Stay Loose On Social Security

Uncertain data call for flexibility

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With the first Baby Boomers headed for retirement within a bare decade, worries are growing about the huge burden this group will place on the federal budget in the 21st century--and politicians are busy unveiling plans to keep Social Security and Medicare afloat.

How realistic are such fears? In a study in the Journal of Economic Perspectives, Ronald Lee of the University of California at Berkeley and Jonathan S. Skinner of Dartmouth College underscore the high degree of uncertainty attached to current demographic and economic projections.

They find that the problems facing Social Security and Medicare may well be underestimated, but that there is also a small but real chance they will prove manageable. Thus, instead of locking itself into drastic overhauls of these programs, the government should adopt a flexible policy framework that permits changes as developments warrant.

On the demographic front, the authors take issue with Social Security Administration projections of a coming slowdown in improvements in U.S. life expectancy, especially among the elderly. Life expectancy in a number of other natIons, they note, is not only higher (chart) but is still risIng rapidly among older people.

The good news is that this may not impose significant pressure on Social Security and Medicare. For one thing, mortality rates will also fall among working-age people, increasing the payroll tax take. And disability rates among the elderly have been declining rapidly, lowering average medical needs.

That's not all. As more people live longer, the number in their last year of life--when health-care outlays explode--tends to decline. And end-of-life costs are far smaller for the oldest elderly, who expire more rapidly and receive less heroic medical intervention to prolong their lives. Meanwhile, the authors believe the government will have to take steps to counter the biggest long-term threat to Medicare: fast-rising outlays for costly new technology.

As for Social Security, recent productivity gains suggest that the system's problems could be more manageable than the experts believe. But those gains are only a few short years old. Indeed, all of the economic and demographic trends affecting the system's fiscal soundness have exhibited a high degree of variability over time.

To deal with this variability, Lee and several colleagues have calculated the probability that the Social Security trust fund will run dry, based on the past performance of such factors as fertility, productivity, economic growth, and real interest rates. Under current policy, they see a 50% chance of this happening by 2032, the year predicted by government officials, and 87% by 2045.

In the face of such uncertainty, Lee and Skinner advocate a gradualist policy that responds flexibly to Social Security's (and Medicare's) fiscal problems as they develop or recede. If shortfalls appear imminent and younger workers aren't doing well, for example, then it might make sense to cut benefits--especially if seniors are enjoying healthier, longer lives. But if youngsters are thriving and oldsters aren't, then tax hikes might well be more appropriate.