. Many question whether a system that requires them to pay ever-increasing taxes will still be in place when it comes time to meet their needs. I believe that it will.

It is true that just a few years ago there was cause for great concern. Beleaguered by high inflation and other economic woes, Social Security was in very serious financial shape—a condition that produced a variety of "gloom and doom" headlines which, unfortunately, still seem to be ingrained in the minds of many people. But since 1983, as a result of the efforts of President Reagan's bipartisan commission on Social Security, and the amendments they proposed (see the box on page 6), there has been a dramatic turnaround. Today the system is operating on a solid financial basis.

The soundness of the system is reflected in its trust fund operations. For example, last year Social Security took in approximately $217 billion in revenues while paying out only about $202 billion in benefits. That $15-billion margin, coupled with reserves already on hand, gives the system a $47-billion balance. For a system that has historically operated on a current cost, or pay-as-you-go basis, this is a substantial amount of money, even though it represents only 3 to 4 months' worth of benefits. However, the trust fund reserves are expected to increase significantly over the next decade or so. This projection is important to keep in mind because these reserves will be necessary to meet the strain that will be put on the system when the baby boom generation reaches retirement age.

However, this good news should be tempered with some words of caution. There is reason to be concerned about the future of Social Security for today's youngest citizens, those now in pre-school or kindergarten. Long-range projections—if they are correct—indicate the system faces another financial crunch around the year 2040. Those long-range projections are based on a 6 percent unemployment rate, a 4 percent per year inflation rate, and a fertility rate of two children per women. In short, significant changes in those figures could dramatically alter the financial stability of the trust funds and a crisis, similar to the one we faced from 1978 through 1982, could come even earlier.

It is for this reason that I have been encouraging public debate about the long-range prospects for Social Security. I have argued that we must not be afraid to look to the future, to explore options, and to discuss alternatives. As a society we must consider the pros and cons of any future changes, but at the same time, continue our commitment to current beneficiaries.

Before we look to the future, however, we have to understand what is happening at present. Studies show that surprisingly few people really know how the Social Security system works. Perhaps one of the best ways to understand how the system operates is to recognize how it does **not** work. First of all, because of the tremendous number of current and future beneficiaries, Social Security does not, and cannot, operate like fully funded pension or insurance plans. If Social Security were to build up the trillions of dollars in reserves needed to cover all of its anticipated obligations, the system's trustees would be in control of most of the money available in our economy. In fact, the amount would be considerably larger than the present national debt. Second, Social Security is not like a bank account. A checking or savings account is **not** established for people when they get their first social security card. Consequently, current retirees do not draw money from a Social Security account to which they contributed while working. Instead, Social Security has historically worked on a current-cost basis. In other words, the taxes current retirees paid into Social Security were used to pay checks to yesterday's beneficiaries, just as the taxes paid today's workers support current Social Security recipients.

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*Commissioner of Social Security. This article is reprinted from the spring 1987 issue of **The Connecticut College Alumni Magazine.**

It is also important to understand that a portion of the current Social Security tax deduction of 7.15 percent for employers and employees is earmarked for each of three trust funds. Each 7.15 percent deduction is pro-rated as follows:

- 5.2 percent goes into the Old-Age and Survivors Insurance Trust Fund;
- 0.5 percent goes to the Disability Insurance Trust Fund; and
- 1.45 percent goes into the Hospital Insurance Trust Fund of the Medicare program.

In 1988, the rates will increase to 7.51 percent, and in 1990 they will rise again, to 7.65 percent. Tax rates for self-employed people are also going up. The current rate of 12.3 percent will increase to 13.02 percent in 1988 and 15.3 percent in 1990. Most of the additional taxes will be added to the Old-Age and Survivors Insurance Trust Fund. The earnings base, the maximum amount of earnings on which Social Security taxes are paid, will also continue to rise based on increases in the average national wage. Currently set at $43,800, it is estimated to be about $50,000 by 1990.

Although Social Security taxes have risen throughout the program's history, recent tax increases have been brought into sharp focus by changes in the income tax law. At the same time that the income tax system has been reformed to reduce personal taxes and to be more sensitive to differences in income, the Social Security tax continues to rise. This growing disparity has not escaped the notice of newspaper columnists and editorial writers, nor will it escape the notice of the general public. The relationship between Social Security taxes and the total tax burden is becoming more and more evident.

Until now, the public has generally been tolerant of Social Security taxes, but we may be reaching the point where the ability to pay may not match the willingness to pay. The higher the tax level, obviously, the greater the burden on those paying into the system. In a broader sense, as more resources are consumed by one social program, less remains for other social programs. To use an analogy from the field of medicine, no one would begrudge funds for the war on cancer. But is cancer a more important target than heart disease? Or cystic fibrosis? Or AIDS? At some point, a determination has to be made about how much and what kind of services the public wants and is willing to support.

For this reason, I believe it is important that people understand what their Social Security tax dollars are buying. For example, in addition to retirement benefits, disability, survivors, and auxiliary benefits for family members are vital parts of the total package of protection paid for with those taxes. In fact, about 40 percent of all Social Security benefits, or $75 billion each year, goes to nonretirees. Those benefits—to wives, husbands, widows, widowers, and children—put into practice one of the precepts of Social Security: That a worker's immediate family should be protected when his or her income stops due to retirement, death, or disability.

The "package of protection" provided by Social Security must be kept in mind when considering the question of getting one's money's worth out of the program. It is only natural to want the best value for a dollar. After all, many people equate justice with individual equity, that is, "What's in it for me?"

However, there is more to consider than just a person's individual equity in the system. When considering options or comparing Social Security to private pension plans, we need to be mindful of the intent of the program. Social Security is a complex social insurance system that embodies elements of group term insurance, pension policies, and income redistribution. Unlike private retirement plans, social objectives are an integral part of Social Security—including such factors as disability and survivors coverage. Moreover, Social Security has a built-in benefit formula that is weighted in favor of workers with low lifetime earnings. Expressed in terms of replacement for lost earnings, this means that at the normal retirement age (currently 65, but going up to 67 in the future), the replacement rate for a low-income worker is about 60 percent; for an average-income worker, about 41 per-

Major Provisions of the 1983 Social Security Amendments

Tax rates adjusted (in short term)

COLA's delayed 6 months

New Federal employees covered

All nonprofit employees covered

State and local government employee termination prohibited

Benefits taxed for higher income people

Retirement age increased in future

cent; and for a high-income worker, approximately 26 percent.

This basic policy of social insurance gives rise to the key choices by which benefits under such a program are to be distributed: Either according to need or according to individual tax payments. This option if 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.

So, when we as a society debate the future of Social Security, we need to be realistic and remember Judge Learned Hand's definition of justice: "the tolerable accommodation of the conflicting interests of society." Those who propose to scrap the current system in favor of a privately-funded alternative fail to grasp the important social goals of the existing program. At the same time, the staunch defenders of the status quo fail to understand the gravity of the economic, demographic, and other factors that will affect the financial stability of Social Security in the 21st century.

My own vision of Social Security's future is seen through a mirror to its past. The founders of the program envisioned the system as a base upon which to build a complete package of protection. Unfortunately the success of the program has led to an exaggeration of its capabilities. I believe Social Security should get back to basics and provide a "floor of protection" to be supplemented, not replaced, with pensions, savings, and other investments. In sum, each individual must take the responsibility for ensuring his or her own financially secure retirement.