

Fall 9-1-2001

Social Security: The Broader Issues

C. Eugene Steuerle

Follow this and additional works at: <https://scholarlycommons.law.wlu.edu/wlulr>



Part of the [Social Welfare Law Commons](#)

Recommended Citation

C. Eugene Steuerle, *Social Security: The Broader Issues*, 58 Wash. & Lee L. Rev. 1235 (2001), <https://scholarlycommons.law.wlu.edu/wlulr/vol58/iss4/5>

This Article is brought to you for free and open access by the Washington and Lee Law Review at Washington & Lee University School of Law Scholarly Commons. It has been accepted for inclusion in Washington and Lee Law Review by an authorized editor of Washington & Lee University School of Law Scholarly Commons. For more information, please contact lawref@wlu.edu.

Social Security: The Broader Issues

C. Eugene Steuerle*

Table of Contents

I. Introduction	1235
II. Sources of Growth in Social Security and Health Benefits . . .	1236
A. Health Program Design	1236
B. Growth in Annual Benefits	1237
C. Longer Retirement Spans	1238
D. Lifetime Value of Benefits	1238
E. Baby Boomers and Declining Fertility Rates	1239
III. The Budget Issue	1239
IV. The Labor Force	1241
V. The Needs of the Elderly	1243
VI. Conclusion	1244
Appendix	1246

I. Introduction

Although a good deal of the public debate over Social Security concentrates on individual accounts – for proponents, the *sine qua non* and for opponents, the *cum qua non* of reform – I view that emphasis as highly misplaced. Fostering saving in Social Security is a worthwhile objective, but it is not the only, nor even the primary, issue affecting either the economy or the imbalance within the Social Security system.

Broadly viewed, the Social Security "issue" concerns how retirement programs should relate to the larger question of how government can change

* This paper is adapted from a presentation made at Washington and Lee School of Law. Some portions are also taken from a series of briefs entitled "Straight Talk on Social Security and Retirement Policy," by C. Eugene Steuerle and Adam Carasso, and can be found at <http://www.urbaninstitute.org>.

to meet the primary needs of the people of different times. While the Social Security debate often narrowly focuses on how to design the system for retirees fifty or seventy-five years hence, I want to deal more generally with how our budget can adapt over time to meet the needs of all people over those fifty or seventy-five years. Right now, Social Security and other elderly programs have large amounts of growth built into them in fairly rigid ways. Legislators simply cannot create systems with that much built-in growth without causing impacts far beyond the systems themselves.

Here, I will devote myself to three major areas affected by the existing structure of growth in elderly programs. The first area is the budget. Built-in growth does not affect just future budgets; it is already a major factor affecting current budget battles. The second area is the labor force. Social Security now induces people to retire in what must be considered late middle age. If that trend continues as the baby boom generation retires, there will be a significant reduction in the percentage of the adult population that will be working. The third area is the needs of the elderly. Because legislators have set growth patterns in ways designed to address problems as they were perceived in the past, the system has become less targeted toward the most pressing problems of the elderly as time goes on. For example, for each additional dollar of expenditures it makes, Social Security is targeting smaller and smaller shares of benefits to either the poorer or the more needy among the elderly. However, the predetermination of growth rules makes change difficult. The structure of the existing system confronts politicians with the dilemma of renegeing on some set of promises if they want to make the system better at meeting its basic purposes.

II. Sources of Growth in Social Security and Health Benefits

It will be helpful at the outset to take a close look at the ways that growth has been built into our health and retirement programs. There are four major sources of automatic growth in such programs: health program design, perpetual growth in annual benefits for new retirees relative to those already retired, longer retirement spans, and fertility changes that reduce the number of workers and output relative to retirees and benefits paid.

A. Health Program Design

While most of this paper focuses on Social Security, it is important to note that health care for the elderly faces most of the same built-in growth as Social Security, plus more. Public health insurance essentially adopted the model of private health insurance in its early phases of development only a few decades ago. Essentially, health insurance is set up so that when a patient

sees a doctor, the doctor and patient bargain over what everybody else will pay. "Everybody else" includes participants in health plans or, in the case of public insurance, the taxpayer. Any system with roughly a zero price at the margin tends to create an infinite demand. In the case of health care, it also leads to a technology that tends to emphasize cost-increasing, rather than cost-decreasing, improvements. The attempt, primarily private, to move toward health maintenance organizations, preferred provider organizations, and similar operations represents at its core an attempt to create an intermediary that has some greater concern over costs. We certainly do not know how all of this will be sorted out in the future, but the current set-up is essentially unsustainable because of its built-in incentives.

B. Growth in Annual Benefits

The Social Security system uses an adjustment known as "wage-indexing" to ensure that if wages grow in the economy, benefits grow as well. The net effect is that if a person earns thirty percent more than his parents during his working life, his annual Social Security benefits are designed – at least from this feature – to be thirty percent higher. The underlying notion is not that individuals need so much money in absolute dollars, but rather that they need to replace a given fraction of their former wages in retirement. If future generations are twice as rich, by this logic, they should get twice the Social Security benefits in their annual retirement checks.

At one level, the goal is reasonable. It follows from a life cycle view that emphasizes individuals evening out consumption over the years. Both past and future generations reasonably might want a relatively stable lifestyle over time, no matter what the level of that lifestyle. But imagine if we made such automatic adjustments for almost everything in the budget. Certainly we might expect that wages in the Armed Forces would follow wages in the economy; thus, we could index them so they grew automatically at the rate of growth of wages generally. The education budget might be automatically wage-indexed to take into account the higher wages that teachers will deserve in the future. Why not do the same for government workers?

The problem with this type of automatic growth becomes apparent when carried to its logical conclusion. If a person wants to save to provide replacement wages for whatever period he retires, that is a fine goal. However, a budget financed primarily out of the current tax receipts of workers has to be allocated according to the needs of the time. If everything is automatically adjusted upward, there will be less – or even zero – flexibility to meet new demands and to try new things.

C. Longer Retirement Spans

Built-in growth in annual benefits through wage indexing generally would be enough by itself to ensure that Social Security would always grow as fast as the economy, even without changes in demographics or retirement patterns. But people are also living a lot longer and retiring a lot earlier. Figure 1 shows life expectancy at the average retirement age.¹ Roughly speaking, individuals are living about four to five years longer than when Social Security benefits were first paid out, and they are retiring earlier as well. The two trends are not strictly additive, but on net, people are living about seven or eight more years in retirement. In point of fact, there would be no Social Security financial crunch if people retired for the same number of years as they did when Social Security first paid benefits.

Having more beneficiaries obviously adds to cost, but this is a leveraged deal. Because people drop out of the workforce for much longer periods of their lives, taxes also decline. The decline in taxes paid involves the income tax as well as the Social Security tax and affects the ability of government to support not just Social Security, but Medicare, education, defense, and everything else. Moreover, retirees stop producing, and production is the major source of income that supports not only government programs, but also the workers themselves.

D. Lifetime Value of Benefits

One way to view the combined effect of rising annual benefits and more years of retirement support is through a calculation of the present value of benefits expected by retirees. This number represents roughly what it would cost if those beneficiaries were to visit a life insurance company and pay up-front for their future benefits. Their total benefits added up over time would actually be much higher because an up-front payment would allow interest to accumulate over time (the lifetime value calculation discounts future payments by the interest rate).

Figure 2 shows some comparisons for a one-earner couple, although the numbers are roughly the same for two-earner couples.² Lifetime Social Security benefits are about \$275,000 for an average-wage couple retiring today and will grow toward \$400,000 as we move into the future. The numbers are much higher with the addition of Medicare benefits. For those born around World War II, or early baby boomers, the total will be about \$600,000 to \$700,000 in combined Social Security and Medicare benefits. Young couples today are promised on average around \$1 million in combined benefits.

-
1. See *infra* Appendix, Figure 1, at 1246.
 2. See *infra* Appendix, Figure 2, at 1247.

It is not hard to come up with those types of figures if we all retire for very long periods of time (the longer living of a typical couple now receives benefits for a quarter century) and absorb very high medical care costs at some point before death. However, almost all the resources to pay for this comes in the form of transfers from others – younger people who still work. Imagine what might be done by society if some of that money were spent on other things, such as education, crime prevention, or improvements in run-down geographical areas. Imagine the gains that might come from simply providing worthwhile activities for our youth throughout most of the day and the summer months, rather than continuing an activity schedule that is structured around the need to do chores on the farm at the end of the day and during the summer.

E. Baby Boomers and Declining Fertility Rates

These figures on lifetime benefits under Social Security do not reflect any changes due to declining fertility rates and the subsequent decline in workers. The growth in lifetime benefits is essentially independent from the baby-bust/baby-boom/baby-bust cycles of fertility. The baby boomers have been described as affecting the economy like a pig being swallowed by a python. Primary and secondary education felt the effect first, then college education, then the housing market, and, more recently, pensions. As the baby boomers begin to retire, however, the nation is projected to undergo a dramatic decline in workers per beneficiary from about 3.4 today to less than 2.0 within three decades.

In demographic terms, that is a very short period of time. Normally, changes in fertility take seventy to ninety years to work their way fully through the economy — essentially a full lifetime. The baby boomers, however, hide this adjustment and force our economy to adjust in a much shorter period of time.

Numbers on the imbalance in Social Security roughly reflect this change in workers per beneficiary. In a pay-as-you-go system, a drop from three payers to two payers per beneficiary means that to maintain the same level of transfer to the beneficiary, the taxes on each payer must go up by one-half. Alternatively, to maintain the same tax rates on the payers, the beneficiary must accept a cut in benefits of one-third.

III: The Budget Issue

In the early 1950s, the federal government's retirement and health expenditures, most of which are for the elderly, comprised only about ten percent of total expenditures.³ Today, those expenditures account for over

3. See *infra* Appendix, Figure 3, at 1248.

fifty percent of the total and are rising steadily. Note that this growth occurred even before the upcoming retirement of the baby boomers, when the share of the population receiving benefits will rise significantly.

Furthermore, if one share of the budget increases, the total of all other shares *must* decrease. Similarly, if a higher percentage of national income is to be spent in one area, then a lower percentage must be spent elsewhere. Consider the issue of education. Although several recent Presidents all claimed to be "education" Presidents, the amount of money that they proposed to spend on education was fairly minor relative to the annual additions to retirement and health programs. There is little doubt in my mind that the built-in growth of retirement and health programs has been a major constraint on what has been proposed and enacted in other programs, such as education. I am not assessing whether the latter growth should have been higher; rather, I am merely demonstrating how automatic growth in one type of program preempts other options.

Figures on mandatory and discretionary spending provide still another view of the budget impact of elderly programs. Mandatory spending represents spending that occurs automatically, whether or not Congress ever meets or takes a vote. Discretionary spending, in turn, is that which must go through a normal appropriations process each year. Figure 4 shows Congressional Budget Office figures on how the federal budget divides between those two categories.⁴ The large growth in mandatory spending in recent years is due mainly to the automatic growth built in from year to year, rather than to the enactment of new legislation.

For a long time, the decline in discretionary spending did not have a major impact upon domestic social programs. As Figure 3 demonstrates, a massive shift has occurred from defense to the domestic side of the budget.⁵ Defense expenditures at the end of the Korean conflict were about fourteen percent of gross domestic product (GDP). Today, they consist of about three percent of GDP. Multiplying the difference of eleven percent of GDP by this year's GDP gives a total of about \$1 trillion a year. This figure represents the amount of the annual switch from defense spending toward domestic spending, over and above the spending levels that would have pertained had we merely kept the allocation percentages the same as in 1950. This domestic expenditure increase could and did occur essentially without any significant change in the average tax rates.

Economists are not known for making very good predictions, but I will stick my head out nonetheless. I predict that we will not witness another eleven percentage point decline in defense spending – to minus eight percent

4. See *infra* Appendix, Figure 4, at 1249.

5. See *infra* Appendix, Figure 3, at 1248.

of GDP – to finance yet further expansion of domestic programs. The primary post-World War II source of increased spending for social programs will no longer be with us, if it has not disappeared already.

In the future, budgetary trade-offs, defined as shares of the expenditure pie, will no longer involve defense versus domestic programs. Once the budget is composed mainly of domestic programs, the trade-offs to be faced must necessarily be made among those programs. This requirement holds true regardless of the amount of tax increases or decreases that might occur. The shares of the federal expenditure pie must still be allocated regardless of whether the pie is larger, smaller, or the same size.

Again, these issues are not waiting until the retirement of the baby boomers. Figures 5 and 6 clearly illustrate the major sources of growth and decline in spending.⁶ Figures 5 and 6 show that "other domestic programs" – that is, programs other than Social Security, Medicare, and Medicaid – have declined significantly when measured as shares of the economy since their heyday in the Nixon Administration. Existing projections of Social Security, Medicare, and Medicaid spending will crunch these programs even more. One reason that protests have been somewhat muted is that, for a time, the physical side of the domestic budget – programs such as energy, community development, and so forth – was able to take the hit, reducing the impact on the purer transfer programs. Thus, at least until recently, income assistance programs (excluding Medicaid, which also grew substantially) were roughly able to hold their own, although their share of GDP has fallen of late.

IV. The Labor Force

I emphasize the impact of retirement decisions on the labor market because, in the end, it is that market that is the most dramatically affected. An obvious question is whether people might begin to work longer rather than retiring, as many do now, for about one-third of their adult lives.

The lower line in Figure 7 shows the labor force participation rates of men of age sixty-five and above over the past few decades.⁷ The top line shows labor force participation rates of men with about sixteen years of life expectancy over that period. Today, men aged sixty-five have a sixteen year expectancy, which is significantly greater than in former years. The latter comparison then contrasts men with roughly the same health status as defined by life expectancy. The latter contrast in labor force participation is even more stark than the former: about eighty-five percent of men with sixteen

6. See *infra* Appendix, Figures 5 & 6, at 1250-51.

7. See *infra* Appendix, Figure 7, at 1252.

years of life expectancy were in the work force when Social Security was created, as opposed to about one-third today.

This set of statistics shows the dramatic impact of a system that tells people when they should retire and provides access to substantial benefits at or near that age. The drop in the male labor force participation among those with sixteen years of life expectancy does not really occur until the government provides an option for early retirement at age sixty-two.⁸ Then, after 1965, the government further provides Medicare benefits within a short period of time after any early retirement. The sudden availability of benefits for those with sixteen years of life expectancy seems to explain the drop in labor force participation more than any linear time trend from the past. By the same token, the figures suggest that a bit more work today would not be that onerous, at least given that almost all men with substantially less life expectancy and more physically demanding jobs previously worked at the ages at which men retire today. The question that is raised is whether a seventeenth or eighteenth year in retirement is a priority for society if it does not reflect a need among those who receive the benefit.

I have become somewhat more sanguine about potential labor force declines in the future. Most projections today are based upon assumptions that age-sex specific labor force participation rates will remain more or less constant. The lower line of Figure 7 reflects this assumption in the leveling out of labor force participation rates for males aged sixty-five.⁹ With the aging of the population due to both mortality and fertility changes, the implication is that we soon will witness a vast decline in the percentage of adults who work.

Closely associated with this view is the idea that people demand more and more leisure as societies get richer. Thus, notwithstanding the short-term trends, over the long term people will retire earlier and earlier. The difficulty with this view is that it does not align well with the post-World War II experience. In 1948, about forty-three percent of adults were out of the labor force. By 1997, that figure fell below thirty-five percent. If people consistently took more leisure, then why were adult employment rates rising?

The short explanation is that while men dropped out of the workforce more than in the past, women entered the workforce at a rate that offset the departing men. Closely related was a social revolution that made it easier for women to work due to factors such as reduced discrimination, smaller family sizes, and durable goods in the home.

Suppose, however, that this growth in adult labor force participation not only is a response to that social revolution, but also implies a much higher

8. See *infra* Appendix, Figure 7, at 1252.

9. See *infra* Appendix, Figure 7, at 1252.

demand for labor – one that was largely met in recent decades by a group with untapped potential. This labor demand – which, of course, derives from the consumption demands of the population – easily might turn in the future to other major sources of untapped potential. The largest potential source of supply, outside of mass immigration, is among those who are in their sixties or early seventies and still have very significant skills and abilities.

V. *The Needs of the Elderly*

The last major issue I wish to address is the increasing deflection of Social Security resources from those with greater needs – the elderly. Social Security is one of the nation's great success stories in reducing poverty, *on average*, among the elderly. Today, the elderly poverty rate is about eleven percent, far below the thirty-five percent rate in 1960. Social Security also protects retirees' benefits from inflation, as it should.

The success of any program, however, cannot be judged solely on how well that program succeeds *on average*. In the case of Social Security, which holds as a primary purpose the alleviation of poverty in old age, it is worthwhile to examine how much each *additional* dollar spent improves the lot of the population it serves. At least two pieces of evidence suggest that Social Security's ability to meet its anti-poverty standard has hit some roadblocks.

First, the significant increase in recent decades in the number of divorced and never-married individuals indicates that a larger segment of society will not qualify for spousal and survivors' benefits in retirement. Today, single and divorced women in particular often accrue only moderate earnings in their working-age years, partly because of the amount of time many spend raising children on their own. Early in its history, primarily to ensure income adequacy for women with little or no earnings, the Social Security Act was amended to include a system of spousal and survivors' benefits. This part of the system was set up as essentially a pure transfer system because no additional contributions or taxes were required by a qualified individual and benefits were not reduced. By contrast, in the private pension system, a worker must reduce his or her own benefit to pay for additional spousal benefits. While these public spousal and survivor benefits do provide old-age protection to many retirees, their size alone requires a separation of their marginal from their average effect.

The particular design of this add-on transfer system of spousal and survivors' benefits creates inequities in benefits distribution. For example, add-on spousal benefits are not tied to additional contributions; instead, the system allocates benefits according to the prime beneficiary's earnings level. As a consequence, spouses of the highest-earning workers receive the greatest benefits. Meanwhile, dual-earner couples whose earnings are split fairly evenly

between spouses will receive significantly fewer benefits than a one-earner couple with the same total family income and tax payments. Even more troubling in terms of anti-poverty protection, this add-on system supports the most needy retirees the least. In particular, single heads of household – again, mainly women with low incomes – do not benefit at all from spousal and survivors' benefits.

Recent Social Security Administration projections show that estimated poverty rates among the elderly are likely to decline only a bit by 2020 if current marriage and earnings patterns remain relatively steady. Meanwhile, Social Security is scheduled to spend hundreds of billions of dollars by providing an *average* of \$3,254 (in constant 2001 dollars) more per recipient per year.¹⁰ Arguably, the increasing unavailability of supplemental benefits to the individuals who need them the most helps account for the very small projected decline in the poverty level despite the very large infusion of funds. Note also that Social Security already paid out enough in 2000 to remove all of the elderly from poverty. Such a low level of additional poverty reduction for this much additional money does not make for a good marginal return.

The second indication that Social Security's anti-poverty agenda has hit a road block is that the amount paid to the oldest retirees has steadily fallen relative to benefits paid to younger (and more capable) retirees. In 1968, men who were expected to live another ten or fewer years received fifty-two percent of all Social Security benefits paid to men. By 1997, they received only thirty-eight percent.¹¹ Under current law, the percentage of benefits going to the oldest retirees is scheduled to decline even further. A major reason for this shift is that people are retiring and receiving Social Security for increasingly more years. Because retirees with longer expected life spans have the most capacity to work and have the fewest chronic or acute health problems, the program as currently designed provides a continually higher percentage of benefits to retirees with fewer needs.

VI. Conclusion

While I do not expect any two people to come to the same policy conclusions from the set of facts I have presented, I do hope that they will agree that the Social Security debate is defined far too narrowly. What we face as a society is the much broader question of how well we are going to allocate scarce resources to meet the most important needs of our nation. Demographic changes have merely forced this issue to the fore, but they would be there to some extent anyway. The issue plays itself out in the three topics I have

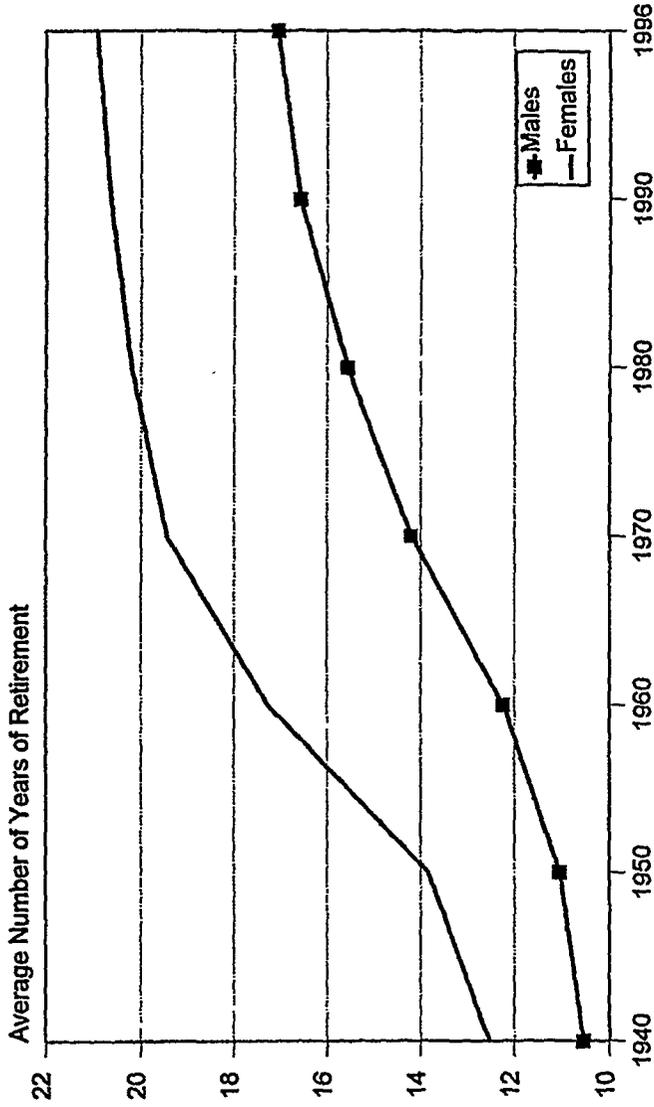
10. See *infra* Appendix, Figure 8, at 1253.

11. See *infra* Appendix, Figure 9, at 1254.

raised here: the current and future allocation of the federal budget and how those allocations are affected by automatic built-in growth of a few major programs; the extent of future labor force participation by adults and how current institutional structures may be blocking a very natural movement toward work by what will soon be a very large stock of older – but not necessarily old – people with significant capabilities; and the continual allocation of decreasing shares of the elderly budget away from the those elderly with the greatest needs.

Appendix

FIGURE 1
Life Expectancy at the Average Retirement Age



Source: The Urban Institute, 1999. Based on data from the U.S. Social Security Administration.

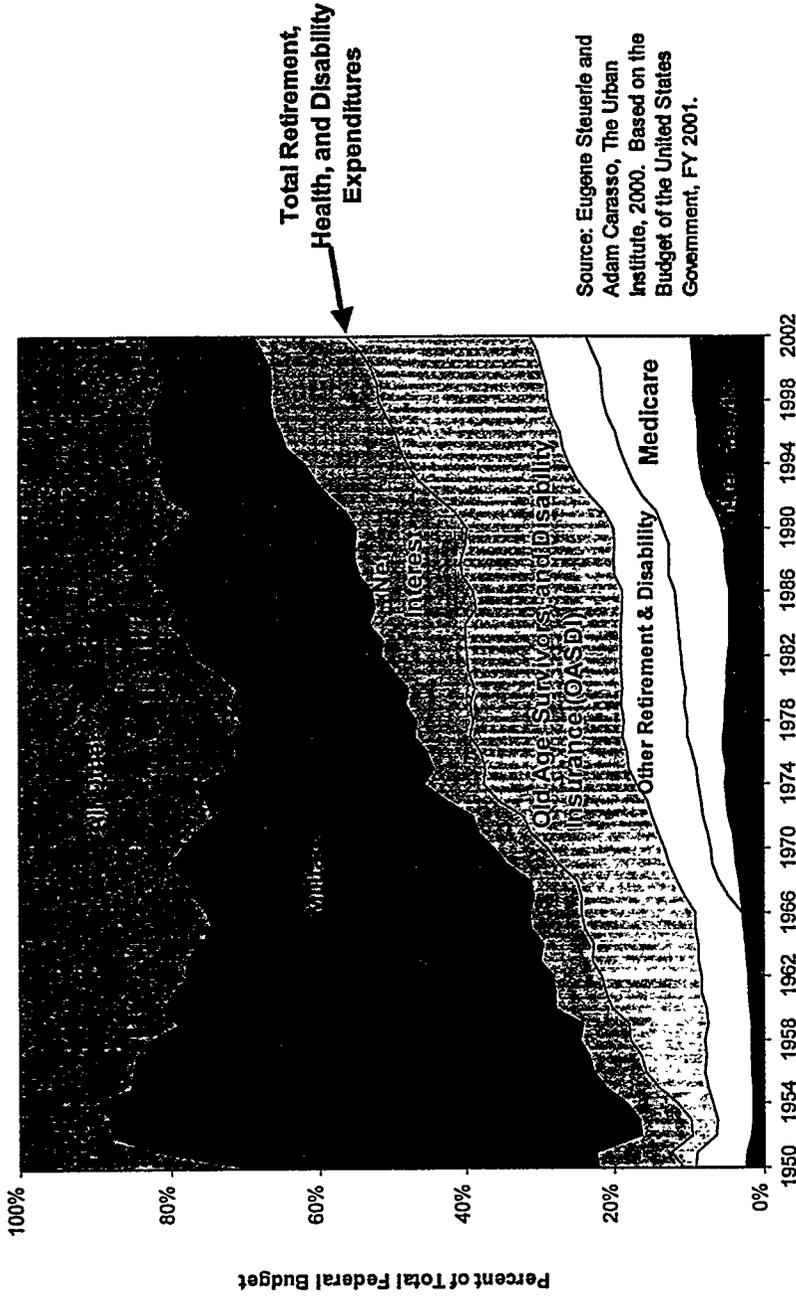
FIGURE 2
 Social Security Benefits for Average
 Wage One-Earner Couple

—2000 Dollars—

Year Couple Turns 65	Annual Benefits	Lifetime Benefits
2000	\$17,845	\$272,655
2030	\$25,891	\$398,651

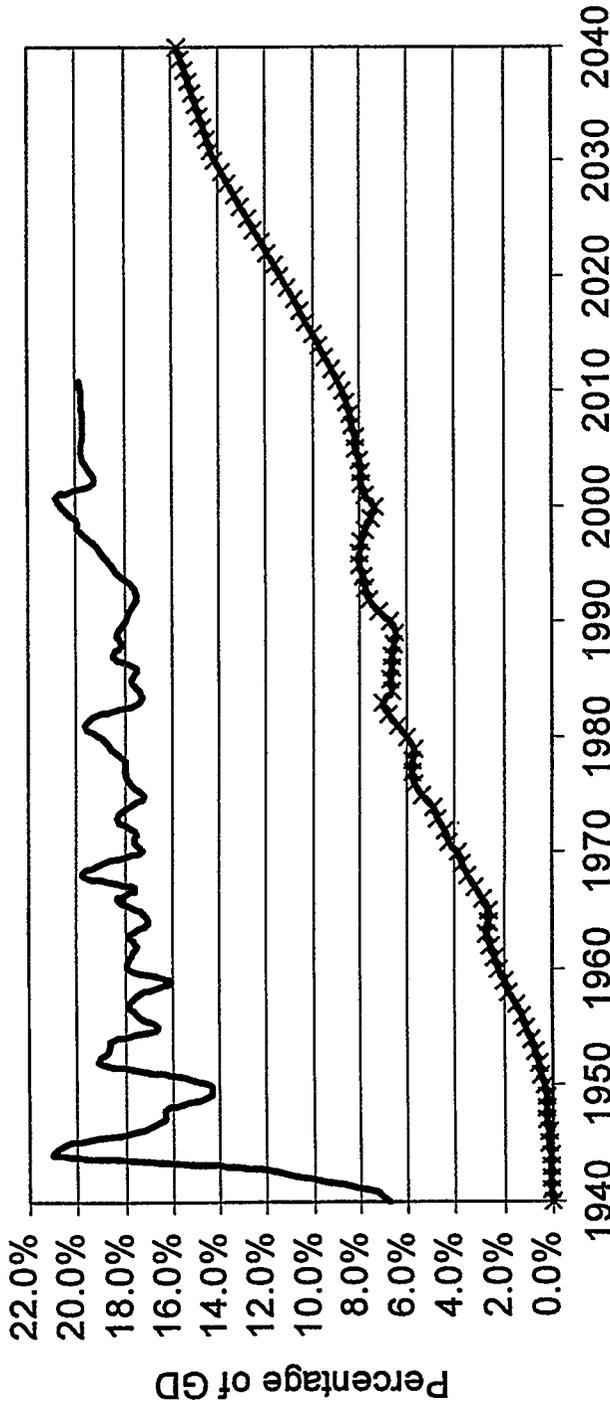
Notes: Data are discounted to present value at the normal retirement age (NRA) using a 2 percent real interest rate. Table assumes survival to NRA. Projections based on intermediate assumptions of the 2000 OASDI Trustees Report. Source: C. Eugene Steuerle and Adam Carasso, The Urban Institute, 2000.

FIGURE 3
Change in the Composition of the Federal Budget



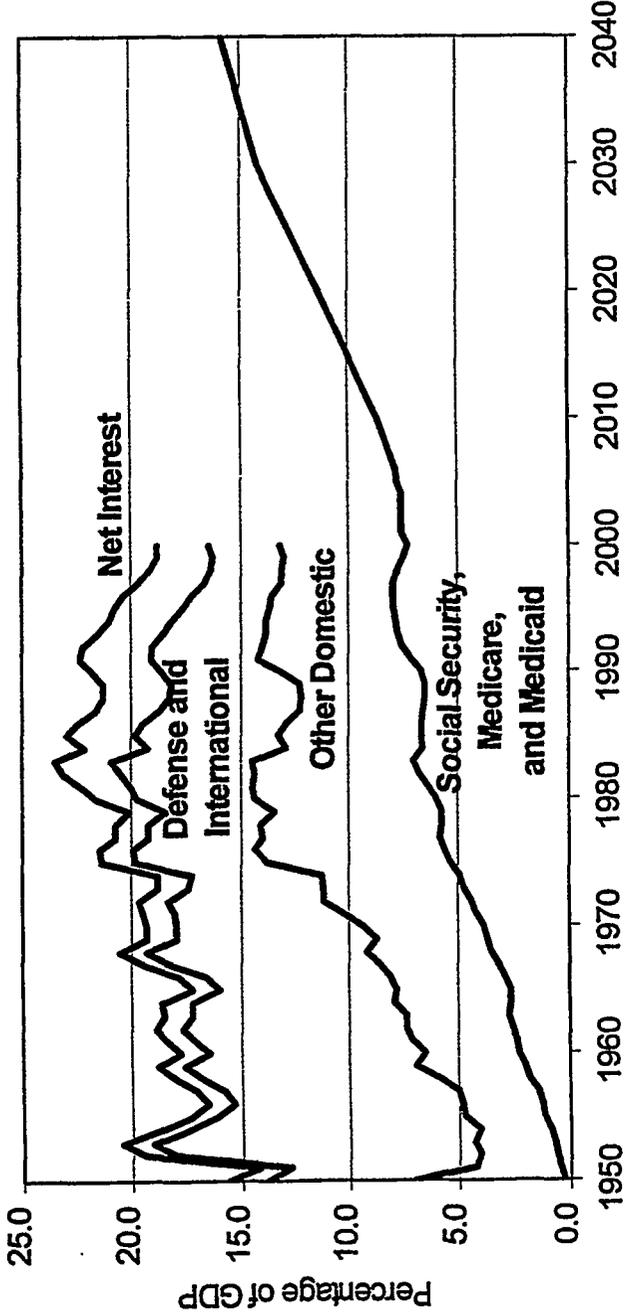
Source: Eugene Steuerle and Adam Carasso, The Urban Institute, 2000. Based on the Budget of the United States Government, FY 2001.

FIGURE 4
Total Federal Revenues vs. Long-Term
Mandatory Spending
— Federal Receipts -x- Social Security, Medicare, & Medicaid Outlays



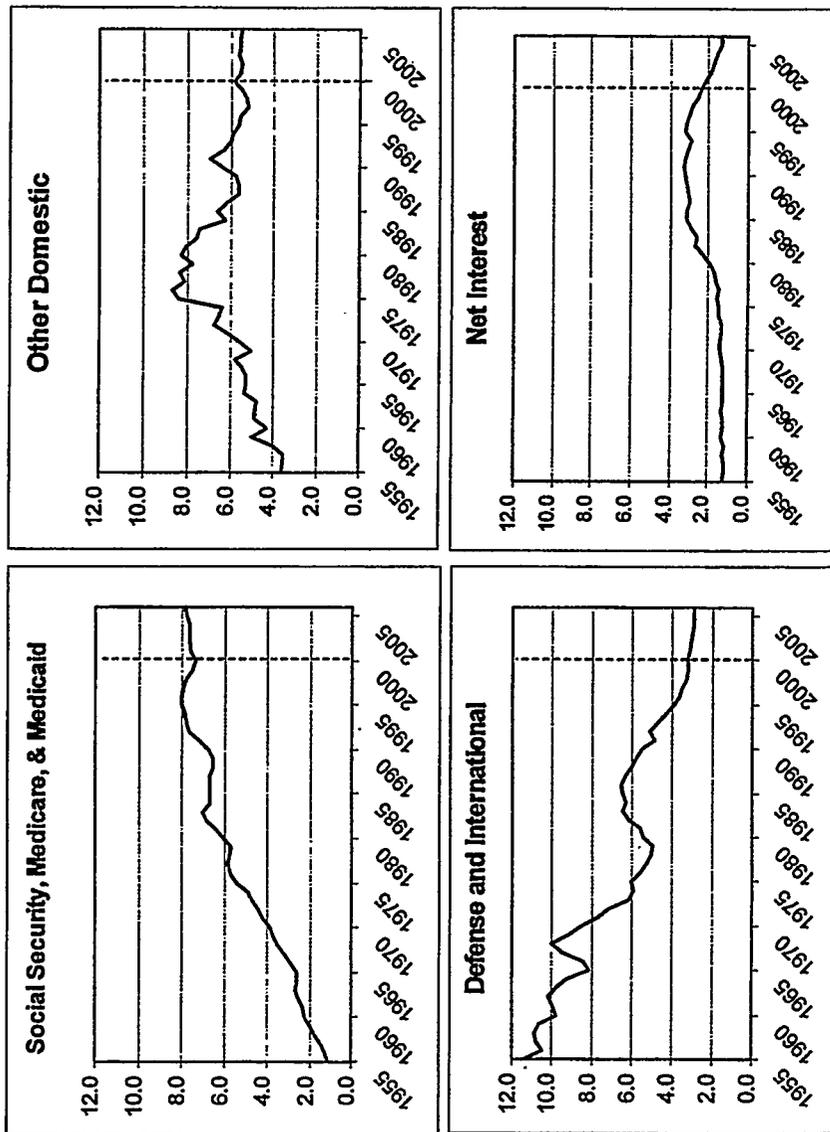
Source: Eugene Steuerle and Adam Carasso, The Urban Institute, November 2001. Includes the 2001 tax cut (EGTRRA 2001).

FIGURE 5
Composition of the Federal Budget as a Percentage of GDP



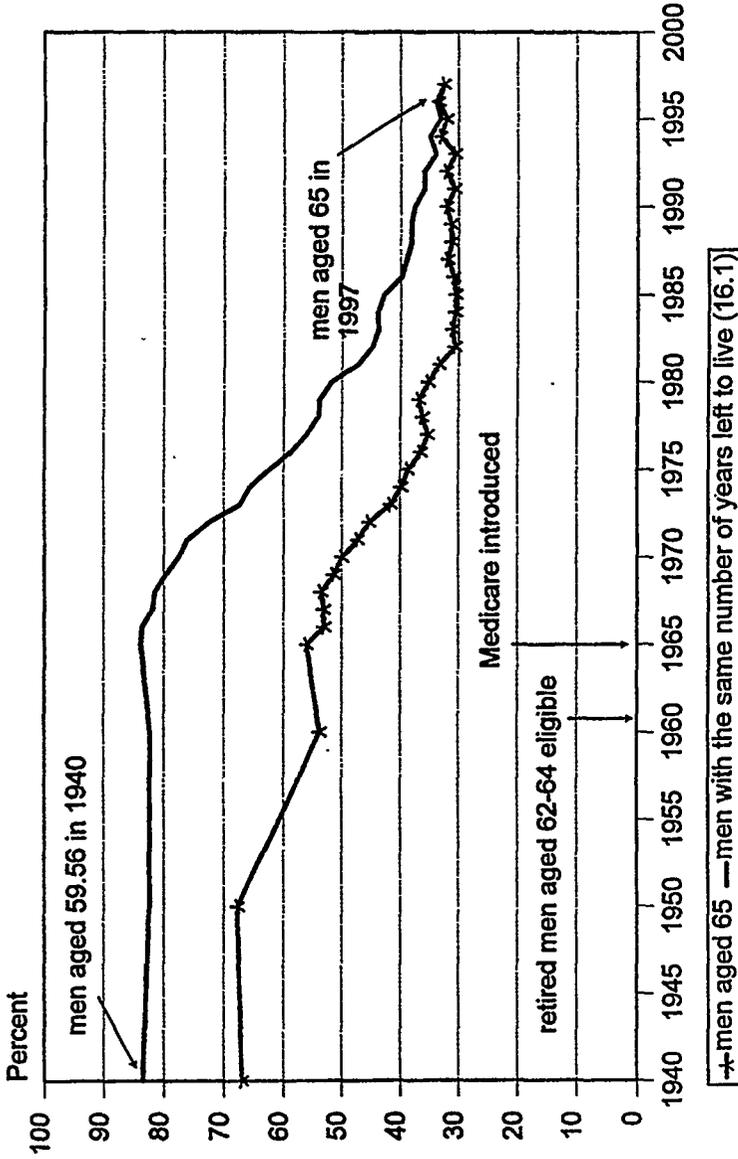
Source: Eugene Steuerle and Adam Carasso, *The Urban Institute*, 2001. Based on the Budget of the U.S. Government, FY 2002 and "The Long-Term Budget Outlook," CBO, October, 2000.

FIGURE 6
Federal Outlays as a Percentage of GDP



Source: Eugene Steuerle and Adam Carasso, The Urban Institute, 2001. Based on the Budget of the United States Government, FY 2002.

FIGURE 7
Labor Force Participation Rate
By Age As Measured From Birth and From Death



Source: The Urban Institute, 1999. Based on data from the U.S. Social Security Administration, the U.S. Census of Population, and the Bureau of Labor Statistics.

FIGURE 8
Comparison of Average Benefits, Poverty Level, and
Elderly Poverty Rate

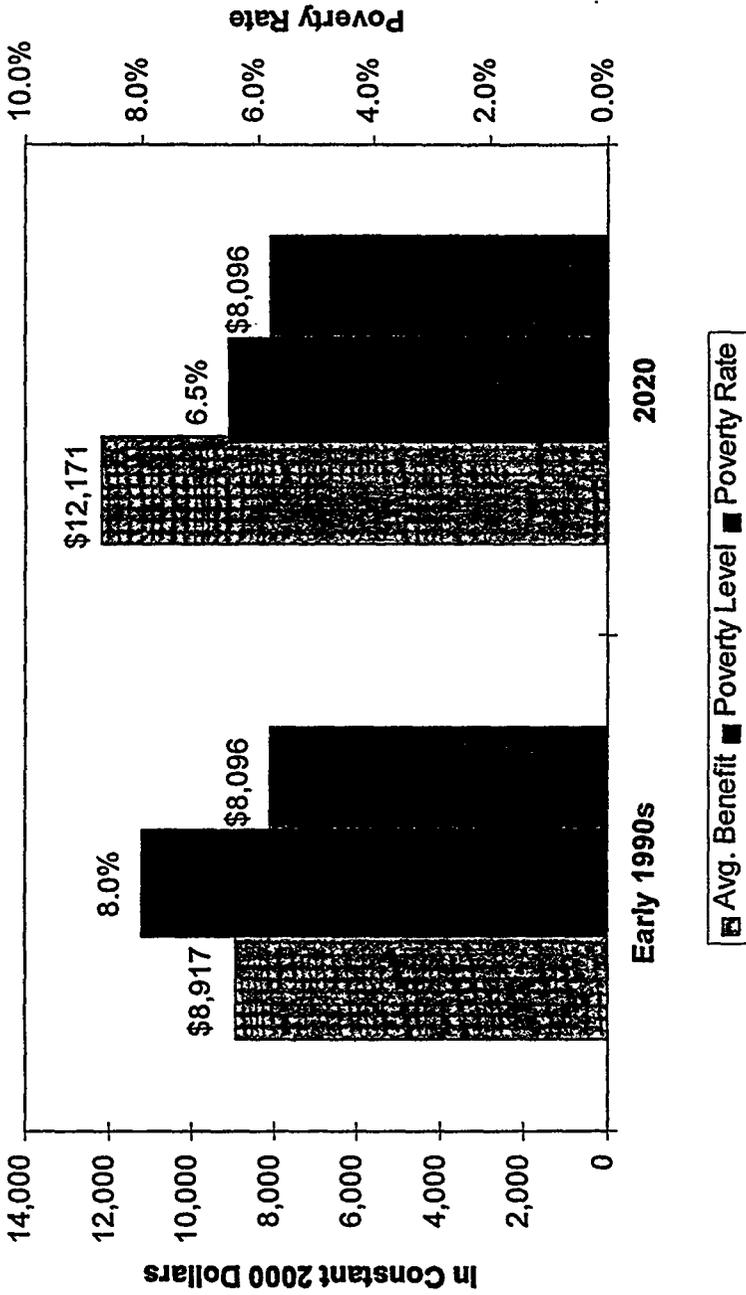


FIGURE 9
Proportion of Social Security Benefits Going
to Males with More Than 10 Years of
Life Expectancy

