



ISTOCK

➤ An Unreasonable Assumption

WHILE I AGREE WITH his conclusion that Social Security should retain its defined benefit structure, I was disappointed in the Ken Steiner article (“Social Security Reform: What’s the Best Fix?”) in your November/December issue.

I see no advantage to the notion that contributions and/or benefits could be continually manipulated to avoid significant surpluses. Surely the better approach is to set a level total contribution, as a percentage of covered payroll, which we can maintain over the long term. That level contribution is essential, I suggest, as a budgeting tool. Once a level contribution is set, the surpluses emerge as a secondary consequence of that approach. *Their* levels should not, I think, be a primary objective.

Assuming, as I think I do, that Figure 1 (Page 52 in November/December 2005

issue) is a better bet as to future experience than the more optimistic approach of such critics as David Langer, it’s clear that we will have to make modest increases in contributions and/or benefit adjustments, such as less generous indexation or later retirement, if we want a contribution that will remain level as far as the eye can see. This will mean that surpluses—significant but not comparable to those that appear in a properly funded private plan—will continue indefinitely.

“Under the current program ... the government is spending surplus Social Security assets and increasing the national debt, thus lowering national savings,” says Mr. Steiner.

Not so! This would be true only if the effect of the surplus were to stimulate addi-

tional government spending: an unreasonable assumption. The fallacy is obvious (a word I do not use lightly) if we consider where we would be if the surplus were now invested in private securities.

Assume that the trustees then decide to switch into government bonds purchased in the open market. The effect would be to move some investments around and not to create additional government debt; similarly if the trustees sold their private securities and invested in newly issued bonds replacing other, maturing governments.

There is simply no reason to assume that government spending would jump as either transaction took place. Nor is there any reason to think that the present position generates government spending and issuance of debt that would not occur otherwise.

It shouldn’t be necessary to say, but I will anyway, that this letter does not endorse deficit spending at the irresponsible levels we see today. I do assert, however, that there is no reason to believe that the Social Security trust fund holding some of the resulting debt, rather than private investors or Far Eastern governments, stimulates even more irresponsibility.

Finally, while I also agree with Mr. Steiner that individual accounts would be “less efficient at providing retirement income than the other two approaches,” I suggest that the main reason to object to them is that the last thing we need is a vast pool of “private” investment capital slopping around the markets under the overall direction of the government and financed by another vast increase in government debt, much of it probably owed to the Chinese Central Bank.

BRIAN A. JONES, BROOKLYN, N.Y.

Ken Steiner responds:

THANKS TO MR. JONES for responding to my article. I’m glad to see we’re in agree-

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ment that Social Security should retain its defined benefit structure. That's an important first step. Instead of trying to avoid surpluses used to temporarily fund government operations (either by adopting pay-as-you-go financing or by investing trust fund assets in private securities), Mr. Jones prefers that we adopt a level-tax-rate approach that maintains investment of the trust fund assets in private-issue government bonds.

Mr. Jones argues that it's unreasonable to assume that government spending increases as a result of the availability of Social Security surpluses in the unified federal budget. It's my experience that the government has had very little difficulty spending every single dollar of the Social Security surpluses and would undoubtedly phase in any proposal to reduce budgeted revenues by investing the surpluses in pri-

ivate equities rather than the special-issue government bonds because of the negative impact on the budget. I believe Congress and the president are very much aware of the budget problems associated with declining Social Security surpluses. That's why they've focused their concern on 2017 or earlier, when surpluses are declining or exhausted, not on 2041 when the trust fund is projected to be exhausted.

What would Mr. Jones' level-tax-rate approach produce? Fortunately, the 2005 trustees report has determined what total tax increases and benefit decreases would be necessary. In order for OASDI to maintain a level tax rate indefinitely, the tax rate would have to be immediately increased or benefits immediately decreased (or some combination of the two) by a total of 3.5 percent of each year's taxable payroll.

I'm not sure that an immediate 28 percent increase in the tax rate or an immediate 32 percent decrease in benefits falls into the category of "modest," but I suppose a combination involving half of those percentage increases/decreases might. For 2006, the surplus of tax revenue over system outgo would be about 5.2 percent of taxable payroll, as compared with 1.7 percent of taxable payroll under current law. If necessary changes were phased in, the surpluses would have to be larger in later years.

At the end of 2005, the OASDI trust fund was projected in the 2005 trustees report to have accumulated about \$1.85 trillion of special-issue government bonds. These bonds represent a promise to tax future taxpayers so that future Social Security benefits may be paid. Under current law, these total promises are expected to increase to about \$3.9 trillion by the end of 2014, just nine years away. (Source: Table IV.A3 of the 2005 trustees report.) Under Mr. Jones' alternative, these promises would be expected to accumulate to about \$6.2 trillion by the end of 2014 and to much larger levels in future years.

Contrary to Mr. Jones' assertion, his approach would not result in indefinite surpluses. There would be crossover some time around 2030, where program outgo would exceed tax income under the intermediate assumptions. At that time, Congress would have to run surpluses in the non-Social Security portion of the budget in order to balance the budget and pay Social Security benefits.

While I'm generally supportive of the idea of a level tax rate for Social Security if we want to try to advance-fund the program (see my paper in Volume 35 of the *SOA Transactions*, 1983), I don't see special-issue government bonds as the most effective investment vehicle for that purpose. Mr. Jones will have a very difficult time convincing taxpayers that they're better off saving for their retirement by giving the government an extra 5 percent of their pay to spend on current projects rather than keeping the money and investing it themselves.

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CONTACT: Mark S. Tenney
4313 Lawrence Street, Alexandria, VA 22309
703-799-0518 Fax: 703-799-4964
mfc@patriot.net www.mathematical-finance.com

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