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THE 1999 SOCIAL SECURITY TECHNICAL PANEL REPORT

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IN 1999, THE SOCIAL SECURITY ADVISORY BOARD convened a technical panel to review the demographic and economic assumptions underlying the projections of the Social Security system. Press coverage of the panel's recent conclusions[1] focused mainly on how changes in assumptions, such as an increased estimate of life expectancy, would affect the balance between revenues and benefits. Garnering far less attention were many of the panel's recommendations designed to improve the evaluation of current law and reform proposals. The following are some highlights from the consensus reached by the 12 experts—demographers, economists, and actuaries—on the panel.

Investment Issues

- Social Security funds are currently invested in government bonds. Reformers often discuss the possibility of investing funds in equity markets through the Social Security trust fund or individual accounts. To understand the impact of these proposals on benefits, one must determine what the future return on equities is likely to be. The panel suggested that in the current market, the return on equities above the return on government bonds—known as the equity premium—should be set at 3 percent. If the return on bonds were 2.7 percent, for example, the return on stocks would be 5.7 percent.
- The panel also noted that an equity premium is accompanied by some increase in risk. Therefore, when reform proposals involving equity investments are evaluated, the cost of increased risk must be taken into account. To do this, the panel suggested that equity investments first be evaluated as if they were expected to yield the same return as government bonds, in effect assuming that the cost of risk is equivalent to the equity premium. Higher returns can also be demonstrated as long as there is some simultaneous recognition of risk.

Needed Information

- To evaluate the sustainability of Social Security, analysts look at its actuarial balance, that is, the difference between the money going into the program and the money going out. Often, they look only at the Social Security Administration's estimates of actuarial balance for a 75-year period. This practice is not a reliable measure of long-term sustainability, the panel concluded, because each new year's balance changes the overall average. For example, as the evaluation period shifts from 1998–2073 to 1999–2074, a year of positive balance (1998) is replaced by a year of negative balance (2074), lowering the average. By also focusing on other measures of sustainability, such as whether revenues and expenditures are in balance in the later years of the period, the problem caused by using an average could be alleviated, the panel noted.

1. The information presented here is a summary. The full report of the 1999 Technical Panel on Assumptions and Methods, presented in December 1999 to the Social Security Advisory Board, can be found at http://www.ssab.org. Eugene Steuerle served as chair of this panel.

- Projections are uncertain and can vary under a range of assumptions. A particular reform may look superior to others under one set of assumptions, yet have a much higher probability of being substantially out of balance under alternative assumptions. The panel noted that uncertainty itself can be a target of policy reform. For example, Social Security can be designed so that its balance between revenues and expenditures is not so sensitive to changes in certain projections, such as life expectancy.

- A large source of growth in the cost of Social Security over time is increased life expectancy. Thus, the typical comparison of today's annual benefits to future annual benefits understates the growth in value of a retiree's overall benefit package. The panel concluded that the value of benefits paid out over the course of a lifetime, not just a single year, should also be used when contrasting the amount paid out to people over time.

- Because current law is ambiguous about how promised benefits will be paid once the Social Security trust fund is exhausted, the panel recommended that various scenarios be considered. In one, taxes would be raised just enough to cover existing benefits. In another, benefits would be reduced just enough to match existing taxes. Such alternatives will better illustrate the potential consequences of leaving current law unaltered.[2]

Methodology and Models

- Current law and reform proposals must be evaluated in terms of their impact on different sectors of the population, especially as these sectors undergo change, the panel concluded. For example, single individuals and divorced individuals who were married for less than 10 years are financially vulnerable because they do not qualify for spousal or survivors' benefits. Their benefits are based solely on their own earnings, which are usually low for those raising children by themselves. As this subset of the population increases, its vulnerability will become a bigger issue.

- A uniform set of criteria for comparing reform proposals should be adopted, the panel noted. For example, current estimates of the impact of reforms take only Social Security revenues into account rather than all revenues, including income taxes. Thus, reforms that would improve the Social Security actuarial balance while increasing the overall federal budget deficit might appear superior to reforms that would improve the actuarial balance less dramatically but reduce the overall budget deficit.

Although many of the panel's recommendations are technical in nature, together they may provide a clearer understanding of the status of Social Security and give the public and policymakers a more thorough, consistent, and detailed picture of alternative reforms.

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2. This point has been demonstrated by the Congressional Research Service.

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