THE NATIONAL COMMISSION'S FAILURE TO ACHIEVE REAL REFORM

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Introduction

On January 20, 1983, the National Commission on Social Security Reform released its long-awaited report, discharging its mandate to identify Social Security's financial problems and propose "solutions to such problems that will both assure the financial integrity of the Social Security System and the provision of appropriate benefits."[1] This report was duly presented on February 1, 1983, to the Committee on Ways and Means of the United States House of Representatives.

The work of the National Commission on Social Security Reform was extremely disappointing. Not because it failed to make recommendations that would resolve all of Social Security's financial and design problems—that would be asking too much. But because it failed to identify and report forcefully the full extent of the problems so that Congress and the public would know that such problems exist. This failure to be honest and forthright with the public, if not corrected, will result in the continued erosion of public confidence—not only in Social Security but in the government itself.

Summary of Major Provisions

The major provisions of the Commission's compromise proposal to resolve Social Security's financial problems are as follows.

Cato Journal, vol. 3, no. 2 (Fall 1983). Copyright © Cato Institute. All rights reserved.

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This article is an edited version of the author's testimony before the Senate Finance Committee on the National Commission on Social Security Reform Recommendations, February 22, 1983.

[1]*Report of the National Commission on Social Security Reform* (Washington, D.C.: Government Printing Office, January 1983), chap. 1, p. 2.

1. The Social Security tax on employers and employees would be as follows:

1983	6.70%
1984	7.00
1985	7.05
1986-87	7.15
1988-89	7.51
1990	7.65

In effect, this means higher taxes in 1984, 1988, and 1989 than scheduled under present law. In 1984 only, the worker would be allowed a refundable tax credit equal to the entire increase (0.30 percent) in Social Security taxes.

2. The Social Security tax for Old-Age, Survivors, and Disability Insurance (OASDI) levied on self-employed persons would be increased from three-fourths of the combined employer-employee rate to the full employer-employee rate. Half of the total payment could be deducted from taxable income for income-tax purposes, but not for purposes of determining the OASDI and HI (Hospital Insurance) tax. Many self-employed people would thus pay a higher net amount of Social Security and income taxes.

3. The annual cost-of-living adjustment, now paid in July, would be postponed this year (1983) until next January and then paid each January. The change would affect all 36 million beneficiaries. A special provision would reduce the impact on low-income elderly and disabled persons who are also receiving welfare payments.

4. Half of a person's Social Security benefits would be subject to federal income tax, but only if he had adjusted gross income of at least $20,000 from sources excluding Social Security, or in the case of a married couple filing jointly, if they had $25,000. Proceeds of the income tax would be paid into the Social Security (OASDI) trust funds. Some 3 million people, or about 10 percent of the OASDI beneficiaries, would pay extra taxes under this provision.

5. As of January 1, 1984, mandatory Social Security coverage would be extended to all new federal workers. It would also be extended to all employees of nonprofit organizations, for whom participation is now optional. Federal workers who are covered by the Civil Service Retirement System would not be affected. It is anticipated that the government would establish a supplementary employer pension for new federal employees, so they would end up receiving Social Security plus a supplementary pension (as is now the case with many private-sector workers).

6. Local and state governments covered by Social Security would be prohibited from opting out as of the date of enactment of the proposed plan, unless the process of termination is completed by such date.

7. The so-called windfall portion of Social Security benefits received by federal, state, and local government employees who qualify for Social Security on the basis of relatively short periods of employment in the private sector would be eliminated for the first people who would be eligible to retire after 1983. They would receive a benefit, but less than under current law.

8. Beginning in 1988, the plan would seek to stabilize the trust funds by providing that whenever the combined OASDI trust funds drop to less than one-fifth of a year's benefits, the annual cost-of-living adjustment would be equal to either the annual rise in prices or the annual rise in wages, whichever is less.

9. From 1990 to 2010, the plan would phase in a larger bonus, equal to 8 percent a year instead of the current 3 percent, for each year a person delays retirement after age 65 and before age 70.

10. The trust fund would be reimbursed by the Treasury for free wage credits granted to military personnel in the past and for uncashed Social Security checks.

11. Benefits and eligibility would be improved for certain types of widows and widowers, divorced persons, and survivors.

12. In the case of salary-reduction plans qualifying under Section 401(k) of the Internal Revenue Code, any salary reduction thereunder would not be treated as a reduction in the wages subject to OASDI taxes.

Financial Aspects of Recommendations

Ignoring the merits and faults of the Commission's recommendations for a moment, how effective are the recommendations in resolving Social Security's financial problems? Unfortunately, they are not very effective.

During its meeting (November 11–13, 1982), the Commission adopted a background book of actuarial cost estimates for OASDI and HI. These estimates defined the size and scope of Social Security's financial problems as follows.

- During the 1983–89 period, provision will have to be made to increase OASDI income or decrease benefits, or some combination of both, by $150 billion to $200 billion (that is, by 9 percent to 12 percent of projected OASDI expenditures).

- During the 75 years from 1982 to 2056, the average annual OASDI deficit (defined by comparing income and outgo according to the intermediate [II-B] demographic and economic assumptions used in the 1982 Trustees Reports), would be equal to average annual expenditures of 14.09 percent of taxable payroll and average annual tax income of 12.27 percent of taxable payroll. This would yield an average annual deficit of 1.82 percent of taxable payroll.
- During the 1983–89 period, scheduled taxes will be barely adequate to pay HI benefits; increased taxes or decreased benefits for HI must be adopted no later than 1990. Under less optimistic assumptions, this remedial action must be taken in the late 1980s, and even sooner if OASDI continues to borrow from HI.
- During the 75 years from 1982 to 2056, the average annual HI deficit (defined by comparing income and outgo according to the intermediate [II-B] demographic and economic assumptions used in the 1982 Trustees Reports), would be equal to average annual expenditures of 8.10 percent of taxable payroll and average annual tax income of 2.89 percent of taxable payroll. This would yield an average annual deficit of 5.21 percent of taxable payroll.

The Commission's recommendations attempt to assure the near-term solvency of the OASDI program by increasing projected net income during the 1983–89 period by $168 billion (primarily by increasing taxes by $129 billion and decreasing projected benefit increases by $40 billion). This would satisfy the requirement stated above, that net income be increased by $150 billion to $200 billion.

The Commission's recommendations would decrease the average 75-year OASDI deficit of 1.82 percent of taxable payroll to 0.58 percent, thus eliminating only about two-thirds of that deficit. No agreement could be reached by the Commission on how to eliminate the remaining deficit. Some members favor a higher retirement age, some prefer higher taxes, and some prefer reduced benefits.

The Commission virtually ignored the HI deficit of 5.21 percent of taxable payroll, which is almost three times the OASDI deficit of 1.82 percent. The Commission also completely ignored the Supplementary Medical Insurance (SMI) part of Medicare, 25 percent of which is financed by premiums paid by participants and 75 percent of which is financed by general revenue. The total cost of SMI is now the equivalent of about 1 percent of taxable payroll, and is projected to rise to some 5 percent of taxable payroll during the lifetime of today's youth.

There is nothing mysterious about Medicare; and there is no excuse for ignoring it. It is a life annuity, paid in kind rather than cash, primarily to Social Security beneficiaries age 65 and older. Almost one-fifth of the taxpayer's FICA (Federal Insurance Contribution Act) tax is now used to finance the HI portion of Medicare. Medicare is a part of Social Security; ignoring Medicare's problems will not make them disappear.

Although the Commission did not address the financial problems of the HI program, and in spite of that program's imminent financial difficulties, the Commission recommended that the OASDI trust fund be authorized to continue borrowing from the HI trust funds during the 1983–87 period.

The Commission's recommendations, therefore, do not even come close to resolving Social Security's financial problems—except those of the OASDI program for the next seven years.[2] To resolve the longer range financial problems, the tax rate would have to rise considerably above its currently scheduled level of 7.65 percent in 1990.

Under "intermediate" assumptions (adopted by the Commission), the tax rate would have to increase to about 14 percent early in the next century (within the working lifetime of today's young taxpayers). This is nearly twice the ultimate scheduled tax rate of 7.65 percent. And under less optimistic assumptions, the tax rate would have to increase to about 20 percent (a combined employer-employee tax rate of 40 percent). This is almost three times the ultimate scheduled tax rate of 7.65 percent.[3]

This tax increase is in addition to the cost of the Supplemental Medical Insurance (SMI) part of Medicare, which is projected to rise to some 5 percent of payroll and is financed primarily from general revenue.

There are alternatives, of course, to these onerous tax rates. The retirement age could be increased to about age 70 for persons under

[2]Under less optimistic (but not inconceivable) economic assumptions, the Commission's recommendations would fail to sustain the OASDI system through the 1980s, and further remedial action would be required.

[3]For long-range planning purposes, it appears prudent to rely upon demographic and economic assumptions that are less optimistic than those adopted by the Commission. For example, the Commission's intermediate assumptions are that the fertility rate will eventually rise about 12 percent above its present level. The latest official population projections by the Bureau of the Census, however, indicate that a better assumption to use for planning is that fertility rates will not rise above current levels.

By assuming higher-than-realistic fertility rates, the Commission is assuming lower-than-realistic future costs. It is wishful thinking to assume that fertility rates will rise above current levels and to make future promises of benefits on that basis. All indications are that fertility rates will remain at their present levels or else decline.

age 35, or benefits for future retirees could be reduced somewhat, or the entire system could be restructured to reflect the changing social and economic environment. But the Commission could not consider changes of this type without acknowledging a longer range problem—and this it failed to do.

The Commission considered it a major achievement that it could get the minority of the commissioners representing those who favor the status quo to admit there will be a relatively minor financial problem during the next seven years, 1983–89. It should not be surprising, therefore, that the Commission was unable to acknowledge the existence of major financial and structural problems that may not become critical for another 10 years.

I urgently suggest that the Senate Finance Committee obtain from the Social Security Administration and the Health Care Financing Administration the most recent projections of income and outgo under the OASDI and HI and SMI portions of Social Security. These projections should be made under the same range of assumptions, from optimistic to pessimistic, that the Board of Trustees used in its annual reports. The projections should extend over the next 75 years—that is, for the remaining lifetime of today's youngsters to whom we are promising benefits. Finally, the projections should be reported on a year-by-year basis and not just as a 75-year average; otherwise the high future costs will be obscured.[4] An impartial examination of these projections of income and outgo would clearly demonstrate the enormity of the system's long-range financial problems. It would also reveal the fact that we have promised more in benefits than the taxpayers will be willing and able to finance, and that we must begin *now*, not later, to redesign Social Security.

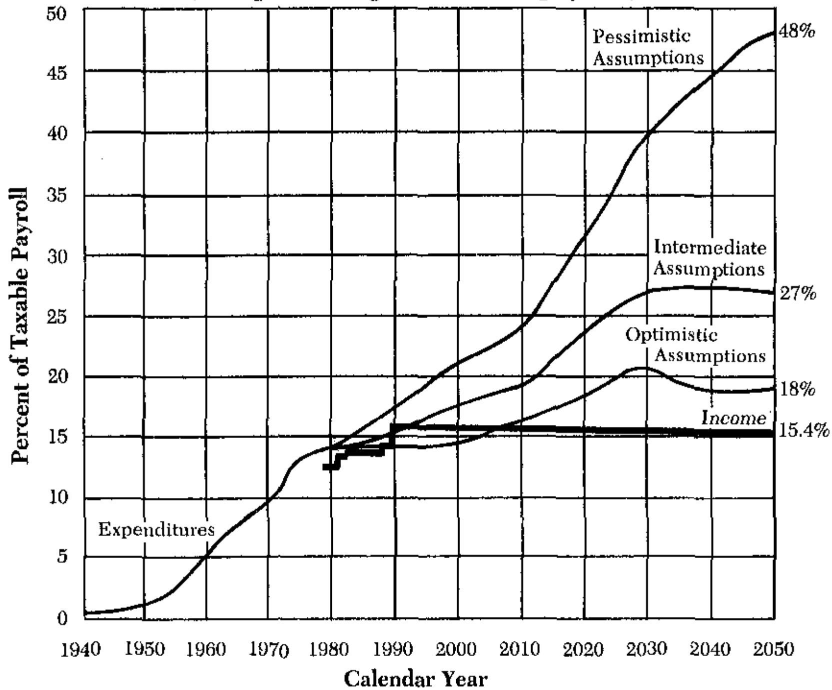
The graph (on p. 409) shows projections for the OASDI, HI, and SMI programs combined, based upon the assumptions used in the 1979 Trustees Reports. The projected costs would probably be even higher, based on assumptions currently being used by the Trustees. Adoption of the Commission's recommendations would not decrease these costs significantly, since they would reduce the average 75-year net expenditures by only 1.24 percent of taxable payroll.

Appropriateness of Recommendations

It is tempting to criticize the Commission for not recommending the "correct solution" to Social Security's problems; however, there

[4]For a more detailed rationale for long-range cost estimates, see A. Haeworth Robertson, *The Coming Revolution in Social Security* (McLean, Va.: Security Press, 1981), chap. 10.

PROJECTED EXPENDITURES AND LEGISLATED INCOME UNDER SOCIAL SECURITY
(as a percentage of taxable payroll)



Source: This chart is derived from data contained in A. Haeworth Robertson, *The Coming Revolution in Social Security* (McLean, Va.: Security Press, 1981), chap. 7.

Note: Projected combined expenditures for OASDI, HI, and SMI (under alternative demographic and economic assumptions) and *legislated income* are expressed as a percentage of effective taxable payroll.

is no such correct solution. The "proper design" for Social Security depends upon one's values and beliefs about social ethics. Unanimity among diverse interest groups should not be expected. Nevertheless, the following limited commentary may be of value in assessing the recommendations offered by the Commission.

For 47 years the public has thought Social Security's benefits were inviolable. People believed that if the government promised a certain type and level of benefit, it would be paid. People were told that by paying "contributions" to Social Security, they were acquiring "earned rights" to certain benefits. In fact, there has been a steady expansion of benefits and people have generally received even more than prom-

ised. As recently as December 7, 1979, the Advisory Council on Social Security had the temerity to declare: "After reviewing the evidence, the Council is unanimously convinced that all current and future Social Security beneficiaries can count on receiving all benefits to which they are entitled."[5]

It should be evident that it is no longer true that benefits once promised will certainly be paid. Witness the cuts in student benefits and mimimum benefits that occurred in 1981. Witness the Commission's recommendation to defer the cost-of-living adjustment for six months, and the recommendation to decrease benefits now being paid to people with income (excluding Social Security) of $20,000 or more for a single taxpayer, or of $25,000 or more for joint-return taxpayers. (This reduction in benefits would be accomplished indirectly by taxing half of their Social Security benefits.)[6]

One disturbing aspect of this selective reduction of benefits by taxing them is the implication that if a person saves successfully for his own retirement, he will be rewarded by a reduction in benefits that he presumably counted upon in making his retirement plans. If this means-test philosophy is carried to its logical conclusion, the government will effectively discourage private saving and individual self-reliance, and may even discourage the disclosure of other income. Such a government-induced change in citizen's behavior would be extremely damaging to the character of our nation.

Furthermore, by reneging on its promised benefits, the government will have damaged its image and that of Social Security. This loss of credibility will make it difficult to convince younger taxpayers that Social Security will honor its promise to pay benefits to them some 30 to 50 years hence. Without such a conviction, taxpayers will be very reluctant to pay the high taxes necessary to support the system in the years ahead.

Higher Retirement Ages

The Commission's recommendations make no mention of the inevitable increase in normal retirement age (from age 65 to at least age 70) for persons now less than about age 35 or 40. This will be absolutely necessary to provide the nation with an appropriate-sized work

[5]U.S., Social Security Administration, Department of Health, Education, and Welfare, Advisory Council on Social Security, *Social Security Financing and Benefits: Reports of the 1979 Advisory Council on Social Security* (Washington, D.C.: Government Printing Office, 1979), p. 18.

[6]At the outset, this effective reduction of benefits would apply to only about 10 percent of the OASDI beneficiaries. But since the reduction is not indexed, inflation would eventually cause it to apply to virtually all beneficiaries.

force, not just to resolve Social Security's financial problems. When today's youngsters retire at age 70 in the next century, they will have more years left to live than their forefathers who retired in the past at age 65. A higher retirement age is *not* a benefit cut; it is a natural consequence of increasing life-spans and improved health. The only tenable way that today's youngsters would be able to retire in their early sixties would be if they had the same short life-spans as their forebears—not a very attractive alternative.

The Commission not only failed to propose higher retirement ages, it indicated that for people to defer their retirement beyond age 65 would not provide any substantial relief to Social Security. This conclusion stemmed from the Commission's proposal to increase the delayed retirement credit for individuals between ages 65 and 70 from 3 percent to 8 percent per year. This is an unrealistic proposal. It is directly contrary to the need for increasing the retirement age and decreasing retirement benefits for future retirees.

Increased Taxes

The Commission's proposals to increase the Social Security system's net income by $168 billion during the next seven years (1983–89) are made up of both benefit decreases and tax increases, with emphasis on the latter. In the face of an immediate fiscal crisis, this emphasis on tax increases may be preferable to an emphasis on benefit decreases. But the system's current financial problems did not arise overnight. They have been in the making since the mid-1970s. Contingency plans could have been made that would have permitted a more even balance between tax increases and benefit decreases. Parenthetically, we have the same opportunity *now* to make plans for accommodating the impending Medicare deficits and to restructure the OASDI program to reflect demographic shifts, the changing role of women in the work force, and so on. Ten years from now, as we frantically search for solutions to this "surprise crisis," we will decry the lack of time to develop well-designed solutions and will once more resort to hastily designed compromises.

Unfortunately, waiting until the last possible moment to resolve the system's financial problems virtually forced the government to use general revenue—a large part of the Commission's recommended tax increase comes from general revenue, particularly in 1983 and 1984. As nearly everyone knows, the nation's budget has a deficit, and there is no general revenue available to use for Social Security. Relying on general revenue to pay benefits is thus tantamount to borrowing—not a very sound basis on which to operate a social insurance system.

The extent of the Commission's proposed use of general revenue may not be obvious at first glance, because it is done rather indirectly. General revenue would be used in the following manner. First, the increase in the employee Social Security tax for 1984 (from 6.7 percent to 7.0 percent) would be returned to the employee as a tax credit or cash refund, thus reducing general revenue by the same amount as the tax increase. Second, one-half of the total increased self-employment Social Security tax would be deductible as a business expense, thus reducing general revenue by a substantial portion of the tax increase.[7] And third, the lump-sum reimbursement to the old-age trust funds for military-wage credits would be from general revenue.[8]

A more subtle introduction of general revenue would arise from including newly hired federal employees in Social Security. Including federal employees in Social Security is expected to bring a financial gain to the system. This gain arises because more tax money is paid into the system for federal employees than is paid out in benefits. But the ultimate source of all the taxes paid into the system for federal employees is general revenue. Therefore, including federal employees in Social Security will simply cause a shift from direct payroll-tax financing to indirect general-revenue financing.

Although it is not widely known, general revenue is already used to finance three-fourths of the cost of the SMI portion (Part B) of

[7]Although this procedure places the high-income self-employed in the same after-tax position as the present procedure, it places a much larger tax burden on the lower-income self-employed.

[8]This is the ultimate example of how waiting until the last minute to resolve Social Security's financial problems can evoke desperate, even ludicrous, "solutions" that have no substance whatsoever.

Under Social Security, gratuitous military-service credits are granted in some cases without the recipient's having paid Social Security taxes. To prevent a loss to the trust funds, the current procedure is to use general revenue to reimburse the trust funds for the amount of the benefits arising from these credits at the time the benefit is actually paid. The recommendation of the Commission would change this procedure. It would require general-revenue reimbursement to the trust fund *in advance* of the disbursement of benefits. This advance funding of military credits could then be used to meet the current shortfall in the trust funds and permit the continued payment of benefits to other recipients.

Careful analysis reveals this to be an artful machination of the government to give the public a false sense of security without taking any substantive action. The procedure is to take funds from nonexistent general revenue (i.e., raise the national debt by borrowing from the taxpayers), and to pay amounts to Social Security that are not due for many years to come, so that those funds can be used to pay current beneficiaries. The net result is an increase of $20 billion in the national debt in 1983 so that $20 billion can be added to the Social Security trust funds to stave off insolvency for a few more months.

equivalent of about 1 percent of taxable payroll. With the total cost of SMI projected to rise to 5 percent of payroll, this means that eventually general-revenue financing will amount to nearly 4 percent of payroll. This is twice what the entire Social Security program cost (a combined employer-employee tax of 2 percent) when it was originally adopted.

Universal Mandatory Coverage

As desirable as universal mandatory participation in Social Security might be from several viewpoints, it seems grossly unfair to ban withdrawal from the system by state and local government employers. These employers (and their employees) voluntarily joined Social Security with the understanding that they could withdraw in the future. A unilateral change in this participation agreement seems highly undesirable, if not illegal. State and local governments should at least have a grace period in which to make a final irrevocable decision as to whether they want to withdraw from Social Security or continue to participate.

Mandatory coverage of newly hired federal employes may be desirable in some respects, but it is doubtful that it will save the nation any money—although some advocates of mandatory coverage suggest it will. It is likely that new hires would receive the same total benefits from Social Security and a revised Civil Service retirement system as they now receive from their present system. If so, the total cost of retirement benefits for federal employees would not be reduced; it would simply be rearranged.

Mandatory universal coverage would be defensible if Social Security provided only a minimum floor of protection. It would then be reasonable to impose Social Security's benefits on all employees, including employees of the federal government, nonprofit organizations, and state and local governments. But Social Security is not a minimum floor of protection; it is much more. It provides an array of benefits far beyond those that everyone would agree is a socially desirable minimum. Accordingly, it does not seem reasonable to impose the existing Social Security program on everyone whether they need it or not. If Social Security were reformed to provide a reasonable level and array of benefits that most people could agree was socially desirable, then mandatory universal coverage would be in order.

Problem Is Not Just Financial

In defining the size and scope of the Social Security problem, the Commission gave practically no attention to the strong likelihood

that the long-range problem is primarily a *design* problem and not just a financial problem. The social and economic environment will be considerably different 30 to 50 years from now, when the children of the post-World War II baby boom approach retirement. The role of women in society and the workplace has changed and will continue to evolve. It is entirely reasonable, therefore, to give serious consideration to a completely new type of social insurance system for the younger segment of our population, even if we continue the present system for the older segment of the population.

What did the Commission have to say on this subject? During the final days of its meetings, the Commission acknowledged that it was committed to the basic structure of the existing Social Security system and contemplated no recommendations for major change. Several members of the Commission noted that the social and economic environment had changed more rapidly than Social Security had changed and that a reexamination of the basic structure of Social Security was therefore in order. They stated, however, that the pressures imposed by the size of the financial problems had diverted their attention from such a comprehensive study. This statement seems absurd for two reasons.

First, the Commission was appointed in December 1981, when the financial problems were well known and well documented, so the Commission had more than adequate time for a thorough study. Second, the inappropriate design of Social Security is a significant factor both in causing the long-range financial problems and in causing doubt about the fairness and thus the long-term viability of the system.

Approximately 80 percent of the nonretired population is younger than 45. It is this large group that is questioning whether Social Security will still be around when it retires. Social Security's future existence depends precisely upon whether or not today's youth will support it, and this depends in turn upon whether it suits their needs and whether they believe it is fair.

Restoration of Public Confidence

The Commission attempted to design recommendations for change in Social Security that would simultaneously resolve the system's financial problems and restore the public's confidence in the long-range viability of the system. This effort to restore public confidence is of paramount importance in view of findings by respected polls that there is now little confidence, especially among young people,[9]

[9]Louis Harris and Associates, Inc., *1979 Study of American Attitudes toward Pensions and Retirement* (New York: Johnson and Higgins, 1979), p. 94.

that the program will continue to operate in the long-range future. Confidence in the continuation of Social Security is essential, of course, if the taxpayers are to keep supporting the system.

Although much of the Commission's work may be commendable in view of the circumstances, adopting the Commission's recommendations will clearly not resolve very many of Social Security's financial problems. *If the public is misled into believing that the financial problems of Social Security have been resolved, there will be a very harsh day of reckoning in the not-too-distant future.* If public confidence in Social Security and in the government itself erodes any further, the stability of the nation will be in danger.

If Congress does not do a better job than the Commission has of recognizing Social Security's significant future financial problems, it may soon be too late to develop rational solutions, since an atmosphere of crisis seldom yields satisfactory results—as shown by the present situation. If Congress tries to solve the future financial problems without resolving the future *design* problems and thus without gaining greater public support, its efforts will be in vain. Much bolder action will be required by Congress than was recommended by the Commission if Social Security's problems are truly to be resolved. And nothing short of bold action will restore the public's steadily eroding confidence.

Conclusion

If Congress adopts the Commission's meager recommendations for Social Security reform[10] and then assures the public that all is well, the following scenario seems probable.

- In the mid-1980s, the near-term financial problems of Medicare will become as evident as the near-term OASDI problems are now. But Medicare's financial problems are considerably greater than the financial problems of OASDI.
- The short-range Medicare problems will be studied for several years and finally "resolved" at the last possible minute—in about

[10]The substance of the National Commission's recommendations was included in the Social Security Amendments of 1983 (P.L. 98-21), which were enacted on April 20, 1983. In addition, the amendments increased the retirement age by two years (from 65 to 67) for persons reaching age 62 in 2022 and later. For persons reaching age 62 between 2000 and 2021 inclusive, the retirement age was increased by varying amounts of somewhat less than two years. For persons reaching age 62 before 2000 (that is, persons aged 46 and over in 1983), the normal retirement age of 65 was retained. For the exact details of the amendments, the reader should refer to the final legislation and not to the Commission's recommendations.—ED.

1987. The public will again be assured that all is well with Social Security.

- Simultaneously, in the late 1980s, discontent with the relentlessly increasing taxes will be aggravated by the inappropriate design of Social Security. The social and economic environment will continue to change faster than Social Security is changed. By then people will understand fully that they are not buying and paying for their own benefits and that Social Security is a huge income-transfer program, and they will be extremely restive.
- In the late 1980s or early 1990s, the long-range financial problems of both OASDI and Medicare will start becoming more believable as they become more imminent. It will be clear that people will have to remain in the work force beyond their early sixties, probably until age 70 or so. The first children of the post-World War II baby boom will be approaching age 50, and they will not take kindly to a suggestion that they work another five years or so beyond their planned retirement at age 65. "Why didn't you tell me sooner?" they will ask.

It is difficult to foresee how all of this will end, but one thing is certain: The strife and turmoil in the late 1980s and early 1990s will make today's problems with Social Security look like an afternoon picnic. Fortunately, there is still time to forestall much of this discord. All we need to do is pay more serious attention to the obvious problems that lie ahead and stop kidding ourselves. Realism may be painful, but it is not nearly as fatal as unjustified optimism.