Global Social Security: How the Rules are Changing in Certain Countries

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Global Social Security: How the Rules are Changing in Certain Countries

Robert J. Myers*

Abstract

Social security programs (i.e., national pension systems) differ widely between countries. This is only natural, and desirable, because of varying social and economic conditions and philosophies.

This paper discusses some of the general worldwide trends, such as the equal treatment of men and women, increases in the normal retirement age, projection of future costs, and the different philosophies of social security. Some of the interesting and unique changes recently made in selected countries—Canada, Chile, Eastern European countries, Germany, Japan, People's Republic of China, Saudi Arabia, Union of Soviet Socialist Republics, United Kingdom, and United States—are described.

Key words and phrases: global social security, social security, national pension systems, philosophies of social security

1 Introduction

There have been several interesting and significant developments that recently have occurred in social security around the world. Some of these suggest worldwide trends, whereas others are unique to particular nations. This paper describes such developments in several selected countries.

The term social security as used here means only the limited concept of a national pension system. It does not include programs such as unemployment insurance, family allowances, workers' compensation, and health care that some persons consider to be branches of social security.

2 Worldwide Major Developments

In recent years two major developments in social security have occurred in most countries. The first one is equal treatment for men

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and women. This is an easy concept to understand. If a higher retirement age applies for men than for women (often a difference of five years), for example, this is not equal treatment. Also, many differences occur where women have been treated less favorably than men: survivor benefits, for example, have been available in some countries for male workers, but not for female workers. Many technical difficulties arise, however, in implementing equal treatment.

The second major development in many countries is the likely future financing problem as the population ages; in other words, as there are relatively more persons at retirement age compared to persons of working age. This growing proportion of older persons creates (or can create) financial problems, especially if a country does not recognize that financing problems are likely to occur in the future.

Some years ago, few countries did any serious forecasting of what their social security programs would cost 20, 30, or even 75 years hence. Many countries merely looked ahead a year or two. This worked well for some years, but as the aging of the population has continued, the financial burden has become heavier. In contrast, some countries (such as the United States) have made long-range projections for many years.

Projecting 50 to 75 years into the future cannot be done with great precision, any more than one can predict with precision what the weather will be in several weeks. But just as with the weather, one does know that, if it is summer and winter is coming in about six months, it will be colder then. One may not know exactly how much colder, though. Long-range projections have given many countries some indication of the problems that will be coming. In recent years more countries have become concerned about the long-range future costs of their social security programs.

3 Role of Visiting Experts

Next I will discuss some of the most interesting specific developments in several countries with which I am familiar. Obviously, one article cannot describe what is happening in all countries!

When a person travels to another country as a consultant in the field of social security (or, for that matter, any other field), he or she should not use what is done in his or her own country as an absolute guide for what other countries ought to do. Instead, technical experts should consider what the particular situation is in a country as compared not only with their native land, but also with countries throughout the world. What operates well and is desirable in one country frequently may have just the opposite outcome in another
country. There is no one perfect way of doing things; there are many different alternatives. The choice of which alternative to take is often not merely financial, actuarial, or economic, but is also dependent upon the political or psychological characteristics of the country.

4 United Kingdom

Now let us take a tour around the world, going eastward from the Americas. The first country I will discuss is the United Kingdom, which faces a serious problem concerning equal treatment by sex. This problem has been especially acute since the United Kingdom joined the European Economic Community (E.E.C.). The U.K. has had a five year differential in the minimum retirement ages for men and women in its social security program (60 for women and 65 for men). The benefits for women with similar earnings records often are higher in order to make up for the fact that their contribution period or service period is shorter. The E.E.C., however, believes that there should be equal treatment of men and women in all respects—social security, pensions, and so forth.

The U.K. has a dilemma because private pension plans must have equal treatment; if they do not, legal suits can be brought in E.E.C. courts. On the other hand, the E.E.C. doctrine on equal treatment does not control social security systems completely. At this time an employer in the U.K. with a private pension plan must provide equal treatment; if women can retire at age 60 with a certain amount of pension, men must have the same amount at that age. At the same time, however, the social security system does not pay the same benefit to men as to women, especially at ages 60 to 64. The employer cannot bridge the gap by providing a temporary benefit to men to equalize treatment in the aggregate between men and women because it would be unfair discrimination against women; men would have larger benefits from the private pension plan!

The real solution to this problem is to have the social security system also provide equal treatment. The U.K. government is struggling with this matter. One difficulty with equalizing retirement ages between men and women by lowering the age for men is the greatly increased cost of the program. But if the age for women is raised, many female workers will be extremely dissatisfied, especially those now near the current retirement age. In the end, however, this equalization must be done. Probably the best way to equalize treatment of men and women is not suddenly, but with a
gradual transition. In any event, the U.K. has a difficult problem in this area.

Another interesting development in the U.K. is connected to individuals opting out of the social security system. The U.K. system is composed of two parts: a flat benefit and an earnings-related benefit. For many years, employers have been able to opt out of the earnings-related benefit portion if they provide at least equivalent benefits. Although this makes the system complicated, it has been working reasonably well. Over the past two or three years, however, changes in the system have allowed persons in a plan that had opted out of the earnings-related benefit portion to opt out of the plan individually if they provide their own retirement protection. Also, persons whose employers do not opt out can opt out individually. Individual opting-out is undesirable, because it will be difficult to prevent adverse selection and the resulting increased costs. At the same time, the principle of social solidarity is violated.

5 Former Soviet Union

The next country is the former Soviet Union, which has the same problem as the United Kingdom: unequal retirement ages for men and women (namely, 55 for women and 60 for men). A Russian colleague of mine informed me that this is a great concern. Their experts know that they should have equal ages by sex, but this is difficult to achieve from a political standpoint. With all of the other problems facing the former Soviet Union, however, this one is undoubtedly not high on the list of priorities.

Another problem in the former Soviet Union is that pensions are low. For many years I attended international conferences on social security where Soviet delegates would proclaim that they had the most wonderful social security system. They asserted that it took care of all the needs of all their people and that it was paid for entirely by employing entities and by government and not at all by workers.

The level of benefits of the social security program relative to earnings in the Soviet Union a few years ago was close to that in the United States. As in the United States, the benefits are graded, i.e., relatively higher for low income persons and relatively lower for high income persons. For example, for a worker in the United States with average earnings over the working lifetime, the benefit is about 42 percent of final wages. For the low paid worker, the benefit is 55 percent to 60 percent of final wages. For the highest paid worker (up to the maximum earnings considered for benefit purposes), the benefit is 25 percent to 27 percent of final wages.
In the former Soviet Union, the minimum retirement ages are lower than in the U.S. Their level of total retirement income is relatively low, however, because the social security benefits are the only source of retirement income in most cases. In contrast, many persons in the U.S. have private pensions in addition to Social Security benefits, as well as more private savings, home ownership, and so forth. The total retirement-benefit level in the former Soviet Union is low, and its policy makers are concerned about the situation. With the recent horrendous inflation, the purchasing value of benefits has dropped sharply despite month by month ad hoc adjustments (which essentially merely raise the minimum pension so that virtually all beneficiaries receive the same amount).

A surprising development occurred in the social security field in the Soviet Union in 1988. The former Soviet Union then had only one insurance company, Gosstrakh, which was owned by the government (although some individually owned companies now are being established). Gosstrakh sells insurance policies of the standard forms that life insurance companies in any country sell, although it tends to specialize in short-term endowment policies of five to ten years. These policies are sold by agents, as in other countries. The premium rates are determined actuarially, so that all policyholders are paid an equitable amount, and the system costs the government nothing. The government probably even makes a profit on it.

In 1988, Gosstrakh began writing individual deferred-annuity policies, under which individuals could buy a certain unit of monthly pension (such as ten rubles), beginning at age 60 for men and age 55 for women. Although these policies were sold by agents, the premiums were collected through payroll deduction. This was unlike their life insurance policies, under which agents usually came to the home to collect premiums.

The basic reason for this new plan, as stated in the decree that established it, was that social security benefits were too low, particularly for workers at average and higher earnings levels. In this way, those in this economic category could provide more adequate retirement incomes for themselves on a voluntary basis.

The premium rates, unlike those for the life insurance policies, were not established on an actuarial basis. Rather, the premium rates reflected a considerable government subsidy. Thus, this plan involved a government policy to increase individual retirement income, but to have individuals partially pay for it directly.

To an actuary, it seems strange that the same premium rate was charged for men and women for a given amount of pension that was deferred for a prescribed number of years in spite of the fact that
women live longer. Further, the premium rate for a woman age $x$ who received the benefit 30 years later (at age $x + 30$) was the same as the premium rate for a man age $x + 5$ who did not receive the benefit until age $x + 35$. A double action was present, which resulted in bargain rates to women because of their favorable mortality and because of the earlier age at which they received the pension.

The rates were graded actuarially by age at issue, however. If one bought a benefit of ten rubles a month at retirement age, the premium was much higher if the policy were bought a short time before retirement age was reached than if a longer period of deferment was involved.

Considerable interest in the new voluntary-annuity program was expressed when it began operating in 1988. A reported 400,000 policies were sold in the first year. By 1989, when extensive liberalizations in the social security benefits were proposed by the government, however, interest in the voluntary annuities plummeted. Thus, most of the policies were allowed to lapse, and few new policies were written. An interesting (and amazing) development apparently came to an end and is unlikely to be resurrected, considering the political and economic upheaval in the Soviet Union in 1990 to 1991. (This upheaval also made existing policies virtually worthless as a result of inflation.)

The dissolution of the Soviet Union into separate independent nations has created many problems in the social security field. Whether each of the nations will establish new systems, how such systems will be funded, how the new nations will divide the old system and its assets, and how they will deal with persons who worked in different former republics are unresolved questions facing the new countries of the former Soviet Union.

6 Germany

Germany is experiencing just the opposite situation. But the reunification of Germany, essentially a merger of East Germany into West Germany, presents many of the same problems in the social security area. West Germany essentially has absorbed the East Germans into their social security system and will pay the extra costs involved. The system for the reunified Germany will be much like (if not entirely the same as) the previous system for West Germany. Nonetheless, some transitional problems will be present, particularly in areas where the East German program provisions were more liberal.
7 Eastern European Countries

The Eastern European countries have problems with their social security programs that are similar, in some ways, to those in the former Soviet Union, as well as some uniquely different problems. Their retirement ages vary by sex and are also very low, which results in high contribution rates. Unlike the former Soviet Union, their benefit levels are high, further resulting in high contribution rates. Their disability experience is high, in part due to loose administration. Coverage compliance has deteriorated as the societies in Eastern European countries have become freer.

Some economic planners within the Eastern European countries—as well as visiting experts from other nations—seek to privatize, in whole or in part, their social security programs along the Chilean line (as discussed later). At the same time, they would like to turn over to the new system some of the assets of former nationalized industries and companies. From another point of view, however, experienced administrators of the social security programs seem to believe that solutions to their problems can be found within the traditional framework of social insurance.

In any event, it seems likely that the level of benefits under some of the Eastern European systems will be lowered somewhat. At the same time, private pension plans (along traditional lines, including private sector investments) are expected to develop.

8 Saudi Arabia

Let us next go south and east to Saudi Arabia. This country has a traditional social insurance system, with contribution rates of 8 percent from the employer and 5 percent from the employee. The pension is related to the individual's most recent salary. Initially there was a very liberal vesting provision, so that persons who worked just a few years and then left the country were eligible for a partial pension payable when retirement age was reached.

Many foreign workers come to Saudi Arabia for short periods. These workers are not only from the United States and Europe, but from many other countries throughout the world, such as Korea and the Philippines. In many ways, this liberal treatment for foreign workers said, in essence, "You'll get a partial retirement pension when you reach retirement age, which will be sent to you in your home country, even though you have been out of Saudi Arabia for some years."
Several years ago, the law was changed. Persons who are not living in Saudi Arabia at the time when they reach retirement age no longer can obtain these vested pensions. Instead, they receive only a refund of employee contributions without interest. This has helped the financing of the Saudi system greatly, because all employer contributions and investment earnings on employee contributions remain within the system. One difficulty in the Saudi system is tracking the location of foreign workers over time. As with many social security systems, when individuals seek benefits, they must go to the system and ask for them. There are many persons who have worked in Saudi Arabia over the last 20 or 30 years who may forget that they have vested pensions coming from the Saudi system when they reach retirement age. It is unlikely that they have heard that the only thing that they can receive is the refund of their contributions.

9 People's Republic of China

Our next stop is China. For the 90 percent of its huge population in rural areas, no national pension system or social security program exists. For workers in industry, commerce, and government, however, legislation has required each establishment to set up a pension plan of a more or less standard type for some years. For example, a steel mill must have a pension plan for its employees. These pension plans usually have a retirement age of 60 for men and 55 for women—again, the problem of unequal treatment by sex—and they pay benefits of about 70 percent of final wages for a lifetime of employment. The plans are financed entirely by the employing establishment, completely on a pay-as-you-go (or current-cost) basis. In other words, there has been no funding (or even establishment of reserves) for persons who currently are retired. Another problem is that individuals are required to be in service when they reach retirement age. Thus, if they move from job to job, almost all pension rights are lost.

In the past five years, the Chinese government has been more concerned about matters relating to economic development. The government has decided that the previous employment system (under which once a person was hired for a job, it was a lifetime one) is not desirable. It now believes that there could be more productivity if there were freedom of movement from one type of employment to another. But the difficulty with this change is that pensions often would not be available because of the lack of vesting.

Another economic development problem is that companies or establishments that have been operating for many years have a relatively high pension cost because current pensions are paid with cur-
rent income. A similar establishment that has just begun operations has no current pension costs and, therefore, can produce at a much lower cost. Thus, the older establishments are at an economic disadvantage.

The Chinese government is concerned about how pay-as-you-go financing of private pension plans affects their economic development. As a result, government officials have been thinking about having a national system to equalize the cost between new and old establishments. Naturally, the new establishments (and the provinces where the establishments are mostly new ones) prefer the status quo because it results in lower costs for them. They do not want to share the higher pension costs of Shanghai or Beijing. This is currently a difficult political, as well as technical, problem in China.

10 Japan

Next let us turn to Japan, which currently has the lowest mortality in the world (in other words, the greatest longevity). This, in turn, means high social security and pension costs. The Japanese government has recognized for some years this coming trend and gradually has increased the minimum retirement ages.

Japan has two national pension systems. One provides flat benefits for the entire general population: not only employees, but also self-employed persons (farmers, operators of small businesses, and so forth). The other is an earnings-related program that applies in manufacturing and commercial industries. In the flat-benefit plan, the minimum retirement age has been increased to 65 for the normal pension for both men and women, but individuals may retire as early as age 60 and receive a reduced pension. On the other hand, persons can retire later, up to age 70, and receive an increased pension.

In the earnings-related plan, the retirement ages at one time were 60 for men and 55 for women, but they are being increased by five years for women on a gradual transitional basis (reaching age 60 for those born after April 1, 1941), which eventually will solve the problem of unequal treatment by sex. The Japanese are concerned about the relatively low retirement ages; some persons in the government want to increase the age for both men and women to 65 in order to solve the problem of high cost that will occur as the population ages. Although the government wants to make this change, the situation is difficult politically. When this change is made, it will be phased in gradually; at the moment, however, it has been put aside until some more propitious time when the government hopes
there will be fewer complaints from both men and women about raising the retirement age.

Another interesting feature in the Japanese system—one that is surprising and one that the authorities now have become aware of—is the factors that are used to adjust benefit amounts for early and late retirement in the flat-benefit plan. Decreases are made because of early retirement and increases because of late retirement.

Despite the technical and actuarial expertise available in Japan, somebody erred when the adjustment factors were established. For a person retiring at age 60, the reduction for not waiting until age 65 to receive benefits should be generally about 30 percent. In the Japanese plan, however, the reduction is 42 percent, a very bad deal from an actuarial standpoint. Thus, if persons can avoid filing for benefits at age 60 and wait until age 65, they are in a much better financial position. Also, rather surprisingly, there is no graduation in the provision. The factor depends on integral years of age; in other words, there is only one reduction factor applicable if retirement occurs between ages 60 and 61, but another smaller factor—35 percent—applies for retirement at age 61. It would seem more reasonable if the reduction factors moved smoothly from age 60 to age 65, with monthly changes.

The beneficiaries involved are aware of this situation; almost everybody takes the benefit at an exact age. The surprising thing is that so many persons take benefits at age 60. Some undoubtedly have to because they do not have other resources, but there are many others who would not have to take benefits. Many persons are disadvantaged by not realizing that a bad deal exists!

At the other end of the retirement band, if instead of taking the benefit at age 65, persons wait until age 70, the actuarial increase should be 40 percent to 50 percent. In this system, however, this differential is 80 percent. Anybody in good health who had the advice of an actuary would not take the pension until age 70! In actual experience, very few persons do.

11 Trust Territory of the Pacific Islands

Next let us go to the Trust Territory of the Pacific Islands, otherwise known as Micronesia which has a population of about 200,000. This is a group of islands in the Central Pacific that the United States received as a trust from the United Nations after World War II. In 1986, the Trust Territory was divided into four parts, three of which are now independent nations—the Republic of Palau, the Federated States of Micronesia, and the Republic of the Marshall
Islands. The fourth part, the Northern Mariana Islands, voted to become part of the United States (just as is Guam, which in essence is the Southern Mariana Islands).

The Trust Territory established a social security system in 1967 at the request of the United Nations, which held that a good trustee should develop a social security system for such a territory. (The author worked on this project, and the system was established and operated successfully thereafter.)

When the Trust Territory was divided, a unique problem arose: how to divide a social security system equitably among different geographical regions. A subdivision was made, and each entity received an equitable share of the assets (and of the future liabilities, too). The Northern Mariana Islands system merely joined the U.S. system, and credit was given for all prior service as though it had been performed in the continental United States. The three new independent countries started with the existing system, but undoubtedly they will modify it in the future. Many persons there think that a retirement age of 60 is too high and they want to lower it. These individuals may not realize that the long-run high costs of such a move will be difficult to bear.

12 Canada

Next we come to Canada. One small change made in 1991 greatly affected the underlying philosophy of its social security system. Canada, like the United Kingdom, has two plans. One is called Old Age Security, under which a flat amount is payable to every person in the country age 65 or older who meets certain residence and citizenship requirements. The other is an earnings-related system, called the Canada/Quebec Pension Plan. The combination of these two plans produces a weighted-benefits structure, just as prevails in the U.S. system. With the flat benefit and an earnings-related benefit, lower paid persons receive relatively higher benefits than do higher paid ones. The combined level of benefits in Canada is about the same as that in the U.S.

The small change in Canadian policy was made considering only budget effects and not the long-range social effects. The government introduced what some persons refer to as the Claw-Back. This is analogous to a lobster clawing money back!

Under this provision, individuals with moderately high income, roughly C$50,000 a year or more, must return part of the flat pension. This provision is to be phased in over several years. After some years, the benefit under the Old Age Security system will not be
available to the highest income Canadians. The income limit at which this applies is only partially indexed; as time goes by, more persons will be affected by the provision. The system will become more a public assistance (or social assistance) system instead of a social insurance or demogrant program. This has been a significant change in the philosophy of the Canadian system. It is not clear whether the change was intentional.

13 Chile

The new Chilean system, which was established in 1981, involves privatization and individual defined-contribution accounts that are determined in real terms (i.e., indexed for inflation). It represents one of the most interesting and important developments in social security in the last decade or so. Many countries around the world—not just North, Central, and South American countries, but also some European countries—are interested in this emerging pension system.

Many observers do not realize that the system involves more than privatized individual accounts. The government also must make mammoth transfer payments from general revenues to meet the cost of prior service credits and large minimum-benefit guarantees. Further, much of the investments of the private funds are in government bonds, which probably were issued to meet the foregoing costs—a circular effect! Although this large cost to the government might be acceptable in Chile (which would have had equally high, or even larger, costs under its previous system), this might not be acceptable in other countries.

The Chilean system is now 12 years old, and it seems to be operating well. A cautious actuary must say, "Twelve years is a short time in the life of any sort of pension plan." Not that any catastrophe is likely to occur, but its experience may not be as favorable as its supporters anticipate. In particular, the real interest rate earned by the various privatized funds may not be nearly as high over the long run as is expected. The purchased annuities would not be as large as is now anticipated.

14 United States of America

We come finally to the United States. Two major issues are present in its social security program (officially known as the Old-Age, Survivors, and Disability Insurance program). One is the controversy about the so-called retirement earnings test, under which persons who
are at least the normal retirement age (currently 65) but not yet age 70 receive reduced benefits when they have earnings that exceed a certain limit. If earnings are sufficiently high, all benefits are lost. The test is not applicable at age 70 and over, and it applies on a more stringent basis to beneficiaries under the normal retirement age. When benefits are received in later years, increases are given to reflect the benefits that are lost, but such increases currently are lower than those needed to provide actuarial equivalence. In 1993, such persons can earn up to $10,560 a year and still receive full benefits. But for every $3 of earnings above this limit $1 of benefits is lost.

A delayed-retirement credit (DRC) is given to individuals who lose benefits in this way, either because of not claiming benefits or because benefits are reduced thereby. For persons who reach age 65 in 1992 and 1993, the DRC is 4 percent per year of delay, pro-rated on a monthly basis. Under present law, the DRC gradually will be raised until it will reach 8 percent a year (which is about the actuarial equivalent) for persons who attain the normal retirement age in 2009 (then age 66). In other words, a person who then does not take benefits at the normal retirement age of 66 and waits until age 70 gets a 32 percent increase. This is about the same increase that a private insurance company would give under similar circumstances to a person who buys an annuity.

This test is unpopular with many persons. Critics say that it discourages persons from working and that, therefore, it is undesirable because work incentives are reduced. For many years, the author was a strong supporter of this test, under the simple but logical principle that retirement pensions should not be paid to persons who are not retired. After long deliberation about this matter and looking closely at the experience, it became evident that persons who had earnings of anywhere from about 50 percent to 150 percent of the average wage (currently, about $23,000 a year) receive little in their take-home pay if they continue working after age 65. Of course, for highly paid professionals who earn $100,000 or more per year, this is a different matter. But persons who earn $12,000 to $35,000 a year have great disincentives to work because the net additional income in their pockets from working is so small.

Therefore, it is clear that something should be done about this provision. The test should be eliminated for persons who are above the normal retirement age (currently 65), but under age 70, although they still should receive larger benefits if they continue working and do not collect benefits. They should receive 8 percent more per year in their eventual benefits under such circumstances. It is true that this
change would result in higher program costs, but only with respect to persons who attain the normal retirement age before 2008. (This is a low cost period for the program.) When measured over the long range, the average increase in cost is small (and can be met in several ways, none being especially painful—for example a temporary increase in the maximum taxable earnings base or, when changing the financing to a pay-as-you-go basis, not reducing the payroll-tax rates in the next two decades as much).

Next consider briefly the current financial situation of the U.S. Social Security program. Some say that it is going bankrupt, that it is in terrible financial condition, etc. Many in the United States think so, because they have heard or read about it somewhere. It is difficult to correct such misinformation. The program did have severe financial problems in the early 1980s, but these have been solved reasonably well.

At the end of 1992 the trust-fund balance was $331 billion; this is almost equal to one year's benefit outgo. The trust fund is building rapidly, some $60 billion to $70 billion a year in the next few years and increasingly larger amounts for the next 15 years. From the short-range standpoint, the system is financially strong. But, as stated previously, one has to look beyond 20 years, because that is a short time in the life of a social insurance or pension program. Under the present method of financing, a large fund balance will be built over the next three decades according to the intermediate cost estimate in the 1993 Trustees Report. And it will reach a level of about $5 trillion in about 30 years. After then, however, it will decrease rapidly. In another ten years, it will be exhausted.

In the long run (after the year 2035), the system will have financial problems according to the current estimates under the intermediate assumptions. These can be solved at some time in the future, either by raising the contribution rates somewhat or by raising the normal retirement age (or both). There already has been a move in the latter direction. The normal retirement age slowly will increase under current law from the present age 65 (which has been in effect in the 56 years of operation of the system), beginning in 2003, to age 67 in 2027. An increase even to age 68 would have a significant financial effect.

The difficulty with the financing procedure for the U.S. system is that it is faulty in building a large fund and then drawing it down. Also—at least in this type of program and in the prevailing political process—building a large fund is undesirable. This may seem a strange thing for an actuary to say! Usually, if one is the actuary for
a pension plan, it would seem that the more money that one has, the better is the situation.

In this case, three good reasons exist why the procedure of building a large fund is undesirable. First, under the manner in which the federal budget is reported, the enormity of the deficit is hidden, to some extent, by the annual excesses of income over outgo of the trust funds. Second, the ready availability of these excesses for general purpose borrowing by the federal government could cause Congress and the executive branch to be less frugal than would be the case if borrowing were necessary from the private marketplace. Third, the mammoth size of the fund could cause irresistible pressures from the beneficiaries to overliberalize current benefits, thereby creating insupportable long-range costs.

Nonetheless, the amount of the present fund balance is needed as a contingency reserve in case an economic recession occurs. That balance (about one year’s outgo) probably would get the system through any sort of business recession, even though income to the trust funds may be smaller than currently is projected.

The program has two trust funds, the Old-Age and Survivors Insurance Trust Fund and the Disability Insurance Trust Fund. These two funds usually are considered in combination when the financial status of the program is analyzed. The current estimates (intermediate) indicate that the combined funds will be exhausted in 2036, with the OASI fund lasting until 2044, but the DI fund only until 1995. This is not a significant problem, however, because the allocation of the OASDI tax rate can be changed slightly—as has been done several times in the past—to show both funds being exhausted at about the same time. Such reallocation would not have any effect on the taxes paid by workers and employers in the aggregate.

The foregoing discussion has not related to the Medicare program, which consists of hospital insurance (HI) and supplementary medical insurance (SMI). The former is financed by payroll taxes on almost the same persons as OASDI covers, while the latter is financed by premiums on the enrolled beneficiaries and by general revenues (which currently bear 75 percent of the cost). The HI program is estimated to have financial difficulties in the next ten years, its trust fund being exhausted in 1999 under the intermediate estimate. The SMI program rates are established in the law for years through 1995 at an apparently more than adequate level, and thereafter they can be adjusted by promulgations of the executive branch on the basis of experience.
Although the HI program has great financing problems over the long range, so too does the diverse health insurance system for the working population and its dependents. The solution to both sets of problems must be found simultaneously, perhaps by a radical change in the method of financing health care (which could mean the elimination of the Medicare program by the substitution of a universal system).

The solution to the foregoing problem of roller-coaster financing of the OASDI program is to change to responsible pay-as-you-go financing. Such a procedure was followed from the mid-1950s until the 1977 amendments. For more details on this matter, see Myers (1989).

The change to pay-as-you-go financing could be accomplished by lowering immediately the combined employer/employee tax rate by 1 percent for the next ten to fifteen years and then having the rate slowly increase over the years. Ultimately, the rate would have to be about 5 percent above the present 12.4 percent rate—just as would be necessary under present law after the trust funds are exhausted. As an alternative to such higher ultimate rates, the benefit costs could be reduced (e.g., by increasing the normal retirement age more than is provided for under present law). For more details on pay-as-you-go financing and its advantages, see Myers (1991).

References


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