# Report of the National Commission on Social Security Reform*

On January 20, 1983, the National Commission on Social Security Reform, established 13 months earlier to provide a bipartisan solution to the financing problems of the Social Security program, sent its recommendations to the President and the Congress. In the interest of making the Commission's Report available to its readers, the **Bulletin** is reprinting all four chapters of that document in this issue. Chapter 1 contains the Commission's mandate and introduces the Report; Chapter 2 discusses the Commission's recommendations; Chapter 3 explores the financial status of the Medicare program; and Chapter 4 contains the supplemental views of individual Commissioners. In its March issue, the **Bulletin** will carry two of the appendices also included in the Report: "Financial Status of the Social Security Program" (Appendix J), and "Actuarial Cost Estimates for OASDI and HI and for Various Possible Changes in OASDI" (Appendix K), which details the estimated cost impacts of a variety of possible changes considered by the Commission.

—Editor.

## Chapter 1: Introduction

On December 16, 1981, President Reagan promulgated Executive Order 12335, which established the National Commission on Social Security Reform. The National Commission was created as a result of the continuing deterioration of the financial position of the Old-Age and Survivors Insurance Trust Fund, the inability of the President and the Congress to agree to a solution, and the concern about eroding public confidence in the Social Security system.[1]

The National Commission is composed of fifteen members, eight Republicans and seven Democrats. Five members were selected by the President, on a bipartisan basis; five were selected by the Senate Majority Leader, in consultation with the Senate Minority Leader, on a bipartisan basis; and five were selected by the Speaker of the House of Representatives, in consultation with the House Minority Leader, on a bipartisan basis.

The Executive Order provides that the National Commission should:

> . . . review relevant analyses of the current and long-term financial condition of the Social Security trust funds; identify problems that may threaten the long-term solvency of such funds; analyze potential solutions to such problems that will both assure the financial integrity of the Social Security System and the provision of appropriate benefits; and provide appropriate recommendations to the Secretary of Health and Human Services, the President, and the Congress.

In carrying out its mandate, the National Commission met nine times, on approximately a monthly basis. Because of the brevity of the time in which to complete its work, the National Commission held no public hearings. However, it reviewed the results of the many hearings, studies, and reports of other public bodies, including Congress, the 1979 Advisory Council on Social Security, and the 1981 National Commission on Social Security. The National Commission on Social Security Reform sought the advice of a number of experts and thoroughly examined a wide variety of alternative approaches.

Chapter 2 presents the major findings and recommendations of the National Commission. Chapter 3 deals with the financial status of the Medicare program. Additional Statements of individual members appear in Chapter 4.

---

*Copies of the report may be purchased through the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402 (GPO Stock No. 040-00-00463-7, $7.50).

[1] Throughout this report, the term "Social Security" will be used to denote the combination of the Old-Age, Survivors, and Disability Insurance (OASDI) program and the Medicare program, which consists of the Hospital Insurance (HI) program and the Supplementary Medical Insurance (SMI) program. The National Commission decided to limit its policy recommendations to the OASDI program. The statutory Advisory Council on Social Security, appointed by the Secretary of Health and Human Services in September 1982, is charged with studying the Medicare program.

## Members of the National Commission on Social Security Reform

**Appointed by the President**

**Alan Greenspan,** Chairman—Chairman and President, Townsend-Greenspan and Company, New York, NY.

**Robert A. Beck**—Chairman of the Board and Chief Executive Officer, Prudential Insurance Company of America, Newark, NJ.

**Mary Falvey Fuller**—Management Consultant, San Francisco, CA (Member of 1979 Advisory Council on Social Security).

**Alexander B. Trowbridge**—President, National Association of Manufacturers, Washington, DC.

**Joe D. Waggonner, Jr.**—Consultant, Bossier Bank and Trust Company, Bossier City, LA (Member of Congress from Louisiana in 87th to 95th Congresses).

**Appointed by the Majority Leader of the Senate, in consultation with Minority Leader**

**William Armstrong**—Senator from Colorado and Chairman of Subcommittee on Social Security, Committee on Finance.

**Robert Dole**—Senator from Kansas and Chairman of Committee on Finance.

**John Heinz**—Senator from Pennsylvania and Chairman of Special Committee on Aging.

**Lane Kirkland**—President, American Federation of Labor-Congress of Industrial Organizations.

**Daniel Patrick Moynihan**—Senator from New York and Ranking Minority Member of Subcommittee on Social Security, Committee on Finance.

**Appointed by the Speaker of the House of Representatives, in consultation with the Minority Leader**

**William Archer**—Representative from Texas and Ranking Minority Member, Subcommittee on Social Security, Committee on Ways and Means.

**Robert M. Ball**—Visiting Scholar, Center for the Study of Social Policy, Washington, DC (Commissioner of Social Security, 1962–73).

**Barber Conable**—Representative from New York and Ranking Minority Member, Committee on Ways and Means.

**Martha E. Keys**—Director of Educational Programs, The Association of Former Members of Congress, Washington, DC (Member of Congress from Kansas, in 94th and 95th Congresses, and Assistant Secretary of Health and Human Services, 1980–81).

**Claude D. Pepper**—Representative from Florida and Chairman of Committee on Rules.

The appendices to this report contain the following materials: Executive Order 12335, establishing the National Commission; Executive Order 12397, modifying the original Executive Order by extending the reporting date by 15 days; Executive Order 12402, giving a further extension in the reporting date (until January 20, 1983); the White House press release of December 16, 1981, announcing the membership of the National Commission; the Charter of the National Commission; the President's letter to the National Commission; a list of meetings held; a list of the technical memorandums prepared for the use of the members during their deliberations; a list of the prepared presentations made by experts who appeared before the National Commission; a roster of the staff; a detailed description of the financial status of the Social Security program; and a detailed listing of possible options and their cost effects and basic tables which served as background material for the meetings. (Due to space limitations, the **Bulletin** will not carry any of the appendices in this issue—Editor.)

# Chapter 2: Findings and Recommendations

The National Commission was assigned the critical job of assessing whether the OASDI program has financing problems in the short run and over the long-range future (as represented by the 75-year valuation period) and, if so, recommending how such problems could be resolved.

The National Commission has agreed that there is a financing problem for the OASDI program for both the short run, 1983–89 (as measured using pessimistic economic assumptions) and the long range, 1983–2056 (as measured by an intermediate cost estimate) and that action should be taken to strengthen the financial status of the program.[2] The National Commission recognized that, under the intermediate cost estimate, the financial status of the OASDI program in the 1990's and early 2000's will be favorable (i.e., income will significantly exceed outgo)—see table 7A in Appendix K. The National Commission also recognized that, under the intermediate cost estimate, the financial status of the HI program becomes increasingly unfavorable from 1990 until the end of the period for which the estimates are made—see table 7B in Appendix K.

The National Commission makes the following recommendations unanimously:

(1) *The members of the National Commission believe that the Congress, in its deliberations on financing proposals, should not alter the fundamental structure of the Social Security program or undermine its fundamental principles.*[3] *The National Commission considered, but rejected, proposals to make the Social Security program a voluntary one, or to transform it into a program under which benefits are a product exclusively of the contributions paid, or to convert it into a fully-funded program, or to change it to a program under which benefits are conditioned on the showing of financial need.*[4]

(2) *The National Commission recommends that, for purposes of considering the short-range financial status of the OASDI Trust Funds, $150–$200 billion in either additional income or in decreased outgo (or a combination of both) should be provided for the OASDI Trust Funds in calendar years 1983–89.*

(3) *The National Commission finds that, for purposes of considering the long-range financial status of the OASDI Trust Funds, its actuarial imbalance for the 75-year valuation period is an average of 1.80 percent of taxable payroll.*[5]

The National Commission was able to reach a consensus for meeting the short-range and long-range financial requirements, by a vote of 12 to 3. The 12 members voting in favor of the "consensus" package were Commissioners Ball, Beck, Conable, Dole, Fuller, Greenspan, Heinz, Keys, Kirkland, Moynihan, Pepper, and Trowbridge; the 3 members voting against the "consensus" package were Commissioners Archer, Armstrong, and Waggonner.

The 12 members of the National Commission voting in favor of the "consensus" package agreed to a single set of proposals to meet the short-range deficit (with Commissioner Kirkland dissenting on the proposal to cover newly hired Federal employees). They further agreed that the long-range deficit should be reduced to approximately zero. The single set of recommendations would meet about two-thirds of the long-range financial requirements. Seven of the 12 members agreed that the remaining one-third of the long-range financial requirements should be met by a deferred, gradual increase in the normal retirement age, while the other 5 members agreed to an increase in the contribution rates in 2010 of slightly less than one-half percent (0.46 percent) of covered earnings on the employer and the same amount on the employee, with the employee's share of the increase offset by a refundable income-tax credit (see the statements in Chapter 4 for a presentation of these approaches).

Various possible short-range and long-range financing options are displayed in the Commission's Background Book entitled **Old-Age, Survivors, and Disability Insurance and Hospital Insurance Programs—Actuarial Cost Estimates for OASDI and HI and for Various Possible Changes in OASDI and Historical Data for OASDI and HI**, revised version, December 1982 (which is included in this report as Appendix K). The derivation and underlying basis of the additional financial resources needed in 1983–89, as stated in item (2), are described in detail on pages 16–21 of Appendix J.

## Provisions of "Consensus" Package

Recommendations Nos. 4 to 16 describe the provisions of the "consensus" package. Table A presents the actuarial cost data for this package for both the short range (1983–89 in the aggregate) and the long range (the 75-year valuation period, ending with 2056). Table B gives the year-by-year actuarial cost data for the short-range period. The cost estimates underlying these figures are based on economic assumptions which have been developed in recent weeks and which assume significantly lower levels of both price and wage inflation than does the Alternative III estimate in the 1982 OASDI Trustees Report (and even somewhat lower than in the Alternative II-B estimate).

The "consensus" package would provide an estimated $168 billion in additional financial resources to the OASDI program in calendar years 1983–89. This amount is very close to the midpoint of the $150–$200 billion range stated in Recommendation No. 2. Actually, because the economic assumptions which are used for this package involve a lower inflation rate as to both prices and wages than those which had been used earlier

[2] The assumptions underlying these cost estimates are summarized in tables 12 and 13 of Appendix K.

[3] See additional views of Commissioner Archer in Chapter 4.

[4] See additional views (with regard to the last point) of Commissioners Archer, Fuller, and Waggonner in Chapter 4.

[5] This figure is the actuarial lack of balance according to the intermediate (Alternative II-B) cost estimate in the 1982 Trustees Report, after adjustment for the effects of legislation and the actual benefit increase for June 1982.

**Table A.**—Short-range and long-range cost analysis of OASDI proposals

| Proposal | Short-term savings, 1983-89 (billions) | Long-range savings (percentage of payroll) |
|---|---|---|
| Cover nonprofit and new Federal employees [1] | +$20 | +0.30 |
| Prohibit withdrawal of State and local government employees | +3 | ... |
| Taxation of benefits for higher-income persons | +30 | +.60 |
| Shift COLA's to calendar-year basis | +40 | +.27 |
| Eliminate windfall benefits for persons with pensions from noncovered employment | +.2 | +.01 |
| Continue benefits on remarriage for disabled widow(er)s and for divorced widow(er)s | −.1 | ... |
| Index deferred widow(er)'s benefits based on wages (instead of CPI) | −.2 | −.05 |
| Permit divorced aged spouse to receive benefits when husband is eligible to receive benefits | −.1 | −.01 |
| Increase benefit rate for disabled widow(er)s aged 50-59 to 71½% of primary benefit | −1 | −.01 |
| Revise tax rate schedule | +40 | +.02 |
| Revise tax basis for self-employed | +18 | +.19 |
| Reallocate OASDI tax rate between OASDI and DI | ... | ... |
| Allow interfund borrowing from HI by OASDI | ... | ... |
| Credit the OASDI Trust Funds, by a lump-sum payment for a cost of gratuitous military service wage credits and past unnegotiated checks | +18 | ... |
| Base automatic benefit increases on lower of CPI or wage increases after 1987 if fund ratio is under 20%, with catchup if fund ratio exceeds 32% | ... | ... |
| Increase delayed retirement credit from 3% per year to 8%, beginning in 1990 and reaching 8% in 2010 | ... | [2] −.10 |
| Additional long-range changes [3] | ... | +.58 |
| Total effect | +168 | +1.80 |

[1] Includes effect of revised tax schedule.

[2] This cost estimate assumes that retirement patterns would be only slightly affected by this change. If this change does result in significant changes in retirement behavior over time, the cost increase would be less (or possibly even a small savings could result).

[3] Alternate methods for obtaining this long-range savings are presented in the Additional Statements of the members (in Chapter 4).

Note: See text for complete description of the proposals.

in the deliberations, the resulting $168 billion of additional financial resources is really relatively near the upper end of the desired range.

(4) *The National Commission recommends that coverage under the OASDI program should be extended on a mandatory basis, as of January 1, 1984, to all newly hired civilian employees of the Federal Government.*[6] *The National Commission also recommends that OASDI-HI coverage should be extended on a mandatory basis, as of January 1, 1984, to all employees of nonprofit organizations.*

It is important to note that covering additional groups of workers such as those specified in this recommendation not only results in a favorable cash-flow situation in the short run, but also has a favorable long-range effect. The additional OASDI taxes paid on behalf of the newly-covered workers over the long run will exceed, on the average, the additional benefits which result from such employment,[7] assuming that the program is in long-range actuarial balance.

The National Commission believes that an independent supplemental retirement plan should be developed for the Federal new hires, which would be part of the Civil Service Retirement system (just as private employers have plans supplementing the OASDI program). It is

[6] Under present law, temporary Federal civilian employees are covered by the OASDI-HI program, and all other Federal civilian employees are covered under the HI program, beginning January 1, 1983. All persons in the Armed Forces are covered by the OASDI-HI program.

See additional views of Commissioner Archer and additional views of Commissioner Kirkland in dissent, in Chapter 4.

[7] The vast majority of the individuals involved would have qualified for sizable OASDI benefits as a result of other employment even if coverage were not extended to these two categories of workers. Also, they tend to have higher-than-average wages and, therefore, are entitled to less-heavily weighted benefits.

**Table B.**—Year-by-year short-range cost analysis of OASDI proposals

[In billions]

| Proposal | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | 1983-89 |
|---|---|---|---|---|---|---|---|---|
| Cover nonprofit and new Federal workers [1] | ... | +$1 | +$2 | +$3 | +$4 | +$4 | +$5 | +20 |
| Prohibit withdrawal of State/local workers | ... | (2) | (2) | (2) | +1 | +1 | +1 | +3 |
| Taxation of benefits for higher-income persons | ... | +1 | +4 | +5 | +6 | +7 | +8 | +30 |
| Shift COLA's to calendar-year basis | +$5 | +5 | +5 | +6 | +6 | +6 | +7 | +40 |
| Eliminate windfall benefits | ... | (2) | (2) | (2) | (2) | (2) | (2) | +.2 |
| Benefits for remarried widow(er)s | ... | (2) | (2) | (2) | (2) | (2) | (2) | −.1 |
| Index deferred widow(er)'s benefits by wages | ... | (2) | (2) | (2) | (2) | (2) | (2) | −.2 |
| Divorced spouse's benefits when husband eligible | ... | (2) | (2) | (2) | (2) | (2) | (2) | −.1 |
| Higher benefit rate for disabled widow(er)s | ... | (2) | (2) | (2) | (2) | (2) | (2) | −1 |
| Revised tax schedule | ... | +9 | (2) | ... | ... | +15 | +16 | +40 |
| Revised tax basis for self-employed | ... | +1 | +3 | +3 | +3 | +4 | +5 | +18 |
| Credit trust funds for military wage credits | +20 | −1 | −1 | (2) | (2) | (2) | (2) | +18 |
| Total effect | +25 | +16 | +13 | +17 | +20 | +37 | +41 | +168 |

[1] Includes effect of revised tax schedule.

[2] Less than $500 million.

**Note:** See text for complete description of the proposals. Those having no short-range cost effect are not shown here. Totals do not always equal the sum of the individual items, due to rounding.

important to note that present Federal employees will *not* be affected by this recommendation (and that the financing of their benefits over the long run will not be adversely affected).

(5) *The National Commission recommends that State and local governments which have elected coverage for their employees under the OASDI-HI program should not be permitted to terminate such coverage in the future—specifically, termination notices now pending would be invalid if the process of termination is not completed*[8] *by the enactment date of the new legislation.*

(6) *The National Commission is concerned about the relatively large OASDI benefits that can accrue to individuals who spend most of their working careers in noncovered employment from which they derive pension rights, but who also become eligible for OASDI benefits as a result of relatively short periods in covered employment with other employers. Accordingly, the National Commission recommends that the method of computing benefits should be revised for persons who first become eligible for pensions from noncovered employment, after 1983, so as to eliminate "windfall" benefits.*

The result of such a work history is to produce OASDI benefits that contain "windfall" elements—the benefits payable are relatively high compared to the proportion of time spent and the OASDI taxes paid during covered employment. This results from the weighted benefit formula, which treats these individuals in the same manner as if they were long-service, low-earnings workers. Specifically, the National Commission believes that these individuals should receive benefits which are more nearly of a proportionate basis than the heavily weighted benefits now provided.

There are various methods of eliminating the "windfall" portion of benefits (while still providing equitable, proportional benefits). One method would be to modify the benefit formula for determining the primary insurance amount by making the second percentage factor (32 percent) be applicable to the lowest band of average indexed monthly earnings (instead of the 90 percent factor), but the reduction in benefits would not be larger than the pension from noncovered employment. Another method would be to apply the present benefit formula to an earnings record which combines both covered earnings and also noncovered earnings in the future for the purpose of determining a replacement rate (i.e., the ratio of the benefit initially payable to previous earnings); then, that replacement rate would be applied to the average earnings based solely on covered employment. The short-range cost effect of these proposals—applied only prospectively for new eligibles—would be relatively small. The long-range cost effect would depend on the procedure used and on whether the recommended extension of coverage is adopted.

(7) *The National Commission recommends that, beginning with 1984, 50 percent of OASDI benefits should be considered as taxable income for income tax purposes for persons with adjusted gross income (before including therein any OASDI benefits) of $20,000 if single and $25,000 if married. The proceeds from such taxation, as estimated by the Treasury Department, would be credited to the OASDI Trust Funds under a permanent appropriation.*[9]

It is estimated that about 10 percent of OASDI beneficiaries would be affected by this provision. The National Commission noted that a "notch" is present in this provision in that those with adjusted gross income of just under the limit of $20,000/$25,000 would have a larger total income (including OASDI benefits) than those with adjusted gross income just over the limit. The National Commission points out the presence of this "notch" and trusts that it will be rectified in the legislative process.

(8) *The National Commission recommends that the automatic cost-of-living adjustments of OASDI benefits should, beginning in 1983, be made applicable to the December benefit checks (payable early in January), rather than being first applicable to the June payments. The National Commission also recommends that the amount of the disregard of OASDI benefits for purposes of determining Supplemental Security Income (SSI) payment levels should be increased from $20 a month to $50.*

The increase in the Consumer Price Index (CPI) for purposes of the automatic adjustments for any particular year is currently measured from the first quarter of the previous year to the first quarter of that particular year. This procedure should continue to apply for the adjustment in benefit amounts for 1983 (payable in early January 1984). However, for subsequent years, the comparison should be made on a "third quarter to third quarter" basis.

The recommended increase in the amount of the disregard of OASDI benefits for SSI purposes is estimated to have an initial cost of about $750 million per year.

[8] Current law provides that withdrawal can occur, after advance notice of at least 2 years, at the end of the calendar year specified in the withdrawal notice. For example, a withdrawal notice filed in February 1981 would (if not withdrawn earlier by the State or local government entity) result in the process of termination being completed on January 1, 1984.

[9] See additional views of Commissioner Archer in Chapter 4.

(9) *The National Commission recommends that the following changes in benefit provisions which affect mainly women should be made:*

(a) *Present law permits the continuation of benefits for surviving spouses who remarry after age 60. This would also be done for (1) disabled surviving spouses aged 50–59, (2) disabled divorced surviving spouses aged 50–59, and (3) divorced surviving spouses aged 60 or over.*

(b) *Spouse benefits for divorced spouses would be payable at age 62 or over (subject to the requirement that the divorce has lasted for a significant period) if the former spouse is eligible for retirement benefits, whether or not they have been claimed (or they have been suspended because of substantial employment).*

(c) *Deferred surviving-spouse benefits would continue to be indexed as under present law, except that the indexing would be based on the increases in wages after the death of the worker (instead of by the increases in the CPI, as under present law).*

(d) *The benefit rate for disabled widows and widowers aged 50–59 at disablement would be the same as that for nondisabled widows and widowers first claiming benefits at age 60 (i.e., 71½ percent of the primary insurance amount), instead of the lower rates under present law (gradually rising from 50 percent at age 50 to 71½ percent for disablement at age 60). Such change would not only be applicable to new cases, but would also be applicable to beneficiaries of this category who are on the rolls on the effective date of the provision.*

(10) *The National Commission recommends that the OASDI tax schedule should be revised so that the 1985 rate would be moved to 1984, the 1985–87 rates would remain as scheduled under present law, part of the 1990 rate would be moved to 1988, and the rate for 1990 and after would remain unchanged. The HI tax rates for all years would remain unchanged. The resulting tax schedule would be as follows:*

| Year | Employer and employee rate (each, in percent) | | | |
|---|---|---|---|---|
| | OASDI | | OASDI-HI | |
| | Present law | Proposal | Present law | Proposal |
| 1983 ....... | 5.4 | 5.4 | 6.7 | 6.7 |
| 1984 ....... | 5.4 | 5.7 | 6.7 | 7.0 |
| 1985 ....... | 5.7 | 5.7 | 7.05 | 7.05 |
| 1986 ....... | 5.7 | 5.7 | 7.15 | 7.15 |
| 1987 ....... | 5.7 | 5.7 | 7.15 | 7.15 |
| 1988–89..... | 5.7 | 6.06 | 7.15 | 7.51 |
| 1990 and after | 6.2 | 6.2 | 7.65 | 7.65 |

*For 1984, a refundable income tax credit would be provided against the individual's Federal income tax liability in the amount of the increase in the employee taxes over what would have been payable under present law.*[10]

(11) *The National Commission recommends that the OASDI tax rates for self-employed persons should, beginning in 1984, be equal to the combined employer-employee rates. One-half of the OASDI taxes paid by self-employed persons should then be considered as a business expense for income tax purposes (but not for purposes of determining the OASDI-HI tax).*[11]

Under present law, self-employed persons pay an OASDI tax rate which is approximately equal to 75 percent of the combined employer-employee rate (exactly 75 percent for 1985 and after) and an HI tax rate which is 50 percent of the combined employer-employee rate. Also, under present law, self-employed persons cannot deduct, as business expenses, any OASDI-HI taxes paid. The reduction in income taxes payable by the self-employed during 1984–89 as a result of considering one-half of their OASDI taxes as a business expense is estimated to be about $12 billion.

(12) *The National Commission recommends that the proposed OASDI tax rates should be allocated between the OASI and DI Trust Funds in a manner different from present law, in order that both funds will have about the same fund ratios.*

(13) *The National Commission recommends that the authority for interfund borrowing by the OASDI Trust Funds from the HI Trust Fund be authorized for 1983–87.*

(14) *The National Commission recommends that a lump-sum payment should be made to the OASDI Trust Funds from the General Fund of the Treasury for the following items:*

(a) *The present value of the estimated additional benefits arising from the gratuitous military service wage credits for service before 1957 (subject to subsequent adjustments if the experience deviates from the estimates).*

(b) *The amount of the combined employer-employee OASDI taxes on the gratuitous military service wage credits for service after 1956 and before 1983 (which were granted as a recognition of non-cash remuneration, and the cost of which is met, under present law, when additional benefits derived therefrom are paid). The payment would include interest, but would be reduced for any costs there-*

[10] See additional views of Commissioner Archer in Chapter 4.
[11] See additional views of Commissioner Archer in Chapter 4.

*for which were paid in the past to the OASDI Trust Funds from the General Fund of the Treasury. In the future, the OASDI Trust Funds would be reimbursed on a current basis for such employer-employee taxes on such wage credits for service after 1982.*

(c) *The amount of uncashed OASDI checks issued in the past (which were charged against the Trust Funds at time of issue), estimated at about $300–$400 million. (The problem of uncashed checks in the future has been corrected as a result of changed procedures of the Treasury Department with regard to checks which are uncashed for a long time.)*

(15) *The National Commission recommends that, beginning with 1988, if the fund ratio*[12] *of the combined OASDI Trust Funds as of the beginning of a year is less than 20.0 percent (except that, for 1988, the fund ratio to be considered would be that estimated for the end of that year), the automatic cost-of-living adjustments (COLA) of OASDI benefits should be based on the lower of the CPI increase or the increase in wages. If the fund ratio is 32.0 percent or more at the beginning of a year, payments will be made during the following year as supplements to monthly benefits otherwise payable to make up to individuals for any use of wage increases instead of CPI increases in the past, but only to the extent that sufficient funds are available over those needed to maintain a fund ratio of 32.0 percent.*[13]

This provision will serve as a stabilizer against the possibility of exceptionally poor economic performance over a period of time.

The increases in wages would be determined from the "SSA average wage index," the series used by the Social Security Administration in determining such elements of the program as the maximum taxable earnings base and the "bend points" in the formula for the primary insurance amount. As an example, assuming that this new indexing method were applicable for 1995 (for the December checks), the COLA percentage would be the *smaller* of (1) the percentage increase in the CPI from the third quarter of 1994, to the third quarter of 1995 or (2) the percentage increase in the "SSA average wage index" from 1993 to 1994.

(16) *The National Commission recommends that the delayed-retirement credit should be increased from the present 3 percent (for persons who attained age 65 after 1981) to 8 percent, to be phased in over the period 1990–2010.*

Under present law, persons who do not receive benefits after age 65 (essentially because of substantial employment of any kind) receive increases in their benefit (and in their widowed spouse's benefit, but not in any other auxiliary benefit) at the rate of 3 percent for each year of delay in receipt of benefits from age 65 through age 71.[14] Under the proposal, the delayed-retirement credit for months in 1990 would be at the rate of 3 1/4 percent, those for 1991 would be at the rate of 3 1/2 percent, etc. until an 8-percent rate would be reached in 2009 and after.

## Coverage of Payments Under Salary-Reduction Plans

(17) *The National Commission recommends that, in the case of salary-reduction plans qualifying under Section 401(k) of the Internal Revenue Code, any salary reduction thereunder shall not be treated as a reduction in the wages subject to OASDI-HI taxes.*

Section 401(k) of the Internal Revenue Code permits employers to install "salary-reduction" plans, under which employees may elect to forego a salary increase or have part of their pay set aside in a tax-sheltered fund. Such deferred salary is neither subject to Federal income tax currently, nor is it subject to the OASDI-HI tax. The National Commission believes that, for both OASDI-HI tax and benefit credit purposes, any salary deferred under a plan meeting the requirements of section 401(k) should be considered in exactly the same manner as cash remuneration.

This proposal will not produce significant additional income to the OASDI and HI programs currently, because not many of these salary-reduction plans have yet been put into effect. However, if the recommendation is not followed, it is quite probable that many such plans will be instituted and that, in the absence of the action recommended, considerable decreases in OASDI-HI tax income to the trust funds and in benefit credits would result.

[12] The fund ratio is the balance in the fund, exclusive of any outstanding loan from the HI Trust Fund, as a percentage of the estimated outgo from the fund in the year.

[13] When the fund ratio at the beginning of a particular year exceeds the trigger level of 32.0 percent, there would be a "catchup" for those individuals on the benefit rolls at the time of the next COLA for whom some benefits in the past had been increased on the basis of wage increases instead of CPI increases. For each such person, the cumulative percentage benefit reduction up to the beginning of that particular year would be recorded. Such percentage reduction would be applicable as a percentage increase for the benefits payable for the first 12 months following the next COLA. If there were not sufficient funds available to provide a complete "catchup," then the percentage increase in the benefits for the 12-month period would be prorated so that the estimated cost of this "catchup" would equal the funds available.

[14] A technical error in the law results in age 71 being stipulated, rather than age 69; this provision should not be applicable after age 69, because the earnings test no longer applies beyond that age. This error should be corrected when the recommended change is legislated.

## Fail-Safe Mechanisms

(18) *The National Commission believes that, in addition to the stabilizing mechanism of Recommendation (15), a fail-safe mechanism is necessary so that benefits could continue to be paid on time despite unexpectedly adverse conditions which occur with little advance notice.*[15] *Several types of fail-safe mechanisms are possible other than the one currently being used—interfund borrowing; there is strong disagreement among the members as to which type of mechanism should be used. A combination of these types of mechanisms would, of course, be possible.*

A number of mechanisms were considered. One would be to borrow, for a limited period, from the General Fund of the Treasury. Such limitation would prevent this procedure from being a part of the permanent method for financing the program. Another possibility along this line would be to permit the Trust Funds to issue their own bonds for sale to the general public.

A second mechanism would be to reduce, temporarily, the benefits payable. Alternatively, such a result could be accomplished indirectly, by reducing the amount of the next benefit increase which would occur as a result of the automatic adjustment provision for benefits in eligibility status.

The third mechanism would be to increase, temporarily, the OASDI tax rates and/or the maximum taxable earnings base.

The National Commission makes a number of recommendations in addition to those discussed previously. Although these additional recommendations are of importance, they will not likely have any significant financial effects, on the average over the long run.

## Investment Procedures

(19) *The National Commission recommends that the investment procedures of the OASI, DI, HI, and SMI Trust Funds be revised so that (1) all future special issues would be invested on a month-to-month basis (i.e., without fixed maturity dates, as under present law), at an interest rate based on the average market rate of all public debt obligations with a duration of 4 or more years until maturity (not including "flower bonds"*[16]*); (2) all present special issues would be redeemed at their face amount; (3) all "flower bonds" would be redeemed at their current market values; (4) all other current holdings would be held until maturity (unless disposed of sooner, if needed to meet outgo); and (5) only special issues would be purchased by the Trust Funds in the future.*

There has been widespread public discussion about the investment procedures of the four Social Security trust funds. The view has frequently been expressed that the investments have not been made on a proper basis and that sufficiently high rates of return have not been obtained, because the **average** rate of return has, in recent years, been far lower than that on newly issued Government obligations. This is not a valid comparison because it compares the **new-issues** rate with the **average portfolio** rate, which includes the effect of the lower interest rates on long-term obligations bought some years ago (at rates which were equitable and proper at that time). The same situation as to a higher interest rate on new issues than on the total portfolio, as of recent years, has also been present for private pension funds and insurance companies.

The National Commission believes that the investment procedures followed by the trust funds in the past generally have been proper and appropriate. The monies available have generally been invested appropriately in Government obligations at interest rates which are equitable to both the Trust Funds and the General Fund of the Treasury and have not—as is sometimes alleged—been spent for other purposes outside of the Social Security program.

Nonetheless, the National Commission makes this recommendation in order to improve the level of public understanding of the operations of the trust funds. On the whole, and over the long-range future, it is likely that such a change in investment procedure will have little (if any) effect on the financial status of the Social Security program. It will probably result in a slightly higher average rate of return in the immediate future. The long-range effects are not determinable and, in any case, are not of great significance with regard to the overall financing of the program.

Although the National Commission has not considered the Medicare program in depth, it believes that the same investment procedures should apply for the HI and SMI Trust Funds as for the OASDI Trust Funds.

## Public Members on Board of Trustees

(20) *The National Commission recommends that two public members be added to the Board of Trustees of the OASDI Trust Funds. The public members would be nominated by the President and confirmed by the Senate. No more than one public member could be from any particular political party.*

[15] It is most unlikely that such a situation would, with proper actuarial guidance, happen with shorter notice than a year or so.

[16] "Flower bonds" are certain series of government bonds that were issued in the past (but which are no longer issued) which contain a provision that if the purchaser holds them for a certain length of time, then for inheritance tax purposes, they are redeemable at par (regardless of the market value).

The National Commission believes that increasing the membership of the Board of Trustees of the OASDI Trust Funds by including two individuals from outside the Executive Branch, on a bipartisan basis, would be desirable from the standpoint of confidence in the integrity of the trust funds. The presence of such public members would inspire more confidence in the investment procedure (even though it is recommended that the procedure should be placed on a more or less automatic basis, as under the previous recommendation) and would help to assure that the demographic and economic assumptions for the cost estimates of the future operations of the program would continue to be developed in an objective manner. Although the National Commission is not generally making recommendations in connection with the Medicare program, it would seem reasonable that the same procedure of having two public members on the Board of Trustees should also apply for the HI and SMI Trust Funds.

## Social Security and the Unified Budget

(21) *A majority of the members of the National Commission recommends that the operations of the OASI, DI, HI, and SMI Trust Funds should be removed from the unified budget. Some of those who do not support this recommendation believe that the situation would be adequately handled if the operations of the Social Security program were displayed within the present unified Federal budget as a separate budget function, apart from other income security programs.*

Before fiscal year 1969, the operations of the Social Security Trust Funds were not included in the unified budget of the Federal Government, although they were made available publicly and were combined, for purposes of economic analysis, with the administrative budget in special summary tables included in the annual budget document. Beginning then, the operations of the Social Security Trust Funds were included in the unified budget. In 1974, Congress implicitly approved the use of a unified budget by including Social Security Trust Fund operations in the annual budget process. Thus, in years when Trust Fund income exceeded outgo, the result was a decrease in any general budget deficit that otherwise would have been shown—and vice versa.

The National Commission believes that changes in the Social Security program should be made only for programmatic reasons, and not for purposes of balancing the budget. Those who support the removal of the operations of the Trust Funds from the budget believe that this policy of making changes only for programmatic reasons would be more likely to be carried out if the Social Security program were not in the unified budget. Some members also believe that such a procedure will make clear the effect and presence of any payments from the General Fund of the Treasury to the Social Security program. (Under present procedures, such payments are a "wash" and do not affect the overall budget deficit or surplus.)

Those who oppose this recommendation believe that it is essential that the operations of the Social Security program should remain in the unified Federal budget because the program involves such a large proportion of all Federal outlays. Thus, to omit its operations would misrepresent the activities of the Federal Government and their economic impact. Furthermore, it is important to ensure that the financial condition of the Social Security program be constantly visible to the Congress and the public. Highlighting the operations of the Social Security program as a separate line function in the budget would allow its impact thereon to be seen more clearly.

## Social Security Administration as an Independent Agency

(22) *The majority of the members of the National Commission believes—as a broad, general principle—that it would be logical to have the Social Security Administration be a separate independent agency, perhaps headed by a bipartisan board. The National Commission recommends that a study should be made as to the feasibility of doing this.*[17]

The Social Security Administration is now part of the Department of Health and Human Services. Its fiscal operations and the size of its staff are larger than those of the remainder of the Department combined.

The National Commission has not had the time to look into the various complex issues involved in such an administrative reorganization and, therefore, recommends that a study group should be formed to look into this matter. Issues involved include whether the leadership of such an independent agency should be assigned to a single individual or whether there should be a governing board of several members, selected on a bipartisan basis, and whether the operations of the Medicare program should be included in such an independent agency, or whether they should remain as a subsidiary agency within the Department of Health and Human Services, as at present.

## Coverage of State and Local Government Employees

Although the National Commission believes that coverage of all persons who are in paid employment is de-

[17] See additional views of Commissioners Ball, Keys, Kirkland, Moynihan, and Pepper in Chapter 4.

sirable, some members do not favor mandatory coverage of employees of State and local governments.

A majority of the members is concerned about the constitutional problem of covering State and local government employees under Social Security on a mandatory basis because the Federal Government may not have the power to compel State and local governments to pay the employer share of the OASDI-HI tax. Other members believe that, regardless of the constitutionality question, the Federal Government should not do so because the two levels of government have equal roles and status. Some members point out that many State and local governments already have adequate, well-financed retirement systems for their employees, so that they do not need OASDI-HI coverage;[18] others point out that many State and local systems have serious financing problems and that protection of the benefits under such systems against inflation (and often protection against other risks) is not as adequate as under the OASDI program.

## Benefit Provisions Primarily Affecting Women

In recent years, there has been widespread discussion as to whether the basic structure of the Social Security program should be altered in view of the changes in the role of women in our society and economy.[19]

Some members of the National Commission believe that there should be a comprehensive change in the program to reflect the changing role of women, for example, by instituting some form of earnings sharing for purposes of the Social Security earnings record. Simply stated, earnings sharing means that all covered earnings received by a couple during the period of marriage would be pooled and half would be credited to each of their earnings records. Some other members believed that such comprehensive changes were outside of the scope of the charge of the National Commission.

## Social Security Cards

The National Commission commends a recent decision of the Social Security Administration to use banknote-quality paper for new and replacement Social Security cards. The Senate Permanent Subcommittee on Investigations estimated in June 1982 that fraud involving identification cards, of which Social Security cards are the vast majority, cost the Federal Government between $15 billion and $24 billion per year.

[18] A relatively small number of State and local government employees do not have either OASDI-HI coverage or public-employee retirement systems.

[19] See additional views of Commissioner Fuller and additional views of Commissioners Ball, Keys, Kirkland, Moynihan, and Pepper, in Chapter 4.

# Chapter 3: Financing Problems of the Medicare Program

This chapter deals with the consideration which has been given to the financial status of the two portions of the Medicare program by the National Commission.

## Hospital Insurance Program

According to the 1982 HI Trustees Report, the HI Trust Fund is estimated to be depleted by the early part of the 1990's and possibly even by the end of this decade. Over the next 25 years, the program is anticipated, under the Alternative II-B assumptions of that report, to have an actuarial deficit that averages about 1 1/2 percent of taxable payroll.

About $12.4 billion was loaned to the OASI Trust Fund by the HI Trust Fund in December 1982, as permitted by the law then in effect. Because the HI Trust Fund will be depleted at some time within the next decade, according to current estimates, the amounts borrowed by the OASI Trust Fund in 1982 should desirably be repaid to the HI Trust Fund as soon as feasible.

These future financing problems of the HI program were not addressed specifically by the National Commission, with the exception of those aspects that relate directly to the financial status of the OASDI program. Such action was taken both because of the more immediate financing problems of the OASDI program and because the recently-named Advisory Council on Social Security will be concerned exclusively with making recommendations on the Medicare program and its future solvency.

The "consensus" package described in Chapter 2 would result in some additional financial resources for the HI program, as indicated below (see text of Chapter 2 for complete description of the proposals):

| Proposal | Short-term savings, 1983-89 (billions) | Long-range savings (percentage of payroll) |
|---|---|---|
| Cover nonprofit employees | +$1.7 | +0.02 |
| Prohibit withdrawal of State/local employees | +.5 | ... |
| Total effect | +2.2 | +.02 |

Although the National Commission did not specifically address the future financing problems of the HI program, some members were concerned about the estimates of large future financing short falls. The first major concern was the possibility that any excess of income over outgo of the OASDI Trust Funds during 1990-2010 could be endangered by the extensive financing needed by the HI Trust Fund during that period. The second major concern was that, by ignoring the cost of the HI program, the potential tax burden of the entire Social Security program might not be properly assessed when making reforms in the OASDI portion of the program. Some members believe that the problem of financing the HI program is not simply a matter of providing the funds to meet the costs projected on the basis of past experience, but rather that first the matter of slowing the rate of increase in hospital costs generally should be addressed.

According to the intermediate cost estimate, the combined OASDI-HI system will develop significant annual deficits (excesses of outgo over income) beginning shortly after 1990. These deficits will become increasingly larger as time goes by. Thus, ultimately (2030–56), the combined deficits will be somewhat more than 12 percent of taxable payroll.[20] About 65 percent of such deficits will be caused by the HI program. In considering these estimates, it should be recognized that the underlying assumption is that hospital costs will continue to rise more rapidly than the general wage level for the next 25 years and at the same rate thereafter. In other words, they assume that mandatory or voluntary actions to control hospital costs undertaken in the next 25 years will be effective only to the extent that the growth in hospital costs as compared with the general level of wages will not be reduced below what is assumed in the actuarial cost estimates for the HI program.[21]

### Supplementary Medical Insurance Program

The National Commission did not believe that it was necessary to make any recommendations with regard to the SMI portion of the Medicare program. Its financing is—as discussed in Appendix J—entirely on a year-by-year basis, rather than on a long-range basis, as are the three payroll-tax-supported programs (OASI, DI, and HI). For calendar year 1982, the payments from the General Fund of the Treasury to the SMI Trust Fund are estimated to represent 77 percent of the total of the premium income and such payments. The financial status of the SMI Trust Fund is currently excellent.

## Chapter 4: Additional Statements

This chapter consists of additional statements of individual members of the National Commission. These statements are presented alphabetically by name of member; those which are signed onto by several members appear first.

The statements appear in the following order:

(1) Commissioners Archer, Beck, Conable, Dole, Fuller, Greenspan, Heinz, and Trowbridge
(2) Commissioners Ball, Keys, Kirkland, Moynihan, and Pepper (long-range financing and issues of special concern to women)
(3) Commissioners Ball, Keys, Kirkland, Moynihan, and Pepper (independent agency)
(4) Commissioners Ball, Keys, Kirkland, Moynihan, and Pepper (HI cost estimates)
(5) Commissioners Dole and Conable
(6) Commissioner Archer
(7) Commissioner Armstrong
(8) Commissioner Fuller (long-range financing)
(9) Commissioner Fuller (issues of special concern to women)
(10) Commissioner Kirkland
(11) Commissioner Waggonner

### Supplementary Statement on Meeting the Long-Range Financing Requirements by Commissioners Archer, Beck, Conable, Dole, Fuller, Greenspan, Heinz, and Trowbridge

The recommendations made in the "consensus" package fail to meet the long-range goal of providing additional financing equivalent to 1.8 percent of taxable payroll. The shortfall is an estimated 0.58 percent of taxable payroll. We believe that this should be derived by a delayed, slowly phased-in increase in the "normal" retirement age (the age at which unreduced retirement benefits are available to insured workers, spouses, and widow(er)s—which is age 65 under present law).

The major reasons for this proposal are:

(1) Americans are living longer.
(2) Older workers will be in a greater demand in future years.
(3) The disability benefits program can be improved to provide cash benefits and Medicare to those between age 62 and the higher normal retirement age who, for reasons of health, are unable to continue working.
(4) Because the ratio of workers to beneficiaries is projected to decline after the turn of the century, younger generations are expected to pay significantly increased taxes to support the system in the 21st century. An increase in the normal retirement age will lessen the increase.
(5) Given sufficient notice, coming generations of beneficiaries can adjust to a later retirement age just as earlier generations adjusted to age 65.

Although we believe that greater action in this direction may be desirable, we are suggesting only enough change to produce approximately the needed 0.58 percent of taxable payroll. The recommended change would apply only to the normal retirement age. Early retirement benefits would continue to be available beginning at age 62 for insured workers and spouses and at age 60 for widows and widowers, but the actuarial re-

[20] These assumptions are summarized in table A1 of the 1982 HI Trustees Report.

[21] See views of Commissioners Ball, Keys, Kirkland, Moynihan, and Pepper as to the undesirability of cost estimates for the HI program going further than 25 years into the future, in Chapter 4.

duction factors would be larger. The minimum age for eligibility for Medicare benefits would continue to be the "normal" retirement age for OASDI benefits. Disability benefits are now available under somewhat less stringent definitions for those aged 60–64. However, because some workers, particularly those in physically demanding employment, may not benefit from improvements in mortality and be able to work longer, we assume that the disability benefits program will be improved prior to the implementation of this recommendation to take into account the special problems of those between age 62 and the normal retirement age who are unable to extend their working careers for health reasons.

Under our proposal, the normal retirement age would be gradually increased—1 month each year—to age 66 in 2015, beginning the phase-in with those who attain age 62 in 2000. Beginning with those who attain age 62 in 2012, the normal retirement age would be automatically adjusted (on a phased-in basis) so that the ratio of the retirement-life expectancy to the potential working lifetime (from age 20 to the "normal" retirement age) remains the same over the years as it was in 1990. The estimated long-range savings of this proposal is 0.65 percent of taxable payroll.

## Supplementary Statement on Long-Term Financing and Issues of Special Concern to Women by Commissioners Ball, Keys, Kirkland, Moynihan, and Pepper (members selected by the Democratic Leadership of the Congress)

### Meeting the Remaining Long-Term Deficit

All of us supported the compromise agreement which is being recommended by a vote of 12 to 3 of the full Commission.[22] The agreement provides for fully meeting the Commission's short-term financing goal and also for meeting about two-thirds of the Commission's long-term goal—1.22 percent of payroll out of the 1.8 percent projected need.

We recommend that the remaining 0.58 percent of payroll deficit be met by providing additional revenues starting in the year 2010, in advance of the period when the bulk of the deficit is projected to occur. Sufficient additional revenues would be provided by an increase of less than one-half of 1 percent (0.46 percent) in deductions from workers' earnings beginning in 2010 and a like amount in employer payroll taxes (with an equal combined rate for the self-employed) or the revenue could be supplied by an equivalent general revenue contribution, or some combination of the two. For purposes of present legislation, we would support putting in the law now an increase in the contribution rate beginning in 2010 of 0.46 percent of payroll (with the employee contribution offset by a refundable income tax credit) recognizing, of course, that in the next century the Congress may prefer to raise the money in some other way and that, in fact, such a rate increase would not be allowed to go into effect unless estimates at the time of the scheduled increase showed that it would be needed.

An increase of less than one-half of 1 percent in the contribution rates in all probability would not mean an increase in the burden of supporting OASDI because: (1) By 2010 real wages are likely to be substantially higher than they are now; and (2) although levied at a higher rate, the rate will apply to a smaller portion of total compensation than today if the expansion of non-taxable fringe benefits projected in the estimates actually occurs. (If such expansion fails to materialize the contribution rate increase would be unnecessary.)

In contrast to our plan for meeting the part of the long-range deficit not addressed by the compromise agreement, some members of the Commission seek to meet the remaining deficit by raising the age at which full benefits are first payable and then continuing to raise the age automatically in relation to improvements in longevity. This proposal is a benefit cut. If the age is raised to 68, benefits would be reduced by 20 percent relative to those received at age 65; if it is raised to age 67, the cut is 13 percent; and if set at age 66, the cut is 7 percent.

The cut would be concentrated on those unable to work up to the newly set higher age and on those unable to find jobs. It would cut protection for those now young, the very group being asked to pay in more and for a longer period of time. And an automatic provision changing the age of first eligibility for full benefits would make it very difficult for people to plan for retirement. It would also greatly complicate private pension planning. In our opinion it is unwise to try to index Social Security for all possible future changes in society. Social Security has enough indexing. Congress can act to make future changes in the long-run future as needed.

We favor the maintenance of the full range of retirement options in present law so that the program will be responsive to the great variety of occupations in the American economy and to the great variety of individual circumstances. It is one thing, for example, to consider a higher age of first eligibility for full benefits for white-collar workers; something else again for those required to do heavy work. The system today has the required flexibility. It provides: (1) full benefits at any age for qualified workers who have long continued total disability, (2) actuarially reduced benefits for those who

[22] Mr. Kirkland is not joining in the recommendation to extend coverage to Federal employees and has filed a supplemental statement on the issue.

apply between ages 62 and 65, (3) higher benefits for those who postpone retirement and continue to work between ages 65 and 70 (3 percent a year additional benefits under present law, to be raised to 8 percent during the 1990's under the Commission recommendations).

Some have argued for raising the age at which full benefits are first payable on the ground that as life expectancy increases, so will the ability to work. However, two leading government authorities on health and the aging testified before the Commission that data on increased longevity carry no evidence that health improved commensurately. If anything, they said, what evidence there is indicates the contrary; more people living longer, but with more chronic illness and impairments. Moreover, recent increases in longevity may be related to retirement at earlier ages.

It is, of course, highly uncertain what the economy and the labor market will look like in the next century. Two major possibilities exist. A labor shortage may result from projected shrinkage of the proportion of persons in the 20–64 age group.[23] In that event, greater market demand for the services of older people would produce greater paid-work opportunities for them. Employers would be seeking older people and the benefit increase for work after 65 recommended by the Commission would encourage older people to work. If, on the other hand, a labor shortage does not materialize, raising the age of first eligibility for full Social Security benefits would force a large number of elderly persons into early retirement with lower benefits than current law provides.

We should not cut benefits in an attempt to keep older persons at work. Instead we should recognize and remove the impediments that stand between older workers and employment. Most important of all, economic arrangements should favor full employment and, then, the voluntary approach—the incentives prepared by the Commission—will have a chance to work. Social Security benefits are not so large as to cancel the lure of good wages. The best medicine for Social Security is full employment and economic growth, not benefit cuts.

## Meeting Problems of Special Concern to Women

Since enactment of the Civil Rights Act of 1964, Federal law has sought to prevent and redress unequal treatment of women. Despite those efforts, substantial inequalities persist and much remains to be done.

In general, gender-based discrimination has been eliminated from the OASDI program through legislative change and court decisions, but in recent years there has been a growing concern regarding the extent to which the Social Security system has adapted to the changed roles of women in society and the economy. The labor force participation rate for married women has almost doubled in the last 25 years. Over 65 percent of all women aged 20 to 54 are now in the labor force. In addition, the divorce rate has increased signficantly. Two decades ago, there was one divorce for every four marriages; in 1976 that rate had risen to one divorce for every two marriages.

Although the scope and urgency of economic considerations appropriately consumed most of the time of the Commission, it did give attention to some of the problems that currently exist for women in Social Security coverage. Four specific recommendations were made for important changes affecting certain groups of widows, divorced women, and disabled women.

Social Security has indeed given extensive protection to women and men. It provides benefits for 91 percent of women over age 65 today (compared to 10 percent of women who received benefits from a private pension system in 1980). Nevertheless, the significant changes in women's roles in society and the economy have caused many inequities and unintended results for women beneficiaries.

Today, the majority (65 percent) of working age women are in the labor force; yet their benefits may be greatly reduced if they leave the labor force for a period of time for homemaking or child-caring. Also, lower family retirement and survivor benefits exist for two wage-earner couples than for one wage-earner couples with the same family earnings history (although there are some advantages to having benefits based on one's own earnings that are partly offsetting).

Homemakers have no individual coverage or eligibility to Social Security and no credits of their own on which to build with later employment because of early widowhood or any other reason. Divorced women may be severely affected by the arbitrary 10-year duration-of-marriage requirement and the inadequacy of the 50 percent dependent benefit for their independent economic needs. Currently, the benefit for the divorced woman depends upon the actual retirement of the former spouse; however, the Commission has recommended a change which will correct this problem. Disability protection exists only for women who remain quite continuously in the labor force and not at all for homemakers. It is often lost to working women during a period of time spent in the home.

Since the introduction in 1976 by Representative Martha Keys and Representative Don Fraser of legislation to implement the concept of earnings sharing, many have believed this to be the best solution to these anomalies. Earnings sharing is a recognition of marriage as an economic partnership with equal respect given to the division of labor chosen by each couple. It

[23] A labor shortage would result only if the relative reduction in the working age population were not offset by productivity improvements.

accords the right of each individual to a retirement income based on half of the total retirement credits earned by the couple during their marriage. This is similar in concept to the sharing of income in the joint tax return of a married couple. Working women would have a continuous record of Social Security credits when they retire instead of zero credits for years spent in the home. It would respond to, and recognize, the economic value to the couple of full-time work in the home by either spouse.

Earnings sharing has been proposed in many forms and was recommended for consideration by both the 1979 Advisory Council on Social Security and the 1980 President's Commission on Pension Policy. Obviously, such a comprehensive change in structure requires careful development of a detailed proposal and thorough analysis of its impact. There are many technical and administrative questions to be worked out and special consideration must be given to continued strong protection for the family against death or disablement of its primary wage earner. These are not insurmountable problems, however. We believe that earnings sharing is the most promising approach to the solution of Social Security problems of special concern to women and we urge renewed efforts to develop a comprehensive proposal based on this concept.

## Supplementary Statement on Social Security as an Independent Agency by Commissioners Ball, Keys, Kirkland, Moynihan, and Pepper (members selected by the Democratic Leadership of the Congress)

We believe that it would improve the operation of the Social Security system and strengthen public confidence in the integrity of the program if it were administered as an independent agency under a bipartisan Board as it was in the early days of the program. We do not believe that an indepth study is necessary, but rather any study should be confined to the details of implementation.

## Supplementary Statement on HI Cost Estimates by Commissioners Ball, Keys, Kirkland, Moynihan, and Pepper (members selected by the Democratic Leadership of the Congress)

We do not believe that the work of the Commission provided any basis for overturning the long-term position of the Board of Trustees that the HI estimates should be limited to 25 years, and we object to the use of a 75-year valuation period for HI cost estimates. The Trustees consider that the degree of uncertainty concerning future hospital costs, relative to the remainder of the economy, is so great as to make projections beyond 25 years thoroughly misleading.

Since official projections for the Hospital Insurance (Medicare) program are made for only 25 years, tax rates are formulated based on expected income and outgo only during that period. It is misleading to extend a fixed tax rate into the distant future while assuming that costs continue to accelerate. This procedure (1) exaggerates program costs and (2) assumes that unlimited growth in health care costs would be permitted without intervention.

## Additional Views of Commissioners Dole and Conable

When the National Commission on Social Security Reform was created on December 16, 1981, few people had real confidence in what the Commission could accomplish. And little wonder. For the better part of a year, Social Security had been embroiled in political controversy. The system moved closer to insolvency as proposals for financial reform were subjected to partisan political attack. The 15 selected as Commission members, moreover, embodied widely divergent views. At least to outsiders, these members probably seemed incapable of reaching any true bipartisan consensus.

In the last several days, the Commission accomplished what some said was impossible. With the cooperation and approval of President Reagan and House Speaker O'Neill, the Commission forged a consensus reform package with broad bipartisan support. As detailed earlier in this report, the package is designed to close the short-term deficit identified by the Commission, and go a long way toward closing the long-range deficit. It requires concessions from all of the parties who have a stake in Social Security—current and future beneficiaries, taxpayers, and government employees who do not now contribute to the system. While no one member is happy with every specific recommendation, the important fact is that a consensus was reached on how to save the system. The bipartisan reform package, which we plan to introduce into the Senate with Senators Heinz, Moynihan, and others, and into the House, merits speedy congressional action.

Agreeing on the essential provisions of a Social Security solution was by no means the only accomplishment of the Commission. It should be noted that the Commission reached unanimous agreement on the size of the short- and long-term deficits in the Social Security cash benefit program (Old-Age and Survivors Insurance and Disability Insurance). That is, in concrete dollar terms, the Commission quantified the seriousness and the urgency of the financing problem. In our judgment, $150–$200 billion is the amount required to keep the system (excluding Medicare) solvent through 1990.

Over the very long term, the next 75 years, the needs of the system amount to about $25 billion a year (in 1983 dollar terms) over and above currently scheduled tax income. Only a year ago, partisan lines were drawn between those who did and did not believe there was any financing problem at all before the year 2000.

In addition, the National Commission provided a valuable forum for the diverse views on Social Security. With the able leadership of Chairman Alan Greenspan and with the expert assistance of Executive Director Robert Myers, members of both political parties were able to work together in studying the Social Security financing problem and options for financial reform. The interests of the elderly, organized labor and business, and the general taxpayer were all well represented. In recent weeks, we engaged in intensive negotiations which were, to a large extent, absent of the political partisanship that so seriously damaged efforts for responsible reform in 1981.

Finally, we believe the Commission's recommendations are significant in that they narrowed the range of realistic options for closing the deficits. Realistic options were not judged to include, nor was there any support for, proposals to reduce or eliminate benefits for people now on the rolls. Options under consideration involved restraining the growth of benefits in future years and providing additional financing through some form of revenue increase. Current and future beneficiaries should be reassured by the unanimously held view that Social Security is an important and vital program that must be preserved.

With these accomplishments under our belts, we in Congress are in a strong position to hammer out the details of legislation in the early months of the 98th Congress. The expiration of interfund borrowing and the likely inability of the retirement program to pay full benefits in July make prompt action essential.

## The Financing Problem

While the Commission Report accurately reflects the size of the Social Security financing problem, perspective may be provided by some additional facts. Most importantly, without prompt congressional action, the Social Security retirement program will not be able to pay benefits on time beginning in July. In fact, were it not for "interfund borrowing," authorized by Congress in 1981 to permit the reserves of each Social Security trust fund (Old-Age and Survivors Insurance, Disability Insurance, and Hospital Insurance) to be used to help pay benefits from another, the retirement program would have stopped meeting its monthly payments on time 2 months ago. With the authority for interfund borrowing now expired (as of December 31, 1982), July is when all of the money borrowed from the other two trust funds—$17.5 billion in total—finally runs out.

Reauthorizing interfund borrowing can not help the retirement program for long. The retirement program is so large—accounting for 73 percent of all Social Security spending—and its borrowing demands are so heavy, the rest of the system could be insolvent before the year is out. The Social Security Board of Trustees, the Congressional Budget Office, and a wide variety of private actuaries and economists all agree that additional Trust Fund revenues must be provided or savings must be achieved if the Social Security system is to remain solvent through the remainder of this decade.

While it is the short-term financing problem that is immediately pressing, the long-term financing problem is equally serious, if not more so. The Social Security Board of Trustees reports that the combination of the baby boom generation retiring and gradually lengthening lifespans will lead to a dramatic increase in the cost of Social Security—about 55 percent between 2005 and 2035 alone. In the year 2035, when the young people of today are beginning to retire, the actuaries expect that the elderly population will account for 21 percent of the overall population (as compared to 11 percent today), and the typical 65 year old will have a life expectancy of 17 years (as compared to 14.5 years today). The effect will be to decrease the ratio of taxpayers to beneficiaries from just over 3:1 today to 2:1, helping to generate the enormous long-term deficits we now foresee.

According to the Social Security actuaries, the long-term deficit in the non-Medicare Social Security programs is 1.8 percent of taxable payroll. This is the figure adopted by the National Commission. To translate, it means that over the next 75 years, the actuaries project that benefits will outstrip payroll tax income, in dollar terms, by about $25 billion per year, or $2 trillion in total (expressed in 1983 dollar terms). Including Medicare, the long-term deficit has been estimated at 7.01 percent of taxable payroll, or nearly $8 trillion in total.

## How Much Does the System Need?

How much the system needs in additional financing depends on how we expect the economy to perform in the years ahead and how much of a "safety margin" is accumulated in reserves. Each set of forecasts provides a different view of the needs of the system, as illustrated in table C.

The Commission settled on $150–$200 billion as the amount required in the years 1983–89 to ensure the solvency of the system through 1990. This is roughly consistent with achieving a reserve ratio (reserves relative to annual outgo) of 15 percent by 1990, under the 1982 Board of Trustees' pessimistic assumptions.

Several points are worth noting in this regard. First, planning for a low growth decade is prudent in light of the experience during the 1970's. (The pessimistic as-

**Table C.**—Additional resources required in the near-term to bring OASDI reserves up to certain level[1]

[In billions]

| Item | Additional resources required[2] | | |
|---|---|---|---|
| | Congressional Budget Office | 1982 Trustees' intermediate (II-B) assumptions | 1982 Trustees' pessimistic assumptions |
| Percent of 1 year's expenditures desired at beginning of 1990: | | | |
| 9 percent (1 month) | $56.6 | $62 | $187 |
| 13 percent | 68.7 | 70 | 195 |
| 15 percent | 74.7 | 74 | 200 |
| 20 percent | 89.9 | 88 | 216 |
| 30 percent | 120.1 | 113 | 246 |
| 50 percent (6 months) | 180.7 | 163 | 303 |

[1] Table includes the effects of the Tax Equity and Fiscal Responsibility Act of 1982. Target reserve levels are attained in even annual increments.

[2] Congressional Budget Office (CBO) estimates and Trustees' estimates are not directly comparable because CBO numbers include added interest on target Trust Fund balances, while Trustees' numbers do not.

sumptions in the 1982 Board of Trustees Report project the economy will perform much like in the past 5 years.) The failure to anticipate, both in 1972 and 1977, that prices would grow more rapidly than wages, and therefore benefits would grow more rapidly than tax income, is why we are in the situation we are in today. Second, a reserve ratio of 15 percent is not, in and of itself, a "goal." At this level, reserves would be lower than at any point in history. Accumulating considerably larger reserves is desirable, although this would be difficult to do very quickly. We believe we express the views of all members of the Commission when we say that it is our hope that the economy will perform better than we assumed when we made our estimates and that a larger reserve cushion will accumulate. Finally, if the Medicare program were under consideration as well, the reserve needs of the system would be considerably higher.

## Not a New Problem

Given the partisan debate that raged over Social Security in 1981, some people may have lost sight of the fact that the financing crisis is **not** a new problem. Trust Fund reserves have been on a downhill course for years. As table D indicates, prior to 1970, there were always reserves on hand capable of financing a year's worth of benefits or more—that is, reserves equal to 100 percent or more of annual outgo. By 1976, reserves had fallen to 57 percent of outgo, and today, the combined reserves of the system stand at about 15 percent of annual outgo, only 8 weeks worth of benefits. The situation is even worse, at least today, when Medicare is excluded.

Among other public groups to report in the last 5 to 10 years, the Social Security advisory councils of 1975 and 1979, an expert consultant panel of actuaries and economists, reporting in 1976, and President Carter's Commission on Pension Policy and the National Commission on Social Security, both reporting in 1981, all underscored the seriousness of the short- and long-term financing problem. Social Security's financing problem dates to the early 1970's and even earlier,when Congress increased benefits and expanded eligibility without facing up to the cost of doing so.

**Table D.**—Historical OASDHI reserve ratios, 1950-83

[Assets at the beginning of each year as a percent of outgo during the year]

| Calendar year | Trust funds | | | | |
|---|---|---|---|---|---|
| | OASI and DI combined | OASI | DI | HI | OASDHI |
| 1950 | 1,156 | 1,156 | ... | ... | 1,156 |
| 1955 | 405 | 405 | ... | ... | 405 |
| 1960 | 186 | 180 | 304 | ... | 186 |
| 1965 | 110 | 109 | 121 | ... | 110 |
| 1970 | 103 | 101 | 126 | 47 | 95 |
| 1971 | 99 | 94 | 140 | 54 | 93 |
| 1972 | 93 | 88 | 140 | 47 | 87 |
| 1973 | 80 | 75 | 125 | 40 | 76 |
| 1974 | 73 | 68 | 110 | 69 | 73 |
| 1975 | 66 | 63 | 92 | 79 | 69 |
| 1976 | 57 | 54 | 71 | 77 | 60 |
| 1977 | 47 | 47 | 48 | 66 | 50 |
| 1978 | 37 | 39 | 26 | 57 | 40 |
| 1979 | 30 | 30 | 30 | 54 | 34 |
| 1980 | 25 | 23 | 35 | 52 | 29 |
| 1981 | 18 | 18 | 21 | 45 | 23 |
| 1982 | 15 | 15 | 17 | 53 | 22 |
| 1983[1] | 11 | 8 | 11 | 39 | 16 |

[1] Estimated using Trustees' intermediate (II-B) assumptions.

Source: 1982 OASDI and HI Trustees' Reports.

**Table E.**—Historical levels of OASDHI Trust Fund assets, number of months worth of benefits on hand

| Calendar year | Number of months worth of expenditures on hand at beginning of year | | |
|---|---|---|---|
| | OASDI | HI | OASDHI |
| 1950 | 138.7 | ... | 138.7 |
| 1960 | 22.3 | ... | 22.3 |
| 1965 | 13.2 | ... | 13.2 |
| 1970 | 12.4 | 5.6 | 11.5 |
| 1975 | 8.0 | 9.4 | 8.3 |
| 1980 | 2.9 | 6.2 | 3.5 |
| 1982 | 1.8 | 6.3 | 2.6 |

## The Time for Action is Now

There is no denying that we have a big job ahead of us in Congress. We face many difficult decisions as to the details of the legislation, and the adequacy of the measures proposed. The balance of the long-term deficit will also have to be addressed. In our view, a balanced solution to this problem will involve bringing the cost of Social Security into line with the ability of our working population to finance the system. The tax burden is already heavy, and the confidence of young people critically low. As reflected in the additional views, a majority of Commission members recommends increasing the retirement age, for people retiring in another 20 or 30 years, as an equitable way of reducing long-range costs.

The American people—the 36 million people receiving benefits as well as the 116 million working people who support the system—deserve more than another "quick fix" that holds the system together until the next crisis comes along. They deserve the speedy consideration of this bipartisan package of recommendations. Confidence in the long-term viability of Social Security will only be restored by enacting measures that put the system back on a sound financial footing and do so without imposing an unrealistic tax burden on present and future workers.

Within a matter of weeks, the House Ways and Means Committee and the Senate Finance Committee will begin the task of weighing the options and then drafting Social Security financing legislation. We feel confident that the essential elements of the reform package we now recommend, as endorsed by President Reagan, Speaker O'Neill, Majority Leader Baker and others, will be adopted by the Congress and enacted into law by May. Moving quickly to shore up the Nation's largest domestic program is in all of our interests.

## Dissenting Views of Commissioner Archer

It is customary in instances such as this to address one's dissenting views to the body of the main report itself.

In this case, however, it is perhaps more appropriate for me to address my comments on the report to my children and future grandchildren and those of their generations who will be most affected by the changes proposed. Should the Commission's proposals be enacted into law, it is they who have the most at stake.

Unquestionably, great credit is due the President, the Congressional leadership and Commission negotiators who were able to arrive at this point where a plan exists to be considered by the Congress. The fact that I personally have strong reservations about the specific plan proposed in no way diminishes my respect for that effort.

It is unfortunate that the agreement reached continues to leave in doubt, in my opinion, the future stability of the Social Security system. We have not taken advantage of this rare historic opportunity to do more toward designing greater stability. The proposals treat symptoms, not causes.

My concern stems from a variety of sources, but primarily from those involving the basic economic and demographic assumptions used to assess the short- and long-term deficits, and the failure to address adequately the basic structural deficiencies which will continue to cause severe strains on the system in the future.

The compromise agreement does not make a specific recommendation regarding a portion of the long-term need (0.58 percent of payroll), even assuming the accuracy of the projections of the dimensions of the gap it sought to close. That significant element has been left open to congressional consideration under the terms of the agreement. Neither does the agreement address certain factors influencing the short-term need, such as the repayment of loans made to the retirement fund by the Hospital Insurance Trust Fund. Those revenues will be badly needed as the HI fund becomes deficient in the near future. In fact, the Commission's agreement bears no relationship to the parallel dilemma faced in the Health Insurance program.

Fundamental principles inherent in the basic concept of Social Security have been abrogated by the Commission's recommendations. The large infusion of general revenues into the system makes it self-sustaining no longer. The "earned right" concept which has been basic to the system since it was created has been abridged by a new means test. The concept of Social Security as a floor of protection to supplement other retirement savings has been further eroded by the agreement's perhaps unintended result of encouraging Social Security to be viewed as a sole-source retirement system.

Certainly, there is some good in the recommendations. The proposal to bring Federal employees into the system is a welcome one, but its coverage of only newly hired employees continues an inequity. Ironically, those now in Congress who must vote on the plan are themselves going to continue to be exempt from coverage. So will those presently employed by the Federal Government who will administer the changes.

The plan provides very modest improvement in the treatment of women, but continues major inequities in this area as well as in other areas of the system.

There is a brief delay in cost-of-living increases for present beneficiaries, as a partial attempt to offset benefit increases which resulted in an increase of 52 percent in purchasing power for the average Social Security recipient over the past 15 years.

This is essentially the only element of the plan which directly affects those now retired or soon to retire—except for those retirees who have set aside a portion of their earnings in savings for their retirement. The plan taxes those who have saved for their retirement and imposes a means test for full benefits. Those who do not save are rewarded by the system because of this change.

A Congress which has acted in recent years to encourage individual retirement savings is now being asked to enact a significant disincentive to retirement savings. There is also a basic flaw in the way the "means test" inherent in the tax on benefits is determined. Individuals with non-Social Security retirement income of $20,000 or more will be taxed on half of all their Social Security benefits. Those with incomes of $19,999.99 or less will not be taxed on **any** of their benefits. One penny of income could make the difference in whether hundreds of dollars in taxes must be paid.

The imposition of a means test, for the first time, destroys the earned-right concept fundamental to Social Security and lends a new welfare aspect to its administration.

The same is true of the large infusion of general revenues proposed by the plan. The self-financing structure of the Social Security system has been significantly eroded.

Of the $168.7 billion in short-term deficit reductions in the plan, approximately one-third is represented by direct and indirect infusion of general revenues, which, combined with payroll tax increases, accounts for some 75 percent of the short-term deficit reductions. In terms of the long-term deficit, new taxes account for even more of the reduction (excluding the portion of the deficit left unresolved by the Report).

I do not hold the position that the deficit reductions for both the short term and long term should be accomplished without **any** additional taxes beyond those already scheduled by existing law to go into effect. I am concerned, however, about a recommended proposal which includes such an imbalance of dependence upon new revenues (taxes and general Treasury funds) relative to structural changes which would restrain the growth of spending outlays. I question the ability of our tax base in the future to support this enormous projected growth.

Structural changes are critical to the long-term stability of the system. The report leaves unanswered the question of what benefit level our economy can afford in the next century and what those in the work force at that time will be able to pay.

What we should be providing here is a basis for realistic expectations for future Social Security recipients against which they can determine their own needs for retirement security beyond what the system may provide them at that time. There is great danger that these proposals have made promises which the system will not be able to support.

Changes which would more directly relate taxes paid into the system to benefits received are the type of structural changes which would lend greater credibility to Social Security. The Commission recommendations continue present inequities instead. An individual with a short covered employment history continues to be treated more favorably than his counterpart with the same average income who has a longer covered employment history.

Another important consideration the agreement does not address adequately is that of demographic changes, increased life expectancy, and improvements in the physical and mental ability of individuals to continue to work. There is no direct recommendation by the Commission that the age of retirement be adjusted to take such changes into account. Nor is there adequate attention given to revision of automatic cost-of-living increases relative to the taxes which support them.

In regard to taxes imposed by the compromise, the use of a refundable tax credit (a concept which has been rejected repeatedly by Congress) ruptures the fundamental parity between employer and employee.

The 33 percent increase in the OASDI tax rate on the self-employed is too great a burden for those who are already operating at the margin because of difficult economic conditions.

In summary, the recommendations proposed by the National Commission on Social Security Reform, in my judgment, leave the system's future very much in doubt. We are again addressing the symptomatic deficits facing Social Security, rather than taking advantage of this opportunity to address the causes of the problems themselves.

We have postponed once again the day of reckoning by transferring the burden of supporting the system's shortcomings to future generations.

Social Security represents the single most important commitment to the elderly made by our society. It is a great testimony to our Nation's dedication to assuring retirement security for our elderly of all generations.

The question facing Congress as we begin consideration of the Commission's recommendations is whether this particular plan exactly fulfills that commitment as completely as it must. I clearly have misgivings that it does.

As the legislative process begins, there remains an opportunity for the thoughtful concerns of others who share those misgivings to strengthen the product which is ultimately enacted. My own greatest hope is that my strong desire to guarantee the solvency of Social Security into the future can be matched by a confidence that the solution accomplishes that goal.

## Views of Commissioner Armstrong

Since 1971, maximum Social Security tax rates have quadrupled. These rates are scheduled to triple again in the 1980's as a result of legislation already on the books.[24] During the approximately same period of time, from 1970–81, the "real" pay of working men and women fell while Social Security benefits went up about 50 percent faster than the cost of living.[25]

Now the National Commission on Social Security Reform is recommending new taxes as well as acceleration of tax increases already scheduled. Can such increases be justified?

---

24 Taxes paid by "average" workers rose 259 percent from 1970 to 1980; they are projected to rise another 246 percent this decade.

25 From 1970 to 1981, pre-tax wages increased 122 percent; the Consumer Price Index rose 136 percent; Social Security benefits (OASDI) went up 205 percent.

I do not think so. The vast majority of workers, small business men and women, and retirees are not likely to think so, either. I expect there will be howls of outrage when Middle America discovers what the National Commission has recommended and some political leaders have already endorsed. Hopefully, grassroots lobbying will be sufficient to convince Congress to amend the Commission's plan to make it more workable, fairer, and more sound economically. If such amendments are ignored, Congress will be repeating the same basic mistake made in 1977. At that time, legislation was enacted which purported to shore up the financial solvency of the Social Security Trust Funds for the rest of our lives. But instead of focusing on basic systemic difficulties of the Trust Funds—especially the growing ratio of retirees to taxpaying workers and benefit increases far outstripping the cost of living—Congress concocted the largest tax increase in history.

A few of us objected. But the majority of Congress went along, and President Carter hailed passage "as the guarantee that from 1980 to 2030 Social Security funds will be sound."

It didn't quite work out that way. Social Security is again running out of money. By midyear, unless Congress intervenes, the Trust Fund will be unable to meet its obligations. The National Commission on Social Security Reform estimates, a funding gap of $150–$200 billion between now and the end of the decade and a long-term deficit of 1.8 percent of payroll—approximately $1.6 trillion. Even these gloomy prospects may prove too optimistic.

And once again the recommended solution is to raise taxes.

On January 15, after a series of marathon negotiating sessions, and with the approval of President Reagan and House Speaker O'Neill, the National Commission recommended legislation. Unfortunately, the Commission suggested closing the gap primarily through new taxes. But even with the recommended tax increases, the plan fails to raise enough money to put Social Security back in the black. It also avoids the permanent structural changes necessary to restore public confidence in the solvency and fairness of Social Security. Moreover, the Commission's recommendations violate several basic principles on which the Social Security system has previously rested. Consider these facts about the Commission recommendation:

Including revenue from expanded coverage, higher taxes account for 75 percent of the proposed deficit reduction between now and 1990—$126 billion out of the $169 billion total. In the long run, the balance is even more lopsided. Tax increases constitute 91 percent of the Commission's total recommendation.

Such tax increases raise serious questions of economic impact. The first payroll tax hike in the Commission's plan will cut paychecks in 1984. Will the higher employment tax dampen the recovery? Will additional joblessness result? I think most economists would agree that higher payroll taxes are bound to have these undesirable effects.

Worse yet, the Commission's recommendations do not close the projected gap between revenues and outlays in the Trust Funds, which totals several trillion dollars: $1.6 trillion is the discounted present value of the deficit. Faced with actuarial estimates of a deficit of 1.8 percent of payroll, the Commission recommends measures to solve only about two-thirds of the problem. Still more taxes have already been proposed to cope with the remaining 0.58 percent payroll deficit that the Commission left dangling.

It would not have been necessary to leave the long-term funding issue unsettled had the Commission been willing to recommend modest changes in the age of normal retirement. Previous advisory groups have suggested a variety of gradual changes such as increasing the retirement age by 1 month each year for the next 36 years or, possibly, even waiting to start such a phasing process 5 or 10 years from now. The approach I favor is to gradually increase the normal retirement threshold to age 66 with a phase-in period starting after the turn of the century; thereafter, the retirement age would be automatically indexed to changes in longevity. Such a proposal would apply only to persons fully able to work and would not preclude early retirement for those entitled to disability. Incredibly, this single, gradual change, which was ignored by the National Commission, would be sufficient to fulfill the entire long-term funding problem of Social Security, according to the actuaries.

Finally, the Commission may have erred in overturning at least three basic principles on which Social Security has long rested: taxation of benefits, the parity of treatment between employers and employees, and general fund financing. These conventions are deeply ingrained in the Social Security system and can only be abandoned at substantial risk of losing public support for the system itself. In my opinion, the present circumstances do not justify doing so.

There are other flaws in the Commission recommendations and, to be fair, a number of good points as well. Overall, however, I cannot escape the conclusion that the plan needs much improving. Whether this will happen remains to be seen. At least one White House insider is freely predicting quick legislative approval with few, if any, changes. He points out that a lot of "heavyweights" are already backing the package. He could be right.

He may be wrong.

There are also some heavyweights who are convinced the package must be amended in order to make it fairer and more financially sound. Among those who insist on amendments and oppose the plan in its present form are the 13 million-member American Association of Retired

Persons and the largest association for small businesses—who will feel the most impact of the plan—the National Federation of Independent Business. If these and other citizen groups will energize their memberships to protest the Commission's plan and work to develop an alternative package, there is reason to hope amendments can be adopted that will significantly improve the final legislation.

As this issue develops, I expect strong support from employees and from business men and women. They have an important economic interest at stake. However, I am increasingly convinced that support will also be forthcoming from retirees and the elderly. Based on many conversations with senior citizens, I doubt they will take a narrow or selfish view. They have much more at stake than merely their personal well-being. They are also concerned about their children and grandchildren. The last thing they wish is to leave a heritage of economic wreckage or an unfair retirement system.

## The Commission's Major Accomplishment —And Some Objections

The most important single achievement of the Commission, under the patient, considerate, and scholarly leadership of Chairman Greenspan, has been to marshall a consensus for admitting the problem. Some of those who now hail the recommendations were quite recently claiming no changes were needed. They said, in effect ". . . don't let them touch Social Security . . . all this talk about reform is just a plot to wreck Social Security . . . ."

As the **Washington Post** pointed out, "The first step toward solving any problem is to get people to admit the problem exists. The National Commission on Social Security Reform, meeting this week in Washington, has already made a huge contribution by getting its members of different political persuasions to agree that Social Security's problems are real, urgent, and—within reason—measureable."

A number of the Commission's recommendations make sense to me. On balance, however, in its present form, the plan falls short of the kind of balanced program needed to restore public confidence in the solvency and fairness of the system. The plan:

- Does not meet the minimum long-term need of 1.8 percent of payroll, but leaves needed reforms open for further consideration;
- Settles the short-term problem at the low end of projected need;
- Taxes benefits for the first time;
- Will create a severe "notch" between Social Security recipients whose adjusted gross income is just above and those just below the arbitrary point at which benefits are to be taxed; the result is unfair and will be so perceived;
- Grants refundable tax credits to employees, thereby upsetting the historic parity between employees and employers;
- Provides permanent General Fund financing;
- Prohibits withdrawal of State and local government units, a legislative solution which may be subject to successful challenge on constitutional grounds;
- Avoids decision on changing the normal retirement age, considered by many experts and earlier advisory groups as essential to the long-term stability of Social Security;
- Including revenue derived from expanded coverage, **increased taxes account for 75 percent of deficit reductions** (63 percent if expanded coverage is excluded);
- In the long term, excluding the portion (0.58 percent of taxable payroll) left unresolved and including revenues from expanded coverage, **new taxes account for 91 percent of deficit reduction** (not including revenues from expanded coverage, 66 percent).

## Congress Must Act Promptly

The need for congressional action is immediate.

- Every single minute of every hour of every day, on the average, OASDI pays out $17,000 more than it takes in.
- Present reserves in the retirement system will be insufficient to fully meet benefit payments by mid-1983, unless Congress enacts corrective legislation.
- In 1950, there were 16 workers paying Social Security taxes for each beneficiary. Today there are just three workers per beneficiary. By 2025, there may be only two workers per beneficiary. The result? A steeply rising burden on workers whose Social Security taxes keep the Trust Funds solvent.
- A fourth of U.S. taxpayers are paying more in Social Security taxes than in Federal income taxes, and sharply higher tax rates are scheduled to support projected benefits.
- Polls show Americans are losing faith in the Social Security system. Fifty-four percent of those surveyed by CBS/**New York Times** doubt that Social Security will have money to pay benefits in the future.

How does Congress begin the important work of enacting a fair retirement system? I suggest adopting five principles to guide its work:

1. Current basic level of benefits on which so many persons depend must not be reduced.
2. Needed changes—whether in future rates of benefit increases, retirement ages, eligibility standards, etc.—should be made gradually, not in a drastic or abrupt manner.
3. Economic projections, on which the system is based, should be conservative—in short, we should hope for the best, but plan for less optimistic economic conditions.

4. Permanent solvency must be achieved. Stopgap solutions are not satisfactory.
5. Public confidence must be restored. The politics of fear—which has surrounded past Social Security decisionmaking—must end.

No solutions are easy, but we are in firm agreement on the goal: Our elderly must feel assured of our good faith, and Social Security must be restored and maintained as a valuable bond between generation and generation.

Toward that end, it is important that everyone know the basic facts of Social Security . . . how it began, how it grew, who it affects, what its future will be.

## Social Security Highlights

- One trillion dollars will be paid out in Social Security benefits the next 4 years.
- Thirty-six million Americans receive Social Security benefits.
- Most Social Security retirees today receive more in benefits than they paid in taxes—by a ratio of 5 to 1.
- Social Security benefits have risen sharply over the past few years. In the beginning, Social Security was designed to be supplemental retirement income. Today, Social Security benefits on average equal 60 percent of their after-tax working income.
- In recent years, Social Security benefits have increased faster than increases in wages or prices.
- Americans are living longer. Women becoming 65 in 1982 live, on average, an additional 19 years; men live an additional 15 years. This is a 20-percent increase in 40 years.
- Social Security comprises one-fourth of the total Federal budget and 5 percent of the gross national product.
- The maximum Social Security tax an employee working from 1935 to 1982 could make is $17,000. This will nearly triple to $44,000 by 1990, just 7 years.
- Social Security taxes for the average worker have increased 2,000 percent since 1935; the maximum Social Security tax has increased 6,500 percent.
- Fifty-one percent of all Americans pay more in Social Security taxes than Federal income taxes.
- Even with the additional $437 billion in tax increases that will be implemented this decade because of a 1977 law, Social Security will exhaust its reserves and total outgo will exceed income by the mid-1980's, unless Congress takes decisive action.
- When Social Security began, only retirement benefits were paid to workers. Today, there are about 21 general types of benefits provided under Social Security.
- One indication of the growth in Social Security: When President Franklin Roosevelt proposed his Social Security program in 1935, he contemplated Social Security expenditures would be about $1.3 billion in 1980. Actual 1980 outlays: $149 billion.
- In designing his Social Security retirement program, President Roosevelt rejected the use of general revenues, wanting instead for the program to pay for itself through separate financing.
- The National Commission on Social Security Reform identified more than 80 options for restructuring Social Security financing to achieve short- and long-term solvency. One example of potential savings through gradual changes in Social Security: delaying the full cost-of-living increase 2 months for 3 years will save $40 billion to $60 billion this decade alone.

## Social Security

### . . . In the Beginning

Social Security was created in 1935 to partially replace earnings lost through retirement or death. Initially, only commerce and industry workers (about five out of 10 jobs in America) over age 65 were eligible for benefits.

Benefits were **supplemental** income . . . about 29 percent of preretirement income (known as the "replacement rate" . . . the percent of working income replaced by retirement income).

Payroll taxes financed these benefits on a pay-as-you-go basis. Initial taxes were also small . . . $60 per worker maximum (cost split between employer and employee). In 1980 dollars, this tax equalled $360.

### . . . Program Expansion

Congress and Presidents dramatically expanded the program through 13 expansionary laws and seven automatic benefit increases (although twice Congress slightly reduced benefits). Today, three separate Trust Funds pay benefits and collect taxes. Two Trust Funds—Old-Age and Survivors (OASI) and Disability (DI)—pay cash benefits directly to recipients. The third—Hospital Insurance (HI)—pays costs of medical care provided to the elderly and disabled.

Nine out of 10 jobs in America are included in Social Security. The program now pays retirement, early retirement, widow, children, parent, disability, and hospitalization benefits to 35.4 million. Basic benefit rules were expanded, and later made inflation-proof through automatic cost-of-living increases. Generally, eligibility has been liberalized. Cash benefits—not counting the value of hospital care—as a percent of preretirement income has increased to 49.3 percent.

Consequently, the tax rate, tax base, and number of taxpayers have also increased. Today, the combined employee-employer maximum tax is $4,340. One hundred ten million workers pay taxes; 11 million (mostly government employees) do not. While the number of taxpayers has increased, the worker/recipient ratio has not. In 1940, there were 16 workers supporting each recipient. Today, the ratio is only 3 to 1, and declining.

**. . . As Part of the Federal Budget**

Total Social Security outlays comprise about one-quarter of the budget. Including all programs, 27.7 percent of the Federal budget is devoted to elderly needs. By 1985, pensions, national defense, and interest payments will comprise 75 percent of the U.S. budget. Total Social Security and other senior citizen Federal outlays amount to $15,000 per elderly couple.

**. . . As Part of the National Economy**

Benefits comprise about 5 percent of the real gross national product, and it's rising. If no changes are made, and if Government spending were to be maintained at 20 percent of GNP, then by 1985 other Government spending must be cut 13.1 percent.

Since Social Security is a major component of the economy, it is particularly sensitive to economic fluctuation. Each 1 percent of inflation increases costs $1.5 billion annually (although the higher costs are offset in part by higher revenues). Each 1 percent of unemployment reduces revenues by $2 billion. Social Security tax increases exacerbate unemployment. For example, the Congressional Budget Office projected that the Social Security tax increases since 1977 reduced employment by 500,000 jobs. Accelerating to 1983 the tax increase scheduled for 1990 is projected to increase unemployment two to four million job years by the end of the decade.

**. . . Economic and Demographic Developments**

Since Social Security began, significant changes have reshaped America. Once an economy dominated by manufacturing and agriculture, America is quickly becoming a service-based economy. Once men dominated the work force; now half of all jobs are held by women. In 1935, a third of all elderly Americans were impoverished; today less than 15 percent have incomes below the poverty threshold. Forty years ago, less than three marriages in 10 ended in divorce; today five of 10 marriages end in divorce. Family size has declined.

Americans are living longer; on average, men live 15 years past retirement, and women 19 years . . . a lifespan increase of 20 percent over 40 years. Even so, more Americans are opting for early retirement before age 65. Today 90 percent of Americans who retire opt for retirement before age 65.

**. . . As Part of the Lives of Recipients**

Social Security is a financial lifeline to most recipients. Fifty percent of benefits are paid to elderly single members of households for whom Social Security is their principal income. Median income for all those over 65 is $5,771. Average median income for a retired couple receiving Social Security is $14,300.

Newly eligible retirees—80 percent of whom opt for early retirement—generally are improved financially. Median retirement income is $14,259, of which 42 percent is Social Security. Gross family assets—including personal residences or automobiles—exceed $48,000. Seventy percent of new retirees either outright own their home, or pay less than $200 in monthly mortgage or rent. The average value of a new retiree's home is $54,000.

Most Social Security recipients today will receive far more in benefits than they contributed in taxes . . . by a ratio of 5 to 1. This ratio will decline for future recipients. Social Security benefits are progressive . . . meaning that low-income receive relatively higher benefits than middle- or high-income.

**. . . As Part of the Lives of Workers**

The maximum Social Security tax a worker and his employer could have paid from 1937 to 1982 is $16,932. This will nearly triple by 1990 when the maximum tax possible rises to $43,000.

For 51 percent of all families—and practically all low-income families—they pay more Social Security taxes than Federal income tax. This is also true for employers, particularly the marginally profitable.

**. . . Benefits**

One trillion dollars will be spent from the Social Security Trust Funds in the next 4 years (1983 to 1986), an amount roughly equal to that spent from 1935 to 1981. Four-year spending and income by Trust Fund:

| | (Billions) Outlays | Income |
|---|---|---|
| Old-Age and Survivors (OASI) | $728 | $634 |
| Disability (DI) | 83 | 135 |
| Hospital Insurance (HI) | 198 | 210 |
| | $1,009 | $979 |

Social Security Administration
September 1982

Monthly Social Security costs exceed $17.9 billion.
Of trust fund outlays . . .
. . . 67% go to retirees, their spouses, children or survivors.
. . . 9% go to the disabled, their spouses, children or survivors.
. . . 22% pay medical costs.

Cash benefits paid from the OASI and DI Trust Funds:

| | (Millions) | Average annual benefit |
|---|---|---|
| Retired workers | 20.3 | $4,686 |
| Their spouses | 3.0 | 2,350 |
| Their children | .5 | 1,841 |
| Total | 23.8 | ... |

| | (Millions) | Average annual benefit |
|---|---|---|
| Survivors: | | |
| Widowed parents | 0.5 | $3,372 |
| Widowed spouses | 4.4 | 4,210 |
| Children | .2 | 3,278 |
| Disabled, widowed spouses | .1 | 2,760 |
| Parents | .01 | 3,732 |
| Total | 5.21 | ... |
| Disabled workers | 4.1 | 4,944 |
| Their spouses | .4 | 1,452 |
| Their children | 1.0 | 1,428 |
| Total | 5.5 | ... |
| Special age-72 | 0.1 | ... |

The maximum possible benefit for a retired couple with children under 18 is $14,748 annually.

These benefits do not include the value of medical benefits provided through Medicare. Since all benefits are tax free, current benefits are about 60 percent of after-tax, preretirement income.

#### . . . Taxes

About $1 trillion in taxes has been raised since 1935. If a worker contributed the maximum taxes from 1937 to 1982, he would have contributed $17,000 (an amount matched by his employer). By 1990, this will nearly triple to $44,600.

Today, the total Social Security tax is 13.4 percent of up to $32,400 of income. This rate will increase to 15.3 percent, and the base up to $45,600 of income by 1990.

The average tax paid by a worker and his employer annually is about $2,000.

#### . . . Individual Equity and Social Adequacy

Social Security emphasizes social adequacy, not individual equity. The social adequacy basis is evident through the provision of relatively high minimum benefits, paying proportionately higher benefits to low average wage earners, the imposition of maximum benefits regardless of past earnings, and the payment of derivative benefits at no additional cost to the worker. While there are some elements of individual equity—benefits in relation to earnings—Social Security, over the years, has moved away from individual equity and more toward social adequacy.

#### . . . As It Affects Women

Social Security was created when men dominated the work force. Since then, a number of economic and demographic changes involving women affect Social Security and its future. More women work today, are living longer, and the divorce rate is increasing. Since these changes were not contemplated at the time Social Security was created, retirement benefit adequacy for women is a significant concern because a high percentage of the elderly poor are widowed, divorced, or were never married. It is also a concern since the current labor force—once male dominated—has a high percent of women workers who pay Social Security taxes, and expect to receive just benefits.

Problems in providing benefits to women exist in part because benefits are linked to an individual's earnings and work history. Working women frequently have interrupted work histories due to childrearing. Women also have had generally lower career earnings than men. As a result, a large proportion of women fail to qualify for Social Security benefits, qualify for benefits on their lower earnings, or they qualify based on their husband's benefits, and then receive half of these benefits. Some of these concerns have been addressed by changes made in the computation of spouse benefits, but questions of equity continue to be raised with regard to women, particularly those who work. The National Commission on Social Security Reform identified 12 options that address the issue of making Social Security equitable for women.

#### . . . and Other Federal Pension Policies

Since Social Security was created, there have been significant developments in Federal pension policy. Among them:

1. **Individual Retirement Accounts:** Most workers can contribute up to $2,000 annually tax free into Individual Retirement Accounts, the proceeds of which are invested, and then paid out as retirement income as early as age 59 1/2. Workers with wives who do not work contribute up to $2,275 annually.
2. **Keogh retirement plans:** The self-employed can set aside up to $15,000 annually to help replace earnings lost through retirement.
3. **Employee Retirement Income Security Act:** Regulates company sponsored, tax-deferred pension plans.

Sixty percent of workers between age 25-34 are covered by retirement pensions other than Social Security.

#### . . . Financial Status

Social Security is going broke. High inflation, slow economic growth, rising numbers of beneficiaries, increased benefit levels, and an eroding tax base have increased Social Security's costs, and depressed revenues. The Retirement and Survivors Trust Fund has run a deficit since the early 1970's. This deficit erased the once large cash reserves . . . to the point where Congress had to enact legislation permitting the OASI Trust Fund to borrow from the DI and HI Trust Funds to make full and timely benefits. By the mid-1980's, however, even these reserves will be exhausted. Technically, Social Security will have no choice but to either reduce all benefits to the amount of income then on hand, or delay checks until enough income is on hand to pay full benefits.

Thus, Congress must achieve two goals in the short-term: Enact legislation that eliminates the future deficits, and achieve adequate reserves so that enough money is on hand to pay 2 months of benefits.

The National Commission on Social Security Reform unanimously agreed that an additional $150-$200 billion is needed this decade to assure Social Security solvency. In addition, the Commission projects that Social Security needs to either increase revenues or reduce spending $1.6 trillion over the next 75 years to guarantee solvency.

## Social Security . . . Explained

To make changes necessary to ensure solvency in Social Security first requires understanding its current benefit and tax structure.

### A. Coverage

Originally, Social Security only provided benefits to those age 65 and over working in commercial and industrial employment. Only five out of 10 jobs in America were covered.

Since then, Congress expanded Social Security to cover about nine out of every 10 jobs. Coverage was extended to most self-employed, hired farm and domestic workers, Armed Forces, and professionals. Optional coverage was provided clergymen. State and local governments and nonprofit organizations can opt for Social Security coverage. Both State and local governments and nonprofit organizations, if they elect Social Security coverage, can later elect to opt out of Social Security.

For certain military personnel, the Armed Forces pays Social Security taxes up to a maximum of $1,200 (representing the cash value of nontaxable income). This contribution is not matched by the servicemen.

Work **not** covered by Social Security is Federal civilian employment, noncovered State and local governments (30 percent are not covered), and noncovered, nonprofit organizations (about 15 percent are not covered).

### B. The Benefit Structure—Retirement and Survivors Benefits—OASI

Four principal components comprise the Social Security benefit structure . . . eligibility, computing initial benefits, annual benefit increases, and types of benefits.

#### 1. Eligibility

To be eligible a worker must be "insured" through earning "quarters of coverage." Some explanation . . .

Becoming "fully insured" means working in a Social Security covered job (and thus paying Social Security taxes) and earning at least $340 in a calendar quarter. Doing so entitles a worker to a quarter of coverage. A worker receives one quarter for each $340 up to a maximum of four quarters. With 31 quarters—as little as 8 years work—a worker and his family is entitled to full Social Security benefits based on his earnings. The number of quarters required will increase one quarter for each year until a maximum of 40 quarters is reached.

"Currently insured status" applies only to a worker dying before retirement. A worker becomes currently insured—and thus eligible for benefits—by attaining six quarters in the 13 quarters preceding death.

Of course, a worker does not automatically receive benefits when he becomes insured. A condition for receiving OASI benefits is reaching retirement age or death. Full benefits are paid at age 65; lesser benefits at age 62. Age eligibility varies for other OASI benefits . . . and are described in part C.

#### 2. Calculating Initial Benefit Levels

Benefit levels for retired and disabled workers, dependents and survivors are generally related to the past earnings of the covered worker, and more directly to a percent of the benefits that the covered worker will receive.

There are four basic steps used in most cases to compute a worker's Social Security benefit:

a. **Computation years** . . . That is, the years worked in Social Security employment between age 21 and the year of death, disability, or the attainment of age 62, then drop out the 5 lowest income years.

b. **Index earnings** . . . The earnings of each year are converted, or indexed, into more recent levels by increasing them to reflect changes in wage levels since the time they were actually earned.

   Indexing creates an earnings record that reflects the value of the individual's earnings relative to national average earnings in the indexing year. The indexing year is the second year before the year in which the worker attains age 62 (in other words, age 60), becomes disabled, or dies. Earnings after the indexing year are counted at their current value (not indexed).

   Earnings are indexed by increasing the actual earnings in each year after 1950 by the percentage increase in national average wages between that year and the indexing year.

c. **Average indexed monthly earnings (AIME)** . . . These indexed earnings are then averaged to a monthly amount . . . known as the AIME. Simply divide a total indexed earnings by the number of months in the computation years.

d. **Primary insurance amount (PIA)** . . . A percentage formula is applied to the AIME to derive the primary insurance amount, or basic benefit level. The 1982 formula is:

   90% of the first $230 of AIME, plus
   32% of AIME over $230, but less than $1,388, plus
   15% of AIME over $1,388

An example follows:

A worker retires at age 62 in 1982, and had earned $2,900 in 1960. The $2,900 would be multiplied by the ratio of average annual wages in 1980 ($12,513), and divided by average annual wages in 1960 ($4,077):

$$\frac{\$2{,}900 \times \$12{,}513}{\$4{,}077} = \$9{,}056$$

Although the worker's actual earnings for 1960 were $2,900 . . . his wage indexed earnings would be $9,056.

This calculation is applied to each year between 1951 and 1980 (the second year prior to his attaining age 62). Once total indexed earnings are obtained, they are divided by the number of months in the computation years. This monthly amount is the AIME.

Let's assume that after this worker's entire wage record is indexed, his AIME is $420. Let's run this through the PIA benefit formula:

| | | |
|---|---|---|
| 90% of the first $230 | = | $207.00 |
| 32% of amount above $230 | = | 60.80 |
| Total PIA | | 267.80 |

His PIA is $267.80. This is the amount he would receive at age 65. Since he opted for early retirement at age 62, he receives 80 percent of that total . . . or $214.00.

### 3. Types of Benefits

As already mentioned, benefit levels for retired and disabled workers, dependents and survivors are generally related to the past earnings of the covered worker, and more directly to a percent of the benefits—or the primary insurance amount—that the covered worker will receive. Below a list of benefits provided through OASI, and the percent of PIA each receives:

1. **Full retirement:** 100 percent of PIA/eligible at age 65/eligible for reduced benefits at age 62.
2. **Widowed spouses:** 100 percent of PIA/eligible at age 65/eligible for reduced benefits at age 60.
3. **Spouses:** 50 percent of PIA/eligible at age 65, or younger if caring for a disabled child, or a child under age 16/eligible for reduced benefits at age 62.
4. **Divorced spouses:** 50 percent of PIA/same eligibility for spouses, but must have been married at least 10 years.
5. **Children:** 50 percent of PIA/eligible until 18 if child of a retired or deceased insured worker, or until 19 if still in high school. College benefits to age 21 will be phased out by 1985.
6. **Surviving children:** 75 percent of PIA/eligibility same as 5.
7. **Parents:** 75 percent of PIA/eligible if surviving spouse caring for a child under 16 at time of death.
8. **Maximum family benefits:** 188 percent of PIA (175 percent of PIA for high-income earners) if total benefits to a family exceed 188 percent of PIA (or 175 percent) then all benefits for family members is reduced by an amount to bring all benefits under the 188/175 percent caps.
9. **Lump sum death benefits:** Not a percent of PIA . . . just a $255 payment on the death of a worker. Paid to survivors.
10. **Transitionally insured benefits:** Not a percent of PIA . . . is paid to those over age 65 with insufficient quarters of coverage.
11. **Special age 72:** Not a percent of PIA . . . paid to those over 82 with insufficient quarters of coverage to qualify for a retired-worker benefit and who do not receive public assistance.
12. **Special minimum:** Not a percent of PIA . . . increases benefits for workers with low average earnings.
13. **Retroactive:** For persons over age 65, retroactive benefits can be paid up to 6 months. For disabled beneficiaries, benefits can be paid retroactively up to 12 months.
14. **Currently insured:** OASDI benefits paid to survivors of workers not fully insured but who worked at least six of the 13 quarters preceding death.

### 4. Annual Cost-of-Living Adjustments

All benefit levels are increased each year when the Consumer Price Index exceeds a 3-percent increase each year, and when it does, the full CPI increase—not just the amount above 3 percent—is applied to benefit levels automatically without action by Congress.

### 5. The Retirement Test

Under current law, all benefits are reduced when a beneficiary's earnings record exceeds certain levels. This is called the earnings test, or retirement test, and applies to beneficiaries until they reach age 72 (in 1983 and later, the retirement test will not apply after age 70). The amount of annual earnings permitted in 1982 without causing a benefit reduction is $4,440 for persons under age 65, $6,000 for persons age 65–72. Each $2 of earnings in excess of these amounts reduces annual benefits by $1.

### 6. Policy Summary

These five sections summarize the mechanics of the benefit and eligibility rules. But what is the overall effect of this formula, and what are the policy implications? Several aspects should be mentioned:

First, only minimum requirements are imposed to become eligible for Social Security. The fact that eligibility is so easy to attain is the reason why there are so many who receive more than one Federal pension . . . the so-called "double-dippers" who receive "windfall" benefits.

Second, the entire benefit structure heavily favors those with low average earnings. This does not necessarily mean the low income . . . it means those with sporadic work histories, those who often shift between covered and noncovered Social Security employment, go through periods of unemployment. It achieves this effect through three ways . . . the low minimum eligibility requirements, dropping out of the computation years the 5 lowest income producing years, and heavily weighting the PIA formula to the low income.

Third, wage indexing provides retirees with a significant though usually not noticed added benefit: By basing retirement benefits on real wage increases, it permits retirees to share in retirement the overall productivity growth achieved by workers.

Fourth, wage indexing, coupled with dropout years and automatic cost-of-living increases for all benefits, is achieving a remarkable effect. This formula increases real benefits paid to new beneficiaries each year. For example, those who retire in the year 2040 will receive **double** the current value of benefits paid to those retiring this year.

Fifth, replacement rates—the percent of working income replaced by retirement income—have increased sharply. When Social Security began, the average replacement rate was about 29 percent. Today, the average is 49 percent for all beneficiaries. That is for pre-tax income. The replacement rate today for after-tax income is closer to 60 percent . . . meaning that in retirement a worker will receive 60 percent of his preretirement income. Incredible though it may seem, a worker with low average earnings in his lifetime who retired in 1981 will in retirement earn more in Social Security benefits than he earned while working.

Because of legislation enacted in 1977, these high replacement rates will gradually decline somewhat.

Replacement rates have increased primarily because of legislative and automatic benefit increases. Cost-of-living increases the past decade have been generous. From 1970 to 1981, pre-tax wages went up 122 percent; the CPI increased 136 percent; Social Security benefits have increased 205 percent.

### 7. Program Growth Since Social Security Began

Although the number of benefits has vastly increased and the requirements determining insured status have been liberalized, the basic notion of insured status has not changed since Social Security began. In 1940, three requirements had to be met before a worker or his family received benefits: The worker had to be industrially or commercially employed, earning at least $50 ($568 in 1982 dollars) in at least 6 calendar quarters, and be over age 65.

Since then, almost all age requirements for benefit eligibility have been reduced, types of benefits expanded. Benefits are now increased automatically each year.

### C. Benefit Structure—Disability Insurance (DI)

Social Security disability began in 1956, and operates on the same insured status concept used by OASI.

To be eligible for disability, a worker must be both fully insured under OASI, as described in section II-A, and disability insured. To be disability insured, the worker must have 20 quarters of coverage in the 40 quarters immediately preceding disability. Generally, disability is defined as the inability to engage in gainful activity by reason of any medically determinable physical or mental impairment that can be expected to result in death, or last at least 12 continuous months. Before benefits can be paid, a waiting period must elapse of at least 5 months, benefits are paid up to age 65, and then regular full retirement benefits are paid, and benefits can be paid retroactively up to 12 months.

A worker disabled in the line of work need not file for workers' compensation. Disability benefits are offset by all other disability benefits, with the exception of veterans' disability benefits. Currently, Social Security and the States are reviewing all disability cases, and terminating benefits to those who never were or no longer are eligible. Benefits are being denied in about 50 percent of all cases, but are restored on appeal to administrative law judges about 64 percent of the time. Appeal takes 6 months or longer, and benefits are paid for only 60 days during that time.

Five types of benefits are paid:

1. Disabled workers: 100 percent of PIA/eligible 5 months after disability
2. Disabled surviving spouse: 100 percent of PIA/eligible at age 60/eligible for reduced benefits at age 50
3. Disabled child: 50 percent of PIA/eligibility begins at age 18
4. Disabled surviving child: 75 percent of PIA/eligibility begins at age 18
5. Retroactive: up to 12 months

Only benefits for disabled workers (and their dependents) are paid out of the DI Trust Fund. Benefits #2–#4 are simply the dependents and survivors benefits paid out of the OASI Trust Fund.

### D. The Benefit Structure—Hospitalization Insurance/Medicare (HI)

Created in 1965, Medicare is a national health insurance program for the aged and certain disabled persons. Almost all citizens aged 65 or older are automatically entitled to Medicare coverage. If they are not, they can purchase the coverage for an annual premium of $1,360.

Medicare has two parts: Part A, hospital insurance, pays hospital, posthospital and home health services. This program is financed through Social Security payroll taxes. Part B, supplementary medical insurance, is a voluntary program, financed through individual medical premiums, and through general revenues. Elderly beneficiaries pay one-fourth of the costs (about $150 a year with a $75 deductible), the disabled pay one-seventh, and the Federal Government pays the difference. Services and fees vary between the two programs.

**Part A:**

During each benefit period—whenever a patient has not been in a hospital for 60 consecutive days, Medicare Part A pays for the following services:

**Inpatient hospital care:** Ninety days of coverage. For the first 60 days, all costs are paid, except for the first $304 deductible. For the last 30 days, Medicare pays for all but $76 daily in covered costs. After that, patients can draw upon a lifetime reserve of 60 hospital days. For reserve days, all costs after the first $152 each day are paid.

**Nursing facility care:** One hundred days of coverage are paid for. The first 20 days of care are free for the patient. After that, all patients pay $38 each day, and the rest of the cost is paid by Medicare.

**Home health care:** Medically necessary home health care visits by nurses, therapists, and other health workers are paid for by Medicare.

There is no limit to the number of benefit periods a patient can have.

Institutions are reimbursed for their reasonable costs incurred in providing services to Medicare patients. Reasonable costs are determined by law and regulation. Services and costs are reviewed by Professional Standards Review Organizations. Medicare is administered by the Health Care Financing Administration which, in turn, contracts much of the operational work to private sector intermediaries.

**Part B:**

During any calendar year, Part B pays 80 percent of reasonable charges for services rendered by doctors, osteopaths, chiropractors, psychiatrists, independent therapists. Most medical services and outpatient and laboratory services are covered.

### E. Administration

Administration costs in 1981 were $1.7 billion or 1.2 percent of OASDI benefit payments or 1.3 percent of revenues.

Retirement and survivors insurance is largely administered by the Federal Government, with Disability Insurance administered by the States.

### F. Taxes

In 1982, the combined employer-employee tax rate is 13.40 percent on earnings up to $32,400. The maximum tax today is $4,342. Self-employed pay 150 percent of the employee's share of the tax.

In 1977, Congress enacted legislation that significantly increased taxes during the rest of this decade. By 1990, the tax rate will increase three times, to 15.3 percent, and the tax base seven times. The total maximum tax paid in 1990 will exceed $9,400. The 1977 law will pump another $437 billion in additional taxes into the Social Security Trust Fund.

Under current law, Social Security benefits are tax free.

Social Security only taxes payroll, and no other tax revenues flow into the Social Security Trust Funds.

### G. Social Security Tax, Benefit, Trust Fund, Chronology, Charts, Tables, and Graphs

The following pages contain selected tables highlighting key aspects of Social Security.
(Space and time constraints prohibit the inclusion of this material—Editor.)

## References/Recommended Reading

Sources: Social Security Administration, General Accounting Office, Congressional Budget Office, Office of Management and Budget, Congressional Research Service, House Ways and Means Committee, Senate Finance Committee, Senate Select Committee on Aging, selected books and publications.

For those interested in further reading, perhaps the five best references about the past, present, and future of Social Security are:


**Policymaking for Social Security**—Martha Derthick, The Brookings Institution

**Developments in Aging: 1981: Volume 1**—Senator John Heinz, Chairman, Senate Select Committee on Aging

**Social Security**—Robert J. Myers, McCahan Foundation Book Series

**Major Federal Expenditures in Jurisdiction of the Senate Finance Committee**—Senator Robert Dole, Chairman, Senate Finance Committee

**Social Security: The Need For Action**—Robert Beck, Chief Executive Officer, Prudential Life Insurance Company


## Major Legislative Changes in Social Security[26]

**1935:** A system of Federal old-age benefits covering workers in commerce and industry is established. Benefits were to be based on cumulative wages and to be payable beginning in 1942 to qualified workers age 65 and over. A payroll tax of 1 percent on employer and employees, each imposed on a wage base of $3,000, was to

[26] Source: Martha Derthick, **Policymaking for Social Security**, The Bookings Institution, 1979, pages 429–432.

be collected as of January 1937; the tax would rise to 3 percent by 1949.

**1939:** The starting date for benefits is advanced to 1940. Benefits for dependents of retired workers and for surviving dependents in case of a worker's death are authorized.

**1952:** Benefits are increased by 12.5 percent.

**1954:** Coverage is almost universal except for Federal Government employees. The wage base is increased to $4,200, and benefits are increased by 13 percent.

**1956:** Disability Insurance (DI) benefits are added payable at age 50. Women are permitted to retire at age 62 with actuarially reduced benefits.

**1958:** Benefits are added for dependents of DI recipients, and the DI eligibility standard is liberalized.

**1960:** The age 50 limitation for DI eligibility is eliminated.

**1961:** Men may retire at age 62 with an actuarial reduction.

**1965:** Medicare becomes part of Social Security. Cash benefits are increased by 7 percent.

**1968:** Cash benefits are increased by 13 percent. The tax rate is now 4.4 percent and the wage base $7,800.

**1969:** Cash benefits increased by 15 percent.

**1972:** Cash benefit increases, which had previously been made in an ad hoc fashion by the Congress, were made automatic as was the increase in the wage base. The 20-percent benefit increase which occurred this year was made possible by a change in actuarial assumptions from a level wage growth path to a dynamic one.

**1977:** An error in the 1972 automatic indexing at initial benefit determination produced a long-run deficit due to the high rates of inflation between 1972 and 1977. This error was corrected and the current method of wage-indexing both the earnings history and the bend points was decided upon. Automatic cost-of-living adjustments remained intact. The long-run deficit necessitated the largest increase in scheduled tax rates in the system's history, culminating at 7.65 percent on employee and employer in 1990.

**1981:** A short-run financing problem requires interfund borrowing and some benefit reductions near-term. The long-term actuarial and economic problems are worse. Even the large pending tax increases are inadequate to cover the large increases in real benefits being promised over time under OASDI. The system's grand promises are depressing the Nation's saving and growth rates, jeopardizing its own tax base. There is a burgeoning long-run deficit under HI which dwarfs the OASDI problem. Some politically acceptable alteration in benefit formulas must be found for the long run. This will inevitably involve indexing changes.

## Supplementary Statement on Working Toward Meaningful Social Security Reform by Commissioner Fuller

After a year's work, the National Commission on Social Security Reform, together with the White House and the Speaker, have produced a package with the potential to be passed into law within the next few months. The overriding objective of our recent negotiations was to produce a package that would generate enough support to be enacted by the Congress in time to prevent either delay of benefit checks in July of this year or an emergency infusion of general revenues. As a result, the compromise includes elements that are distasteful to many Commissioners for different reasons.

In my view, the package contains two major provisions that are commendable:

1. **Extension of coverage to new Federal employees and all employees of nonprofit organizations,** so that Social Security becomes closer to a universal-coverage system.
2. **Shift in the COLA to wages or prices or lesser after 1988** if the Trust Fund ratio falls below 20 percent. Although this stabilizer of outgo relative to income is effective only in times of real wage loss, it is a step in regulating the COLA to reflect economic conditions.

However, there are a number of additional provisions that I believe are necessary for meaningful reform that we should work for vigorously in the months and years ahead, specifically:

1. **A clear commitment to increase the retirement age** to reflect the increased longevity of the American population. The increased life expectancy of beneficiaries, coupled with the declining birthrate, means that we will have only two workers supporting each beneficiary in 2025 and after, in contrast to the 16 we had in 1950.
2. **A combination of COLA stabilizer and fail-safe mechanism** to guarantee that crises like the one we face now, and the one we had in 1977, will not recur before the end of the decade and in the future.
3. **A balance between tax increases and benefit restraints** that is realistic and fair over the long term. This package relies on new sources of revenue and tax increases for about $100 billion of the gap of $168 billion, and the tax increases come on top of $300 billion enacted in 1977 that apply to the 1983–89 period. Relatively little has been accomplished to date in restraining the growth of benefits over the long term.

4. **Reliance on the payroll tax as the sole source of financing.** This is essential to preserve the discipline in managing the growth of benefits relative to taxes, the parity between the employer and employee contributions, and the earned-right character of the program.

The remainder of this statement discusses each of these areas.

## Clear Commitment to Increase the Retirement Age

The bipartisan package leaves open a gap of 0.58 percent of payroll as part of the total long-term gap of 1.80 percent. The package stipulates that the gap would be filled by either a gradual increase in the normal retirement age or a combination of other measures. I support the proposal to fill the entire gap through a gradual increase in the normal retirement age. In fact, I believe that this measure, while adequate based on the economic projections used in costing out the package, may fall short of what will actually be needed. Furthermore, the age of 66 in 2015 is about 5 years below the age at which a person would work the same portion of his/her life as that determined by using age 65 when it was enacted in 1935. Consequently, I believe that the increase in the normal retirement age should be adjusted at some later time so as to reach age **68** by 2015. This would produce long-range savings of 1.3 percent of payroll. There is a growing belief that this will be needed to fill a long-term gap of 2.4 percent of payroll, which results from the latest projections of fertility rates by the Bureau of Census.

The Congress and the public may not be aware that actual economic performance has, in recent years, consistently fallen short of the most pessimistic economic projections made in the annual reports of the Board of Trustees. It would be responsible, forward-thinking policy to provide for this gap soon—especially since a retirement age of 68 is what the many research studies have shown to be appropriate by the year 2015 to reflect longevity at that time—even allowing for some growth in the proportion of life spent in retirement. One could then delay the indexing schedule to begin after 2020 if the Trust Funds show a substantial surplus. This would be fairer to the working population than allowing another crisis to loom before taking needed action.

## Combination of COLA Stabilizer and Fail-Safe Mechanism

The bipartisan package includes a provision that would substitute the lesser of the percentage wage increase or the percentage price increase, beginning with 1988 if the combined OASDI Trust Fund ratio falls below 20 percent. While this is a positive step, it is possible that action will be needed before 1988 to avoid another funding crisis. Several Commissioners had proposed putting a cap on the COLA between 1984 and 1988 or basing the COLA on wage increases minus 1 1/2 percentage points. The latter method would make the adjustment independent of the CPI and yet produce exactly the same benefit increases over the long term (after the 1980's) as under present law, if economic conditions are the same as those assumed under the intermediate assumptions of the 1982 Trustees Report. On the other hand, if economic conditions are unfavorable, and wages do not exceed prices by as much as is projected, the financial solvency of the program would be protected, because benefit increases would be smaller than under present law. Conversely, if economic conditions are more favorable than assumed, benefit increases would be larger than under present law, and the financial condition of the system would still be strong.

If another funding crisis develops before 1988, we will be faced with further tax increases—on top of those enacted in 1977 and those that are proposed in the "consensus" package—or another COLA delay. I hope that this does not occur, because our credibility in controlling the financial condition of the Social Security program would be damaged in the eyes of the American people. However, based on recent experience with actual economic conditions versus projections, we cannot rule this out.

Several of us also recommended a fail-safe mechanism to ensure that benefits would continue to be paid on time despite unexpectedly adverse conditions, which can occur with little advance notice. One mechanism would be to reduce, temporarily, benefits payable. Alternatively, the same result could be accomplished indirectly by reducing the next benefit increase that would occur as a result of the COLA. Another mechanism could be to increase, temporarily, the OASDI tax rates. Because of the already large tax burden on today's workers, I would favor the first or second alternative. I recognize that Congress is more likely to respond to actual, rather than potential crisis, but I am concerned about further damaging public confidence in the Social Security program by frequent short-term threats.

## Balance Between Tax Increases and Benefit Restraints

The current estimated short-term gap of $150 to $200 billion for 1983–89 comes on top of a tax increase in 1977 that amounts to about $300 billion during this period. The bipartisan package contains new sources of revenue and tax increases of about $100 to $130 billion depending on whether the taxing of benefits is classified as a tax increase or a benefit reduction. In any case, this means that at least $400 billion in new revenues and tax increases will have been enacted in 1977 and after to close a gap of $500 billion. This is, in my view, an unbalanced reliance on taxes, which places an excessive burden on today's working population, while holding retirees relatively harmless. There is a limit to the psychological as well as financial capacity of the working population to absorb continued tax increases. This is especially true during times when they are asked to accept wage increases that do not keep up with inflation.

The clear preference for tax increases rather than benefit restraints has been shown by the actions taken over the last decade. This is one of the major reasons that young people are afraid that the Social Security program will not be around to support them when they retire. The public may be beginning to realize that our overall budget deficit of about $200 billion is, essentially, a commitment on the part of the next generation to pay increased income taxes. The combined effects of increases in Social Security taxes, income taxes, and, inevitably, Hospital Insurance taxes appears formidable, to say the least, and unfair when certain groups of people are partially exempt.

## Reliance on Payroll Tax to Finance Social Security Program

The Social Security system has been based on the philosophy that benefits are financed by payroll taxes, paid equally by employers and employees. The bipartisan package contains a refundable income tax credit for 1984 that would offset the payroll-tax increase. This is a direct violation of this fundamental principle; it upsets the parity between employer and employee contributions and infuses general revenues into the Social Security program. It should not be repeated under any circumstances. In my view, it is essential to maintain the self-financed character of the Social Security program—both to maintain discipline in managing the system and to protect its status as an earned right, rather than a welfare program. The self-financed character of the system is essential to prevent moving to a system that conditions benefits based on financial need. Furthermore, to inject general revenues at a time when we have the highest budget deficits in American history, it is very unfortunate and should not be repeated in any form. Americans value the Social Security system as a contributory program, and this is essential to the long-term health of the system.

It has been a privilege to serve on this Commission and, though many of us have had to swallow hard, some constructive steps have been taken. I am hopeful that some meaningful reforms will emerge from the upcoming deliberations in the Congress.

## Supplementary Statement on the Changing Role of Women by Commissioner Fuller

The effect on women of the Social Security program is a subject of major importance, and much analytical work has been done to identify and evaluate alternative approaches to correct the unintended inequities. In fact, the 1979 Advisory Council on Social Security spent more time on this issue than on any other single issue. Unfortunately, our Commission could not address this issue due to the urgent priority of restoring the solvency of the system. But we do not intend this choice to detract from the importance of restoring the equitable treatment of women in today's world. The provisions of the bipartisan package, while advantageous to certain groups of women, do not begin to address the fundamental, though unintended, inequities that act to the disadvantage of all people except members of intact one-earner couples.

The Social Security system was designed at a time when most families each had one wage earner with a dependent spouse, and marriages were, for the most part, lifelong. As a result, the benefits of the dependent spouse are determined as a function of the earnings of the worker, and divorced spouses do not receive any benefits unless the marriage has lasted for more than an arbitrary number of years (which is now 10). Today, the times are different; a substantial majority of women spend most of their lives in the paid work force, and there is one divorce for every two marriages, with two-thirds of divorces occurring after less than 10 years. The Social Security program, therefore, has some unintended inequities that need to be corrected:

1. The secondary earner, in most cases the woman, gets little, if any, return on her Social Security taxes. Only if she earns more than one-third of the combined couple's income do her benefits as a worker exceed those she would receive as a dependent spouse.
2. Two-earner couples receive less in benefits than one-earner couples with the same earnings. Survivors of two-earner couples are, correspondingly, penalized.
3. Single retirees receive lower benefits relative to their tax contributions than married couples.
4. The spouse receives no benefits on divorce unless the marriage lasted 10 years or more.

These inequities result from the continued use of the concept of a dependent spouse which is, in today's world, an anachronism. Marriage today is an economic partnership, and each partner contributes to the well-being of the family. The most direct method of restoring the proper treatment of both spouses is through a program of earnings sharing, where each spouse receives credit for one-half of the combined earnings of the couple during the life of the marriage. In this way, each spouse receives credit for her/his contribution to the marriage year by year with no requirement based on duration of the marriage. The conceptual precedent is community property, which prevails in several states.

Such a program would need to be tailored to special circumstances, such as protecting the family in the event of loss of the primary earner's income through disability. Moreover, the transition would need to be orderly and fair, which is not to say, protracted and expensive. However, there is in my view, no need to hold harmless groups (like divorced men) whose total benefits may have been high relative to their contributions. There is also no need for increased costs except for the transition. The earnings-sharing program developed for evaluation by the 1979 Advisory Council had an increased costs of 0.09 percent of payroll—excluding the cost of adding disability protection for certain groups, primarily homemakers. I do not believe that the evaluation of earnings sharing should be complicated by adding benefits that do not exist today. Responsibility for supporting homemakers during retirement and disability is a separate subject with different arguments, which are based on different issues.

The fact that transition to such a program will be complex to design and implement should not prevent this much-needed change. Work on the program should begin now so that the details can be worked out and communicated well in advance. Implementation should begin as soon as the system is in a position to support the cost of transition—hopefully, by 1990. Change is natural in a healthy society, and effort is better spent implementing orderly change than trying to force-fit elements of the status quo that have outlived their relevance.

## Supplementary Statement on Mandatory Coverage of Public Employees by Commissioner Kirkland

I cannot support the Commission's recommendation for mandatory Social Security coverage of newly hired Federal and postal employees. The many complex issues involved make it difficult to protect Federal and postal employee rights under the best of circumstances. This is even more difficult at the present time since the proposal is being put forward in the context of a search for additional sources of revenue and Congress is not likely to decide the issue solely on its own merits.

I could not support coverage unless all of the following conditions were met:

1. No reduction in the level of pension benefits now available to government workers.
2. No additional financial burden on government employees without a commensurate adjustment in benefits.
3. Preservation of the identity for government workers' retirement plans.
4. No diminution in the opportunity for these employees to improve their retirement systems.

The Commission cannot know in advance whether the pension rights of present and future employees will be adequately protected if Congress enacts mandatory coverage. Federal and postal employees should have the right to know and evaluate in advance the details of any proposal before they are asked to take this step.

Discussions are going forward to try to develop a solution to this problem which will strengthen and reinforce both the Social Security system and the Civil Service Retirement System. Those discussions ought not to be hampered by untimely and imprecise recommendations of this Commission. The Commission should not recommend nor should the Congress act when the coverage details are unknown. Otherwise, there can be no assurance that they meet criteria essential for assuring equity to those affected.

A majority of the Commission supports in principle Social Security coverage of State and local government employees but has not so recommended because of concern about constitutional barriers. The implication is that Congress should mandatorily cover these employees if the constitutional issues can be resolved. I will not support such coverage unless the protections previously specified for Federal employees are met by any legislation applicable to State and local government employees.

I support legislation that would remove the option for State and local governments and nonprofit organizations to withdraw from Social Security once they have elected for coverage. The unilateral right of these employers to withdraw has resulted in their employees losing valuable retirement, survivor, and disability protections. This "loophole" in the law should be eliminated. Once this has been accomplished, public employers that have withdrawn in the past should be permitted to reenter the system. The legislation should specify a way for workers or their unions to initiate such action. This is not possible under present law.

Proponents of coverage will contend that $20 billion will be lost between now and 1990 to Social Security Trust Funds if coverage of Federal and postal employees does not take place. As a substitute source of revenue and as a meritorious proposal in its own right, I recommend requiring employers to contribute to Social Security on the basis of their total payrolls. This would bring into the system about $40 billion between now and

1990 and would reduce Social Security's long-run deficit by 0.56 percent of taxable payroll.

The wage base is necessary to determine the maximum employee benefit but plays no similar role for the employer. Employers' responsibility for the welfare of their employees should be based on their total payrolls, not just on a portion of workers' earnings. Employees must pay Federal income tax on their Social Security contributions. Employers do not pay the full rate since they deduct their tax as a business expense.

This give-back to employers in reduced income taxes is largely financed by the income taxes of workers since Federal revenues to an overwhelmingly degree are based on taxes provided by individuals' incomes. Individual income taxes now provide 71 percent of general revenues, up from 47.5 percent in 1954. The corporate share is expected to be only 11 percent of general revenues for 1982. In 1954, corporation income taxes supplied 34 percent of all revenues (excluding employment taxes). As a result, employers pay only about one-third of the combined costs of the program and employees two-thirds. Thus, there is every reason why employers should pay Social Security taxes on their total payrolls.

## Dissenting Views of Commissioner Waggonner

It has been a privilege and an honor to serve on the National Commission on Social Security Reform. Our country needs a sound, adequately financed Social Security program. I thank the President for the opportunity to serve.

I strongly support the Social Security program and recognize its critical role in providing income security. The program has been extremely successful and must be preserved for this generation as well as future generations.

I am in complete agreement with the initial finding of the Commission, that the fundamental structure of the Social Security program has proven to be sound and should not be altered.

Since its inception nearly a half century ago, the program has been maintained on a self-financing, contributory basis. With a few limited exceptions (i.e., gratuitous military wage credits and special benefits for certain uninsured persons age 72 and over) the program has been financed exclusively by taxes paid by workers and employers.

The self-financing principle has served a dual purpose. It has helped to protect the program—although it has not completely guaranteed it—against unwarranted and ill-considered over expansion. At the same time, the "earned right" concept inherent in a self-financed program has helped to protect it—although it has not completely guaranteed it—from gradual conversion to a needs-tested welfare program. Therefore, the public should rest assured that there is strong support for the program. Neither party wants to see the system fail. Consequently, I believe that the program is too important to be subjected to politics. It is now, and in fact long since, time to cease the political rhetoric and enact legislation that responsibly solves both the short-term and long-term financing problems. The longer such action is delayed, the more severe the consequences of such inaction.

There are a variety of reasonable solutions to the financing problems of the system. Those solutions do not have the dire consequences that people fear as a result of the emotional rhetoric. It is unnecessary to reduce benefits currently being paid or to make precipitous changes in the future growth of benefits. However, the future growth of benefits must be slowed. Revolutionary or radical changes are not desirable. Similarly, there is no need for massive tax increases or for the use of nonexistent general revenue financing.

It is critical that the solutions to the problems address the causes of the short-term and long-range problems. The immediate cause of the short-term problem is a technical deficiency in the cost-of-living adjustment that causes the program to be unstable. It absolutely must be changed if a stable system is to survive. The long-term problem is essentially the product of demographic changes. The "baby boom" generation and continuing improvements in life expectancy will overwhelm the program unless changes are made. Demographics in the long-range demand structural changes. Demographics is the long-term problem.

I am greatly concerned that proposals have been made that do not adequately address those causes. A brief background on the growth of the Social Security program and further explanation of the causes is warranted.

Disability and Medicare benefits have been added since monthly benefit payments started in 1940, coverage has been expanded, the level of benefits has grown, and the tax liabilities of workers and employers have increased. Fundamentals for financing and redistribution of benefits have changed very little. The combined maturing of the program and the growth of real benefits brought on by the runaway inflation of the 1970's, have raised the increased tax burden. In 1950, only 20 percent of people above age 65 received Social Security benefits. Today, more than 90 percent do. The average retired-worker benefit has increased from $70 a month in 1960 to about $420 a month today.

It was unquestionably intended that Social Security benefits provide a basic floor of protection to be supplemented by other retirement income when Social Security was enacted. Other retirement income was available then and continues to increase. Too often, older Americans are portrayed as being totally dependent on Social Security benefits for retirement income. Those who paint the economic picture of the elderly often overlook certain truths. In past years, the relative value of other sources of income has significantly increased. Among these sources are (1) pension programs, which have increased from some 750 plans (private) in 1935 to some 700,000 plans today; (2) the Keogh program for the self-employed recently was enlarged to encourage savings; (3) Individual Retirement Accounts have been liberalized and will encourage a more responsible attitude for retirement planning among employed workers; (4) CODA's, which are cash or deferred arrangements are allowed by changes to the tax code in 1978 which provide that workers can now establish cash or deferred arrangements under qualified profit-sharing or stock-bonus plans; (5) in addition, some 70 percent of the elderly couples own their homes at retirement and some 80 percent of those have no mortgage; (6) many have accumulated a significant amount of wealth at retirement; (7) some continue to work after age 65; and (8) programs with means-test eligibility criteria for the elderly such as the Supplemental Security Income program, housing, food stamps, Medicaid, and energy assistance provide additional protections for low-income elderly persons.

Just since 1968, cumulative Social Security benefit increases have totaled 270 percent, compared with a CPI increase over that same period of 189 percent. The proportion of before-tax income replaced by Social Security benefits has increased steadily over this same 15-year period. A male aged 65 with average covered earnings who retired in January 1968 had a 32.3 percent of his before-tax earnings replaced by Social Security; in January 1983 a similar individual will have 45.7 percent of his before-tax earnings replaced.

As Social Security benefits and replacement rates have been steadily increasing, the Federal Government has essentially placed itself in direct competition with the private sector in the providing of retirement income security.

As indicated previously, the method by which benefits are adjusted for inflation permits benefits to increase more rapidly at times than the wages of those paying taxes to support those benefits. As a result, benefits can grow more rapidly than taxes, causing the program to be unstable when economic conditions are adverse.

For example, in the past 4 years, CPI-indexed benefits grew by 50 percent, while average wages grew by only 37 percent. If benefits had increased at the same rate as wages, the program would be generating excesses of income over outgo and there would be no short-term problems.

The Social Security program as presently structured is widely accepted by the American people, although their confidence in its financing basis has been unnecessarily shaken. The present financial difficulty is real, arguments to the contrary notwithstanding, but emotion has overwhelmed reason. This Commission is obligated to the President and the American people to recommend a plan whose policy or policies would assure an ongoing program for the benefit of this Nation, our present and future generations. What are our options? Basically only four exist. They are:

**(1) Increase or accelerate already scheduled tax increases.** Surely, past experience has demonstrated and proved the futility of such a policy. The last major Social Security refinancing legislation, enacted in 1977, is a good example. At that time, Congress and the Administration attempted to solve Social Security's financing problems by the enactment of the largest peacetime tax increases in U.S. history. In spite of this tremendous tax increase, because subsequent economic conditions were far worse than those assumed in the formulation of the legislation, the solution failed. This recent experience must not be reenacted. Because forecasting future economic conditions is, at best, an imprecise science, extreme caution must be taken when considering current reform proposals to err on the side of caution—to avoid simply another short-term fix.

Four tax rate changes have already gone into effect since 1977. Three more are scheduled to go into effect during the next several years, and large increases in the maximum earnings subject to taxes are also scheduled. Because of the 1977 legislation, wage earners and their employers will pay an additional $299 billion in taxes during the period 1983 through 1989. That does not include the huge tax increases scheduled to begin in 1990.

Since 1977, maximum annual taxes paid by an individual have increased from $965 to $2,392, an increase of almost 150 percent. In fact, since 1949, maximum taxes have increased by **7,900** percent.

I am strongly opposed to a solution that depends to a large extent on tax increases, which increase the cost of labor at a time when we should be concerned about creating jobs. A further tax on labor will only serve to significantly increase unemployment, as forecast by several econometric studies. Such action would weaken some of our major industries struggling for survival in the face of stiff foreign competition, as well as many small companies struggling to avoid bankruptcy. Furthermore, despite the adverse effect on unemployment, large payroll tax increases would be inflationary because some companies would be able to pass along the higher labor costs to consumers. Alternatively, further tax increases will tend to depress wage growth.

While decoupling provisions of the 1977 legislation cut the long-term deficit by about 80 percent, its short-term financing provisions relied primarily on tax increases rather than on reductions in costs. Thus, legislation which was heralded as guaranteeing the financial soundness of the program well into the second decade of the next century has proven inadequate in less than 5 years. **You simply can't raise enough money by taxation to satisfy people's wants. We have long since exceeded our ability to pay for all that people want from government.**

(2) **Provide General Treasury direct or indirect financing to meet the program needs.**

This approach is totally unrealistic in the light of today's circumstances. Even with the budget growth cuts that have been painfully enacted in the last 2 years, there is now no end in sight for annual Federal budget deficits in the neighborhood of $200 billion. Under these conditions, introducing general revenues into the financing of the Social Security program would require the program to compete with all of the other demands for the General Funds of the Treasury. It would be disastrous on the economy. Financial stability of the Social Security program depends on a healthy economy. **The "earned-right" concept would be abandoned, and almost overnight the program would take on all the aspects of a welfare program.** It would in fact become a **"guaranteed annual income" from the Government such as the already rejected "Family Assistance Plan." I strongly oppose this.**

(3) **Combine additional taxes through the system or Treasury financing.** A mix of unrelated taxes such as excise taxes would simply employ the use of concepts which would work to undermine the earned-right concept so central to Social Security. I strongly oppose this.

(4) **Tailor benefits to revenues. This is the only reasonable course.** In fact, this Commission and this policy may have been our last chance to preserve the Social Security program as it was intended and should be. There will be no return to reason, stability, and solvency, you just don't go back. We must tailor benefits to revenues.

The elderly are fair and responsible. They don't want to see their children and grandchildren, whose wages have not been keeping pace with inflation and who face high levels of unemployment, burdened with large tax increases. However, they are also very concerned about drastic cuts in benefits because of all the political rhetoric. When the problems and solutions are presented to them objectively and unemotionally, most agree to balanced solutions that address the causes of the problems.

The demographic problems are well documented. The "baby boom" represents a tidal wave of future beneficiaries. Their benefits will be paid for by the relatively small "baby bust" generation that results from the dramatic reduction in birth rates since 1970. Substantial improvements in mortality compound the problems because benefits will have to be paid over longer periods of time.

Once the baby boom generation retires, "best estimate" projections predict there will be only two workers supporting each beneficiary. If the Office of the Actuary modifies those "best estimate" assumptions to reflect continuation of current birth rates, as has been done by the Census Bureau in its most recent population forecast, even fewer workers will be expected to support each beneficiary.

While this Commission has not addressed the financing problems facing Medicare, I recommend that the policy implications of Medicare be reflected in OASDI legislation. The long-term deficit for the Hospital Insurance portion of Medicare is almost three times as large as the OASDI deficit. It is 5.21 percent of payroll. That deficit occurs despite massive cost shifts and despite assumptions that predict that health care costs will ultimately be controlled.

I recommend that it is imperative that long-term changes be enacted now for several reasons. First, the confidence of young workers must be restored. The best way to accomplish this is to make realistic and affordable benefit promises. Second, those who are to be affected must be given adequate advance notice for personal and financial planning, and the changes should be gradual. If action is delayed, the changes may have to be precipitous. Third, the Hospital Insurance program will begin to experience large deficits by the end of the decade and proper OASDI changes can help mitigate the effect of those deficits.

The Social Security program is an intergenerational transfer program. As such, parents have to ask the question, "At what age should they expect their children to support them and what level of income should their children transfer to them?"

With all of this as background, I believe that the legislation should meet certain reasonable and specific tests and/or constraints as follows:

1. All changes in their totality should be perceived to be fair to everyone affected by Social Security—taxpayers and beneficiaries alike.
2. All changes should have the objective of placing the Social Security program on a sound financial basis for the short term and long term. Those changes should not have the objective of balancing the budget, but rather of preserving the solvency of the Social Security program. Conversely, those changes should not increase the enormous budget deficits of other government programs. The objective should be to consistently maintain the trust funds in total at a reasonable level through the years.
3. Changes should not be precipitous—gradual changes can and should be made so as to allow adequate time for planning.
4. Changes need not and should not reduce benefits of those now receiving benefits.
5. Recommended changes to improve the viability

of the Social Security program and to restore public confidence in the system must respond to the causes of both the short- and long-term problems:

- There is a technical deficiency in the cost-of-living adjustment that permits benefit increases to grow faster than wage increases.
- The "baby boom" generation is not replacing itself. It is responsible for the "baby bust."
- People are living longer.
- The ratio of taxpayers to beneficiaries will decrease.
- Health care costs continue to increase rapidly.

6. Future tax rates for the entire Social Security program, including Hospital Insurance, should be reasonable and affordable.
7. Should not (a) increase already scheduled tax increases; (b) provide General Treasury, direct or indirect, financing to meet the program needs; (c) funnel unrelated additional taxes through the system.

Recommendations approved by the National Commission on Social Security Reform show progress toward closing the gap between projected revenues and outlays in the OASDI system. The efforts which produced this package of proposals also reflects credit on those who took part in extended negotiations, including representatives of the President and the Speaker of the House.

**Unfortunately, however, in its present form, the bipartisan plan falls far short of fulfilling the mandate of our Executive Order** insofar as it does not specifically address or assure the long-term solvency of the Social Security system. It is also deficient as a balanced solution which is necessary to restore public confidence in the solvency and fairness of the Social Security program.

Specific elements of the plan that I find unacceptable are:

1. **The granting of a temporary refundable income tax credit** to employees for the differential between the proposed payroll tax rate and the already scheduled payroll tax rate **establishes a precedent for permanent General Treasury financing of the program.** It moves us closer to the establishment of a guaranteed-annual-income policy by putting the Government in support of a refundable tax credit for the first time and it upsets the historic parity of taxes between employers and employees. The matter of providing a refundable tax credit is a major tax policy consideration. It should not be resolved as a Social Security matter in isolation from the Tax Code.
2. **Taxing Social Security benefits establishes a means test on benefits,** effecting a penalty upon those who are prudent in saving and investing for their retirement. Future program financing difficulties or efforts to further enhance the regressive redistribution of benefits will exert pressure to retain the fixed thresholds of $20,000/$25,000 which will result in the taxing of a greater proportion of beneficiaries in the future. **In effect, certain people will never quit paying into the system.** Future retirees, especially those of the baby boom generation and beyond will receive far less of a return on the taxes they will have paid while working. Also, major "notches" will develop as a result of this recommendation. The matter of taxing Social Security benefits is a major tax policy consideration, as is, for example, taxing Unemployment Compensation, and should not be considered in isolation of the Tax Code.
3. **The short-range deficit is met only at the low end of the projected need.** There is no adequate margin of safety provided through the end of this decade, particularly in the years prior to 1988. Unless economic conditions are much better than expected over the next few years, we could once again be in a situation of having inadequate revenue to pay checks on time. In fact, I believe the short-range deficit is far more serious and the projected need is inadequate.
4. **Over the period 1983-84 over one-half of the new revenue comes directly from the General Treassury.** The large infusion of general revenues for the first time into the system assures that it will never again be self-sustaining. General funds should never be used. To combine Treasury revenues and a refundable tax credit will complete the transition of the program in **welfare** and once done, will not be changed. The hope of the young is diminished.
5. **The plan adds to projected budget deficits** by permanently increasing the cost of the Supplemental Security Income program at a time of severe overall budgetary concerns. This is a welfare consideration.
6. **Major necessary structural long-term reforms are entirely avoided.** There is no specific plan by which the long-term cost is met. Demographic changes which are the primary cause of the long-term problem are not adequately addressed. The proposed change in the retirement age is tragically deficient.
7. **Adding to the cost of the program in the long-**

**term** through increasing the delayed retirement credit is irresponsible inasmuch as the long-term cost reduction goal is not specifically met.

8. **It repeats the mistake of the 1977 amendments by relying primarily on increasing taxes.** Including revenue derived from expanded coverage, **increased taxes account for 75 percent of deficit reductions;** (63 percent if expanded coverage is excluded). In the long-term, excluding the portion left unresolved (0.58 percent of taxable payroll) and including revenues from expanded coverage, **new taxes account for 91 percent of deficit reduction** (not including revenues from expanded coverage, 66 percent).
9. **It does not provide a specific fail-safe mechanism** to assure that benefits could continue to be paid *on time despite unexpectedly adverse conditions* which occur with little advance notice. (See point #3.)

The list of options which I would now like to present *do meet the tests and/or constraints* previously described in this statement. While these options do address the basic causes of both the short-range and long-term problems they by no means constitute an all inclusive list. It should be noted that the options do not specify a single solution to either the short-range or the long-term problem, but instead, the list provides several examples of changes, that in combination could resolve the problems facing Social Security more fairly and equitably *than those in the Commission Report*. At the same time, these options avoid violating the basic tenents of Social Security, in that they allow the system to remain self-financing and do not introduce any elements of means-testing. (The bipartisan approach developed in 1981 by Congressmen Barber Conable and Jake Pickle adopted a combined approach.)

| Some alternative options to the Commission report | Short-term savings (billions) (1983-89) | Long-term savings (percent of payroll) (75 years) |
|---|---|---|
| 1. Coverage of new Federal hires and *Federal employees with under 5 years* of service, all nonprofit employees, and elimination of windfall benefits (also, prohibit opting out) | $33 | 0.31 |
| 2. Suspend COLA adjustment for 1 year, 1983 | 80 | .13 |
| 3. COLA based on, CPI minus 2 percent for next 3 years COLA's, with cap on COLA of 6 percent; thereafter, use "wages minus 1 1/2 percent" basis | 80 | .15 |
| 4. Four percent cap for 3 years COLA's; thereafter, lesser of wage or CPI increase if fund ratio is under 25 percent (with catchup when fund ratio is over 50 percent) | 33 | .04 |
| 5. Provide future benefit increases equal to 75 percent of the CPI, effective 1983 | 75 | 1.45 |
| 6. Prorate both CPI and wage increase adjustments in initial OASDI benefit based on month of eligibility, effective 1984 | 40 | .40 |
| 7. Accelerate State and local deposits | 3 | ... |
| 8. Increase retirement age to 66 in 2002, beginning phase-in in 1995; thereafter, adjust according to changes in longevity | ... | 1.68 |
| 9. Gradually increase the "normal" retirement age from 65 to 68 in 2017 beginning the phase-in with those who attain age 62 in 2000 | ... | 1.22 |
| 10. Increase "bend points" in the PIA benefit formula by 75 percent of the increase in wages until they are 80 percent of what they would have been under 100 percent wage indexing, effective 2000 | ... | .80 |
| 11. Reduce percentages in PIA benefit formula by 10 percent relatively, over a 15-year period beginning 1984-98 | 1 | 1.10 |

## "Fail-Safe" Mechanism

A "fail-safe" mechanism should be provided in the event that the OASDI Trust Fund ratio falls below a specified level. In the event of the determination of a fund-ratio deficiency, all benefits due during the coming year should be guaranteed to be sent out on time, **but** should be proportionately reduced automatically by first affecting any scheduled COLA increase. In the event that the fund-ratio deficiency exceeded the scheduled COLA increase, then the existing benefit amounts would be reduced proportionately unless Congress acted to provide for the remaining fund-ratio deficiency through raising payroll tax rates.