SOCIAL SECURITY FINANCING AND OPTIONS FOR THE FUTURE

HEARINGS

BEFORE THE

SUBCOMMITTEE ON SOCIAL SECURITY AND INCOME MAINTENANCE PROGRAMS

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

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SOCIAL SECURITY FINANCING AND OPTIONS FOR THE FUTURE

TUESDAY, JULY 7, 1981

U.S. SENATE,
SUBCOMMITTEE ON SOCIAL SECURITY
AND INCOME MAINTENANCE PROGRAMS
OF THE COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9 a.m., in room 2221, Dirksen Senate Office Building, Hon. William L. Armstrong (chairman) presiding.

Present: Senators Armstrong, Dole, Danforth, Durenberger, Symms, Grassley, Byrd, Moynihan, Baucus, and Bradley.

[The press release and Senator Armstrong's opening statement follow:]

Press Release No. 81-145

PRESS RELEASE

FOR IMMEDIATE RELEASE
June 18, 1981

COMMITTEE ON FINANCE
UNITED STATES SENATE
Subcommittee on Social Security
and Income Maintenance Programs
2227 Dirksen Senate Office Bldg.

FINANCE SUBCOMMITTEE ON SOCIAL SECURITY AND INCOME MAINTENANCE PROGRAMS SETS HEARINGS ON
SOCIAL SECURITY FINANCING AND OPTIONS FOR THE FUTURE

Senator Bill Armstrong, chairman of the Subcommittee on Social Security and Income Maintenance Programs of the Senate Committee on Finance, announced today that the subcommittee will hold hearings beginning Tuesday, July 7, 1981, on the financing of social security and options for the future.

The hearing will begin at 10:00 a.m. in Room 2221 of the Dirksen Senate Office Building.

Secretary of the Department of Health and Human Services Richard S. Schweiker, accompanied by Social Security Commissioner John A. Svahn, will be the initial witness appearing before the subcommittee. The hearings will continue on the afternoons of July 8 and 9, beginning at 2:00 p.m. in room 6226 of the Dirksen Senate Office Building.

Senator Armstrong noted that "the financial condition of social security has understandably caused alarm among millions of people, beneficiaries and taxpayers alike. These hearings will provide us with a valuable opportunity to thoroughly examine the nature of the system's financing crisis as well as possible solutions." Senator Armstrong expressed his hope that the hearings will air a wide variety of constructive options for the future.

Requests to testify.--Witnesses who desire to testify at the hearing must submit a written request to Robert E. Lighthizer, Chief Counsel, Committee on Finance, Room 2227 Dirksen Senate Office Building, Washington, D.C. 20510, to be received no later than the close of business on Friday, June 26, 1981. Witnesses will be notified as soon as practicable thereafter whether it has been possible to schedule them to present oral testimony. If for some reason a witness is unable to appear at the time scheduled, he may file a written statement for the record in lieu of the personal appearance. In such a case, a witness should notify the committee of his inability to appear as soon as possible.

Consolidated testimony.--Senator Armstrong urges all witnesses who have a common position or who have the same general interest to consolidate their testimony and designate a single spokesman to present their common viewpoint orally to the subcommittee. This procedure will enable the subcommittee to receive a wider expression of views than it might otherwise obtain. Senator Armstrong urges that all witnesses exert a maximum effort to consolidate and coordinate their statements.

<u>Legislative Reorganization Act</u>.--Senator Armstrong stated that the Legislative Reorganization Act of 1946, as amended, requires all witnesses appearing before the committees of Congress "to file in advance written statements of their proposed testimony, and to limit their oral presentations to brief summaries of their argument."

Witnesses scheduled to testify should comply with the following rules:

(1) All witnesses must submit written statements of their testimony.

(2) <u>Written statements must be typed on letter-size paper</u> (not legal size) and at least <u>100 copies</u> must be delivered not later than noon of the last business day before the witness is scheduled to appear.

(3) All witnesses must include with their written statement <u>a summary of the principal points included in the statement.</u>

(4) <u>Witnesses should not read their written statements to the subcommittee</u>, but ought instead to confine their oral presentations to a summary of the points included in the statement.

(5) Not more than five minutes will be allowed for the oral summary.

<u>Written statements</u>.--Witnesses who are not scheduled to make an oral presentation, and others who desire to present their views to the subcommittee, are urged to prepare a written statement for submission and inclusion in the printed record of the hearing. These written statements should be typewritten, not more than 25 double-spaced pages in length, and mailed with five (5) copies to Robert E. Lighthizer, Chief Counsel, Committee on Finance, Room 2227, Dirksen Senate Office Building, Washington, D.C. 20510, not later than <u>Tuesday, July 21, 1981</u>. On the first page of your written statement please indicate the date and subject of the hearing.

P.R.#81-145

Opening Statement of
Senator William L. Armstrong, Chairman
Senate Social Security Subcommittee
July 7, 1981

We are here today to consider the future of the nation's largest domestic program...Social Security.

Social Security is so woven into the nation's economic and social fabric that it is hard to grasp its daily impact on 150 million Americans. A typical American will work 45 years and, with each paycheck, he and his employer will contribute to Social Security throughout his working life. In retirement, the average worker and his spouse will get a Social Security check of $568 -- adjusted annually for inflation -- each month for an average of 15 years. For this couple, and millions of others, this check is a critical, if not the only, source of retirement income.

This monthly check, however, does not come from the taxes he paid while working. The check is paid by those who are now working, and paying up to $3,500 annually in Social Security taxes. In turn, these workers trust the next generation will finance their retirement on a pay-as-you-go basis.

The commitment made to this worker and 150 million others is now on the line.

Social Security is going broke.

Unless decisive action is taken, the trust funds will soon be unable to make ends meet; the Social Security System will be destroyed. Social Security has been operating in the red for six straight years, and now loses $10,000 every minute. Today, the System has enough money to pay full benefits for only two months. By approximately November 1, 1982, the Social Security Pension Reserve will be exhausted and the fund will not be able to pay even a month of full pension benefits, according to the 1981 Social Security Trustees

Report. Long-term, the problem is even worse: Social Security faces a one and a half trillion dollar shortfall over the next 75 years, according to the Trustees.

I doubt anyone can comprehend the disastrous consequences of a bankrupt Social Security.

Social Security is the financial lifeblood for most of its 36 million recipients. The System is going broke. It must be repaired.

Inescapable facts frame this hearing and are the backdrop for the work of this subcommittee.

I have with me six charts portraying the Social Security crisis. The first chart paints -- in red -- the System's mounting deficit. Social Security has operated in the red for six straight years, and by 1982, will not be able to pay full benefits. For all practical purposes, the System will be insolvent.

How did we get in this mess? These other charts tell the story. The second chart shows the explosion in benefit payments since 1950. In 30 years, benefits have been adjusted upward 699 percent. One trillion dollars has been paid out. Average monthly benefits per person in 1935 were $22. Today, the average exceeds $370. We are now to the point where in 1985 alone total pension and disability benefit payments will exceed $220 billion. We are paying benefits in one year that equal one-fifth of the total benefits paid out over the last 30 years.

Frankly, Congress has been promising benefits it just can't deliver.

These benefits are financed on a pay-as-you-go basis. In other words, benefits paid today are being financed through today's Social Security payroll taxes. The third chart shows the radical changes that have reshaped the American workplace, and jeopardize Social Security's long-term survival. In 1950, there were some 16 workers paying for each person receiving Social Security benefits. In 1980, only three workers paid taxes for each beneficiary and in slightly more than one generation, there will be only two workers supporting each person drawing benefits.

Obviously, fewer people are carrying the burden. The result is dramatic, though not surprising. Social Security taxes have skyrocketed. This is shown in the fourth chart.

In 1940, the maximum combined employer-employee Social Security tax was a mere \$60 annually. Today, that tax exceeds \$3,000 and will rise to \$9,000 by 1990. Incredibly, even with these higher taxes, Social Security will have an accumulated deficit of \$111 billion by 1985.

Possibly even more dramatic is the chart's inset. Since 1950, real wages in the United States increased 490 percent, while federal taxes increased 594 percent. And Social Security taxes? They soared 2,011 percent.

Can anyone seriously contend that Social Security payroll taxes can or should be pushed even higher?

Some believe the cure for Social Security's problems is using general revenues. Social Security trust funds have always been kept apart from the Federal Treasury. Earlier I said Social Security is losing \$10,000 every minute. Well, the Federal Treasury is losing \$173,000 a minute! Our national debt has increased 27 timesfaster than our population. Can anyone seriously contend that a federal government with a trillion dollar debt can bail out Social Security? That would be like asking Amtrak to bail out Conrail.
How much more can Congress increase deficit spending which is the prime cause of ruinous inflation?

So there it is. Social Security is very deeply in debt. The System now lacks the financial wherewithal to pay promised benefits. Incredibly, all this occurs at a time when benefit payments are soaring.

But there is reason to hope. Social Security can be lifted out of this financial quicksand. But permanent solvency -- which is our goal -- can only be achieved by facing the following facts.

First. Social Security must not become a political grenade lobbed back and forth for exploitive purpose. Those seeking political gain at the expense of Social Security solvency perform a national disservice. I am absolutely committed to fashioning a fair, non-partisan, compromise bill that will place Social Security on a sound financial bedrock and that will ensure a piece of that rock for our retirees.

Second. Congress must learn from its past mistakes in shaping Social Security policy, and then resolve not to repeat them. Congress has overpromised benefits without providing the long-term financing necessary to pay for them.

Third. Congress can no longer mislead the American people. Just four years ago, Congress enacted a sweeping Social Security reform bill that resulted in history's largest peacetime tax increase. It was hailed by President Carter "as the guarantee that from 1980 to 2030, Social Security funds will be sound." Experience has proven the prediction wrong and this final chart shows the danger of over-optimistic estimates. In 1978 -- the same year Congress passed its Social Security "reform bill" -- the Trustees for Social Security said the System would remain solvent forever. Yesterday's announcement by the Trustees flatly contradicts the earlier report.

This may be our last, best chance to achieve permanent solvency and assure the retirement security for the people who pay for the System and rely on it. If we fail, Congress will lose forever any vestige of credibility on this issue.

Fourth. Congress must acknowledge that Social Security has the potential for fracturing American Society by creating a new kind of "generation gap." Those now receiving Social Security believe their juniors are obligated to pay the taxes necessary to support their benefits. Yet younger Americans grow increasingly bitter about their heavy Social Security tax burden. This conflict must be squarely faced.

This subcommittee should operate from the premise that all Americans deserve a financially sound, compassionate Social Security System, and one that offers reasonable value for the Social Security taxes they pay over the years.

Unfortunately, pessimism about this is high. A recent ABC-Washington Post poll reported that 75 percent of the public believe they will never collect a penny of benefits in their lifetimes.

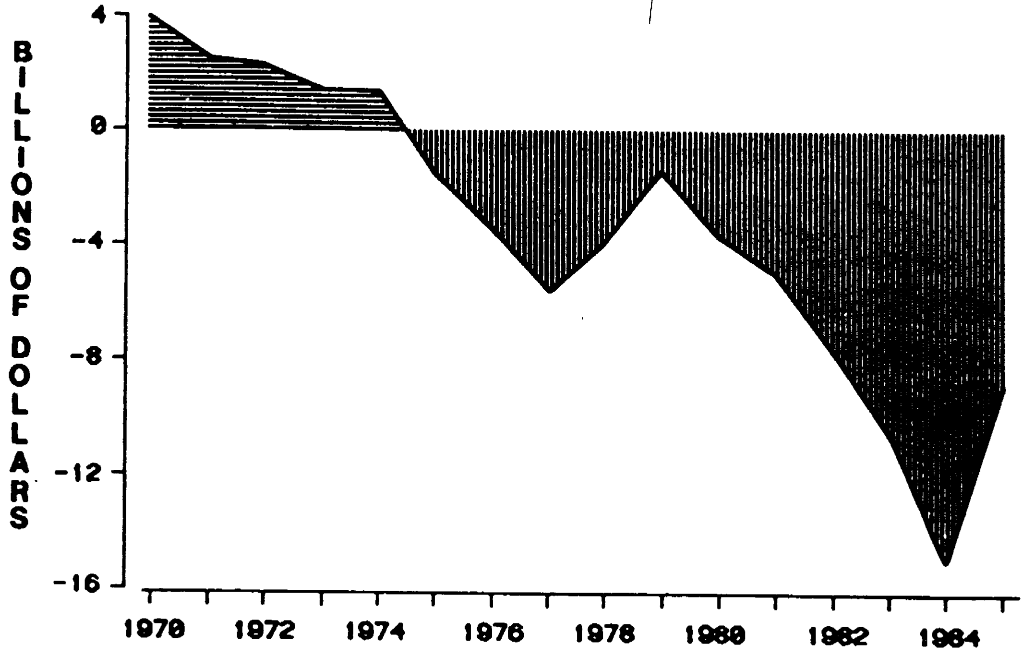
Today we will learn more about the dimension of the Social Security financing crisis from Secretary Schweiker and Social Security Commissioner Svahn. Yesterday the Administration released its 1981 Social Security Trustees Report. The findings show the Social Security funds are being depleted at an alarming rate, and the situation is much worse than was reported just a year ago.

It is critical that this Congress and all Americans understand the exact nature and depth of the Social Security problem. We Americans have demonstrated time and again that when we understand our problems we have an amazing capacity to work together to solve them.

Let us undertake these hearings in that spirit. This is the time for all of us to join together to save the Social Security System.

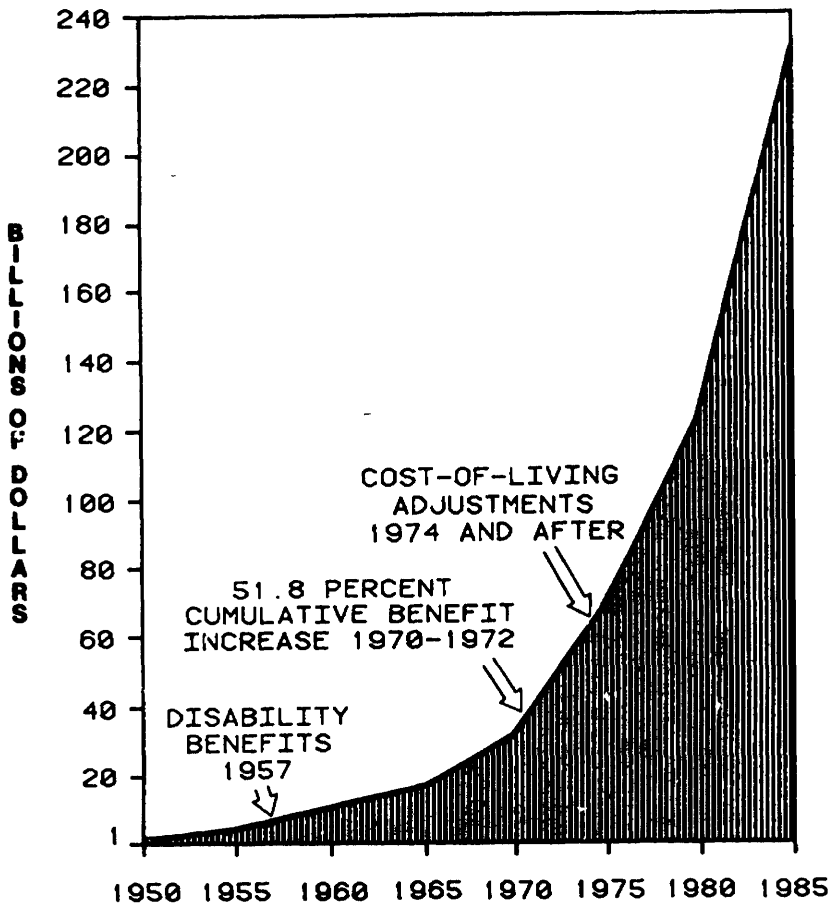
I welcome Secretary Schweiker and Commissioner Svahn.

SOCIAL SECURITY'S DEFICIT



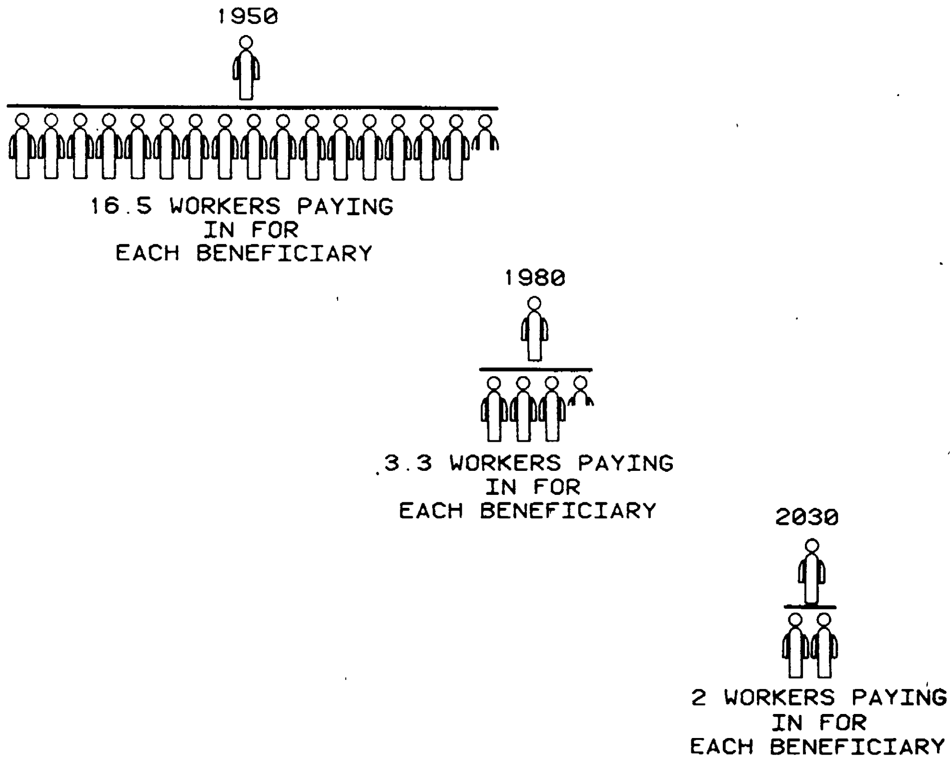
NOTE: 1981-1985 BASED ON INTERMEDIATE PROJECTIONS FOR OASDI

TOTAL ANNUAL EXPENDITURES
OASI AND DI PROGRAMS COMBINED



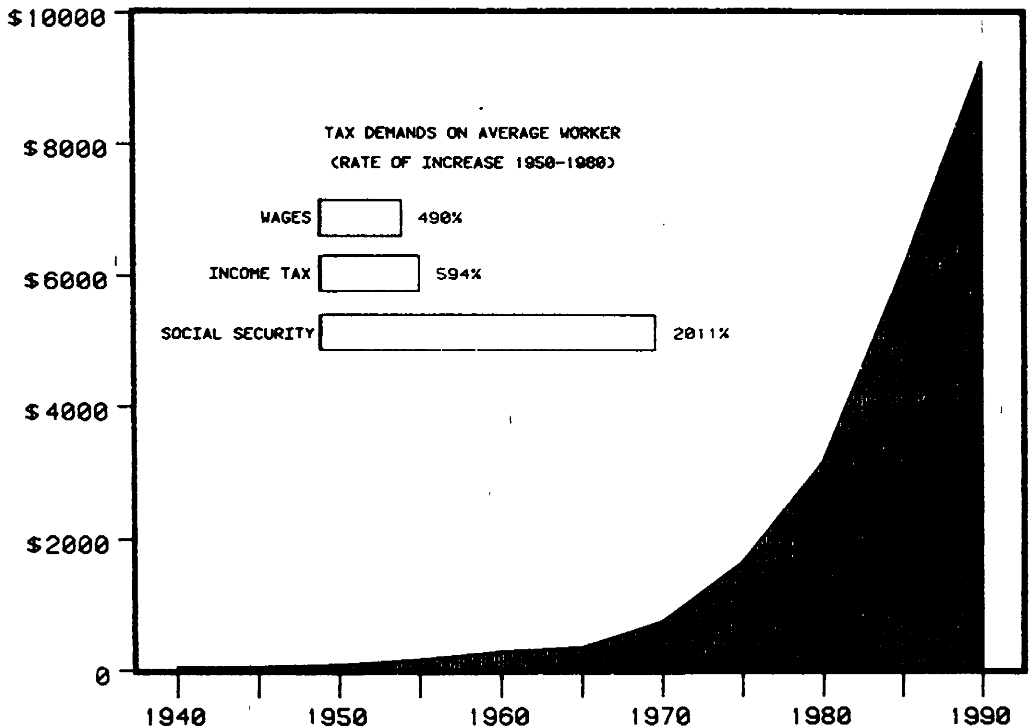
NOTE: 1985 BASED ON INTERMEDIATE PROJECTIONS

WHO PAYS FOR SOCIAL SECURITY



MAXIMUM SOCIAL SECURITY TAX

EMPLOYEE AND EMPLOYER COMBINED



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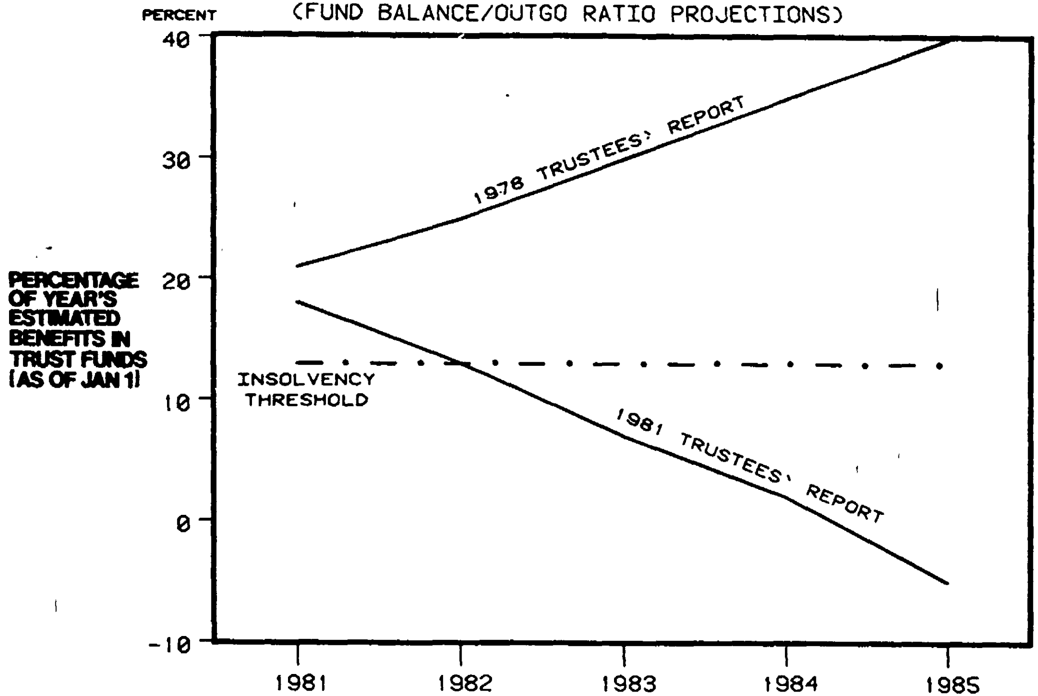
HOW ESTIMATES HAVE CHANGED

(FUND BALANCE/OUTGO RATIO PROJECTIONS)



NOTE: BASED ON INTERMEDIATE PROJECTIONS IN SOCIAL SECURITY TRUSTEES' REPORTS

Senator ARMSTRONG [chairman, presiding]. Ladies and gentlemen, the committee will come to order.

We are here today to consider the future of the Nation's largest domestic program, social security.

Social security has become so much a part of the every day life of 150 million Americans, including 36 million recipients, that it is almost impossible to overestimate the impact of social security on the lives of these people.

In my judgment, social security is on the line, here and now.

According to information which we are all aware of, released by the 1981 social security board of trustees yesterday, social security is on the verge of going broke.

Unless decisive action is taken, the trust funds will soon be unable to make ends meet. The social security system would, in that event, be destroyed.

Social security has been operating in the red for the last 6 years. I am advised that it is now losing $12,300 a minute.

Today the social security system has only enough money on hand to pay full benefits for 2 months.

By some time next year, the social security retirement fund will be exhausted, and it will not be able to make timely payment of full benefits, according to the trustees report.

The long-term problem is even worse. Social security faces a $1.5 trillion shortfall over the next 75 years.

Social security is the financial lifeblood for most of its 36 million recipients. If the system is in the kind of serious financial condition we are led to believe, obviously it must be repaired.

Members of the committee, I have asked the staff to prepare six charts as a background for this hearing, and for the work we have ahead. I direct your attention to these charts.

The first chart, which is appropriately etched in red, shows the mounting deficit of the social security system [indicating No. 1].

For all practical purposes, by November of next year, the system will be insolvent.

How did we get into this crisis condition? The other charts tell the story. The second chart shows the explosion in benefit payments since 1950.

That sharp crag is not Mount Everest. That is the line of benefit increases which have been adjusted upward in the last 30 years by 699 percent.

Thus far, $1 trillion has been paid out. Average monthly benefits per retired worker, in 1940, were $22.

Today, the average exceeds $370 [indicating No. 2].

It appears to me, and I trust that our witnesses this morning and through this week will help us to zero in on this question; that Congress has promised benefits which simply cannot be delivered under the present ground rules.

The third chart explains why this is so. It shows the radical change which has reshaped America's workplace and now jeopardizes the long-term survival of the social security system.

In 1950, there were some 16 workers paying for each person receiving social security benefits [indicating No. 3].

By 1980, only three workers paid taxes for each beneficiary and, in slightly more than one generation, there will only be two workers supporting each person drawing benefits.

Obviously, fewer people are carrying the burden and the result is that social security taxes have skyrocketed and are predicted to rise at a very rapid rate.

This is shown in the fourth chart, on my right [indicating No. 4].

Possibly even more dramatic than the line graph in red, is the inset.

Since 1950, real wages in the United States have increased 490 percent, while Federal taxes have increased 594 percent, and social security taxes have increased 2,011 percent.

It appears to me, and again, this is something that the committee will want to make a judgment on, that the prospect of further tax increases is not a viable or desirable option.

Some may believe that the cure for social security's shortfall is using general revenue. Social security's trust funds have always been kept apart from the general treasury. With social security losing $12,300 a minute, before we plan to combine that with the general revenues or to seek general revenue support of social security, I would urge caution. The Federal Treasury is losing at the rate of $173,000 per minute.

So that is the general picture. This is the summation of where we are and where the trustees, according to their report yesterday, believe we will be, as shown in the final chart [indicating No. 5].

I would especially invite the attention of the committee to this final chart, because it shows how dramatically the trustees estimate of the situation has changed in recent years.

The top line is their projection in 1978, and the second line showing a sharp nose dive, is their current best estimate.

It is my understanding that of the five projections, from optimistic to pessimistic, which have been submitted by the trustees, but even the most optimistic of the five shows a shortfall in the trust fund next year.

Members of the committee, I would recommend that as we begin this task of determining the extent of the problem facing social security and attempting to arrive at an answer, we might be guided by at least three principles.

First of all, I trust that the social security issue will not become a political grenade that gets lobbed back and forth between the Republicans and the Democrats or the House and the Senate or the Congress and the administration.

In my judgment, if that happens, we will not be able to put together the kind of social security reform that is necessary in the long term to protect the integrity of the system.

I am dedicated to saving the social security system.

We are not, I trust, going to focus entirely on graphs and charts and numbers and the abstractions of the actuaries. This is a problem that affects people and their everyday lives. It is just too important to in my judgment to become primarily a political issue.

Second, I think we would be well advised to learn from the mistakes which prior Congresses have made in overpromising benefits without providing the long-term financing that is necessary.

Third, I think we ought to be just as frank with the people of the country and with our colleagues in the Senate as we can.

There is a suspicion in many quarters that in the past we have made overoptimistic assumptions rather than face clearly a more realistic projection of the difficulties.

In my judgment, for us to make that mistake again would be the height of irresponsibility.

Finally, my colleagues, I think we ought to recognize that if we fail to achieve a permanent reform of the social security system, we run the risk of permitting a very divisive generational fracturing of this country.

Those now receiving social security believe that their juniors are obliged to pay the taxes necessary to support the benefits. Yet, I am encountering an increasing number of younger Americans who are bitter about being forced to pay the taxes to support a system which they do not believe will be available and intact to pay benefits to them when they retire.

So this is the dimension of the problem. I trust that we can move quickly through this week of hearings and then, at an early date, arrive at a consensus bill which will be broadly acceptable to both parties, to the House, to the Senate, to the Secretary, to the administration, and to the President, and most importantly, which will have broad public support throughout the country.

Senator Dole.

Senator DOLE. I ask that my statement be made a part of the record. I don't want to infringe on the Secretary's time, except to indicate my thanks to the subcommittee chairman, Senator Armstrong, and Senator Moynihan, for moving these hearings ahead.

[Senator Dole's statement follows:]

SOCIAL SECURITY SOLUTIONS WILL REQUIRE "STRAIGHT TALK," DOLE SAYS

WASHINGTON.—Senate Finance Committee Chairman Bob Dole (R-Kan.) said today that finding a solution to the current Social Security problems "will require straight talk to the American public, and not the rhetoric we have so often heard in the past." Dole made his remarks in the Finance Committee's subcommittee on Social Security, which today began its first day of hearings on ways to bolster the ailing system.

"Finding a solution won't be an easy task, but it is absolutely essential that we find one that can be supported by both taxpayers and beneficiaries," Dole said. "I believe we can do this, but it will require straight talk to the American public. It is possible that the solution will affect future beneficiaries as we carry out our responsibility to save the system for generations to come. I'm confident, though, that sooner or later these efforts will be applauded.

A CRITICAL TIME FOR THE SYSTEM

"This is a critical time in the history of Social Security. Never before have so many peoples' lives been affected by the program. One hundred fifteen million people pay taxes to support the system, 20 million more than in 1970. Thirty-six million people receive benefits, nearly a third more than in 1970. Yet, the Board of Trustees reports released yesterday confirm that we are faced with an unacceptable long-term deficit in the system, one that exceeds a trillion dollars, and a potentially huge short-term deficit—possible as high as $100 billion—that could threaten timely benefit payments as early as next year. Further, we learn that there is no conceivable economic scenario under which Old-age and Survivors' Insurance could pay benefits throughout 1982.

"We are here for just one reason: to find ways to shore up a failing system. Unfortunately, this is exactly what brought us together for Social Security hearings just four years ago. In 1977, the condition of the trust funds had deteriorated seriously since the last major program expansion of 1972, to the point that all three trust funds (OASI, Disability Insurance and Hospital Insurance) were projected to be broke within the decade. Board of Trustees reports had gotten progressively grimmer as the economy grew more slowly and the program grew more rapidly than anticipated.

"In an atmosphere of crisis, not unlike today, Congress took steps in 1977 to cut the long-run cost of the system, while passing the largest peacetime tax increase in U.S. history. Working men and women were told that their taxes would be increased six times between 1977 and 1990, so that an additional $200 billion in revenues could be produced during the 1980s. In return, taxpayers and beneficiaries were 'assured' that the condition of the trust funds would improve continuously and that the system would remain sound through the year 2030.

"And yet here we are today, just four years later. As we begin these hearings, I hope that we will all be mindful of these facts. Nobody wants to take the kind of steps we took in 1977, only to find ourselves back here again in 1985.

POSSIBLE STEPS

"Deficits must be eliminated. But further tax increases, when there are already four more to come by 1990, are obviously out of the question. Using general revenues is not a solution either, since this certainly involves significant tax increases too. This makes it clear that we will have to carefully consider methods of limiting the future cost of the system. It may well be necessary to take steps now to ensure that as the population ages and the proportion of workers supporting each beneficiary falls, our current structure of benefits does not produce a tax burden that becomes unrealistically high.

"It is my hope that these hearings will provide some fresh ideas for achieving both of these goals: trust fund solvency, and a system that is politically, socially and economically viable in the long run. The 1981 Board of Trustees reports underscore the need for Congress to move quickly."

Senator DOLE. I think the financing crisis in social security is something we must and should address very quickly. While there is a lot of precedent in this committee for a bipartisan approach to some of the severe problems over which we have jurisdiction, this will certainly be a test of that bipartisanship. We had our exchange in May, on the Senate floor. We expressed caution on the administration's proposal at that time.

The President was trying to get our attention and that of the public. He did just that. This was followed by the Secretary and others who offered to work with us. We certainly appreciate that.

I would also commend Congressman Pickle who held hearings for weeks on the House side, and I believe is making every effort, with Congressman Archer and others, to put together a bipartisan package.

I recall being on this committee less than 4 years ago, when we were trying to come to grips with the same problem. I think the committee report reflects the problems we had at that time.

So, we took action. We were going to solve this problem until the year 2030. We were going to do it by imposing six tax increases on employers and employees.

We have had only two of these. There are four more tax increases coming between now and the year 1990.

I would just suggest we don't follow that approach in these deliberations.

I would also suggest that we don't have any money in the general fund so there is no need to talk about borrowing money from general revenues. At least as far as I know, there is nothing there to borrow.

I went back just briefly to look at last year's board of trustees report, because that report was filed by the outgoing administration. In the highlights of that report, the trustees suggested that OASI was going bellyup unless changes were made in the law.

I think that report along with the 1981 report sets the stage for a bipartisan approach. We are happy to have the Secretary here. We are going to work very carefully and very diligently to put together a package that will have broad public support.

We understand this is an emotional issue. It is controversial. There is bound to be some politics involved. But in the long-run, in my view, we will be applauded by the beneficiaries and the contributors to social security if we solve this problem, once and for all, this year.

Thank you, Mr. Chairman.

Senator ARMSTRONG. Senator Moynihan.

Senator MOYNIHAN. Thank you, Mr. Chairman.

I have a statement which I would put in the record at this point, with your kind permission.

[Senator Moynihan's statement follows:]

OPENING STATEMENT BY SENATOR DANIEL PATRICK MOYNIHAN

The primary purpose of the hearings we commence today is to find out whether the administration still wants Congress to enact its Social Security proposals of May 12, 1981. If adopted, those proposals would:

1. Reduce the average future of Social Security benefit by about ten percent, compared with current law.

2. Reduce the average Social Security benefit for early retirees (those aged 62, 63, or 64) in the future by about 38 percent, compared with current law.

3. Repeal the principle that persons who continue to work beyond the age of 65 and who have high earnings should receive smaller Social Security benefits than persons with no earnings at all.

4 Deny Social Security disability benefits to person who are unable to work for reasons not strictly related to medical factors, and to disabled persons who were not covered by Social Security for 7½ of the preceeding ten years.

The administration proposed these changes, and more. Our first task in these hearings is to determine whether the administration continued to recommend them and, if so, to attempt to understand the reasoning behind them, the projections that give rise to them, the relationship of these proposals to the administration's economic and budgetary strategies, and the alternatives that the administration considerd and rejected in coming up with these proposals.

Our second task is to attempt to ascertain the actual condition of the Social Security system at present, in the near future, and over the long run, in the context of various assumptions about the economy, to assess the probabilities of those assumptions coming true, and to inform ourselves of alternative solutions to whatever problems the Social Security system is likely to encounter.

If this week's hearings are not sufficient for these purposes, we will have more.

Senator MOYNIHAN. Mr. Chairman, I would want to accept on behalf of the Democratic side of the committee, your proposal that these be bipartisan and, as much as we can do, nonpolitical hearings, and that we reach a bipartisan conclusion and program at the end.

But if that is to be done, Mr. Chairman, it has to be done by both sides.

I am sorry to have to say, Mr. Secretary, that the administration in the last 48 hours has been conducting a campaign of political terrorism on this subject.

You have described a basically sound social insurance program as on the verge of going broke, and it is not.

You have discussed difficulties that will have to be resolved in the middle of the 21st century as if they were upon us this afternoon.

You have disavowed positions the administration took with the utmost political enthusiasm just months ago.

In the middle of May, the Republican National Committee was sending out a newsletter entitled "Senior Republicans." Its headline was, "President Reagan keeps promise. Retirement benefits go untouched."

Now, the statement that benefits would go untouched was conconmitant to a message sent to us by the same people, a message that you sent us, Mr. Secretary, on May 12, which proposed, on 8 months notice, to cut 40 percent of the retirement income of persons entering the system at age 62.

No such proposal had been made before. It is utterly unjustified, and the Senate, on May 21, 96 to 0 rejected that proposal.

We are here to ask you, and we have a right to ask you, Mr. Secretary: does the Administration still propose a 10 percent, across-the-board cut of benefits?

A 40 percent cut in the benefits of persons retiring at age 62, leaving them with a retirement income of 19 percent of their average earnings, an income in most cases that is well below the poverty line?

Mr. Secretary, we hope to hear from you. Is it not the case that there are three trust funds, three checking accounts, that only one will be in difficulty at the end of next year, and that the other two are in perfectly good shape?

Mr. Secretary, is it not the case that the economic assumptions which the trustee's report presented to us yesterday, would represent one third the growth rate of President Reagan's budget?

Are you saying that the administration now rejects the statements the President has made to us about his economic assumptions for the next 4 years? Rejects the assumptions underlying the budget?

If you don't reject them, how can you term optimistic, proposals that don't even reach that level.

Finally, Mr. Secretary, is it not the case that you are proposing these huge reductions in benefits in order to get money for use elsewhere in the unified budget balance sheet?

Mr. Secretary, is it not the case that the administration came to office assuming that its tax cut would be self-financing?

The President, May 17, in Flint, Mich., said, "We will take the increased revenues that come from the decreased taxes to build up our defense capabilities."

You found that couldn't be so. You found yourself facing a long series of deficits. Are you not, sir, in all truth, I don't think it would be you doing it, are you not being told, 'Take away from the retired people of America. Take it out of their household budgets, and put it into the President's budget to make that budget look better."

Those are questions, sir, which I hesitate to put to someone for whom I have so much respect, but on the other hand, I put them to you because we know we will get straight answers.

I thank you, Mr. Chairman.

Senator ARMSTRONG. Thank you, Senator Moynihan.

Senator Durenberger.

Senator DURENBERGER. Mr. Secretary, I hope you don't take that last as any lessening of the spirit of bipartisanship and nonpartisanship that this committee has always displayed. [Laughter.]

The Senator from New York was very careful to couch those all in questions and not in comment.

I am just going to add a comment since you were not on the Finance Committee last year, nor were any of the Republican colleagues to my left or right, that I learned about a lot of this from the then junior and now senior Senator from New York.

When he sat on this side of the table, he often educated some of us new people on that side of the table to the problems of social security financing.

It was from him I think that I first learned about the 3 weeks from paycheck withholding to blue check outgo.

He could say it better than I could, but I am indebted to the Senator from New York for educating me on the near insolvency of the social security system in the first 2 years. I know that when he talks about bipartisanship we are going to get it.

Mr. Chairman, I want to make just one comment based on several months of listening to the American people that you and others were talking about.

We may look at this issue through the board over here, in terms of a problem of financing a bankrupt system or a problem created by overgenerous politicians and benefits.

But it seems to me that the real issue that is involved here in the next few months and probably in the next few years is the issue of a definition of social security.

Those boards and the record of the last at least 8 or 9 years, is a record of a whole variety of signals being sent to the American people about what social security really is, and a lot of conflicting signals throughout that whole process.

It seems to me, looking at it from the eyes of my retired parents or surviving orphans or whoever the case may be that the No. 1 mission we have as Members of the U.S. Senate and that the administration has, is to give some definition to the American people as to what social security is, what social security will be, so that they can make plans for all the other things that they do with their lives and with their earnings, that relate to social security.

It takes some political guts to address that kind of an issue, but I hope that as we go through these hearings, we are going to remember that that is really what the American people are asking.

It isn't a question about I want more of this or I want less of that or I want to change this or that. It is a question of what in the world is it so that I can count on it.

This is not a today system for a lot of people, it is a tomorrow system. They want to know what form this system is going to take when they really need it.

Senator ARMSTRONG. Thank you, Senator Durenberger.

Senator Grassley.

Senator GRASSLEY. Thank you, Mr. Chairman, members of the committee.

I think that there have been enough mistakes in the last 30 or 40 years made by both parties to go around.

We are now at a point where blaming anybody else is not a solution to the problem. We have to look for a bipartisan approach to what we are doing.

I think the best thing we can do in this series of hearings and the deliberations of this committee and this Congress ~~in the~~ next few months, is not to repeat some of those mistakes that have been made in the last several decades.

I think that most of those mistakes are centered around the fact that the Congresses and past administrations have been long on promises and we have been short on performance.

I think that that is best illustrated by the debate in 1977, that the chairman of the committee, Bob Dole, has already referred to, in which I remember very distinctly sitting in the House of Representatives as a Member of that body and listening to the leadership of the committees at that time say that the bill we passed would take care of the social security problems for the next 50 years.

Yet, here we are looking—just 6 months down the road—at a worse financial situation than we faced in 1977.

Those initiatives that were taken in 1977 only came as a result of the urging of President Ford in his last year in office, when he suggested a tax increase to take care of a problem he even saw at that time similar to what we are dealing with here.

So, we have to deliver on what we promise and either promise less or else, if we are going to promise as much as we have, perform accordingly, and that means financing the system. That means, as far as I am concerned, not taking any easy way out, of borrowing general revenue funds or of using general revenue to finance the system.

I think one of the other promises we have to remember is that the whole social system was formulated in the first instance because people were not saving and forced on welfare and the stigma of welfare was associated primarily with people in their senior years.

The whole idea of social security was to relieve people of that stigma of welfare.

Now, some of the suggestions that have been proposed, such as borrowing, and general fund supplement to the social security system, tend back to that very welfare philosophy that social security was supposed to get us away from by having people save for their retirement.

I think too often social security has been used as a way of solving unemployment problems. Some of the "increased benefits" that we talk about today were early retirements of 62 and then 60. It was argued that by doing this, we could help solve the unemployment problem by opening jobs up to younger workers.

I think what we have to do is look at social security as a system in and of itself to give dignity to people who are on retirement, not to solve any problem other than that of allowing people to provide for their own welfare and their own security. The pay-as-you-go system has helped to bring about an intergeneration gap because a growing number of workers is beginning to resent the burden of providing for retirees.

So, I hope what we get out of these hearings and the deliberation of this committee, is performance commensurate with our promises, or cutting back our promises.

Ideally, I would like to see us devise a system where people retire on their own savings as opposed to the welfare concept of people benefiting from things other than their own savings.

As an end result of whatever we do with the social security system, I hope we can also bring our generations back together.

I am not talking just about defusing the so-called intergenerational timebomb that the chairman of the subcommittee has referred to but I am talking about bringing about a meshing of relationships between generations so that we do not have a segregated society of those who are working and those who are retired, but one society, a cohesive society of American citizens that are living together and understanding each others' needs and joining arms in arms in meeting those needs.

Senator ARMSTRONG. Thank you, Senator Grassley.

Senator Symms.

Senator SYMMS. Thank you, Mr. Chairman, and Senator Dole and members of the committee.

Mr. Secretary, I want to say that I am glad to hear Chairman Armstrong make the point that he wants this to be a bipartisan issue. I have found as recently as last week, at home, in my State, there is no issue that is more on the minds of the American people than getting the social security system fixed.

I would see that, I think we kind of have two jobs to do here with this committee. I would urge the chairman to do this rather rapidly.

I think we can fix the social security system so that we can save it from bankruptcy in the near future, to remove this fear that continues to go out to the population of the country.

I think we need to do that. But then, I think in the long term, that we need to, as a committee and as a Congress, address the problem that there is a couple of inherent failures, based on the premise of the social security system, and try to make a long-term fix of the social security system. It might take another year or two of correction.

What I am alluding to, of course, is the basic problem, is that this system is a chain letter. If you live long enough to get your name at the top of the chain, you maybe expect to draw something out of it.

Well, the 19-, 20-, 25-year-old worker can look at this chart and see that by the time they get to retirement age, the year 2030, there are two workers paying in for one person taking out.

They don't have to be too intelligent to figure out that that means they are going to be carrying one other worker with them. That becomes a very expensive burden and it simply is a chain letter. It is not an annuity vested system such as an insurance program would be.

The Congress of the United States, the State legislatures around the country, they passed laws against chain letters.

It is illegal, yet we run the biggest one of all right here in Washington, D.C. We might as well face reality and address that problem in a long term.

Now I am not suggesting, Mr. Chairman, that you do that in our first go-around to save the system from insolvency. But I am suggesting as we address this problem, that we look at it in the long term, to correct the system so that there will be an element of ownership on the part of each beneficiary, that they have paid in so much money and they keep that with all the modern computerization we have today, why every American couldn't have an accountability of how much money they have invested into the system, and how much it is worth and have it be something they own and they know it is theirs.

It would have a much better incentive for people to participate in. I mention the reason that the interest that people have in it. Every single place I have been in the last 2 weeks, there have been at least one young person would stand up in the town meetings and so forth, in the age of under 30, and ask how can we get out of the system.

It comes up everywhere. I think Senator Grassley alluded to it. We do have a problem here that will cause a problem. I think that, Mr. Secretary, where you received a lot of criticism and the President did, over this, I would have never voted against—I would never have voted with the 96 people in the Senate had I realized that that vote in any way would be interpreted as a repudiation of what you are trying to do.

I viewed that vote as saying that this Congress will not act on social security without a very careful hearing, to weigh all of the effects of impacts of how it will affect each person that is affected.

I interpreted that your suggestion was you laid it out on the table and said, "Here is a suggestion. Now you—Congress take it and work with it and something has to be done."

I praise you for doing it because the problem in this country is there are too many people consuming and not enough producing.

If we are going to continue to encourage everybody to stop working when they just reached their most productive capability, in many cases. This is true in many, many jobs that require skills and some art and thoughful judgment, particularly in agriculture, many of our best productive agriculture workers are over age 62.

We have often said in some of the sandy ground in Idaho that a person doesn't learn how to irrigate until he gets to be 65. It is just too difficult.

Then, all of a sudden, we try to force him into some kind of a state of retirement.

So, I personally want to praise you for it, even though I don't agree with the entire package. I certainly do not agree with a raising of the retirement age without a gradual phase in. I know that. I think that would just disrupt people's ability to plan. It would not be just to those who made plans immediately.

But, I think you are on the right track. I want to praise you and the President for being willing to address the issue to the American people. I find that the American people are generally, despite what has been said, are in favor of biting the bullet and correcting this system for a long-term benefit.

Mr. Chairman, you have my cooperation, as one member of this side, to try to work with both sides of the aisle, to solve the problem immediately, to save the system from insolvency, and then keep on working toward a system of vested ownership and to hopefully get away from the chain letter system so that the Americans that invest money in there, then you can get out the same money you invested in.

If we have a true savings program, then I think that could be brought about.

I think it is possible and it is doable and that is what I would like to work toward.

Thank you.

Senator ARMSTRONG. Thank you, Senator Symms.

Senator Baucus.

Senator BAUCUS. Thank you, Mr. Chairman.

Mr. Secretary, I will somewhat echo what Senator Symms said. When I was home to my State of Montana last week, I found that this issue by far was on the minds of more people than any other single issue.

I had three senior citizen town meetings in three major communities in my State. Ordinarily, when I call such meetings about 100 people arrive. This time there were in excess of 350 and they asked very good questions. They were very precise questions. They were questions that I often do not have the answers to.

The point is, they are very, very concerned.

Also, I think they are concerned in a fair, constructive way. They realize the trust fund is in trouble. They don't want their benefits cut, but they do want to find some solution that makes some overall long-range sense; that is, they want a solution that is fair.

I frankly, though, have been one of those Senators who voted in the 96, because I don't think the administration's proposals are fair. Essentially they cut benefits too quickly, and even cut benefits more than I think need be cut.

I was a little alarmed at the question that Senator Moynihan raised when he asked you, I don't want you to respond to this question now, is it the intent of the administration to lower some of the benefits so some of the funds are available for other Federal programs.

I don't know that is the intent of the administration. I don't know whether that is even on the minds of any in the administration. But, if it is, I strongly suggest you cast that aside and dash it immediately, because if it turns out to be true, I think you will agree that the Congress and the people are going to be, to say the least, outraged.

I just have several questions though, and I won't ask you that last question.

The questions I have are whether you think we in the Congress should adopt a pessimistic assumption or should we adopt the more rosy economic assumptions when we formulate some proposal here.

I ask that because in some cases the administration asks us to enact legislation, tax legislation, based upon what I would regard as rosy assumptions, rosy economic assumptions.

From the tone of your statement, I apologize I was not here to hear it, but in reading it, it seems you suggest we enact legislation based upon pessimistic assumptions.

The more I hear that, the more it leads me to conclude that perhaps some in the administration are thinking about using some of the funds for other purposes.

I just ask that you be consistent in suggesting whether we adopt rosy assumptions or pessimistic economic assumptions in all areas, whether it is social security reform or whether it is tax legislation or whether there are spending cuts.

I think you will follow that advice and be consistent. But I hope that everyone in the administration is more consistent in suggesting reform.

Thank you, Mr. Chairman.

Senator ARMSTRONG. Thank you, Senator Baucus.

I have good news for you. You have not missed the Secretary's statement. You are about to hear it.

Members of the committee, we are pleased and honored to welcome the distinguished Secretary, our old friend and colleague, Dick Schweiker.

I note with pleasure that he is accompanied today by another old friend, the Under Secretary, Dave Swoap, and by the Social Security Commissioner, Mr. Svahn, who brought to the attention of the committee and the Nation yesterday, the trustees' report.

We are glad to welcome you all.

I understand, Mr. Secretary, that you have a commitment for a Cabinet meeting late this morning. I am confident, as I am sure that you must be after hearing these expressions of interest, that we will be able to wrap this up and you will be able to report to the President later this morning that we have the problem well in hand and a solution in sight. [Laughter.]

With that word of encouragement, thank you for coming. We are eager to hear your testimony and have your thinking on this important issue.

STATEMENT OF HON. RICHARD S. SCHWEIKER, SECRETARY, DEPARTMENT OF HEALTH AND HUMAN SERVICES; DAVID SWOAP, UNDER SECRETARY, AND JOHN A. SVAHN, COMMISSIONER, SOCIAL SECURITY ADMINISTRATION

Mr. SCHWEIKER. Thank you, Mr. Chairman. I have a presentation to make to the Cabinet on immigration and refugees at a little after 11 o'clock, so I do appreciate the Senate's understanding in working out this schedule.

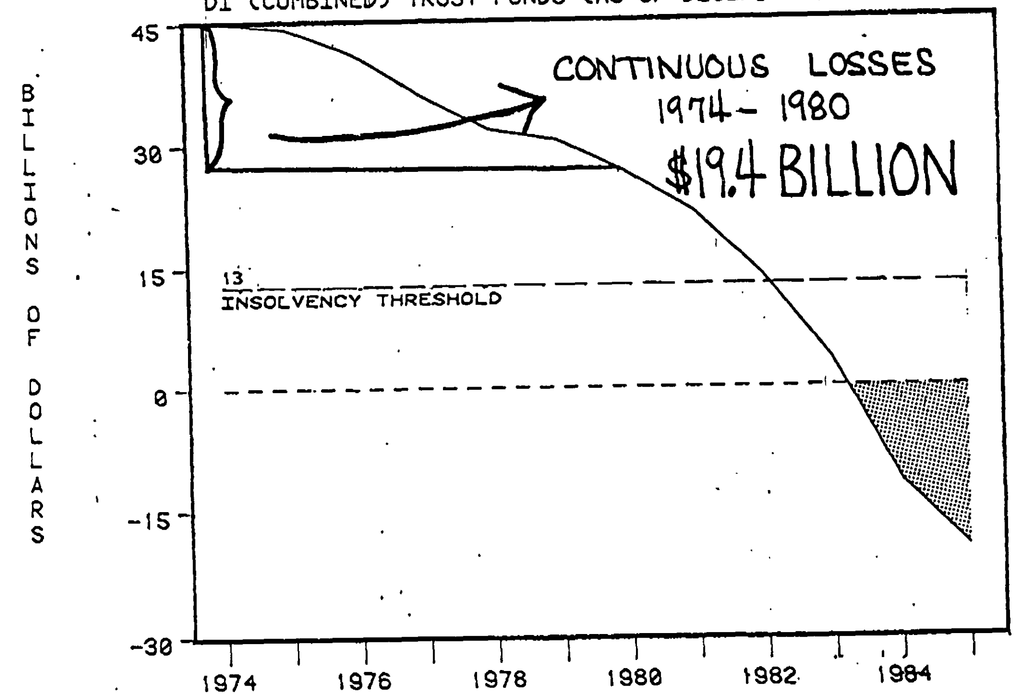
Mr. Chairman, in the interest of time, I will ask to put my whole statement in the record, and just give a 5-minute summary of where I see us at the present time, if that is agreeable.

Senator ARMSTRONG. Yes, of course. Thank you.

Mr. SCHWEIKER. I think this particular graph shows where the problem began [holding up a graph].

DECREASE IN BALANCES IN OASI AND

DI (COMBINED) TRUST FUNDS (AS OF DECEMBER 31)



NOTE: 1981-1985 BASED ON INTERMEDIATE B PROJECTIONS

Mr. SCHWEIKER. The problem began back in 1974. In 1974 we started losing money in the old age and survivors insurance trust fund and the disability insurance trust fund. We have lost money every year in those two funds since 1974. In other words, the problem has been pretty apparent for some time.

At the end of 1974, since we operate on a pay-as-you-go basis, we began running into the red in the sense that we were paying out more money to beneficiaries than we were taking in as revenues for the two funds, the disability insurance fund and the old age survivor's fund. We have lost money on that basis every year since then, 1975, 1976, 1977, 1978, 1979, and 1980.

There shouldn't be any mystery about where the crisis has come from. You obviously can't keep paying out more money than you take in.

I think that is a very important point because we have actually depleted the social security trust fund by $19.4 billion in the last 6 years. We have not had a year where we made money in social security in any of the last 6 years, a pretty good harbinger of things to come.

Far from crying alarm or viewing with a great distress or crying wolf, this is the truth of the matter. It has been this way for 6 consecutive years, for a total loss of $19.4 billion.

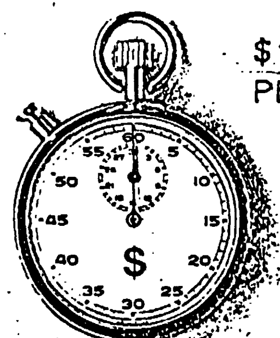
The second point is that the rate of loss is now so great that with the latest cost-of-living increase, we are now losing $12,300 every single minute [holding up a graph].

CASH FLOW FROM THE OASDHI TRUST FUNDS
(JULY 1981)

ESTIMATED BENEFIT PAYMENTS $14.7 BILLION

ESTIMATED TAX INCOME $14.2 BILLION

DEFICIT
$.5 BILLION



$12,300
PER MINUTE

Mr. SCHWEIKER. That is based on estimated benefit payments for July of $14.7 billion, and revenues of only $14.2 billion. So, the clock is going. While we are talking here, we are losing $12,300 every single minute.

Now no reasonable person, no person who just objectively looks at the facts could dispute we are losing money at the rate of $12,300 a minute or that we have been losing money consistently for 6 solid years. I think it is important to begin these discussions with a few facts, rather than some of the obvious differences in opinion and philosophy and analysis that rightly belong in this discussion.

I think there are two problems, Mr. Chairman, that we face in this regard. One of them obviously is the long-term problem. The long-term problem I think is summed up by the fact that our population is in fact shifting dramatically . We have a demographic explosion taking place with our senior citizens.

Over the next 50 years our population will grow about 40 percent. But the number of people who are 65 and over will more than double. So our senior citizen population will explode in this time frame.

The people who are 85 and over will triple, which is another significant increase in our older population.

This phenomenon will have a dramatic impact then on the social security trust funds. I think the Commissioner's chart shows it quite well. Back in 1950, when we had 1 beneficiary supported by 16 workers, nobody minded paying social security taxes.

Currently, we have three workers supporting one beneficiary. That has substantially changed the taxes, as we see from the chart. Of course, when the post World War II baby boom generation retires, we will have only two workers supporting each retiree.

No logic or reason can change these demographic facts that we have to deal with.

Now on the short-range problem, as I just articulated that, we lost money every year in the last 6 years from these two funds, and we are in a situation where we have loaded up the system with a lot of social welfare programs.

One of them is disability. The GAO made a study of our disability program recently and found out that there was a 20-percent error rate, that in one out of every five cases we are paying people who weren't disabled or shouldn't have been found disabled, either because the administrative law judge had acted too liberally in his interpretation of the law or because the law was drawn too loosely. You can take your choice. That has cost us about $2 billion a year.

So, we have made the social security fund into other things, that is, a welfare fund rather than a retirement fund, which was social security's original purpose.

Now, there are no easy choices. I think the chairman articulated some of them. You can reduce to some extent the cost-of-living adjustment to everybody, the 36 million people who presently receive a check. You can raise the retirement age from 65 to 68, as Congressman Pickle wants to do. You can reduce the incentive to retire at 62, which is basically our proposal, or you can take the money from the Treasury.

When you see the fact that the OASDI trust funds have been losing money every year for 6 years, it is certainly not a very good way to begin by siphoning it off the Treasury, when the Treasury is already losing money. With interest rates high because of Government borrowing and with the economic situation caused by Government deficits, that will only compound the problem.

The fact that there is a short-term problem is articulated by Congressman Pickle and Congressman Pepper. They don't particularly agree with our solution, but they have introduced bills that would shift funds from the general treasury to the social security funds. The shift is about $100 billion, over 4 years in Congressman Pickle's bill and $156 billion over 5 years in Congressman Pepper's bill.

So, whether you come from our side or the other side of the aisle, there is agreement that there is a shortfall of $100 to $156 billion in the next 4 or 5 years. Even though they have different solutions they define the problem in the same way that we do.

We believe that our proposal does several things. It keeps the traditional 65-year-old age for retirement. We don't pull out the plug on people who figured on retiring at age 65.

No people who are presently retired, who are now depending on the cost-of-living adjustment would be affected by our plan. The 36 million social security beneficiaries who are out there now fighting to make ends meet, in terms of inflation, will have the assurance that their benefits will continue to be adjusted annually for inflation. We think that is a very fundamental point and a very key point.

In addition, we also eliminate the earnings test so that we encourage people to consider working past 65 on a voluntary, not compulsory, basis which we think will help the situation.

We do not propose to change the cost-of-living adjustment, as I mentioned a moment ago, and we will permit people to retire at 63 years and 8 months, and get almost as much as they would get if they retired at 62 under present law. It is not a matter of retiring at 62 versus 65. It is a matter of saying that if you wait 1 year and 8 months, you will get about 80 percent of your full retirement benefit the same as you would at 62 under present law. I think somehow this has been forgotten.

We believe, Mr. Chairman, that this is a logical proposal. I have said from the beginning that we are willing to phase in our proposal. We recognize the criticism that people should have adequate notice. We made it clear that we are willing to compromise on the point of notice and give people time to prepare, time to adjust, in a time frame that is reasonable and fair. We are open-minded. So, we are willing to adjust and amend that particular part of the proposal that would allow a phase-in period so people could be put on notice and could in essence consider that.

To summarize where the problem is presently, the old-age and survivors insurance trust fund and the disability insurance fund actually lost $3.8 billion in 1980. They will lose $4.8 billion this year. In 1982, they will lose $7.5 billion if nothing is done.

So, this trend of year after year losses beginning in 1974, will accelerate, will get worse: $3.8 billion in 1980; $4.8 billion in 1981; $7.5 billion in 1982, and that is in spite of the fact that we had the largest peacetime tax increase in history just a few years ago. In spite of that fact of the largest peacetime increase in taxes in history, we will still sustain those losses.

So, we feel this is a realistic assessment of the rate of loss and the problem. We believe that we have a solution. We have made it very clear that we want to be bipartisan in this. If somebody has a better solution, we are open to it. If somebody wants to compromise with us, and work out a reasonable package, we will do that. We already have a group underway, as this committee knows. We are delighted that everybody here has indicated their willingness to join in that effort. We are going to do the same thing in the House.

To conclude, Mr. Chairman, we appreciate the opportunity to be here to present the facts as we see them and to say that we are open to compromise. We are open to a reasonable proposal. Nobody has any monopoly on truth in this particular area.

Senator ARMSTRONG. Thank you, Mr. Secretary.

Thank you for your statement. I especially want to congratulate you, not only on what you said today but for the fact that you have been willing to confront head-on, the long-term problem.

There are a lot of people who would have naturally assumed that it would be easy to just suggest a short-term approach to this problem and to put off the hard decisions and the tough choices that you have outlined.

It seems to me that we really owe a debt of gratitude to you for taking a forceful, long-term look at this and bringing the problem to the attention of the committee, and for that matter, putting it on the agenda of the country.

I thank you for that.

Mr. Secretary, I have a number of questions I want to propose to you. But I think I would first want to recognize Senator Dole for his questions and the other members of the committee, and then, consistent with the time available, I will have a number of questions at the end that I would like to present.

Senator Dole.

Senator DOLE. It seems to me, Mr. Secretary, that the biggest problem we have may be one of education.

I have watched some of the interviews of social security recipients in response to changes suggested. There are a number of people who are very worried. I should guess everyone would be very worried, whether they are now receiving benefits or may receive benefits 10 or 15 years from now or 1 year from now.

You have already indicated your willingness to phase in reductions in benefits rather than make abrupt change as earlier recommended; is that correct?

Mr. SCHWEIKER. That's correct, Senator Dole. I want to say that I think that was a valid criticism and as much as we wanted to balance the sheet on the fund as soon as possible, we do believe there should be fair notice. That is one part we are willing to change and we say so.

Senator DOLE. I read a book by Mr. A. Haeworth Robertson. He will be a witness here later in the hearings. He indicated that the biggest problem with social security is a lack of information and a lack of understanding of the system.

Is there going to be any effort made so that those who will be retiring down the road, will have some easy way to find out what their benefits may be?

Mr. SCHWEIKER. Mr. Chairman, they can go to their Social Security office now and ask for that information, so that is available now. While it may take a few weeks to get it, depending on the computer load at the moment, they can get that information now.

Senator DOLE. That is why I asked the question. In case some of them may be listening, they now know that these services are available.

It would seem to me then we have another problem. Many people believe that social security benefit amounts are a matter of right. If they paid in, and are covered by social security, benefit formulas or actual benefits should never again be examined.

I would just hope that during the course of these hearings we can focus on that.

There is a group called SOS. It has over 100 member groups. The leaders of SOS indicate that we really don't need to cut anything.

Have you analyzed their proposals or their statements?

Mr. SCHWEIKER. Well, Mr. Chairman, most of the people who are in that group are the same ones who told us when we passed the 1977 act that this would assure that the trust funds would be safe for 40 years. Of course, in hindsight that turned out to be a ridiculous statement, but it is the same team whose projections of what the fund would do and could do were so wrong in the past. We maintain they are wrong about the future.

Senator DOLE. As I understand it, the reason for concern this time, in addition to the obvious concerns in the short term, is that there is fairly broad understanding that in order to preserve the integrity of the system, we need to make some fundamental changes.

There have been some who indicate that the administration is not really concerned about the social security system, but wants to somehow balance the budget by cutting back benefits.

I would like to have you address that question.

Mr. SCHWEIKER. That is completely false, Senator Dole; absolutely false. The money is put into a trust fund account. It couldn't be used for any other purpose. I am a trustee of that account. So is the Secretary of the Treasury. So is the Secretary of Labor. We are the trustees. We have to sign and certify what happens in that fund. The money couldn't possibly be used for any other purpose. Anyone who says that is not aware of how the trust fund operates or of our duty as trustees.

Senator DOLE. Well, again, I think that statement needs to be made a number of times. I think there will be a lot of rhetoric indicating to the contrary.

Can we get through the short-term crisis by, borrowing from two of the funds for the third fund that may be a little short right now? I have heard that suggested as recently as this morning on one of the networks. We just take a little out of this fund, a little out of that fund, until the shortage is covered.

Can that be done?

Mr. SCHWEIKER. Well, first let me say that the figure that I gave you on the time clock running, where I said that social security was losing $12,300 a minute, included the hospital insurance fund. All three funds combined are losing $12,300 a minute.

It is true that presently the hospital insurance fund is making money on its own. If you disregarded the two other funds would be losing $18,000 a minute.

So, even including the hospital insurance fund, we are losing $12,300 a minute.

The Trustees project that within another decade we will have similar problems in the hospital insurance fund, I think we should not kid ourselves about that.

All these funds have problems. The Hospital Insurance Trust Fund has a longer time frame, so we are not immediately concerned about that. But even if you did what you suggest which is to borrow among the funds, and frankly, our proposal includes that, you might put off the crisis a year at the most. So, you still have to face up to the problem. You might delay it 6 months to 1 year by interfund borrowing, but the net deficit is there. It is getting worse daily.

Senator DOLE. My understanding is that the deficit in the hospital insurance fund could be as high as double the deficit of the OASDI funds in the long term.

So, I think we can't overborrow from any of these other funds.

Mr. SCHWEIKER. In the long term, the hospital insurance fund probably has more severe problems than the Social Security Old-Age and Survivors Insurance and Disability Insurance Trust Funds, but they just aren't with us yet.

Senator DOLE. Finally, could you give assurance to those who are receiving benefits now that the Congress and the administration will not let them down come next year. We are going to solve this problem. That is the goal of this administration; is that correct?

Mr. SCHWEIKER. We have gone all along on the basis that the people who are currently getting benefits now will be protected.

We are going to do everything under the Sun to solve the real problem. We gave people some bad news which isn't popular. That is why we started out in a very unpopular climate.

The guy who bears the bad news is a very unwelcome person. I have been the target of that and I understand that. But I think that is my job as Secretary. We in the Reagan administration feel that by giving people bad news and taking your medicine, you can cure the health of the fund and get it straightened around.

So, we are making every effort to promote the health of the fund and restore it. It begins by taking some bad medicine. But we are going to keep the integrity of the fund intact. That is why we are here fighting for our proposals or some compromise proposals.

Senator DOLE. My time has expired. Thank you, Mr. Secretary.

Mr. SCHWEIKER. Thank you, Senator Dole.

Senator ARMSTRONG. Senator Moynihan.

Senator MOYNIHAN. Thank you, Mr. Chairman.

Let me go back to your original theme that we want this to be a bipartisan exercise and we do. It is also proposed that the extension of the debt limit to $1 trillion be bipartisan.

But today we have heard some things on the other side of the committee that suggests we are back in the middle of the 1930's arguing the principle of social insurance.

One of my colleagues, who I respect and admire, even said that he thinks people should retire on their own savings and not rely on a welfare concept.

Social Security is not a welfare concept. It is social insurance. It is not a chain letter, a gamble. It is insurance. It insures you against loss of income.

We have had it with us in good shape for 50 years and suddenly, its very principles are being questioned.

Mr. Secretary would you raise that graph you showed us, your first chart you were showing us?

You keep pointing out how it is going down, down, down. Mr. Secretary, there are three social security funds. How many are on that curve?

Mr. SCHWEIKER. Two.

Senator MOYNIHAN. Why aren't they all there, sir? It is all social security money. Why do you present us a chart with only the two we agree are in difficulty, but not with the one which is not in difficulty at the moment?

Mr. SCHWEIKER. Well, if we did put the other fund in there, the fund would soon be even further in the red, further down the line, Senator.

Senator MOYNIHAN. I don't accept that, Mr. Secretary.

That is not what your data show, Mr. Secretary. When the other one gets to be in trouble, the first two begin to revive.

Mr. Secretary, let me ask you this question. You said you propose to reduce the incentive for retiring at age 62.

Now, Mr. Secretary, there is not now any incentive to retire at age 62. There is a reduced payment which actuarily equals out to the amount that would be received if the beneficiary retired at 65.

Most people who retire early are sick, Mr. Secretary. They get out of the system no more than they would get had they not been ill and stayed employed until 65.

Now, sir I ask you this in the beginning, and I am very serious about it. Is it still your proposal to reduce benefits for persons retiring at 62, to 49 percent of their age 65 entitlement?

Mr. SCHWEIKER. Well, they go from 80 percent to 55 percent.

Senator MOYNIHAN. But since everybody else goes from 100 to 90, you get 55 percent of 90 which is 49.

You are still with that proposal, even though you are prepared to phase it in?

Mr. SCHWEIKER. Well, I——

Senator MOYNIHAN. I mean, prepared to give fair notice.

Mr. SCHWEIKER. I don't know the exact figures, Senator, but there is no question we put a disincentive on early retirement. However, about 1 year and 8 months after age 62 a person could retire with the same 80 percent rate that he had at age 62 under current law.

Senator MOYNIHAN. You are reducing those benefits.

Mr. SCHWEIKER. No question.

Senator MOYNIHAN. There is no question that this is your intention.

Mr. Secretary let me ask you one key question in response to the statement that the chairman made. I give you this situation. Mr. Secretary, it is 1984, and the budget is $40 billion in deficit. But somehow you managed in that year to cut social security payments by $40 billion and add that money to the fund reserves.

What happens to the deficit? It disappears; correct?

In the unified budget it disappears.

Mr. SCHWEIKER. Senator, you keep mentioning unified budget. The truth of the matter is——

Senator MOYNIHAN. The budget. There is only one budget.

Mr. SCHWEIKER. I am a trustee. I can only account for the money that comes in and goes out. I have to take an oath to that. I have to certify to that. The money can't be used for any other purpose.

Senator MOYNIHAN. Mr. Secretary, no one is suggesting the money will be used for any purpose other than social security. While you are a trustee it will be meticulously maintained.

I ask you the question, however, if social security payments were $40 billion less, would not the $40 billion deficit disappear on paper?

The answer, sir, is "Yes."

Mr. SCHWEIKER. Well, I am glad that you answered your own question, then.

Senator MOYNIHAN. Do you think otherwise? Does Mr. Svahn think otherwise?

Mr. SCHWEIKER. I think you are trying to create the illusion that one offsets the other and it doesn't. We have to put it in a separate account.

Senator MOYNIHAN. I am asking you what the deficit would be.

Mr. SCHWEIKER. We have to dispense money from it. We can't take it and use it for any other purpose or we would be violating our oath and I think even a future trustee——

Senator MOYNIHAN. Mr. Secretary, the deficit would be zero.

Mr. SCHWEIKER. Your deficit would be zero, but our deficit would be quite a different proposition.

Senator MOYNIHAN. You would have built up your funds.

Mr. SCHWEIKER. As a trustee of the fund.

Senator MOYNIHAN. That's right. But the Federal budget would be in zero deficit. That's the point we make and no other.

Thank you.

Mr. SCHWEIKER. I don't agree with your point.

Senator MOYNIHAN. Well, Mr. Secretary—let me ask Mr. Svahn. Do you think if there is a $40 billion deficit and somehow social security payments are reduced by $40 billion that the deficit on paper does not thereby disappear?

Mr. SCHWEIKER. You are implying that we are using one to balance the other and we are not.

Senator MOYNIHAN. I am not implying anything. I am just asking you if these events occur would the deficit not disappear. Now, the answer is yes. It would. There would be no deficit.

Mr. SCHWEIKER. Not if you went back and read the detail on the budget of the social security trust funds. It would make clear exactly where the money was.

Senator MOYNIHAN. You have a surplus in the trust fund and no deficit.

Mr. SCHWEIKER. I am sure you wouldn't let us do that, Senator. I am sure you would be the first one to tell us if somebody tried to pull that charade. That is all it would be.

Senator MOYNIHAN. Thank you, Mr. Chairman.

Senator ARMSTRONG. Senator Durenberger, would you like to pursue this or other matters? [Laughter.]

Senator DURENBERGER. Thank you, Mr. Chairman.

Let me ask you, Mr. Secretary, what elements you do agree with in the characterizations made by the Senator from New York.

For example, in the beginning of his question he said this is not a welfare system. This is not a chain letter. It is not a bunch of other things. He says it is a social insurance system.

Do you agree with that statement, and if you do, would you give us the definition of what you think a social insurance system is?

Mr. SCHWEIKER. Well, I think, Senator Durenberger, we want to try to get back a little bit to the more narrow constraints of the program.

I think in disability insurance particularly it is probably going too far. I think in terms of student benefits it went too far. I think in terms of minimum benefits it went too far.

I think that is how I would define it. I think we do want to provide social insurance, but we want to narrow the definition because if you look at that chart on benefit payments, what drives it up the wall is the fact that we have made the definition for social welfare so broad that payments have escalated way out of sight. All we want to do is to restore the social insurance concept to what it was.

The fund got into trouble in the last decade.

The answer to your question is, if we go back to the provisions in effect before some of the more recent amendments, we might well define social insurance correctly.

Senator DURENBERGER. It seems to me there are several implications that can be drawn from the use of the word "insurance."

One is that it is a cash form of income security, usually taking the form of cash that you receive in the event of something happening to you, death, disability, the death of your sole supporter, or retirement, whatever the case may be.

That is one form of insurance.

Another form may be just having made a series of payments into an insurance policy in our insurance policy concept, then you have a right to take out whatever the payee promised you.

This form of insurance is the version that Senator Symms was talking about. We have to guarantee people that the payments made into the system are going to provide them with some repayment should some of these things happen.

I want to ask you principally about the health issues. I consider you as having been a health expert before a social security expert.

I listened to your comments that the $12,300-a-minute loss would be an $18,000-a-minute loss if we excluded health insurance from consideration.

I look at the impact of the withholding tax for health insurance at 1.3 percent per worker; 2.6 percent for the worker and the employer combined.

If the health insurance tax were used for the other eventualities, the cash eventualities, you could reduce this drain down to at least $6,600 a minute.

So there are some substantial savings if you will, to be achieved, by taking health payments out of the system; is that not correct?

Mr. SCHWEIKER. If you put the hospital insurance fund in, it is still $12,300. Maybe I wasn't clear. In other words, if you throw all three funds together now, today, we are losing $12,300 every minute from the three funds. If you took the hospital insurance fund out of the pool we would be losing $18,800 every minute from the OASI and DI funds.

Senator DURENBERGER. Then the point is that there is $5,700 a minute to be saved by not taxing payroll for health insurance; is that correct?

Mr. SCHWEIKER. Well, the hospital insurance trust fund is gaining about $6,000 per minute at the present time, yes.

Senator DURENBERGER. Now with regard to your comments on transfer from one fund to the other. You talk about the potential bankruptcy of the health insurance fund but that is a fund that we as policymakers can control.

There was an automatic premium adjustment, for example, that took effect on July 3.

We can control the amount of premium. We can control the amount of deductible. We can control the amount of copay, if we wanted to go copays. We can control, if we ever get our minds to it, the escalating cost of health care in this country.

We can control, as we tried to do on the floor of the Senate last week, who gets into the medicare program. In other words, our efforts to go after the FEHB and make that primary for retired persons health care rather than secondary.

My question to you is what you or the administration is doing to look at the issue of medicare and as a way to bring some solvency to the retirement, the cash retirement program, survivor programs or disability programs.

Are you taking a serious look at the noncash part of the social security system to see if there aren't some changes that could be made there?

Mr. SCHWEIKER. Yes, we are. I have appointed a task force in my department to work in the health area and to focus particularly on that.

We hope to have some proposals to this committee for making changes in the health and hospital part of this operation some time later this year. .

Senator DURENBERGER. Thank you.

Senator ARMSTRONG. Senator Symms.

Senator SYMMS. Thank you, Mr. Chairman.

Mr. Secretary, again, I want to emphasize that I think what you are doing to bring this issue up to the American people is good and not bad. That is going to be the way we are going to get the problem solved, is by looking it right in the eye.

I want to ask a question—I mentioned about the computerization we have nowadays and the accountability and the way people can keep track of their records.

How much additional burden to the administration of the program would it be if every month, on the check that is mailed out to the recipients, that you put on the check that this recipient, John

Doe, had paid in so many benefits and has now taken out so many benefits?

So that you carry a balance for each person so that when the get up to where they have taken out say twice as much as they have put in—is it possible to do that at least so that the recipient would know it and the American people would know it, that this system isn't based on ownership or a vesting rights or an annuity?

Mr. SCHWEIKER. Let me say, Senator, it is possible to do it. It would entail some extra paperwork and bookkeeping, but I want to say your point is well taken, because a person who retires today at age 65 will get all his taxes back in about 19 months.

Senator SYMMS. In 19 months.

Mr. SCHWEIKER. That would not include interest. But in terms of pure money in and out, he gets it back in 19 months. If you put interest in there, obviously it is a longer period of time, but 19 months is fairly short.

Senator SYMMS. Well, another question I would have is that last week when I was in Idaho, I ran into an 81-year-old constituent of mine who talked to me about the social security program and suggested that for those people who were in the top bracket, which this constituent happened to be, that there be no increase in benefits.

He looks at the Federal budget and he looks at me as a newly elected conservative Republican in part of the Reagan landslide, and said it is incomprehensible to him that those people, that you people in Washington, as he puts it, would not have enough commonsense to not give—this gentleman happened to be getting his social security as $1,045 a month.

He said when he looks at the budget and the inflation and all the problems that have been brought about by excessive Government spending, he can't understand why we are raising his benefits when he said he is getting along nicely as it is.

His house is paid for. His car is paid for. He doesn't really want the increase. He would rather have the budget balanced and get the mess straightened out in Washington as he put it.

What about that person? Is there any way we could do this on a phase in that the top people don't get as much and the lower 25 percent get the full benefit, and maybe in the middle they get part of it?

Mr. SCHWEIKER. We could certainly look at that aspect of it, Senator Symms. The proposition has been that this is social insurance as opposed to welfare. So you would be reversing those concepts. By the same token, that could be studied in terms of cost and savings.

Senator SYMMS. Well, it seems to me that—the reason I think we ought to address the cost-of-living increases is we do have a problem with inflation, but the recipients of social security are completely shielded from any problem with inflation.

So there is no incentive, at least from that whole segment of the economy, to worry about inflation. I think that is—that is why I am happy you finally brought this to the forefront, because I think it is a mistake not to address that big population out there.

There is a growing number of people in the retired numbers of our population and if they are going to get automatic cost-of-living increases, in many cases, due to their own personal increased cost, as the gentleman I referred to, his cost of living doesn't go up as much as the CPI does.

Yet, he is going to get an 11-percent increase; is that correct? That will make 100 and some dollars a month. Now that is a double benefit, a man and a wife. A 74-year-old wife, 81-year-old husband who has paid in the maximum, obviously, over the years to get that kind of a benefit.

I would like to go on to one other question on that, if there is time. I guess there is time.

I talked, at the same time I mentioned the young people bring this question up. The proposition I am asked everywhere I go is that these young people say to me that they would not invest their personal money in a chain letter as a private investment. That if they were going to buy a retirement program they would put it in an account where it was accountable to them and every month if they put so much money in it, that it would be their money, plus interest, and upon either death or retirement, that either them as the beneficiary or their heirs or their family or whoever, would get that benefit, but they would never invest their money in a chain letter, hoping that someday their name gets to the top of the list.

Now, is this a vested annuity system or is it actually a chain letter?

Mr. SCHWEIKER. No. 1, it is not a vested annuity system. It is not like most pension funds. No. 2, up until now, it has been financed on what we call a pay-as-you-go basis.

By the same token, if we don't take action now, if we let these charts go on up through the ceiling in terms of benefit payments and new beneficiaries, if we let the deficits go on down, it could turn into a chain letter.

That is exactly why we are here today arguing for some medicine and for some changes and for some narrowing of focus. Because it could turn into that unless we have the courage and foresight and determination to do something about it now.

Senator SYMMS. Well, now, you have in the chart at the year 2030, there will be two workers paying in for each beneficiary.

Now I heard Senator McClure speak in Idaho in the last 6 months, and he made the statement that in the year 2020, under our present actuary tables, that there will be one person paying in and one person taking out.

Now, is that accurate, in the year 2020?

Mr. SCHWEIKER. No, it is two. Our figures and estimates show it is two.

Senator SYMMS. Two?

Mr. SCHWEIKER. Two people paying in for one beneficiary taking out.

Senator SYMMS. So if the average—what does the average beneficiary take out?

To put this in perspective?

Mr. SCHWEIKER. About $350 a month.

Senator SYMMS. About $350 a month. In other words, each American then would have to figure on carrying $175 a month on today's standards.

Mr. SCHWEIKER. On today's standards of benefit payment and who is eligible and how many programs are piggybacked onto it, yes, if you count the employer portion of the tax in that figure.

Senator SYMMS. So I think that is why these 25-year-old people at the town meetings are asking these very perceptive questions.

Thank you very much, Mr. Chairman.

Senator ARMSTRONG. Senator Baucus.

Senator BAUCUS. Thank you, Mr. Chairman.

Mr. Secretary, I understand that the administration's proposal to solve the short-term problem here is to basically reduce early retirement benefits, also the minimum benefit and that the administration's projections, those short-term solutions will solve their problems, are based upon pessimistic projections of a 9.1 unemployment rate in 1984 and a CPI increase in 1984 say at 10.9 percent. Is that correct?

Mr. SCHWEIKER. Let me explain, if I may, the projection. We have several sets of projections and we are calling the ones that you are referring to the worst case projections.

Even though they are pessimistic—and I think it is awfully important to make this point—even though they are pessimistic, for the next 5 years, they are better than what has happened to this economy the last 5 years. So, you can say our projections are too pessimistic, but in fact, they are better than what has happened for the last 5 years.

Senator BAUCUS. They are also the projections that the administration is relying upon to show that short term problems of the trust fund will be solved.

Well, if that is the case, I would like to follow up a little bit on the point Senator Moynihan is making.

Mr. SCHWEIKER. Yes.

Senator BAUCUS. Let us say that in 1984 it turns out the economic results, that is, the CPI and the unemployment rate turn out to be not these "pessimistic assumptions," but rather the administration's economic assumptions the administration has given us, in 1984, and arguing for its tax cut in essential economic programs.

That is an unemployment rate of 6.4 percent, in 1984, as opposed to a 9.1, which is the pessimistic rate that you talk about, and also, for a CPI of 5.5 increase in CPI in 1984, under the administration's economic program, compared with yours at 10.9.

If it turns out that the economy does perform in the way that the administration suggested it will, and tells us that it will in 1984, isn't the result that the decreased benefit, that is, in the social security trust fund, result in increased surplus in the trust fund because the economy performed much better than we assumed it would, isn't the result that the administration's proposed wash of deficit in 1984 or a slight surplus, will in fact be a big surplus?

That is, isn't the result that the reduced benefits that we will be giving to people if we enact the administration's program result in an increase surplus or decreased deficit in the budget in 1984?

Mr. SCHWEIKER. First of all, it gets back to how much should be in the reserve ratio, Senator. The first time that the OASDI trust funds went under 100 percent of reserves was in 1971. Even if the optimistic assumptions come into being, we will just be building the reserve ratio back up to what a lot of people in the past said it should be, and what it was up until 1971.

It was from 1972 on, that we started getting into trouble. After 1974 everything was in the red, going down hill. So, there is some logic, even if our pessimistic assumptions don't come true, in building up the trust funds to what they ought to be.

Senator BAUCUS. Let me ask you another question. Is the trust fund in better or worse shape if the administration's economic assumptions come—occur, rather than your economic assumptions?

Mr. SCHWEIKER. Well, don't say mine, because we have five projections.

Senator BAUCUS. But you are saying your proposals are based upon the pessimistic. I am assuming that you are acting on the pessimistic one?

Mr. SCHWEIKER. Well, we are in the short run. I have to go back to a little tradition and history here. The trustees have historically presented pessismistic assumptions for the short run. But for the 75-year projections, the trustees have relied on the intermediate assumptions.

So, we have followed that.

Senator BAUCUS. In the short run, won't the trust fund be in better shape if the administration's economic assumptions occurred, than would be the case if the pessimistic projections occur?

Mr. SCHWEIKER. Well, we still would be only up to 35 percent of full funding for a whole year.

Senator BAUCUS. Could you answer my question, please?

My question is: Won't the trust fund be in better shape——

Mr. SCHWEIKER. A ratio of 35 percent would be better; yes.

Senator BAUCUS. Better. So if that is the case, then isn't it true that the budget, the administration's budget for 1984 is in a lot better shape and will show in either no deficit or reduced deficit or greater surplus, if the administration's economic assumptions occur in 1984, and won't the result be that we will have reduced benefits taking from social security recipients, taking the pessimistic assumptions, and using those reduced deficits to show a better administration budget in 1984?

Mr. SCHWEIKER. You know, we keep coming back to the administration's budget. It was Lyndon Johnson who unified the budget, so let's put it all on the table.

Senator BAUCUS. That is not the question, who unified it. We are talking about what the result will be.

Mr. SCHWEIKER. President Johnson had very good reasons for unifying the budget. You keep twisting and distorting the purpose today. He was the one who did it.

Senator BAUCUS. Mr. Secretary, I suggest it is you who is twisting and distorting by evading the question. You are not answering the question.

Mr. SCHWEIKER. Well, repeat the question.

Senator BAUCUS. The question is: If we adopt your suggested pessimistic assumptions and reduce the benefits as you suggest we do, but if it turns out to 1984, the economy is not performing that pessimistically, but better, that is, using the administration's economic assumptions in 1984, the result will be that reduced benefits to social security beneficiaries will help balance the budget or show a greater surplus in 1984.

It will be unnecessary to reduce benefits because the economy performed a lot better than was—than you suggest it would perform——

Mr. SCHWEIKER. Not a penny of the trust fund will go to balance any budget. Not a penny of that trust fund will go to pay any other expense of Government. Not a penny of that Government money will be used for any purpose except the social security checks. We will be building up a reserve to 35 percent and the trustees say it should be 50 percent. Some people say it should be 100 percent.

Senator BAUCUS. I am not suggesting that social security funds are going to be used to pay for other programs.

As you know, when we calculate the budget, we look at total receipts and total expenditures. That includes trust fund receipts and outlays.

I am just suggesting, whether or not it is intended, as the matter of fact, the budget surplus would be much greater, if the economy performs much better, than you suggested it will perform in suggesting what solutions we enact to solve the trust fund.

Mr. SCHWEIKER. Of course, the budget will be whatever Congress makes it, Senator. In other words, Congress can play games, too.

Senator BAUCUS. I am assuming everything else being equal.

Mr. SCHWEIKER. Well, the fact is that the trust funds stand on their own—fiscally, legally, and any other way.

To imply that we somehow use money to pay somebody else's bills is just totally false, just totally false.

Senator BAUCUS. Mr. Secretary, that is exactly my point, the words out of my mouth. We are not implying that. I am not implying that trust fund money is going to be used to pay other bills.

I am just trying to establish, and I think you agree with me, but you are not willing to answer the question fairly and honestly, I am trying to establish that as a factual matter, once again, if we enact the proposals that you suggest we enact to solve the trust fund problem, but also if the economy is performing much better in 1984, that is, according to the administration's economic data, that the net result will be, everything else being equal, that we will be reducing social security benefits to show a greater than necessary surplus in 1984?

Mr. SCHWEIKER. Well, the purpose won't be to show anything. That is where I disagree with you.

Senator BAUCUS. Whether it will show it or not, that will be the net result.

Mr. SCHWEIKER. It is not for show.

Senator BAUCUS. That will be the next result.

Mr. SCHWEIKER. Well, that will be a result that you would interpret, but I would not interpret it that way.

Senator BAUCUS. How would you interpret it?

Mr. SCHWEIKER. I would interpret it as a way of stopping the hemorrhage in the fund that is going on at the rate of $12,300 every minute. I would interpret it as a way of saying that after we have been losing money in those two funds every year since 1974, this is a way of stopping the loss of money every year.

That is the way I would interpret it. It is unfair to interpret it the other way. That is our purpose. That is our motivation. That is why we are here today. That is why we are taking all the political heat that we are to restore integrity in the fund and give people assurance they are going to get their checks.

Senator BAUCUS. My time is up, Mr. Secretary, but that is all right.

Senator ARMSTRONG. I thought Senator Bradley had yielded his time to you.

I guess not.

Senator Bradley.

Senator BRADLEY. Thank you, Mr. Chairman.

Mr. Secretary, I think what Senator Baucus pointed out is that the administration has two sets of books here.

Mr. SCHWEIKER. No, it was Lyndon Johnson——

Senator BRADLEY. Please, Mr. Secretary.

Mr. SCHWEIKER. No, no, Lyndon Johnson set it up, Senator Bradley. I was here when he did it. He did it for some other reasons. But he set it up. Let's put it where it belongs.

Senator BRADLEY. What is the question I was going to ask you that you are now responding to? [Laughter.]

Mr. SCHWEIKER. The two sets of books.

Senator BRADLEY. What does that mean? What was the question I was going to ask?

Mr. SCHWEIKER. That we had two sets of books here.

Senator BRADLEY. No, we have two sets of books in which there are two different sets of economic assumptions.

One of the sets is the budget of this administration upon which all the spending cuts are based, and upon which this ridiculous tax plan is based. That set says there will be unemployment of 6.6 percent.

That is what the first budget resolution says.

Then we have the pessimistic assumptions for the social security trust fund which is the second set of books involving completely different economic assumptions. That set says that unemployment will be 9.7 percent in 1983, not 6.6 percent.

So, this is your classic case where you can't have it both ways. The American people are not going to be fooled by such differences.

Let's assume that you are acting responsibly, which I would assume you are. Let's assume that you want to protect social security recipients. So you plan with the pessimistic assumption of 9.7 percent unemployment in 1983. That is what these cuts are based upon, 9.7 percent unemployment.

If the rate of unemployment was 9.7 percent, how much greater would the deficit be given the first budget resolution? After all, if your conservatism here is based upon a possible reality, you want to cover yourself. You are the head of HHS. You are looking at the trust fund and you want to protect the trust fund. I give you credit for that.

So, you say, "I must protect against all eventualities, and among all the possible eventualities is an unemployment rate of 9.7 percent."

My question to you is: If you are prudent, which I think you are, and indeed the unemployment rate is 9.7 percent in 1983, how much greater will the Federal deficit be?

The question then succinctly is: For every 1 percent increase in the Federal rate of unemployment, how much loss is that in budgetary terms?

Mr. SCHWEIKER. Basically, Senator Bradley, our assumptions, the worst-case assumptions are still better than what has happened to this economy during the past 5 years.

Senator BRADLEY. That is not the answer to my question.

In the Budget Committee, and the chairman will probably correct me if I am wrong, every 1 percent increase in unemployment is worth about $29 billion in lost tax revenues and increased unemployment payments.

So, if your budget says you have a 6.6 percent rate, and your pessimistic assumption says you have a 9.7 percent rate, you have a slight difference of 3 percentage points in unemployment. If 9.7 percent is closer to the truth, this will have a major effect on the set of books which is the budget in the first budget resolution.

Mr. SCHWEIKER. What I am trying to say, Senator Bradley, is that we use a different standard than the Budget Committee uses, because we look at the growth in real wages. How much do wages grow ahead of the cost of living? That is what affects us. That is what we budget on.

We use an assumption of a negative six-tenths of a percent when actually we had a minus 1.1 percent for the 5 years we have been through.

So, what I have been trying to say is that even our worst case is 50 percent better off in terms of the change in real wages than what we just went through.

Senator BRADLEY. Here is a sheet, prepared by my staff, comparing the first budget resolution assumptions with those underlying the pessimistic scenario. It says, "First Resolution, unemployment rate, 1983, 6.6 percent. Pessimistic unemployment rate, 9.7 percent." Now that is a 3 percentage point difference. For every 1 percent increase in the unemployment rate you are going to have close to a $29 billion impact on the budget. Thus, if your pessimistic assumptions are correct upon which you are basing your cuts in benefits to social security recipients, you will have close to a $100 billion deficit to deal with.

Senator ARMSTRONG. Thank you, Senator Bradley.

Senator Byrd.

Senator BYRD. Thank you, Mr. Chairman.

We are dealing, as I see it, with a program which is more important to more people than any other Government program.

Mr. Secretary, I have had a chance just to read your testimony today. As I look it over, you are saying in effect, are you not, that there is no good solution to the situation in which we find ourselves with regard to the social security program.

That there are certain basic, certain fundamentals that you and the administration adhere to; namely, one, that you want to preserve the integrity of the social security system; two, that you want to hold down the tax burden on current workers who finance the social security; and three, that you want to revise various benefit features of the system. I guess that is fundamentally where you make your suggestions—in the field of various miscellaneous features and abuses of the system.

Fourth, finance the primary ongoing benefit provision solely from visible payroll taxes and not from general revenues. I think that is a very important point.

If we start financing the social security program from the general fund which itself is in deficit, I think that jeopardizes the entire future of the social security program.

I gather that is what you are saying on page 10 of your statement?

Mr. SCHWEIKER. It certainly is, Senator Byrd. In 1972 we went through this exercise and in 1977 we went through this exercise again. In both cases we made the same big mistake. The mistake was that our economic assumptions were too optimistic. We have done it twice in a row. That is why we are in this mess. So, when Senator Bradley asked me why do we have worst-case assumptions, the answer is obvious. We just made two crash dives because we were so wrong in the past.

If we have learned anything, we surely have learned that.

Yes, it is a worst case, but, oddly enough, it is still better than what we have experienced in the last 3 or 4 years. That is the point that doesn't seem to be getting across. So, our worst case isn't all that far out of line given past history, and we would be derelict in our duty if we didn't make a worst case assumption. Traditionally, the trustees have always made pessimistic assumptions. We thought we shouldn't put on rose colored glasses.

So, we are trying to prevent the debacle of 1972, the debacle of 1977. We are trying to be honest and straightforward and also to make sure the trust fund does get back into balance.

Senator BYRD. You mentioned the year 1972 a number of times. As you point out, that is when the real trouble began for the social security program. Up to that point, I think the facts will show that the program was doing quite well, and on a sound basis.

But, as we both recall, in 1972, about half of our colleagues in the Senate were running for President, and that had quite an effect on the social security program.

Senator DOLE. A lot of early retirees, too. [Laughter.]

Senator BYRD. As I see it, we have—we don't have many options. The general fund, I think, would be a very bad option, just for the reasons you have outlined.

We could do nothing and hope for the best, but that is not much of an option.

We can modify the benefits or modify the increase in benefits. I assume that is a part of your basic program from reading pages 10 and 11.

Am I interpreting that correctly?

Mr. SCHWEIKER. That's correct, Senator Byrd.

Senator BYRD. Then, another option would be to increase the social security tax which you rule out.

Mr. SCHWEIKER. We do. I think the chart that Senator Armstrong worked up to show that social security taxes have increased something like 2,000 percent since 1940 is a good illustration.

Senator BYRD. So what we are really getting down to, as I interpret your statement, is tightening up on what you might call abuses of the program, and, second, to eliminate what you might call features of the program which are not basic.

Mr. SCHWEIKER. That is correct, Senator Byrd. We also tried to bring some realistic, pessimistic assumptions into the situation. Since the trustees and the Congress have erred twice in a row on being too optimistic, we felt dutybound to bring in a pessimistic set that at least recognized our past mistakes.

Senator BYRD. Thank you. My time has expired.

Thank you.

Mr. SCHWEIKER. Thank you, Mr. Byrd.

Senator ARMSTRONG. Mr. Secretary, if we have you out of here in 9 or 10 minutes, is that sufficient to meet your schedule?

Mr. SCHWEIKER. Yes.

Senator ARMSTRONG. I have several questions I would like to address to you. I also see that Senator Danforth has arrived.

Let me propound four or five and then some others if I may, in writing, for the record.

First of all, one of the Senators has characterized the crisis in social security financing as something we could address in the next century.

Would you respond to that? Is this something we really have to come to grips with now or could we really put it off?

Mr. SCHWEIKER. Even Congressman Pickle and Congressman Pepper, in their bills, say we need $100 to $150 billion in the next 5 years.

We concur with that. That is exactly what the solution is.

Senator ARMSTRONG. Well now, you have mentioned $150 billion in the next 4 or 5 years. I am told, at least I have the impression, that there is a potential deficit in the system of more than $1 trillion.

In fact, a number I hear used a lot, I think by the Commissioner of Social Security, is $1.5 trillion. Now, where does that number come from? How is that derived?

Mr. SCHWEIKER. That is the long-range figure. In other words, I gave you the short-range estimate. The short range is $100 to $150 billion.

The 75-year projection is about $1½ trillion using intermediate assumptions.

Senator ARMSTRONG. Now, when we talk about $1.5 trillion, are we talking about inflated dollars a century from now or are we talking about current dollars?

Mr. SCHWEIKER. Current dollars.

Senator ARMSTRONG. In other words, a trillion and a half 1981 dollars and it might be, depending upon your inflation assumption, much more than that in the future?

Mr. SCHWEIKER. Right. There is a horrendous long-range problem.

Senator ARMSTRONG. Mr. Secretary, let me just ask you this question, because one of the issues we are coming down to very quickly in this committee is whether or not we think the problem is real or whether or not it is just somebody's pessimistic imaginings.

Suppose we do nothing? Suppose we just continue the benefits as they are, leave the eligibility standards alone, and so on. Then out in the future, we would cover the cost presumably by some increase in the social security tax.

Have you or has the Social Security Administration prepared any estimates of the tax rate that would be necessary to close that $1.5 trillion deficit, if in fact it materializes?

Mr. SCHWEIKER. We will have to provide that for the record.

[The following was subsequently supplied for the record:]

Question. What increase in the Social Security tax rate would be necessary to meet current law benefits payments over the next 75 years?

Answer. Social Security taxes would have to increase by 1.82 percent of taxable payroll, or about .91 percent for employers and employees, each. (The 1981 Trustees Report projects the cost rates—annual cost, or outgo, expressed as a percentage of taxable payroll—over the next 75 years. Under the II-B intermediate assumptions, the average cost of the OASDI program over the next 75 years is 14.07 percent of taxable payroll, whereas the tax rate scheduled under current law averages 12.25 percent of taxable payroll. This difference of 1.82 percent represents the increase in taxes that would be necessary in order to balance income and outgo in the OASDI system over the next 75 years.)

Senator ARMSTRONG. I think that would be helpful. That is really one of the central issues—what tax rate would be necessary to support the projected benefits if your economic assumptions pan out.

Now, you said this before, but I want to be sure that this is absolutely clear. Five different projections have been made of the possible condition of the trust funds in the next several years, from optimistic to less optimistic to finally, somewhat pessimistic.

You have said that under all five of these, even the most optimistic, we are going to experience a shortfall some time next year, in our ability to meet the payments in a timely manner.

Mr. SCHWEIKER. That's correct, under current law.

Senator ARMSTRONG. But the shortfall will occur even under the most optimistic of the five projections?

Mr. SCHWEIKER. Correct.

Senator ARMSTRONG. You have said the most pessimistic of the five projections is actually predicated on better economic performance than we have had in recent years?

Mr. SCHWEIKER. That is an important point. I can't emphasize that enough. Regardless of how you break down its components it assumes a better economy by almost 50 percent in terms of growth in real wages than we have had for the last 4 years, so it can't be all that pessimistic.

Senator ARMSTRONG. Could I just relate then what would actually happen. We talk about the zone of insolvency and bankruptcy.

What would really happen if we get right down to it, say, in November of next year, and we didn't have enough money.

Would payments be reduced on a pro rata basis or would the payments be sent out late? What would actually happen?

In other words, would people's checks arrive a week or two late or would they arrive a dollar or two short or some combination of those two?

Mr. SCHWEIKER. We would have to go to late payments.

Senator ARMSTRONG. In other words, everyone would be paid in full, but instead of getting their checks on time, they would get them a few weeks or a few days late?

Mr. SCHWEIKER. Well, they wouldn't be paid in full because we would be delaying benefit checks weeks and then months. Eventually, unless some action is taken, there would be no benefit checks.

Senator ARMSTRONG. Mr. Secretary, for the benefit of the record, I do have a large number of questions which I would like to submit in writing and ask that you respond to in writing because they address questions which I think our colleagues will want to have answers to. I won't take time for those now.

Mr. SCHWEIKER. Thank you.

Senator ARMSTRONG. I would now like to yield the balance of the time available to the Senator from Missouri.

Senator DANFORTH. Mr. Chairman, thank you very much.

Mr. Secretary, let me apologize for being late. I have only two questions, and they may be repetitious of what you said previously.

The first question is this, it is well known that there is both a short-term and a long-term social security problem. The short term is the one that has been the most publicized in the last 24 hours in the press of what is going to happen in 1982.

Is it the position of the administration that it would be irresponsible for Congress to address the short-term problem alone?

Is it your position that we should address the long-term problem while we are addressing the short-term problem?

Mr. SCHWEIKER. We believe that both should be addressed simultaneously, because the reason we have gotten into trouble in the past is that we didn't look far enough ahead, and we know we have a monumental, gigantic explosion of senior citizens coming. We owe it to them to do that.

Senator DANFORTH. So, we should be looking down the road another 50 years and not just what happens in the next year or two?

Mr. SCHWEIKER. That is right. That is the basis for our proposal and we hope that any proposal the Congress makes would do that, too.

Senator DANFORTH. Second, the administration opposes using general revenue to finance social security. Some have distinguished between that general proposition and using general revenue to finance either medicare or the so-called welfare component of old age and survivor's insurance.

Would the administration favor using similar revenue for either of those two purposes?

Mr. SCHWEIKER. No, we are opposed to both for a couple of reasons.

First, I think we are mortgaging the future of the young people today by borrowing against them. We are beginning to pay benefits not out of pay-as-you-go, but based on what the young people will be taxed in the future. You didn't see it, but I will just point out again.

[Chart exhibited.]

Mr. SCHWEIKER. We have a chart here, Senator, that shows that beginning with the year 1974, the old age survivor's fund and the disability fund have been actually running in the red each year, 1975, 1976, 1977, 1978, 1979, and 1980, to the tune of $19.4 billion. At this very moment, even throw in the hospital fund which is making a profit, we are losing $12,300 every minute. So the point is, we do have a serious problem. We can't duck it or hide it.

Senator DANFORTH. But the hospital insurance could be financed out of general revenue, but the administration would oppose that; is that correct?

Mr. SCHWEIKER. We do. We have some real problems with that. I said a moment ago, before you came, that we really have serious problems with that because in the next decade hospital insurance is going to be running in the red as well. It has grown phenomenally from something like $5 billion in 1970 to $25 billion today.

Senator DANFORTH. If general revenue would be used for either hospital insurance or for the welfare component of Old Age and Survivor's Insurance, that would simply be a back door way of using general revenue to support social security wouldn't it?

Mr. SCHWEIKER. It would be a copout and actually saddle the burden of social security on the young workers even more than today.

Senator DANFORTH. The administration would oppose such a program?

Mr. SCHWEIKER. We would oppose it.

Senator DANFORTH. Thank you.

Senator ARMSTRONG. Mr. Secretary, we are indebted to you for your testimony. There may be others who want to submit questions in writing, as I will. We will be grateful for your prompt response so that we will have a complete record.

Unless we have something else, the committee will now stand in recess.

Senator DOLE. Mr. Chairman.

Senator ARMSTRONG. Senator Dole.

Senator DOLE. Could I just ask for the record, that in the event that there are additional question to come up during the course of the week, you would be available for additional questions from us?

Mr. SCHWEIKER. Sure.

[The prepared statement of Mr. Schweiker follows:]

DEPARTMENT OF HEALTH & HUMAN SERVICES

FOR RELEASE ONLY UPON DELIVERY

STATEMENT

BY

RICHARD S. SCHWEIKER

SECRETARY OF HEALTH AND HUMAN SERVICES

BEFORE THE

SUBCOMMITTEE ON SOCIAL SECURITY

AND INCOME MAINTENANCE PROGRAMS

COMMITTEE ON FINANCE

UNITED STATES SENATE

TUESDAY, JULY 7, 1981

Mr. Chairman and members of the Subcommittee, I appreciate the opportunity to appear before you today to discuss the financial condition of the Social Security program.

As the members of this Subcommittee know all too well, Social Security faces both a short-range financing crisis and a long-range actuarial deficit. No matter whose economic forecasts or assumptions you use, the basic Social Security program is going to be unable to meet its commitments to millions of Americans unless some legislative action is taken, and taken soon. The time for bland reassurances and for further studies or stop-gap measures is over--by late 1982 there just won't be enough money in the OASI Trust Fund to pay benefits to retirees, to widows, and to orphan children and their mothers.

The American people have been told repeatedly over the last several years by some individuals that Social Security will not go bankrupt. And the Congress has repeatedly taken action to shore up the system's financing with large tax increases and measures to help control the growth of benefits. But here we are again faced with the threat of bankruptcy and a continuing threat of insolvency in the long run, which seriously undermines public confidence in Social Security.

Current Projections and Status of Trust Funds

The attached table, which I would like to submit for the record, shows the estimated operations of the Old-Age and Survivors Insurance (OASI), Disability Insurance (DI) and Hospital Insurance (HI) Trust Funds, under "worst case" economic assumptions. In developing Social Security financing proposals, we believe that the most prudent course is to use such assumptions so as to provide an adequate margin of safety just in case unfavorable economic circumstances should arise. These projections show the status of the trust funds if present law is not changed.

Under these very pessimistic assumptions, the OASI Trust Fund will have insufficient funds to pay monthly benefits, by the latter part of next year. Under these assumptions even if, as we have proposed, the OASI Trust Fund could borrow from the DI or HI Trust Funds to meet the deficits, the combined funds would be exhausted in late 1983. So you can see that while interfund borrowing may be a valuable and necessary interim device, by itself the problem is only postponed by about a year. As things stand, without changes, the deficit of the Social Security program would, under the pessimistic economic assumptions, be $111 billion during the next 5 years.

Under the Administration's economic assumptions, the exhaustion of the OASI Trust Fund will still occur in 1982 if no change in the present law occurs, although deferred for a few months. In fact, under almost any reasonable economic assumptions, the OASI Trust Fund will be at an insufficient level to pay monthly benefits in the latter part of 1982, or at most in early 1983.

I am pleased to be able to tell you that the Trustees of the OASI, DI, and HI Trust Funds met on July 2 and concurred in the respective Trustees Reports for 1981. The reports were transmitted to the Congress yesterday. I must tell you, however, that the OASDI Trustees Report that you received does not differ greatly from the 1980 report with respect to either the short-range or long-range actuarial status of the OASDI system. Under all sets of assumptions, the 1981 OASDI Trustees Report shows that, under present law, the assets of the OASI Trust Fund will become insufficient to pay benefits timely in the latter part of 1982. You will notice a departure from past practice this year in that we show two sets of intermediate economic assumptions, reflecting the estimated progress of the funds under relatively more favorable and relatively less favorable experience in economic growth. Under the two sets of intermediate assumptions, the combined OASI and DI Trust Funds show an average deficit over the 75-year valuation period of 0.93 and 1.82 percent of taxable payroll. Under even more pessimistic assumptions, the average deficit in the OASDI system is estimated at 6.25 percent of taxable payroll.

In examining the causes of the current crisis, a review of recent experience is instructive. The assets of the combined OASI and DI Trust Funds have fallen continually since 1974. The fund ratio--the assets on hand at the beginning of the year expressed as a percentage of the outgo during the year--fell from 103 percent for 1970 to 66 percent for 1975 and then to only 25 percent for 1980 and 18 percent for 1981. The draw-down of the assets of the Trust Funds has masked the fact that outlays have exceeded revenues each year after 1974.

Only 4 years ago, there was the largest peace-time tax increase in history, which was supposed to have placed the Social Security system on a sound financial basis for at least the next 40 years. The grim recital of these figures illustrates the enormous damage that can be done to the balances in a very short period by unanticipated downturns in the performance of the economy. Even while we work to restore growth, we must prepare in advance for unexpected shocks. There will be no time to react in the future, because there is now no margin for slippage in the trust funds.

The element in the cost estimates with the greatest effect is the projection of real growth in wages--i.e., the excess of the increase in wages over the increase in the CPI. When wages do not keep up with inflation, increases in Social Security tax revenues do not keep pace with the increase in expenditures arising from the automatic adjustment of benefits to prices. In 1977, the Board of Trustees assumed that real wages would grow by an average of 2.5 percent per year in 1977 to 1980. The reality, however, was that real wages actually declined by an average of 1.5 percent during that period.

This example highlights past difficulties in relying on predictions of economic performance, that by their very nature are inexact and volatile, to provide a rationale for taking minimal action to ensure the financial integrity of Social Security. In early 1981, some economic indicators have been more positive than earlier predictions, but people can read too much into these short run fluctuations. As for the economic predictions themselves, common sense will tell you that when they cover such a wide range and change so often, you would not want to bet your next paycheck on them, let alone the benefit checks of millions of American people. The prudent course is to prepare for the worst, while striving to adopt policies which produce the best. By using assumptions that allow for real-world domestic and international economic contingencies and the range of possible economic performance, we are acting on the side of prudence.

As you know, Social Security is financed on a pay-as-you-go basis. Current contributions are, on the whole, used to pay current benefits, and the balances in the trust funds act as a contingency reserve. Any discussion about maintaining appropriate trust-fund levels involves determining the amount of assets that is adequate to provide a margin of safety against economic variations and other contingencies, so that benefit commitments can be met even if payroll tax revenues are temporarily reduced.

An important, accepted measure of adequacy of the trust funds is the fund ratio--the ratio of the assets at the beginning of a year to the total outgo during the year. For the OASI and DI Trust Funds, if income is exactly equal to expenditures each month over the course of a year, the fund ratio must be at least 9 percent to assure that there will be sufficient funds to meet current benefit commitments. A considerably larger ratio is required, however, to assure adequate funds in the course of normal fluctuations in income and outgo, and to provide a margin of safety if economic conditions worsen.

The 1979 Advisory Council on Social Security recommended that a ratio of at least 75 percent be present before the start of a recession, in order to provide an adequate cushion and allow sufficient time to take remedial action. The National Commission on Social Security recommended that a ratio of 100 percent be developed over time. Naturally, we all wish that the trust funds were now at these levels. As a matter of prudence, I personally believe that a level of at least 50 percent is reasonable, and that once the financial integrity of the system is restored, a fund ratio of at least 50 percent should be maintained as nearly as possible.

Long-Range Considerations

While it is possible for analytical and discussion purposes to separate the short-run and long-run financing of Social Security, as a practical matter the two are inseparable. What we do for the short run has impact, obviously, on the long run, and so it is necessary to view them together.

Of course, there are different factors affecting the long-range picture which do not affect the short run. The primary cause of the long-range financing problem is the anticipated demographic changes. Some 50 years from now, the Nation will have a very large retired population being supported by a smaller relative number of workers than at present. Intermediate projections indicate that, by 2030, there will be 2.0 workers per Social Security beneficiary, as compared with a ratio of 3.2 workers per beneficiary today. Put another way, while the total population is estimated to grow by about 40 percent over the next 50 years, the population aged 65 or older will increase by about 150 percent. Growth in the very oldest portion of the population will be greater still--those over age 85 will triple.

This change in the age structure of the population will have a growing effect on Social Security. Despite cash-flow problems in near-future years, under the more optimistic intermediate assumptions of the 1981 Trustees Report, the OASDI system will have an excess of income over outgo averaging 1.27 percent of taxable payroll over the next 25 years. However, the picture changes drastically when the post-World War II baby boom reaches retirement age. A deficit of 0.67 percent of payroll is shown for 2006-2030, while for 2031-55, it is 3.39 percent of payroll. Under the less optimistic intermediate assumptions of the 1981 Trustees Report, these figures would be 0.43 percent, -1.47 present, and -4.41 percent, respectively. Under the pessimistic assumptions, there is a deficit of 5.10 percent of payroll for 2006-30 and 13.03 percent for 2031-55. These deficits would intensify and continue beyond the end of the usual 75-year planning horizon, representing an ongoing concern.

One point to bear in mind is that these are projections, not certainties. They represent the best estimates of capable actuaries, based on the best information available. As I said earlier, economic and actuarial forecasting is an inexact science. However, despite many uncertainties, there is no doubt that a major demographic shift will occur in the next four decades. Therefore, it is important to act now to ensure the integrity of the Social Security system for the relatively large, aged population which will be present in the 21st century.

Restoring the system's financial integrity will not be easy, popular, or painless. There are really only two basic solutions available: restrain the growth of benefit outgo or increase taxes.

Increasing the Social Security tax rates to cover whatever the current program requires would be both unfair to current taxpayers, who have to bear the tax burden, and a serious drag on the economy. The apparent alternative of turning to general revenues for additional financing is not really a viable or proper option. The current congressional budget process makes it very clear that there really are not any uncommitted general revenues present to turn to for Social Security. Any general revenues for this purpose would have to come from new or increased taxes of other types. This would mean that additional taxes would need to be paid by--and be a burden on--the same people who now pay Social Security taxes. The remaining option of slowing the growth of the benefit outgo under the program is the only real choice.

The Administration's initial budget proposals were a first step toward that goal. Subsequent to these proposals, the Administration has developed further proposals to reform the program. These proposals will overcome Social Security's serious funding problems by eliminating excessive incentives to claim benefits early, by removing penalties for continued work efforts, and by lessening the emphasis on the social-adequacy or welfare aspects of the system at the expense of its basic purposes.

We are prepared to work with interested parties to improve our set of proposals to deal with the fundamental problems. However, we are committed to the following principles:

1. Preserve the integrity of the Social Security system, the basic benefit structure that protects older Americans.

2. Hold down the tax burdens on current workers, who finance Social Security.

3. Eliminate the anomalous features and abuses in the system.

4. Finance the permanent, ongoing benefit provisions solely from visible payroll taxes--and not from general revenues, which in reality involve other, hidden taxes.

Generally, our proposals would restore Social Security to program and financial soundness by:

1. Relating disability benefits more closely to a worker's recent work history and medical conditions. For example, we propose a requirement of, in essence, 7 1/2 years of covered work (rather than the present 5 years) in the 10-year period preceding disability and the elimination of vocational factors in determining disability.

2. Encouraging workers to stay on the job at least until the traditional Social Security retirement age of 65. For example, this would be done by reducing to a

greater extent the benefit amounts for people who retire early and by not paying benefits with respect to their children.

3. Reducing the social-adequacy (or welfare-oriented) elements that duplicate other programs. These have been over-emphasized in recent years. For example, we propose the same maximum family benefit for families of retired and deceased workers as is now provided for families of disabled workers.

4. Lowering by about 3 percentage points the future replacement rate of a worker with average covered earnings--that is, the initial benefit as compared with recent preretirement earnings. This would be done by moderating, for the next 6 years, the indexing of the initial benefit formula computation. This would be done so as to adjust for benefit over-liberalizations made in the early 1970s, which substantially exceeded the increases needed then to keep pace with changes in prices.

5. Reducing the opportunity for "windfall" benefits--that is relatively high benefits payable to persons who spend most of their working lifetime in noncovered employment, and only a short time in covered work.

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These reforms would have very little effect on the 36 million beneficiaries now on the rolls or on the several million persons now aged 62 or over who are eligible for benefits but not receiving them because of employment or other reasons.

Conclusion

If these proposals and those that we proposed in April reflecting the Administration's budget are enacted, the Social Security system will be financially viable in the short range and well into the next century. This can be stated without qualifications concerning the state of the economy in the short run. Under the pessimistic economic assumptions, the combined Social Security trust funds will not decrease below 17 percent of annual expenditures in the next few years. Quite naturally, the program would be in more favorable financial condition in the short run according to the estimates based on the economic assumptions which reflect the effect of the Administration's Program for Economic Recovery. Under these more realistic economic conditions, the low point for the fund ratio would be reached next year, at 22 percent.

It will be possible, even under pessimistic economic assumptions, to have a somewhat smaller Social Security tax-rate increase in 1985 than that now scheduled. Then, in 1990, the Social Security tax rates can be decreased below the current level. The present tax rate for employers and employees of 6.65 percent each is scheduled to go to 7.05 percent in 1985, and this rate could be decreased to 6.95 percent. Similarly, the 1990 scheduled rate of 7.65 percent could be 6.45 percent. If the economy improves at a more rapid rate--as we anticipate that it will under the President's Program for Economic Recovery--the tax rates could be further reduced.

If strong actions are not now taken, the Social Security system faces financial insolvency. The economic security of the millions of people who now receive Social Security benefits, and the many more millions who expect to receive them in the coming decades, is threatened. Under the Adminsitration's proposals, these future benefits will be paid, even under the pessimistic economic assumptions.

We recognize that there are other possible ways to deal with the financial problems of Social Security. We are working with congressional leaders to develop mutually agreeable solutions to the Social Security financing crisis. I should emphasize that, although there may be room for debate over the specific details of our proposals, we strongly believe that any alternatives must meet the fundamental objectives mentioned earlier.

Estimated operations of the OASI, DI, and HI Trust Funds under present law,
based on pessimistic economic assumptions,
calendar years 1980-86

(Amounts in billions)

Calendar year	Income: OASI	Income: DI	Income: OASDI	Income: HI	Income: Total	Outgo: OASI	Outgo: DI	Outgo: OASDI	Outgo: HI	Outgo: Total
1980	$105.8	$13.9	$119.7	$26.1	$145.8	$107.7	$15.9	$123.5	$25.6	$149.1
1981	122.7	17.0	139.7	35.3	175.0	126.7	17.9	144.6	29.4	174.0
1982	132.7	23.9	156.7	40.3	196.9	147.7	20.0	167.7	34.4	202.2
1983	143.0	27.1	170.2	44.7	214.8	171.5	22.4	193.9	40.5	234.4
1984	159.7	31.3	191.0	50.8	241.8	196.4	24.8	221.2	47.9	269.1
1985	184.9	41.0	225.9	59.2	285.1	222.6	27.4	250.0	56.2	306.2
1986	205.1	47.3	252.3	70.6	322.9	249.0	30.1	279.1	65.4	344.5

Calendar year	Net increase in funds: OASI	Net increase in funds: DI	Net increase in funds: OASDI	Net increase in funds: HI	Net increase in funds: Total	Funds at end of year: OASI	Funds at end of year: DI	Funds at end of year: OASDI[a]	Funds at end of year: HI	Funds at end of year: Total[a]	Assets at beginning of year as a percentage of outgo during year: OASI	Assets at beginning of year as a percentage of outgo during year: DI	Assets at beginning of year as a percentage of outgo during year: OASDI[a]	Assets at beginning of year as a percentage of outgo during year: HI	Assets at beginning of year as a percentage of outgo during year: Total[a]
1980	$-1.8	$-2.0	$-3.8	$0.5	$-3.3	$22.8	$3.6	$26.5	$13.7	$40.2	23%	35%	25%	52%	29%
1981	-4.0	-.9	-4.9	5.8	1.0	18.8	2.7	21.6	19.6	41.2	18	20	18	47	23
1982	-15.0	3.9	-11.1	5.8	-5.2	3.9	6.6	10.5	25.4	35.9	13	14	13	57	20
1983	-28.5	4.8	-23.8	4.2	-19.6	*	11.4	*	29.6	16.3	2	30	5	63	15
1984	-36.8	6.5	-30.2	2.9	-27.3	*	17.9	*	32.5	*	*	46	*	62	6
1985	-37.7	13.6	-24.1	3.1	-21.0	*	31.6	*	35.5	*	*	65	*	58	*
1986	-43.9	17.2	-26.8	5.2	-21.5	*	48.8	*	40.8	*	*	105	*	54	*

* Trust fund is exhausted, and so benefits could not be paid.

a/ Assumes interfund borrowing is in effect.

Senator ARMSTRONG. We will stand in recess until 2 o'clock.

[Whereupon, at 11:15 a.m., the hearing recessed, to reconvene at 2 p.m., the same day.]

AFTER RECESS

Senator ARMSTRONG. The committee will come to order.

This morning, we had some extraordinarily interesting testimony by the Secretary of HHS. Those of you who were here will recall that there was some disagreement about how serious the projected shortfall in the social security's trust fund really is.

This afternoon we are particularly glad to welcome Dr. Peter A. Morrison who is director of the Population Research Center of the Rand Corp., who I hope and believe is going to address some of the underlying demographic issues on which the projections are based.

Dr. Morrison, we are very glad to have you with us and appreciate very much your giving us your insights about this problem.

STATEMENT OF DR. PETER A. MORRISON, DIRECTOR OF POPULATION RESEARCH CENTER, RAND CORP.

Dr. MORRISON. I am a demographer with the Rand Corp.'s Population Research Center.

My testimony describes demographic changes that will impinge on the social security system's financing over the long term. First is the rise in the fraction of elderly people in the population. Second is the shift of wives into paid employment outside the home. Third is the lengthening of life expectancy. Fourth, changes in the average age at retirement; and finally, some uncertainties about future immigration.

In addressing these topics I have drawn on research and expertise at the Rand Corp.'s Population Research Center, which I direct. But the views and conclusions expressed here are my own, not those of Rand or agencies that sponsor its research.

My message can be summarized as follows.

First of all, the long-term demographic outlook is uncertain in important respects. Demographic surprises have occurred in the past; we should look forward to such surprises in the future and be prepared for them.

Second, as long as social security payments are financed by intergenerational transfers rather than by the contributions of the recipients themselves, the system will be vulnerable to demographic shifts that legislation cannot fully anticipate.

Third, the element of demographic surprise can be reduced by continually reappraising the assumptions that underlie projections of the numbers of donors and recipients.

But early warnings are useful only if linked to a procedure for acting on them, and therefore, I have two recommendations.

The first is to set up procedures for monitoring demographic trends more closely, especially to detect early warnings of significant departures from past trends.

Second is to institutionalize a more thorough and ongoing reappraisal of the demographic assumptions underlying long-range projections of social security's financing.

Both steps could be accomplished through interaction with demographers who have the appropriate specialized expertise.

Now, in the body of my prepared testimony distributed to you, I have focused on five aspects of demographic change that bear centrally on the social security system's long-term financing. I will simply highlight several of these.

First, of course, the rising elderly fraction of the population from now into the next century. The overall impacts of this so-called graying of the population will be, first, an eventual near doubling of the dependency ratio, that is, the ratio of prospective retirees to prospective wage earners; and second, a rising fraction of older persons over the age of 72—hence exempt from today's social security earnings test.

Now, the fertility trend in the eighties and nineties is of particular importance here, because it will govern changes in the number of working-age persons early in the next century, and it may indirectly affect the number of wives paying into social security as wage earners during the remainder of this century.

Most demographers are hesitant to predict the fertility rate's future course, however, not only because uncertainties cloud the outlook, but also because there are genuinely conflicting scholarly views on what determines the long-term trend in fertility in this country.

The message again is that we have been surprised before and we anticipate future surprises. But by monitoring ongoing fertility trends more closely, it is possible to reduce the element of surpise. After all, babies born in 1981 will not join the workforce for another two decades.

The second trend that I have discussed in my prepared testimony is the shift of wives into paid employment. As you know, in the traditional American family—the one that the originators of social security envisioned when they first started the program—the husband was the sole income earner. The wife's eligibility for social security benefits derived from her status as a dependent, not a wage earner.

For the majority of today's couples, however, all that is changed—the wife earns income outside the home. As of 1980, the labor force participation rate of married women exceeded 50 percent.

So, the typical couple today is one in which the wife works outside the home and earns income.

This is a trend of profound significance and one with considerable built-in demographic momentum. One impetus behind this trend is the change in how wives are ordering their careers as mothers and income earners. They are going to work earlier in life and continuing to work after children arrive.

Another is the sharp rise in the age-specific labor force participation rates for each succeeding generation of wives. Unfortunately, time does not allow me to elaborate on these points, but I do want to call your attention to a newly issued Rand study, prepared at our Population Research Center, by my colleague, Linda J. Waite. It is entitled, "U. S. Women at Work." I am furnishing a copy and ask it be entered in the written record to make it available to the subcommittee.

[The material referred to was made a part of the official committee files.]

Taken together I believe these developments in the rapidly increasing labor-force participation of wives foreshadow higher labor-force participation rates in the future, perhaps well above current Federal projections. Earlier generations of nonworking women are being replaced by more recent generations who, early in their adult life, have developed the foundations of lifelong careers in the work force.

This shift of wives into the work force carries two important implications for social security.

First, we are going to have more wage earners paying into the system. That means more dollars being generated by wives earning income—the only question is how many dollars?

Second, in future years, many more women reaching retirement age will have worked long enough to qualify for benefits based on their payroll contributions, not as dependents.

Of course, that will restructure social security in terms of how much is being paid out at that time.

How extensive will the shift of wives into the work force be? Once again, we are vulnerable to surprise. Previous projections have persistently underestimated actual levels. Bureau of Labor Statistics projections issued in the seventies with a time horizon of 10 years were realized in a matter of only several years.

We are in a position to reduce the element of surprise. Demographers are in a better position today than ever before to monitor the trend, to analyze its structure, and hopefully to foresee its future course.

I am going to skip the lengthening of life expectancy and early retirement in order to turn to the fifth important topic on which I want to focus your attention—uncertainties about the future course of immigration. Here I have questions, not answers.

The United States, of course, will continue to feel the effect of the changes in immigration policy wrought by the 1965 reforms and the pressures to accept a rising flood of worldwide refugees.

The magnitude of legal immigration, of course, is dwarfed by that of illegal or undocumented immigration; which we can scarcely measure let alone forecast.

However, the future level of immigration—both legal and illegal—is not the most important aspect. No less important is the composition of this immigration—the age, skill level, national origins, and so forth.

These uncertainties pose, important unanswered questions, such as:

How much are the future immigrants likely to earn?

How many immigrants will be around to collect Social Security benefits when they retire?

How many of those retirement dollars will end up being spent in other countries?

Finally, what will happen when those undocumented immigrants whose contributions are presently being credited to counterfeit or duplicate social security numbers retire and demand their benefits?

I don't have the answers to these questions, but I hope someone is looking into them, because I think they have important future implications.

Let me now state my conclusions and recommendations.

Our understanding of these demographic trends has been advanced considerably in recent years, thanks in large part to the National Institute of Child Health and Human Development's Center for Population Research, and its sustained program of scientific research. That understanding strengthens the basis on which demographic trends can be monitored and foreseen.

Moreover, current population trends are delineated with greater precision and in greater detail than ever before. We have at our disposal a wide array of technical indicators that can signal demographic "early warnings".

Certain aspects of the long-term demographic outlook nevertheless are shrouded in uncertainty and are likely to remain that way for some considerable time. Demographic surprises have occurred in the past. Recent examples include the "surprisingly" steep decline in the fertility rate and the "surprisingly" rapid shift of wives into the work force.

As long as social security payments are financed on a "pay-as-you-go" basis, the system will remain sensitive to these unforeseeable shifts that cannot be anticipated once and for all in legislation. The element of demographic surprise can be reduced through more effective use of existing capabilities to monitor these areas of demographic uncertainty.

My recommendations, again, are as follows: First, to set up procedures for monitoring demographic trends more closely, especially to detect what I call "early warnings" of significant departures from the past trends.

Second, I recommend institutionalizing a more frequent and thorough reappraisal of the demographic assumptions on which social security financing is based.

Both steps can be accomplished through interaction with demographers having the appropriate specialized expertise. Such outside expertise is available through the demographic profession. Briefings and information fact sheets, like the one distributed to you, are available on request.

Thank you.

Senator ARMSTRONG. Thank you, Dr. Morrison.

You posed a number of very thought-provoking questions. I will make the same confession that you did, that I don't know the answers either.

But we are in a position in this committee and in the Senate where we are going to have to make some decisions. We are going to have to have some assumptions in mind.

So, I want to come back to a couple of questions that you raised.

You pointed out, correctly no doubt, that we could be fooled. We could have a demographic surprise. Have you had a chance to look at the demographic assumptions which were used by the trustees in preparing their 1981 report?

Dr. MORRISON. Yes; I had an opportunity to scan it very briefly. If you are referring to the demographic assumptions concerning fertility, the pessimistic assumption as I recall, is a total fertility rate of 1.7 children per woman.

The optimistic assumption, I believe, is 2.4 and the middle-range assumption is 2.1. Are those the assumptions you are referring to?

Senator ARMSTRONG. Yes. My question is this. As an expert in this field, is this a reasonable range? In your opinion, if we adopt this range as a guideline, are we recognizing all the uncertainties of fertility and work force participation and so on?

Are the demographic assumptions that have been presented here reasonable in your opinion?

Dr. MORRISON. I regard them as overly narrow. I believe that the downside assumption, 1.7, does not fully capture the possibilities for fertility to go lower.

I would regard the upper and lower boundaries of these assumptions as quite plausible in terms of our experience and what we know about fertility.

If you want a "worst-case" assumption, that is to say fertility sinking lower than we think it will but still including the outer limits of plausibility, I think 1.7 is not low enough.

Senator ARMSTRONG. Why?

Dr. MORRISON. One reason it is not low enough is that women's wage rates may increase sharply in the future, encouraging many women to remain childless.

There is, at present, a convergence on the two-child family, but there could emerge in our society 20 or 30 years from now—and I am stating this simply as a possibility—a substantial fraction of women who choose not to bear children at all. That could bring the fertility rate down to 1.6 or 1.5.

Senator ARMSTRONG. Is 1.5 the lower limit of what you would regard as plausible?

Dr. MORRISON. I would feel more———

Senator ARMSTRONG. That is absolutely the lowest that you can see under any foreseeable circumstances?

Dr. MORRISON. I would regard 1.5 as a better choice of the lowest plausible limit, if one is referring to many decades into the future.

Senator ARMSTRONG. I am not quite clear. Were you saying that 2.4 is a reasonable upper limit, but you would increase it?

Dr. MORRISON. I would feel more comfortable with a slightly higher upper limit, perhaps 2.6, but I am more concerned about the possibilities for fertility going lower than for it going higher. There are more plausible scenarios whereby fertility might drop to as low as 1.7, 1.6, 1.5.

Senator ARMSTRONG. I think that is very helpful. I don't want to put words in your mouth, but let me see if I understand your testimony.

You are saying that the range of 1.7 to 2.4 is reasonable, but that you would personally be more confident of the final outcome falling within the range, if the range were adjusted?

Dr. MORRISON. Especially on the downside.

Senator ARMSTRONG. Let me ask this. How did the assumptions that have been made in this year's trustees' report compare with prior years?

Dr. MORRISON. The prior years' assumptions?

Senator ARMSTRONG. Yes.

Dr. MORRISON. I am afraid I can't answer that question. I don't know what they were. If you can tell me what they were, I can react.

Senator ARMSTRONG. I think it would be helpful. Perhaps we could confer on that by mail or in some way to get your further thinking on it.

Doctor, I have one other question before I yield to my colleagues. On page 9 of your testimony, you cite the life expectancy of men and women at different times through history.

I note that the total life expectancy, that is, the combined expectancy for men and women in the year 1900, was 47.3 years. In 1950, 68.2. In 1978, 73.3.

It is my understanding, and I have been meaning to verify this, that the notion of retiring at age 65 was first popularized by Bismarck sometime before 1900.

Do you happen to have any idea what the life expectancy was, say, 100 years ago, in Germany?

Dr. MORRISON. I believe it was less than 65 years. So Bismark could anticipate that many people would not reach retirement age.

Senator ARMSTRONG. Well, could I jump to the conclusion that it was less than 47 years?

Dr. MORRISON. I am not sure.

Senator ARMSTRONG. Well, am I misinterpreting what I am reading here. Isn't that what this chart portrays that in 1900 the life expectancy was 47 years?

Dr. MORRISON. Yes.

Senator ARMSTRONG. Are you saying it may have been higher than that in Germany?

Dr. MORRISON. It could have been.

Senator ARMSTRONG. But something close to that?

Dr. MORRISON. Something in that general vicinity, plus or minus a few years.

Senator ARMSTRONG. Are records of that kind of a thing available? Is that something we could look up?

Dr. MORRISON. Yes; records of that are available. Unfortunately, I don't know what they are, but they are readily accessible.

Senator ARMSTRONG. We will pursue that.

Thank you very much.

Senator Durenberger.

Senator DURENBERGER. Thank you, Mr. Chairman.

One question on your presumption relative to fertility. Your concern about the low side of the fertility ratio had to do with economics, as I recall.

I think you said that if we could ever get the 59 percent up to something close to 100 percent in terms of the equality of pay between men and women, this might encourage more women to remain childless; is that correct?

Dr. MORRISON. It might encourage them to remain childless, or it might encourage many to have only one child rather than two. Essentially, higher wage rates would create a situation in which women would have much more remunerative things to do with their time than bear children.

Senator DURENBERGER. What if, in addition to doing that we eliminated all the economic inequality that exists which has nothing to do with level of compensation. If we eliminate the inequality in determining when and at what age pensions begin to accrue.

I could go down a long laundry list of discrimination that exists in private pension plans and private employment and in Government policy.

But, it would seem to me, it keeps the woman, once she has entered the work force, in the work force, rather than giving her an incentive to remain out and have two children knowing she is in effect protected in her role as mother.

How might that impact if we adopted those policies on the low side projections?

Dr. MORRISON. The honest answer is we don't know what kind of effect that would have or to what extent it would lower fertility.

I would call your attention to what we do understand, which is as women's involvement with the work force and their rate of compensation converge toward that of men, fertility is likely to go down and stay down.

Now, if one starts to change other kinds of economic incentives that might encourage or discourage continuation in the work force or exit from it, that could affect fertility as well.

Indeed, I think most demographers would agree that we are likely to see much more short-term fluctuation of fertility rates on a year-by-year basis, because of changing economic circumstances.

So, when one talks about a total fertility rate of 1.7 versus 2.1 or 2.4, we are going to see that rate bounce that are going to be bouncing up and down within those limits in the future. That is my expectation.

The long-term trend, however, is one that I think could go lower than many people anticipate today, in my opinion.

Senator DURENBERGER. Thank you.

Senator ARMSTRONG. Senator Moynihan.

Senator MOYNIHAN. Thank you, Mr. Chairman.

Dr. Morrison, we are all much in your debt for bringing the basics to our discourse, which was perhaps not as reflective this morning.

I would like to ask some of the possible implications for what we call the middle term which begins in 1985 and seems to go to about 2010 in our thinking.

I can remember when the labor force participation rate was referred to as one of the great ratios in economics. It was a constant that 59 or 60 percent of the population was in the work force, whether in business, child labor, on a farm, and then suddenly it rose in the 1960's.

We are now about 63.8 percent as I remember. To the degree that labor force participation rises or stays high, you could expect to have more social security payments, contributions in the course of this next 40-year range.

Wouldn't you agree with that?

Dr. MORRISON. That's correct.

Senator MOYNIHAN. So we ought to get a very clear idea from the administration of what rates it does project and see if it just picks one and runs it out or if it makes it curvilinear in some respect. I think we could—we should ask the administration's views on this, Mr. Chairman.

Demographers are just about the only people in the country who can tell you anything. They can tell you how many people will be

17 years old 16 years from now, with a pretty good degree of accuracy. What can anybody else tell you in this country? [Laughter.]

The only thing I would like to ask you is, If immigration should rise, or perhaps even continue its present trend, which is with some episodic events rising, we should also expect more contributions to be made to the system.

Dr. MORRISON. That's correct.

Senator MOYNIHAN. That immigration will rise whether we wish it or not seems to be the case.

So in that sense there is a probability in the next 40 years would see higher rates of payment into these funds than the past 40 years; wouldn't you think that?

Dr. MORRISON. That's correct. Some people point out that immigration over the next several decades may provide an infusion of dollars into the social security system that will help out.

But, of course, these immigrants eventually will retire. The crucial questions are: Will they retire in this country? Will they claim their benefits? And what kind of a bargain is it to have money paid in now in exchange for obligations incurred by the social security to cover the immigrant's retirement later on.

Somebody should work out the calculations to see whether there is a net advantage or disadvantage.

I would like to underscore the point you made about the assumptions, because you have pinpointed a critical part of this whole process—this twilight zone of actuarial assumptions which very few people myself included, are qualified to judge.

This is an area where one needs specialized expertise. The assumptions being adopted have to be subjected to the review of outside experts who bring specialized expertise and are qualified to judge the reasonableness and plausibility of the range of uncertainty.

Senator MOYNIHAN. I know there are many of us who are concerned about this intergenerational conflict that seems to be looming in the next century. We look to the year 2040 here, when something like 18 percent of the population will be 65 and over.

Well, Switzerland has an 18-percent ratio today.

Great Britain has 16 percent.

The Federal Republic of Germany has 14.

There doesn't seem to be intergenerational conflict in those societies. They don't seem to have this problem.

Dr. MORRISON. No, they don't and there is no necessary reason for such conflict in this country.

Senator MOYNIHAN. That's right.

Dr. MORRISON. I think it is the transition to an older population that will be difficult. The more time we have to make that transition, the easier it will be.

Senator MOYNIHAN. Well, would you think a half century is about as much time as we usually set aside for these large issues?

Dr. MORRISON. That would be ample time if we had an economy that was performing well.

Senator MOYNIHAN. You are a hell of a witness, I will tell you. [Laughter.]

Dr. MORRISON. Thank you.

Senator MOYNIHAN. Thank you very much, Dr. Morrison. Your testimony has been very important.

Mr. Chairman, could I suggest that we need to hear from the actuaries of the system. Bring them in and have them talk about their assumptions and the points Dr. Morrison raised and see what their judgments are.

It has to be a judgment. I am sure they are very good. But we ought to look at them and see.

Senator ARMSTRONG. Senator Byrd?

Senator BYRD. I haven't had a chance yet to digest these statements. I would delay momentarily.

Senator ARMSTRONG. Of course. I think we could come back to Dr. Morrison for further questions, if he could stay.

I think we will go ahead and call on our panel of economists.

I thought you were a little tense, Senator Moynihan, when you said actuaries or demographers were the only people who could tell you anything.

Senator MOYNIHAN. Ask any economist. [Laughter.]

Senator ARMSTRONG. We are very happy to welcome a panel consisting of Dr. Rudolph Penner, director of tax policy studies, of the American Enterprise Institute, Dr. Robert Kaplan, dean, Graduate School of Industrial Administration of Carnegie-Mellon University, and Dr. Henry Aaron, senior fellow at Brookings.

STATEMENT OF DR. RUDOLPH PENNER, DIRECTOR OF TAX POLICY STUDIES, AMERICAN ENTERPRISE INSTITUTE

Dr. PENNER. Thank you, Mr. Chairman.

I would like to thank the subcommittee for this opportunity to testify.

In 1977, the Congress created the social security benefit structure that was too generous to be financed by the schedule of payroll tax rates enacted at the same time.

At the time, the Congress knew that it was creating a deficit for the full 75-year period traditionally used for social security planning purposes.

However, the Congress thought that the 1977 amendments earmarked sufficient resources for social security to maintain financing at an adequate level for the rest of this century.

Unfortunately, this belief was based on the assumption that real earnings in the United States would grow at rates not far below those experienced through our past history.

In fact, because of a dismal productivity performance and the not unrelated need to transfer real income to foreign oil producers, real hourly wages in 1981 will be significantly below those of 1977 when the new law was passed.

While other factors have played some role in depleting the social security trust funds, the lack of growth of real average hourly earnings is of overwhelming importance in explaining our current difficulties.

Since economic growth has been lower than expected, I believe it clear that we cannot afford the degree of generosity implied by the benefit structure created in 1977.

It would certainly be perverse to respond to the current situation by raising payroll or income taxes on declining real hourly wages.

I also believe it important to minimize borrowing from the public under current circumstances since current spending and tax proposals are already likely to lead to very high deficits over the next 5 years.

Yet, reductions in benefits must be tempered by the fact that recipients have made longrun work and savings plans on the assumption that benefits will be close to those promised.

Therefore, benefit changes cannot be abrupt and must occur gradually, unless reduced benefits will be replaced by benefits under some other welfare system for those least able to tolerate declines in real income.

That means two things to me. First, it will be very hard to avoid some shortrun borrowing by the trust funds.

Second, the fact the change must be gradual means that we must immediately begin addressing the problem emerging in the early 21st century when the members of the baby boom of the forties and the fifties retire.

Indeed, this should have been done in 1977, because our current shortrun problem pales in significance relative to the longrun problem and the long run shortens every day.

Nevertheless, in an effort to minimize shortrun borrowing, I would suggest the following actions, some of which accord with the proposals made by President Reagan in his March budget.

First, eliminate the minimum benefit. This benefit is primarily of interest to fairly well off individuals who work most of their lives in the Federal Government or in some other uncovered occupation.

To the extent that the poor are affected, the benefit would be replaced by SSI.

Eliminate student adult benefits. Again, educational support from other programs will be available to those with modest incomes.

Third, eliminate the lump sum or death benefit, while creating a similar benefit under SSI for low income recipients.

Fourth, index the benefits of the retired population to the lower of the wage index or a CPI.

SSI benefits should continue to be indexed to the latter.

This proposal is also part of my preferred longrun solution and will be discussed in more detail later.

Fifth, postpone the date of cost-of-living increases from July 1 to September 1. This will result in a modest decline in real benefits, but those benefits have recently risen unjustifiably because of upward biases in the CPI.

Unless we are extraordinarily lucky with the economy, these proposals are unlikely to cure the entire shortrun problem and some borrowing will probably be required.

It is often suggested that additional revenues could be obtained by taxing one-half of benefits. This is a fair, reasonable proposal which seems to have absolutely no chance politically, even if it was phased in.

On the other side, it is popular to propose spending more money by eliminating the retirement test. While this has much appeal, I do not believe that this is the time for money spending proposals.

It would probably be feasible to remove the test and to solve the whole shortrun problem with the taxation of one-half of benefits.

But the two proposals should be considered as a package.

The longrun problem, which is really the serious problem, has two components. It has already been noted that the ratio of the retired to the working population will begin to soar early in the 21st century.

In addition, the current benefit formula implies that average real benefits per retiree will grow significantly between now and then.

Under current law, a worker who worked at the maximum wage base throughout his or her career and who retires with a dependent spouse, received a tax-free benefit of a little over $11,000 in 1980.

In the year 2030, the same person, with maximum earnings throughout their career, would receive tax free, $26,714, under the intermediate assumptions.

I can't resist pointing out that with the 5-percent inflation rate the benefit will be over $300,000 a year. I love compound rates of growth. [Laughter.]

In my view, there isn't justification for such benefit growth in a mandatory pension system, which at such benefit levels, must only crowd out private pensions almost dollar for dollar.

It therefore seems reasonable to reduce the growth of average benefits in order to avoid tax increases beyond those scheduled by current law.

This means that the ratio of benefits to lifetime earnings must be reduced over time.

I want to emphasize that that does not mean that average real benefits must be reduced below current levels.

With economic growth, average real benefits can continue to grow. It only means that the growth must be slowed below the rates implied by current law.

There are a number of ways that the ratio of benefits to lifetime earnings can be lowered. I do not feel strongly that any one approach is far superior to all others.

However, the choice is, of course, very important to longrun income distribution, both within generations and between the generations.

One can identify three major lines of attack.

First, the Congress could undertake periodic discretionary actions, each slightly reducing the generosity of the formula which determines the benefits of future retirees.

This would be politically difficult and the discontinuous nature of the approach is somewhat disturbing.

Second, retirement ages should be increased gradually. Retirement could still be allowed at age 62, but with a fair actuarial reduction from the full benefit paid at say age 68.

The replacement ratios for people retiring at ages 62 through 67 would be lower than implied by current law.

Third, the indexing of the benefits of the currently retired and the formula determining the benefits of future retirees could be altered to slow the growth of average real benefits below the growth of average real earnings.

Obviously, the three approaches can be combined in an infinite variety of ways. As I stated previously, I have no strong preference regarding the approach taken. However, I do see certain advantages in the last approach, that is changing indexing.

I believe that indexing should be modified because I think that the approach taken in 1977, aside from being too generous, also implied some peculiar value judgments.

That approach strives to insure that on average the ratio of benefits to preretirement earnings remains constant through time for each cohort of retirees.

That is accomplished by indexing the width of the brackets in the benefit formula, what has come to be known as the "bend points," to average wages.

But once a person retires, his or her benefits are held constant in real terms by indexing to the CPI.

As a result, the retiree shares none of the benefits of economic growth after retirement and since retirements of 15 years are no longer uncommon, the long-term retiree falls further and further behind the standard of living of the rest of the population compared to where they were when they started retirement.

It seems to me that it would make more sense to follow an approach which starts the retiree off at a lower benefit level, but then lets the person have some share of subsequent increases in the general living standards of the working population.

In reforming indexing techniques, it is not practically possible to find one that will be fair to both taxpaying workers and retirees for all time.

It is not feasible to devise an index providing a perfect measure of inflation or wage growth, and even if we could, the system will be hit with economic and demographic surprises which will over time, change our notion of what is an adequate and affordable benefit level.

Therefore, we must resign ourselves to the fact that both indexing and discretionary actions will be necessary in the future.

Since discretionary actions which increase benefits are less painful than those which lower benefits, the indexing part of the system should be downward biased.

Or, in other words, the automatic part should provide lower expected benefits than we think we can afford in the long run.

This can be accomplished by indexing both the bend points in the benefit formula and the benefits of the retired population to the lower of price or wage growth.

To the extent that economic growth made higher benefits affordable or lower taxes possible, the growth dividend could be shared between the currently retired population, future retirees by widening bend points, and taxpayers by reducing some of the future tax increases scheduled in current law.

In any system that leaves part of the determination of benefits to automatic indexing, future economic events will play a large role in determining the relationship between the living standards of retirees and the working population.

More certain reduction in replacement rates can be achieved by gradually extending the retirement age and some small extension may be desirable to complement the above indexing proposal.

Well, I see I have exceeded my time limit. The remainder of the testimony discusses the issue of including Federal employees in the system.

Senator ARMSTRONG. Thank you, Dr. Penner. We will have some questions for you in a few moments.

Dr. Kaplan.

STATEMENT OF DR. ROBERT KAPLAN, DEAN GRADUATE SCHOOL OF INDUSTRIAL ADMINISTRATION, CARNEGIE MELLON UNIVERSITY

Dr. KAPLAN. I am very pleased to be here today to speak with the Senators and their staff on the problems of social security financing.

These problems will not go away by themselves. They need congressional action, preferably this year, to address the financial difficulties of the system.

These problems are not insoluble and prompt action will provide assurance to both workers and beneficiaries about the security of current and future benefits.

Unfortunately, there are no simple answers to solve the problems of short- and long-term deficits in the social security system.

Anything that Congress does will make some people angry, and a few people quite angry. But if Congress fails to act in a responsible manner this year, then many more people will become very angry.

They will be angry because of the continued financial deficits and the scheduled large tax increases in the social security system.

In addition, current and future beneficiaries will remain highly uncertain about the security of their promised benefits.

The traditional answer for dealing with social security deficits has been to increase the taxes on current workers.

The implementation of this policy, during the past decade, has led to sharp increases in the payroll taxes of covered workers.

As with Rudy Penner, I agree that we should not follow that path this time. We are trying to reduce the share of Federal expenditures as a percentage of gross national product and to allow for more initiatives in the private sector.

I believe that continuation of the higher tax strategy would run counter to the wishes of the American people as they expressed it in the last election.

It would also prevent Congress from carefully reexamining all the benefits and formulas and levels that have evolved during the past 45 years.

Congress has many options that will maintain the current benefit levels to current and future social security beneficiaries, while at the same time curing the financial deficits of the system and eliminating the need for further increases in the payroll tax rates.

At present, as we know now, large increases in the payroll tax rate are scheduled to be implemented during the next decade. These higher tax rates are still inadequate for financing the long-term deficit of the system.

I will talk more about the short-term problem, since I believe that Rudy Penner covered the long-term problem and my approach to it very well.

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The current deficit, for which we have various projections ranging between $5 billion and $10 billion a year and perhaps increasing in the next several years, has been caused by two factors.

One is the decline in productivity so that prices are going up faster than wages. The second factor is the great overstatement of the inflation rate caused by inadequacies in the Consumer Price Index which has been overstating the true rate of inflation in the economy.

Because of this decrease in productivity, during the past several years, as well as the overstatement of the inflation rate by the Consumer Price Index, benefit levels have been increasing faster than the ability of the working population to pay the payroll taxes.

There is an obvious solution to this problem. Benefit levels should not be allowed to increase at a rate faster than the ability of taxpayers to meet this burden.

Therefore, benefit increases should be limited to the lower of wage increases or the inflation rate.

Had this policy been in effect during the past several years, social security would not be in the financial difficulties that it now faces.

This policy can be implemented immediately, starting in the 1982 benefit increase and should be recognized as a sensible scheme since the system cannot expand benefits at a rate faster than it is expanding its taxable earnings base.

A second action should be to obtain a better measure of the rate of inflation than is now available from the Consumer Price Index.

There are a number of known problems with the Consumer Price Index having to do with its failure to recognize the substitution of goods and services which are rising in price less rapidly than other goods and services.

There are also problems in picking up quality improvements in goods and the fact it omits the benefits to consumers from the introduction of entirely new products into the marketplace.

But these types of technical and well-known limitations are completely overshadowed by the CPI treatment of housing which has created a very large distortion in the true cost of housing to individuals.

This comes about because the CPI counts not only the cost of the new house, but also the mortgage rate necessary to finance the house.

If you purchase a house for $100,000, and got an $80,000 mortgage, in effect, it would count the cost of housing at $180,000.

A related issue is that the interest rate that is used in the CPI to calculate the carrying cost of the house is the actual rate, what we call the nominal mortgage rate, which has been running at 15, 16 percent or even higher, recently.

Now we believe that interest rates are the result of inflation, not the cause of it. Therefore, when using a carrying cost for financing purchases of durables, such as housing, automobiles, and appliances, we should use an interest rate after taking out the rate of inflation, what we call the real interest rate, the real interest rate is much closer to say 1, 2 or 3 percent than it is to the high interest rates that are now being used to compute the CPI.

Many of these problems of the CPI could be avoided by shifting to an alternative index and a number of them have been suggested, such as the Personal Consumer Expenditure component of the GNP deflator.

This does use a rental equivalent for measuring housing costs which is more appropriate, I believe, for measuring the price of housing.

Had we been using the PCE index and the proposed rule to limit benefit increases to the lower of average earnings or the increase in the PCE, the system would have saved up to $7 billion in 1980, and perhaps up to $10 billion or more in 1981.

Therefore, virtually all of the short-term deficit in the social security system would have been avoided had these measures been in effect.

Unfortunately, we now have the problem that we have a short-term deficit and even moving to the proposed indexing changes will not solve the short-term deficit.

It is not an easy problem to solve. I believe that one method for dealing with the short-term deficit is to consider, in 1982, limiting the increases in social security benefits to current retirees, to make up for the overindexing of benefits that occurred in the 1980 and 1981 increases.

If we could perhaps reduce by three or four percentage points the increase that would otherwise occur in 1982, that would make a substantial savings in the short-term deficit and perhaps eliminate it entirely.

Rudy Penner discussed some variety of other proposals that the administration has put forth. I have no independent comments on those, except to endorse the idea of extending universal coverage for all wage earners.

Right now the Federal workers are excluded from coverage in social security. Were they to be included we would get a short-term benefit from the inclusion of new workers.

I believe that a combination of these proposals, solving the over-indexing problem, perhaps the one-time limit on benefit increases in 1982, and an expansion of social security coverage, will solve the short-term financial deficits of the social security system without requiring increases in payroll taxes.

It will not produce any harm to beneficiaries in that no benefits now being granted will be cut.

It will enable Congress to retain options to expand social security benefits in the future, should the economic environment prove more favorable than we now anticipate.

There have been a variety of other proposals for solving the short-term problem.

I would like to talk specifically about them, since I believe they are ill-advised and I do not recommend their adoption.

One proposal would reallocate funds from the hospital insurance trust fund to the OASDI trust fund.

At present, the HI program is running a modest surplus and therefore, provides additional funds that could bail out the OASDI system.

I believe that such a reallocation would be a big mistake.

First, it suppresses the real problem that benefit levels in the OASDI program are increasing faster than the tax base available to pay for them.

It would only for a short time suppress the previously discussed problems in the defects in the Consumer Price Index for adjusting benefits for inflation and the previous granting of benefit increase in excess of wage growth.

It does nothing to either increase the taxes available to pay for social security programs or contain the increase in benefits for those programs in the future.

Finally, perhaps most important, while the HI trust fund is now running a modest surplus, the actuarial projections we have seen in the last 2 days show very large deficits occurring in this program starting in the 1990's.

These large deficits in the HI program must also be looked at by Congress in the near future. But certainly, Congress should not aggravate these problems by eliminating the few resources now being accumulated in the HI trust fund to pay for sharply increased benefits that will come due in several years.

The second ill-advised proposal to deal with the short-term financial problem has been to infuse general revenues to supplement the payroll taxes.

This proposal can be accomplished either by a complicated set of triggering events as recommended by the Carter administration or by shifting some or all of the financing of the hospital insurance program from the payroll tax to general revenues.

The problem with this proposal is that, as Congress knows all too well, there is no excess of general revenues. Despite the active efforts of the Reagan administration and Congress, the Federal Government is still running large deficits in its budget, deficits that would only be aggravated were $10 billion to $30 billion of new financing be required to bail out the social security system.

As in the previous suggestion, the infusion of general revenues to the social security system does nothing to address the substantial problems of unintended benefit increases that have crept into social security. General revenue financing would mask these problems.

More seriously, once the link was broken between benefit increases on the one hand, and the need to finance them with payroll taxes on the other hand, I believe the fiscal discipline of the social security system would be seriously compromised.

There are constant pressures to increase social security benefits and one of the few ways we have of containing them is the link to finance these increases by increasing payroll taxes.

Having the opportunity of increasing benefits just by increasing the deficit in the Federal budget would not be a healthy development for social security and, more broadly, for the country at large.

The third course of action that I do not recommend is to change eligibility requirements of benefit levels over a short period of time.

There should not have been much surprise to the widespread opposition to the Reagan administration proposal for sharply reducing the benefit levels for early retirees starting in 1982.

Workers and their employers have done much planning for retirement benefits. It would be unfair and highly costly for there to be sudden changes in benefit levels or eligibility requirements.

Such actions should be phased in slowly over a 10- to 20-year period so that individuals and their employees have a chance to adjust to any new provisions.

The proposals to increase the retirement age or decrease the benefits paid to early retirees are plausible for solving the long-term financial deficit of the social security system.

They are not good options for dealing with the short-term problem.

For the long-term problem, the options we have are well known and discussed: A gradual increase in the retirement age, the gradual decrease in the replacement ratios. Both of these proposals should be looked at very seriously.

There is a possibility of taxing some of social security benefits and that might also be looked at.

I think whatever options you choose, it is important that Congress deal with the long-term problems now. I believe it would not be responsible for Congress to delay acting on this problem for 20 or 30 years.

It seems to take a short-term crisis for Congress to seriously consider further amendments to the social security system.

Congress had one such opportunity when it had to eliminate the double indexing problem in 1977 that was introduced by the 1972 amendments.

At that time, Congress did nothing to deal with the long-term financial deficit in the social security system.

Congress has another opportunity before it this year because of the short-term financial deficits now being incurred by social security.

I hope that it does not also let this opportunity pass without dealing with the very serious long-term financial deficit in the system.

I have a few remarks about the treatment of spouses and the spouse benefit which I will not go into, but I believe that again, given—that we are discussing social security, that Congress should look at the spouse benefit and consider a plan of moving to an income-splitting plan that would reflect the types of demographic trends that Peter Morrison pointed out in his testimony.

Finally, I would just like to endorse Rudy Penner's philosophy that Congress should retain flexibility to grant benefit increases should future conditions prove more favorable, rather than try to make generous commitments today.

I believe that we should take conservative and perhaps even pessimistic economic and demographic assumptions for the future so that we can be sure that we can pay for these benefits within the existing tax structure.

If, after 5 or 10 years, we learn that social security beneficiaries are not sharing in the real productivity gains of the economy and that the trust funds are accumulating more reserves than we had anticipated, Congress would then be in a position to liberalize benefit increases so that the beneficiaries would obtain a fairer share of favorable economic and demographic experience.

Senator ARMSTRONG. Thank you, Dr. Kaplan.

Dr. Aaron, you are a person who has had great experience with the social security system. We are looking forward to your testimony.

STATEMENT OF AARON, DR. HENRY, SENIOR FELLOW, BROOKINGS INSTITUTION

Dr. AARON. Thank you very much. I made the mistake of writing my dissertation on social security and I have not been able to get away from it since.

Let me say at the outset that I agree with almost everything that Rudy Penner said. I am not sure he will agree with everything I say, but he will be able to tell you that himself.

My statement consists of a main portion and three supplements which I submit for the record.

It is by now very well known that the immediate financial prospects of the social security system are going to require this Congress to take some kind of action during this session.

The unexpected excess of price over wage increases caused by the productivity slowdown and the necessity to transfer funds abroad to which Rudy Penner referred have caused a substantial OASI deficit.

At the same time, the disability and health insurance systems are in substantial surplus.

Neither of those situations was forecast in 1977, when I think Congress did a good day's work in eliminating 80 percent, approximately, of the long-term deficit that was then projected under prior law.

What has happened since then is that the forecast underlying the OASI fund has proved overly optimistic and those underlying the DI and HI fund have proved overly pessimistic.

To the degree that those surpluses and deficits offset each other, I can see no sense whatsoever to panicking over the deficit.

It is time to reallocate either reserves or incoming revenues so that that imbalance is eliminated.

There are long-term problems to be dealt with and I fully agree with Professor Kaplan that those need to be addressed.

We do not need to exacerbate them by maintaining a fictitious separation among the reserves of the funds.

Now, turning to the short-run problem, which I believe is really quite distinct from the long-run problem and should be treated as such, I made a series of recommendations in an article in the Washington Star a week ago Sunday that I have attached to my statement and submit for the record.

Briefly, I suggest that there are several ways to protect social security over the short run from economic events less favorable than those the administration projects in its economic game plan.

First, there are the kind of benefit changes already contained in the reconciliation bills that have gone through each House of Congress.

Second, as both of the preceding witnesses have suggested, it is time we take very seriously the proposal to index benefits to the lesser of the rate of growth of prices or wages.

If we had that provision in effect in 1977, there would be no short-run financial crisis today.

Third, Congress has contemplated in the past, granting social security trust funds the authority to borrow from each other and from the Treasury if reserves sink to unacceptably low levels. I think this authority should be granted, provided that explicit arrangements are made for repayment of such borrowings when economic conditions warrant tax increases and certainly within a stipulated number of years.

Fourth, I think it would be desirable to inject some general revenues into the social security system in a carefully limited manner, either to offset the effects of protracted high unemployment or to pay for part of the costs of medicare, along the lines that has been recommended by the last two advisory councils, one appointed by President Ford and one appointed by President Carter and by the National Commission on Social Security.

Had any one of those four proposals been in effect since 1977, we would not have a shortrun crisis today.

If you enacted all or any two of them, the system would be able to weather even relatively pessimistic economic events in the future.

Now, once you deal with the short-run problem, I think, as Professor Kaplan suggested, it would be a grave mistake not to address the long-run problem as well.

We are going to face a period of about 30 years during which the cost of social security is not going to rise materially.

Last year's trustee's report suggested that the cost would actually drop over the next 30 years.

This year's report gives you so many alternatives, it is hard to tell whether they stay flat, trend up slightly, or trend down slightly.

But we don't face a social security problem over the next 30 years because the baby boom generation is going to work and staying at work during that period.

After the baby boom generation retires, we do have a problem we need to address. I think it would be desirable to begin our planning now.

This fact leads to the conclusion that it is intellectually dishonest, although it may be politically expedient, to use the short-run problems that the social security system faces today, as the basis for making changes in the system that are more relevant to the long-run problem.

Let me stress that attention should be paid to both of those problems. The short-run problem is critical and demands our attention now. The long-run problem potentially much larger can be handled best if it is addressed now.

It is important to recognize though that the solutions to those two problems are quite different in character.

Page 4 of my testimony and a copy of testimony that I delivered to the House Aging Committee, contains some specific criticisms of the administration's proposals.

I would like to suggest a set of actions which is sufficient to deal with each of those problems and to deal with them each on its own terms.

Congress, in my opinion, should immediately provide for interfund borrowing and/or reallocate revenues among the three trust funds.

In addition, it should authorize the trust funds to borrow from the Treasury under specified conditions and with carefully stipulated rules for repayment of these loans.

It should base the annual adjustment of currently payable benefits on the lower of the consumer price index or wage index rather than on the consumer price index alone.

The time has come to pay for part of medicare hospital insurance out of general revenues.

I would also favor, as I think both preceding witnesses indicated, including in taxable income, some fraction of social security benefits and the returning of resulting revenues to the trust fund. I recognize that proposal is controversial, but this committee needs no reminder that Congress recently took the step, unthinkable until it was made, of subjecting part of unemployment insurance to income tax.

I would suggest that a similar model might be appropriate to social security.

Adoption of all or some of these changes would prevent any short-run financing problems under existing law with plausible economic fluctuations and economic activity until the next century.

To deal with the long-term problem, I would urge Congress to choose either, but not both, of two solutions.

One is a gradual increase in the retirement age beginning in about the year 2000 by about 3 years, provided that such a change is combined with some supplemental benefit payable to workers between the ages of 65 and 68, working in physically burdensome occupations, for whom an extension of the working life would constitute an undue burden.

Alternatively, Congress might elect to replace the present method of adjusting the benefit formula with an alternative, along the lines suggested by Professor Hsaio, in a study for this committee several years ago. In support of this position, I submit a supplementary statement to the 1979 advisory counsel supported by five members, myself, Gardner Ackley, former CEA chairman, two business representatives and one public member that supported the replacement of the current wage-related index with a price index beginning in about the year 1995.

The reason for the deferral is our belief that the principle that Professor Kaplan embraced, that major changes should not be enacted until recipients have had ample notice, should be honored and stressed.

Furthermore, the financial problems of social security don't begin until some years after that. I see no evidence at the present time that the average benefit, now about $350 a month for current retirees, is excessive.

In addition to those changes, other modifications in benefits would be desirable that would not necessarily reduce benefits or increase them.

The 1979 advisory council report urged an offsetting benefit change which would have liberalized benefits for very high wage workers and for very low wage, long service workers, matched with a reduction in benefits for short service workers in all categories. On balance such a change would have not increased total costs of the program at all, but it would have accomplished three equity objectives which have been widely discussed recently.

Again, joining the previous witnesses, I think that the time is ripe for enactment of universal coverage, a move that has been supported by every study group that has examined the question in recent years.

If you took these proposals altogether, you would put social security on sound financial footing for both the short and the long run and you would improve the ability of the system to serve as the basic retirement program for older Americans.

In closing, let me suggest that it is more than a little misleading to read history as saying that the social security system has become a sufficient retirement program for middle-income Americans.

Social security, since its inception, has been regarded as a foundation upon which people could build retirement protection with their own savings and private pensions.

The average retirement benefit of $350 a month, I think you would agree, is not an adequate income for middle-income Americans to retire on. We are not looking at a large, munificent program paying large benefits to the bulk of retirees, but a floor on which they can build.

Senator ARMSTRONG. Thank you, Dr. Aaron. Thank you, gentlemen.

Senator Durenberger.

Senator DURENBERGER. Thank you, Mr. Chairman.

Dr. Aaron, let me start with you and with regard to your comments on the wage-price alternative index. I am going to ask you—I am going to read you a statement and ask you to react to it.

> Despite the logic of the rationale for mixed wage price adjustments, this method would be particularly harsh on the elderly.
>
> It places them in a no-win situation, penalizing them when the economy is both good and bad.
>
> When times are good, price adjustments keep them at the same standard of living, while everyone else's living standard rises.
>
> When times are bad, however, through wage adjustments, they share with everyone else, an erosion in their standard of living.
>
> The difference between the elderly and everyone else is that when good times return, everyone else's living standard rises again, making up for earlier losses.
>
> The elderly, on the other hand, remain fixed at this lower standard of living, with each periodic down swing in the economy, the elderly fall further and further behind.

Dr. AARON. I think there is some merit in that statement. If we get into the situation where on a sustained basis money wages rise faster than prices, as they have in the past, I think it would be appropriate to restore at that time, reductions that occurred in years during which wages rose less rapidly than prices.

I believe it is important to inject a degree of automatic flexibility into the system so that at the present time, because of the fact that the reserves of the system are at a very low level. Given that fact, we face a choice between large cuts in benefits forced upon us for reasons that really have nothing to do with the system itself, or injecting some degree of automaticity in the adjustment mechanism along the lines I have described.

My own personal preference would be to continue price indexing year in and year out for those people currently receiving benefits if there were sufficient reserves.

I would favor that because social security is the only source of income for the elderly that is fully protected against inflation.

I think we would pay a cost, a serious cost, and the elderly would pay a cost if we surrender that feature of the system.

My concern is that a greater cost may end up being paid if we do not build this kind of flexibility into the system.

Senator DURENBERGER. Let me ask all three of you one question that I think a couple of you spoke to. What are your reactions to including social security and taxable income with an exclusion, a dependent exclusion for survivors which we could agree on as a matter of policy, and a similar exclusion for retirees, perhaps depending on their age, but include all income, earned and unearned income, remove the earnings limitation and include social security payments in taxable income, but with appropriate exclusion?

What might that do to the system?

Dr. AARON. It depends on where you set the exclusion.

The principle that I hold in the background is that we ought to treat social security just like we treat private pensions. That is, we should allow individuals to recover without tax contributions they have made out of after tax income. We should tax that portion of the benefit that is payable out of untaxed income.

Unfortunately, consistent application of that principle would lead to the taxation of something on the order of 90 percent of each person's benefit.

Consequently, it seems to me, political realities and the need for gradualism would dictate a less draconian initial approach than that rigid principle would imply.

But I believe that eventually it is desirable to treat social security as much like private pensions as you gentlemen believe it is politically feasible to do.

Dr. PENNER. Well, I agree with everything that Henry said. Just to clarify one point. I think you meant that 90 percent of benefits go into adjusted gross income.

Dr. AARON. Yes.

Dr. PENNER. They wouldn't necessarily be taxed. We already do give the elderly two exemptions. So that a couple both over 65, with the zero-bracket amount, would have $7,400 of income tax free.

That would mean that if you approximated Henry's rule of just taxing the amount above what has been contributed out of after-tax income, if you approximate that by a half of the benefit, then they could be up to over $14,000 in benefits without paying any tax if that was their only source of income.

That is a higher benefit than someone would get today if they worked all their life at the maximum wage.

No one living entirely on benefits would be affected by their taxation. I think it is an eminently fair thing to do.

A colleague of mine at the American Enterprise Institute named Mickey Levy, has written a detailed monograph on that issue.

His estimates suggest that you could, I think, solve the whole short-run financing problem that way.

Dr. KAPLAN. I also agree with the proposal as Henry Aaron and Rudy Penner have said, though I guess I would be uncomfortable should more than 50 percent of the benefits be included in the taxable income.

Again, I don't see how this could solve the short-term problem, because you would not want to phase that in right away. That would be a big penalty to existing beneficiaries.

It seems like one of the options for the long-term problem, something you might phase in, as I say in my statement, starting 5 years from now, taxing 5 percent of the benefits and then move it up by 5 percentage points a year. Over a period of 10 years you would eventually have 50 percent of the benefits included in taxable income.

I think it has the right distributive properties and could help finance the system in the future.

Senator DURENBERGER. Dr. Penner, there was some agreement here on universal coverage, but on a portion of your statement that you quit just before you got to for the sake of time, you make reference to its undesirable properties.

Bob and I had an experience last week on one of the undesirable properties. [Laughter.]

Trying to force secondary medicare coverage on Federal employee health benefit program.

What are the other undesirable properties that might relate to universal coverage?

Dr. PENNER. Well, I think two. One is relatively minor. The revenues flow in immediately and the liabilities accrue gradually. It may fool us into thinking that the fund is more healthy than it truly is.

The second one is purely political. As you just suggested, the political constituency consisting of the Federal workers is very powerful. Adding them to the already powerful constituency of the elderly just creates a system of political incentives that make it even more difficult to change the system than it is today.

Senator DURENBERGER. Thank you.

Mr. Chairman, I have other questions, but I will wait until others have asked theirs.

Senator ARMSTRONG. Senator Moynihan.

Senator MOYNIHAN. Thank you, Mr. Chairman.

I thank Dr. Penner for an unaccustomed bit of political science in the testimony of a very distinguished economist.

Mr. Chairman, I just have two questions by way of confirming what I think we have heard.

Could I ask all three of the economists and Dr. Morrison too, if he wants to join in.

Dr. Aaron pointed out that as best we make of projections, the proportion of gross national product that goes to social security payments will decline in every decade until, I believe, the second decade of the 20th century.

Is that not so? It is 4.79 today. In 1990, it will be 4.55, down. In 2000, it will be 4.35, down. In the year 2010, it rises to 4.59, but is still below today's level. Only in the year 2020 does it go to 5.66 which is above today.

Now, I don't expect you to have these numbers in your head, but this is your understanding?

Dr. PENNER. Yes; that is correct.

Senator MOYNIHAN. So I am not trying to make any large conclusions, but those charts tend to suggest all sorts of runaway phenomena.

The proportion of GNP going to social security benefits is higher now than it will be at any time before the year 2020. This suggests a fairly stable phenomenon. This is not a runaway, out-of-control program.

Dr. PENNER. Except, Senator, it is a result of a very peculiar combination of the demographics, the depression babies retiring before this——

Senator MOYNIHAN. Right.

Dr. PENNER. The problem comes eventually.

Senator MOYNIHAN. I don't deny we have a very funny demography in the next 40 years, but it is the case that we have a manageable problem.

At least I would take that position.

Dr. AARON. It seems to me that fact cannot be overstressed. It is lost so frequently in reports that suggest that the costs of the social security system are going to go up without limit almost immediately.

The fact is that we have a problem, but it doesn't occur for about 30 to 40 years. As you suggested in your earlier question, such a period is usually sufficient for the deliberative processes to work.

Senator MOYNIHAN. It better be enough if they want to get the benefit of the wisdom of Senator Dole and Senator Moynihan and Senator Durenberger.

I think Senator Byrd and Senator Armstrong would be around. But I am not sure about some of us. [Laughter.]

I want to thank Mr. Aaron for his contributing to the growing lexicon on this subject with the term automatic flexibility. I like that. That shows a man who served at least one term in HEW. [Laughter.]

Forgive me, was it Dr. Kaplan or Dr. Penner who spoke of income splitting. I think it was you, Dr. Kaplan.

Dr. KAPLAN. I did.

Senator MOYNIHAN. Would you tell us what—how you see that? Is that the proposition that would entitle a husband and wife at retirement to half of whatever their combined benefits might be and that is the way it stays? You tell us.

Dr. KAPLAN. It might work out that way, but it is the process of how earnings are credited during the employment of either spouse. If the husband is working, has a wife, then half of his earnings would be credited for him and half to his wife.

Similarly, if she was working, he would be entitled to a——

Senator MOYNIHAN. So it is a 50–50 split for both.

Dr. KAPLAN. Then each would develop an earnings record in his or her own right. Therefore, if there was a divorce, then each party would take away its own earnings record and you don't have to deal with all the special problems of divorced spouses.

Senator MOYNIHAN. It seems to me a subject we might want to talk about. It is a rather helpful idea.

I want to thank the panel, Mr. Chairman. I think we got very solid, competent, careful advice.

I guess I would note that Dr. Penner and Dr. Aaron are in favor of interfund borrowing, in the near term situation; Dr. Kaplan is not.

The vote is 2 to 1. That is the way that they run things around here.

Dr. KAPLAN. We didn't hear from Mr. Morrison on that subject.

Dr. MORRISON. I am against borrowing.

Senator MOYNIHAN. You are against borrowing. That is my luck. [Laughter.]

Senator DURENBERGER. Come back tomorrow. [Laughter.]

Senator MOYNIHAN. Thank you, Mr. Chairman.

Senator ARMSTRONG. Mr. Byrd.

Senator BYRD. Is there a consensus among the members of the panel as to the program outlined by the administration to take care of this problem?

Dr. KAPLAN. It is probably a complex program with many features. Maybe you would want to highlight some of the more important aspects; we could talk about them individually.

Senator BYRD. Well, I don't think I am in a position to summarize the administration's program. I thought perhaps you might be familiar with it.

Dr. PENNER. Yes, there were a very large number of elements to that program. I endorsed some of the elements in my testimony; for example, the moving of the date for the automatic benefit increase from July 1 to September 1.

I think the part of the program that is too harsh is the part which would immediately reduce the benefits going to the early retirees without giving those people who planned on early retirement more notice.

If you look at their longrun estimates of costs savings, one of the most important elements of the Reagan program was this increasing the so-called bend points in the formula by only 50 percent of wage growth.

Really that is a variant on the theme which I was recommending. I was going to increase those bend points by the lower of wages or prices.

So, in a sense it is a very similar kind of proposal and don't feel too strongly about one variant versus another.

There are 13 proposals in all.

Senator BYRD. Let me ask this without going into the merits of the individual proposals. Do you feel that assuming the administration's program were enacted either in whole or substantially as recommended, that that would take care of the near term problem?

Dr. AARON. Could I comment on the program itself?

Senator BYRD. Yes.

Dr. AARON. I believe it is a seriously flawed program and that Congress would be ill-advised to enact it.

Let me give you an example of some of the effects that would flow if that program were enacted. I go through these in the part of the testimony that I didn't cover before.

There would be a 43-percent reduction in benefits for age 62 retirees, starting in 1987.

Starting in January 1982 no person, no matter how much they had earned in their working life, if he or she retired at age 62, would receive a benefit even as high as the official poverty threshhold.

The eligibility for disability benefits would be tightened significantly although 70 percent of applicants are now refused benefits when they apply. And of those who are refused benefits, 80 percent never work again regularly.

They would deny eligibility for disability benefits for a period of 7 years after she returns to work to a woman who has a baby and stays home until the child is 3 years old. Such a woman does not lose eligibility under current law.

The formula proposed by the administration for cutting initial benefits is defective. It would cut benefits for 75 years in a fashion that depends on what the rate of inflation is over the next 5 years.

That would be, Senator Moynihan, an example of automatic rigidity. Incidentally, the term automatic flexibility is drawn not from my HEW years but from the debates of the 1960's over whether tax rates should be adjusted by formula based on economic conditions.

Dr. KAPLAN. I have not had a chance to look at these proposals in detail. Let me just indicate what I feel the defects are. I agree with the other two panelists that a sudden drop in benefits for early retirees is not a desirable program and would not recommend that.

Relative to my own testimony, the program proposal does nothing to deal with the circumstances when prices are rising faster than wages which leads to many of the problems we are now facing and does nothing to deal with the defects in the Consumer Price Index as the index used to escalate benefits.

So, in those three areas I find the program deficient.

Senator BYRD. So the panel seems pretty much unanimous that the aspect dealing with the age reduction is an undesirable part and is perhaps the most undesirable part of the administration proposal.

Dr. KAPLAN. It is not only undesirable from the part of the individuals, it is undesirable for their employers who frequently have integrated with social security. Were there to be a sudden drop in the benefits for these individuals on early retirement, that would make a very heavy demand on employer pension plans which they had not anticipated either.

Senator BYRD. For clarification, when you speak of the short term, that is the 1980's I assume.

Dr. KAPLAN. Yes.

Senator BYRD. Now in regard to universal coverage, as I visualize that, that would help only on a temporary basis, wouldn't it? It would not help the program on a permanent basis?

Dr. AARON. Actually, it would help a slight bit on a permanent basis, although, as you point out and as I think Dr. Kaplan pointed out, the revenues would flow in mostly early on and benefits would accrue later.

Some money is saved overall because, at present, people in nonintegrated employment are viewed by social security as low-income workers when they retire because they have a lot of years during which their covered social security earnings are recorded as zero.

Consequently, they receive the high replacement rate intended for truly low-earnings workers. That effect is unintended and that cost would be eliminated even over the long run.

Senator BYRD. Thank you.

Dr. PENNER. Could I just make a general point, Mr. Chairman?

Senator ARMSTRONG. Yes.

Dr. PENNER. I think that in a number of our answers that we have been slipping into something I would like to correct.

In Senator Durenberger's question about the wage or price indexing and Mr. Aaron's comment about the administration's adjustment to bend points, the same problem arises.

We have a tendency to think that indexing is supposed to do the whole job. Instead we should begin to look at the social security system from this time onward in a way which would involve you gentlemen doing a bit more work.

That is to say, opening it up for discretionary action from time to time.

Therefore, my proposal to index the bend points by the lower of wages or prices is admittedly arbitrary. It is an arbitrary way of building a downward bias into the system.

I regard the administration's proposal as an arbitrary proposal in the same sense. But I don't think that is necessarily bad. It just makes very explicit the assumption that you all are going to have to adjust the system maybe every 3, 4, or 5 years.

Senator BYRD. What you are saying is regardless of how you do it, you need a downward bias?

Dr. KAPLAN. Senator, it is better to have a downward bias because it is easier for you Congressmen to be liberal than it is to be nasty.

If we make it too optimistic, then we get in circumstances like we are today. Where no one is going to be very happy with what you do.

Senator DOLE. Is the opposite of liberal, nasty? I didn't know that. [Laughter.]

Dr. AARON. Let me suggest that the term "downward bias" may not even be a correct description. The proposal that Rudy Penner suggested would still provide that workers at different earnings levels would receive higher benefits over time than they are receiving today.

So, benefits would continue to be liberalized, although less quickly than they are under current law.

I share his view that it is important for Congress to be put in a position to make discretionary changes periodically.

Senator BYRD. Just one final question. How large a surplus, I don't know if that is the word to use, but how large a surplus should the fund have? A 12-month surplus? A 6 months? A 4 months? It is 2½ months now, I think.

Dr. AARON. That is a much-studied question, Senator Byrd. The answer, I regret to say, is it all depends.

What it all depends on is the nature of the benefit commitment that you have and that was the thrust of my reply to Senator Durenberger's question.

If the system is structured as it is today, with commitments to indexing benefits on the basis of prices, with no provision for borrowing authority, with no circumstances at all under which general revenues could come into the system, then I think gradually, we should return to a reserve of approximately 75 percent of 1 year's outlays.

That amount would be sufficient to see the system under its current, relatively rigid form, through a recession about as severe as we had in 1974.

But we are not going to get there for a long time, even under an aggressive program of building up the reserves. For that reason, I think it is very important to build some flexibility into the system for the next few years, so that if our economic projections turn out to be unduly optimistic, if we get hit with another oil price increase, if there is another crop failure somewhere in the world, if some serious event occurs which causes revenues to fall or outlays to rise, we won't be thrown into a crisis by events that are in a certain very basic sense extraneous to what our long-term social security policy ought to be.

For that reason, it seems to me, it is important to build in these elements of flexibility as we build up gradually that trust fund to a level of perhaps 50 to 75 percent.

Senator BYRD. Fifty percent you don't think is too low?

Dr. AARON. With the kinds of flexible provision that I outline in my testimony, I don't think it is. But if somebody wanted to go to 75 or even a considerably larger reserve, toward the end of this century, in anticipation of the needs we are going to have for retirement benefits later on, and provided that those funds in effect led to higher rates of national savings, I could see an even larger reserve being quite desirable.

My point is, it is going to take us a while to get there.

Senator BYRD. Thank you.

Senator ARMSTRONG. Senator Dole.

Senator DOLE. Thank you very much, Mr. Chairman.

As I understand it, there is some difference, not extreme, in the views of Dr. Aaron, Dr. Penner, and Dr. Kaplan. I think each of you would use general revenue funds in a carefully limited way.

If the three of you got together with those differences, could you come up with a program?

Dr. AARON. I think very easily.

Senator DOLE. We might try that. We would like to see any such proposal. We have pretty much the same problem on this committee. I think we all recognize that there is a need to do something.

We are looking for expertise and assistance. I say that seriously. Any recommendations the three of you could make would be appreciated.

As I understand it, none of you would recommend additional tax increases; is that correct?

Dr. AARON. I would not.

Dr. PENNER. I would not.

Dr. KAPLAN. I make it unanimous.

Senator DOLE. I assume most of you would probably say Congress will not tax benefits. In fact, we have a race around here every even numbered year, depending upon who is up for reelection, as to who introduces the resolution first—the resolution that we will not tax social security benefits.

Last year it was Gaylord Nelson. [Laughter.]

This year John Heinz won the trophy. We all voted not to tax benefits.

Now, nobody really believes that is going to happen in the foreseeable future on the panel; would that be a fair statement?

Dr. PENNER. Yes.

Dr. AARON. I would have said the same thing about unemployment insurance. I wonder what made that a different kind of benefit to tax.

Fewer unemployed, perhaps? [Laughter.]

Senator DOLE. I think we have to say that taxing social security benefits is probably not going to happen. I don't mean we don't have the appetite for it, but we have so many appetites these days that we can't touch everything.

I get a lot of mail asking, "Why aren't you on social security? You are a Member of Congress. Why isn't the Social Security Administration covered by social security?'

With the exception of Dr. Penner's qualification, I guess you each believe that universal coverage could be of some help. Senator Byrd indicated that the help for the system would be limited and it would not be lasting.

The last time we voted on that in this committee, I think it was 14 nays and 4 yeas. That indicates a problem there.

Dr. Kaplan.

Dr. KAPLAN. I would like to say just like the issue of the spouse benefit and the income splitting, it is a proposal that may not only introduce some cost savings, certainly in the short run, a lesser amount in the long run, but it just improves the equity and efficiency of the system.

But the statement that Rudy Penner said, which I concur with, is we would not want to have a social security bill held hostage to that particular provision if that is the real stumbling block of getting it through Congress.

It is not that important that it should prevent some sensible other reforms to be made this year.

Senator DOLE. Dr. Penner?

Dr. PENNER. Well, I think it is a horribly complicated issue because if you include Federal workers you have to separate out their work-related pension system from the social security system. That is very hard to do justly.

I think the more important thing to do is simply to prevent the Federal worker from exploiting the progressive nature of the social security benefit structure. You have to take away what the administration calls windfalls.

Now I think that can be done in a variety of ways. I have not seen the details of their particular program.

Senator DOLE. I hope we could do that. I know that a former Member of Congress will testify later. He tells me he receives $1,000 a week from his congressional retirement program, $900 a month from social security, and his wife also has a pension.

They never had it so good. He thinks it is wrong and he wants to change it. He will be here with Mr. John Macy, former Commissioner of the Civil Service Commission. In cases where there are windfalls, they should be addressed.

Dr. AARON. There are also some holes in the system as it is now constituted which people focus on a bit less. But if you move in and out of say Federal employment or State employment in Ohio or Colorado, you are going to spend a substantial period of time ineligible for social security disability benefits, even when you are working in supposedly covered employment.

That is because of the fact you are not working in covered employment when you are in these Government plans.

So, I don't think one should view universal coverage solely as a program to cut unintended benefits, but also as a way to improve the coverage and protection.

Senator DOLE. I assume that you have thought about the ideas we have discussed, in connection with the tax bill, of using individual retirement accounts. IRA's, for example, to encourage savings as a supplement to the social security benefits.

I don't know whether you have addressed that potential in your statements, That is probably beyond the scope of this hearing, but it is an area over which this committee has jurisdiction. We have an interest in it.

Dr. AARON. That is, I think, in some ways an even more important question.

I would commend to you a plan that was developed jointly by my colleague at Brookings, Joseph Pechman and myself which would provide a generalized incentive to savings in whatever form it would occur based on either a credit or deduction for savings.

It would entail a modest but not by any means an insuperable addition to the income tax form. It would be free from a serious flaw that I think the all savers plan, or variations on that theme have, which is encouraging people simply to move their funds around in order to take advantage of a savings incentive.

What we want to do is encourage more savings not encourage people to move funds to secure a tax advantage, without increasing their overall savings.

Senator DOLE. I agree that the all savers plan may be less than perfect, but it is a substitute for one that was even less perfect. We hope we can find ways to modify it or maybe find a better approach.

Dr. Morrison, people are living longer, of course, as you understand better than the rest of us. We are going to have a larger older population.

Based on that, do you support recommendations to encourage later retirement as a way of dealing with some of the financial problems of the social security system?

Dr. MORRISON. Based on the demographic trends that one sees occurring over the long term, I think there is a very persuasive rationale for a gradual phasing in of incentives for people to remain in the work force if they are in good health and wish to remain productive for future generations.

Now that does not mean changing the rules of the game as was discussed this morning for those who are verging on retirement.

What it does mean is that the generation of 65-year-olds, 20, 30, 40 years from now are going to be in much better health than today's 65-year-olds who in turn are in much better health than 65-year-olds of a generation ago.

The fact is that we have better health in older years and that the linking of social security to a chronological age counting forward, fails to keep pace with the demographic shifts that are resulting in improvements and in the existence of several years of life in the late sixties when people could remain productive.

I see this demographic rationale as being one factor that would argue in favor of a gradual increase in retirement age, however that is accomplished.

Senator DOLE. Is it fair to say to anyone who is in the system—there are 115 million people paying social security taxes and 35 million receiving benefits—particularly to the 115 million who are paying, you will pay more and receive less when you retire.

Is that an overstatement? If we do what we should do, will they actually pay more and receive less if they are 45 or 50 years of age now or younger?

Dr. PENNER. I think it is just inevitable because of the demographics and because of the apparent slowdown in the rate of real wage growth. The current working generation will get a lower ratio of benefits to their taxpayments. There is just no way of avoiding that unpleasant fact.

Senator DOLE. Is that pretty much agreed to by the three economists?

Dr. KAPLAN. Also the current beneficiaries got the benefit of the expanding covered employment that went on during the sixties when we included more people in the system to pay taxes. Some people may not have been in the system that long but are getting the benefits.

But you can only expand the coverage to your population once.

Dr. AARON. Could I go back and respond to your previous question, Senator Dole, regarding early retirement and indeed, I think the same principle applies to increasing retirement age.

It is true that life expectancy is increasing. It may be true that the elderly are healthier than they used to be. But those are averages.

Inside those averages are people like you and me who don't have to lift heavy things or to work at numbing machinery all day long.

There are still millions of workers who are engaged in those kinds of activities. I think if we move to discourage early retirement or to raise the normal retirement age, we should provide as a backstop a liberalized disability benefit or an extended unemployment benefit or some kind of special early retirement benefit for people for whom continued work is an undue hardship.

Then by all means, encourage people like me to work longer and encourage other people who sit and have desk jobs or relatively lightweight jobs to work longer.

We can, and I think the incentives ought to be changed to encourage us to do so.

But, be careful, I would only urge, in legislating for averages.

Senator DOLE. Thank you.

Thank you, Senator Armstrong.

Senator ARMSTRONG. Dr. Penner, I believe that you engaged with Senator Moynihan in a discussion about the portion of the gross national product accounted for by social security benefit payments.

I was not sure that I understood that discussion with the Senator or perhaps it was with one of your colleagues. What I thought I heard was Senator Moynihan explaining that the actual percentage of gross national product which constitutes social security benefits would remain stable or decline for the next 2 or 3 decades. There seemed to be some agreement on that point at the table. Is that correct?

Dr. PENNER. That is correct, because of the peculiar demographic history we are going through.

Senator ARMSTRONG. Now then, if you asked same the question about the percentage of the gross national product which is accounted for by social security taxes, could we make the same observation?

Dr. PENNER. Well, the taxes are now set by law out far into the 21st century. If we take that schedule seriously, then that ratio goes up constantly.

Senator ARMSTRONG. You know, I almost thought that I had misunderstood what I was hearing. I regret that Senator Moynihan has departed, because you will recall he gestured toward those charts and made some noises of derision as if to say the sky is not really falling.

That is why I thought there was some confusion. There is really nothing painful you know, about receiving benefits. The fact that that percentage of our economy is declining doesn't mean anything in terms of the tax burden on our Nation's economy. It is that red line that goes up through the roof that is the tax burden. That line on the graph, by the way is not expressed as a percentage of GNP; it is just expressed in dollars.

I will have to check signals with him on that, because I think perhaps he hasn't thought that through to its conclusion.

Dr. KAPLAN. I have not studied the statistics. I can't comment.

The taxes should really be staying level with expenditures because the program is self-financing.

But I think what Rudy was saying that the demographic shift is that if we tax current workers heavily for the next 30 years to pay for the increased benefits, it may stay as a constant or slightly declining portion of GNP, but when that cohort retires some time in that 21st century, there is an enormous liability that has been built up based on the taxes. That liability is not unrelated to the point Senator Dole was making.

If we raise the taxes on these people now and we have no way of paying them higher benefits when they retire, then their rate of return on these contributions is going to be extremely low.

It is very unfavorable and that is something you have to watch out for.

Senator ARMSTRONG. You make a good point. I want to talk about the impact of that liability.

Dr. Aaron, did you wish to make a point?

Dr. AARON. Yes, I did. The real burden that the elderly constitute for the active population is the goods and services they use up that are not available to the rest of the economy.

If one is looking for the portion of those goods and services that are financed by social security, it is the benefit side you should look at as measuring the burden on the economy as a whole.

Now, the fact is that the fraction under the assumption under which comes closest to the administration's economic scenario in 1981, is 4.97 percent of GNP.

That drops to about 4.2 percent in GNP in the year 2005. It reaches a maximum of 6.02 percent of GNP in the year 2030.

So that is about 1 percent of GNP higher 50 years hence than it is today.

As one who knows that our GNP is quite large, 1 percent of GNP is not a number to sneeze at and I would not want to minimize it.

But as you also know, Senator, the fraction of our gross national product taken by the budget fluctuates from year to year by similar amounts.

Indeed, we are now a point or two higher than we were in 1978. If the President's program is successful we will reduce the fraction of GNP taken by the budget by 4 or 5 percentage points.

So, I think that to put this long-term problem in perspective, that 1 percent of GNP is a revealing number. It does show the amount of goods and services for the elderly and the disabled that we are going to pay for with social security benefits. It is not a small number, but we have 50 years to adjust to a 1 percent of GNP change.

Senator ARMSTRONG. Well, let's talk about that for a minute.

Dr. Penner, did you want to comment on that as well?

Dr. PENNER. Just to interject that obviously all of these numbers depend crucially upon what assumptions you make about the economy and the demography. If you put all of the pessimistic ones together, what Senator Moynihan said is not true.

Under the pessimistic path, the share goes up slightly in the late eighties and remains roughly constant for the eighties and nineties.

Senator ARMSTRONG. Well, this is not the moment to argue that point. What Dr. Aaron has said about how best to measure the burden that social security credits on the economy may be an economist's viewpoint.

People who are wage earners think the correct measure is how much it is costing them in taxes; they are furious. They are outraged at the tax increases. In fact, there is almost an element of desperation in many people you talk to about the rising cost of the social security program to them as individuals.

I want to talk about two or three other things quickly. I am conscious of the passage of time.

One is this question of how imminent the problem is. It seems to me we have had a kind of a logical inconsistency here today.

We talked about the fact that part of the problem occurs in the next couple of years, but that a big portion of the problem occurs way down the line, maybe 30 or 40 years, as if to say, well, we don't have to do anything about it for 30, 40, or 50 years. This is something the next generation of Senators can look at.

We have also been told and I believe all three of you have testified to some degree that the worst thing that could be done would be to make drastic changes soon.

Now, it seems to me we can't have it both ways. Either we are going to make very gradual changes or more abrupt ones. For example, one gradual change that is talked about is to increase the age of retirement by 1 month for each year for the next 36 years.

Now that is certainly a gradual change. But if the problem really begins to arise 30 years from now, that would imply not that we can delay, but that we are already 6 years too late in getting started on the problem.

What do you say to this? In your judgment can we put another patch on the balloon and get by next year's short-term problem and then let somebody who gets elected to the Senate in 1996 start to worry about the long-term problem or do we really need to get on with it?

Dr. KAPLAN. It is certainly not too late to start dealing with the long-term problem now. I would not get that discouraged. The long-term problem doesn't hit until until 2005, 2010. We have 30 years to plan it. If we are not all the way where we want to be, we are close enough.

I would not get discouraged that it is too late to do anything about the long-term problem gradually.

Senator ARMSTRONG. Do you think it is too soon?

Dr. KAPLAN. No.

Senator ARMSTRONG. I don't think personally there is any danger that we are going to act too soon. The danger is exactly the opposite. Some may find it is convenient to put off the solution for one reason or another and that somebody in 1990 is going to be sitting in this room saying, "Ten years ago they could have solved this problem easily without resorting to drastic measures and failed to do it."

Dr. AARON. My view is that the retirement is really one of the basic life events, a major passage, the decision about when to retire and under what circumstances. People plan for decades ahead.

I am 45 and I am planning already setting aside funds for my retirement.

If you are going to change the rules of the game under a retirement program, it is important to give people very long notice of what you are going to do.

Now what that means is that since the problem is not going to hit us for about 30 years, it is important now to legislate and announce and inform people what you intend to do at the time when the problem does hit.

Put that on the books now.

If events unfold as our best guess now suggests they will, you will have given them the notice. You will be prepared at the time it occurs.

If good luck strikes and the birth rates rise or some other economic event relieves us of the burden at that time, I don't think that your successors or yourselves if you are still here, would find it unduly burdensome to tell people that you weren't, after all, going to increase the age at which unreduced benefits are paid.

Senator ARMSTRONG. Or we could just declare a dividend.

Dr. AARON. You might just do that.

Senator ARMSTRONG. I would like to ask Drs. Penner and Kaplan to comment on Senator Byrd's question on the proper level of the reserve funds.

It was Dr. Aaron's suggestion that 75 percent was reasonable. A higher figure might even be in order under certain circumstances.

What do you say to that, Drs. Penner and Kaplan?

Dr. PENNER. Well, in a sense, the fund is simply an accounting device that tells us how we are doing relative to certain past assumptions.

I pretty much accord with everything Mr. Aaron said. Ironically, because of the dearth of depression babies retiring in the 1990's, if we stay on the current path, the fund will actually accumulate, according to the intermediate estimates, to more than 300 percent of outlays just at the turn of the century.

I think the danger then is that we will think of ways of spending that money when the deluge is just about to hit us.

If you look at the actuaries' estimate of that fund, it just soars and then goes on a steep downhill after that.

But, from the point of view of just cash flow purposes, I think we need a fund at least equal to 9 percent of outlays to go from month to month without checks bouncing. Then to take care of more major recessions, 50 to 60 percent is probably adequate. But we won't be there for a long time.

Dr. KAPLAN. I don't have a strong recommendation on a particular level, except I would like to comment on something that Dr. Penner just said. I think it is more than just an accounting device. There are some real assets that are in those trust funds.

So it is more than a way of keeping score. I believe it does make a difference.

Senator ARMSTRONG. Well, your point, it seems to me, is well taken. This morning, we looked at some charts which show how much the trustees' estimate of the near-term future of the fund has changed this year versus just 2 years ago.

That is shown by those two lines that are divergent in the first chart.

[Indicating.]

Senator ARMSTRONG. You gentlemen have testified that a 50- or 75-percent reserve ratio would be in order. That a 6- or 9-month reserve would be in order is a source of concern to me when I look at the fact that the present ratio is 20 percent, not 50 or 60 or 70 or 300 percent.

I think you are correct that there is some minimum figure. I would have said more than 9 percent is necessary just to get by from one month to the next.

It seems to me that a ratio of 9 percent is far from having anything like an acceptable degree of surplus and that we are skating on very, very thin ice.

Now, presumably, if there were something totally unforeseen, we could make some short-term emergency borrowing arrangements, but that doesn't sound to me like a very prudent way to approach the problem.

I tend to agree with what you say about the need to have a larger reserve fund of some kind or another.

Senator Durenberger, anything further?

Senator DURENBERGER. If I may, I would like to conclude two pieces of practical advice in terms of what we ought to do in 1981. Dr. Aaron surprised me by saying he was 45 and thinking about his retirement.

I made the mistake at a recent senior citizens' gathering as using myself as an example of someone who doesn't think about retirement, having practiced law before Keogh and not saved anything other than a dinky little insurance policy.

Then having gone into State government for 4 years and taking out my money when I left and then gone into a business that didn't vest until 10 years. I got out in 7 years and so forth.

I guess my question is this: How much can we really do to tell the American people what social security really is and what it is going to be like when they retire, until we address issues like portability and the way private pension plans force early retirement.

Until we take a look at all the income security systems we have developed in this country around particular accidents of circumstance and sex and age and workplace injuries and so forth, until we do something about IRA's and LIRA's and the savings that you talked about, is it even feasible to tell the American people we are going to make any sense out of social security?

We may reverse some trends and buoy up some financing, but is it practical to suggest to any of us up here that we really deal with what social security ought to be to Americans 30 or 40 years from now, without a whole lot of other policy changes that ought to take place?

Dr. AARON. I think it is possible to deal with the basic program without in effect putting right everything that is relevant to retirement.

Social security was originally conceived, as you know, as the basic program on which people would build voluntary savings, private pensions, and other forms of retirement income.

I think it is entirely right, necessary and proper for you to try to set that system on a sound financial footing so that for the millions of Americans for whom social security is the principal source of income, so that a needless fear is erased, so that each person knows that he or she will receive a social security benefit next year.

I am sure each of you now receives, as I did when I was advisory council chairman, fretful and worried letters from people who needlessly are concerned about the receipt of benefits 6 months, 1 year, 2 years, 3 years hence, benefits that you know Congress will take every necessary step to make sure get paid.

So, I think it is important to set the system on a sound financial footing in the short run and in the long so that people can plan on that basis, so that private pension planners can plan on that basis and so that indeed, you yourselves, in thinking of legislation for other areas can plan on the basis of a sound, underlying retirement program.

Dr. KAPLAN. I completely agree. I think after the report came out yesterday about the impending deficits in the social security system and the headlines about going broke, I listened to talk shows in Pittsburgh. All the workers calling in were convinced that they would never get a nickel of benefits in the future.

So, there is a great deal of concern now that has been engendered about their future benefits. If we could set the system straight, put it on a sound financial basis, based on conservative assumptions, with the option for benefit increases in the future, if things work out better than we thought, there would be a great number of people in the United States that would be reassured.

Dr. PENNER. I would just like to emphasize the same point. I think it important to note that all of our solutions to the long-run problem do not involve cutting benefits at all compared to current levels.

They just involve slowing down the rate of growth of benefits that is built into the current system.

I think you can deal with social security separately and think about the rest of the private pension system adjusting to the basic social security system.

The main problem that the private pension system faces today is inflation. It is very hard for private pensions to deal with inflation.

If we can conquer inflation, then we can expect private pensions to replace any slowdown we engender in the social security system.

Senator DURENBERGER. My last question is along this general line, but I think it has more immediacy. I was going to ask you a whole series of questions that came up this morning when we were trying to determine whether various elements of social security were either an actuarily based insurance benefit or, as Senator Moynihan called it, a social insurance benefit, or as the Secretary of HHS called it, welfare.

Senator ARMSTRONG. Or chain letters.

Senator DURENBERGER. Or chain letters as it was also referred to. Obviously, if you want to in some way reform the system, you might take that track.

I have chosen to take the track in exploring possible reforms that raise the question about health insurance and retirement. Can we divorce health insurance from retirement and if we can, is this an appropriate reform to make?

We have built up a very substantial subsidized health care system in this country that now delivers about $100 billion in services and is about $80 billion in governmental costs.

Only a part of that, the hospital part of medicare, is funded out of the payroll tax.

Yet, my colleagues on the Republican side are saying we can't get into general revenue. We can't get into general revenue. There is no leverage in general revenue.

Well, we leverage about $2 billion worth of reductions here in this committee about 2 months ago into the system, not with a lot of benefit changes, but with copayments and deductibles and premium increases and a whole variety of other things.

So, I guess I would like your advice. I heard what Dr. Kaplan said in his speech about the fund. I would cast the third vote to break the tie here on interfund borrowing, but I would just ask you, why it is important public policy to fund the hospital portion of medicare out of the payroll tax as part of social security?

Dr. KAPLAN. My feelings on that were to maintain a mechanism for controlling increases in benefits or deferring them in the Federal budget.

You say let's cut out from the payroll tax whatever is now allocated, I don't know what the percentage is, for medicare.

Senator DURENBERGER. It is 1.3.

Dr. KAPLAN. Let's just reduce that and make it up in general tax revenues. I suspect I would not find that strongly objectionable because it is not an earnings related benefit.

I was a consultant to the 1975 advisory council that first raised this possibility of tapping general revenues.

What I would object to is keeping the payroll taxes the same rate and then taking out the hospital insurance program or a significant fraction of that and burying that into general revenues. That would be a de facto increase in taxes.

Senator DURENBERGER. I don't know if you followed the arguments we went through here on the floor last week and earlier in this committee on FEHB and making medicare a secondary to the health insurance programs for Federal retirees.

But the argument was made on the floor and I suppose legitimately, why pick on Federal employees? Why not do it to everybody?

Why don't we have a system in which private insurance programs are taking on the burden from an employment base for retirees health care.

It seems to me we are not going to get to that point if that is a good point to be. I happen to think it is because we can leverage more cost containment in that area, than through medicare, as long as we guarantee everyone who reaches retirement age that their hospital bills will be paid.

Dr. AARON. I share your belief. I must confess that although I recognize it is universal appeal, the idea that payroll tax financing is somehow a strong fiscal discipline, whereas general revenues leave us free to do anything, strikes me as a triumph of myth over reality.

Over recent years, the portion of the budget that we finance with payroll taxes has grown rapidly, relative to the portion that is financed with general revenues.

You gentlemen have just gotten through voting large reductions in general revenue financed expenditures and voting 96 to nothing, a resolution that at least put a small amount of distance between yourselves and the administration's proposal to cut social security.

Payroll tax financing not only is used as a mechanism, allied with trust fund financing, to pay for social security, but also generates the sense, on the part of millions of Americans that they have an earned right to benefits. That fact makes them very, very appealing benefits and very, very hard ones to cut.

Indeed, it is the reason why many supporters of medicare and social security in general defend payroll tax financing even though it falls most heavily on many people whom they represent.

Dr. PENNER. I am not sure I agree with that. There is no more politically popular program than social security and the pension part of that and the medicare part of that are both especially popular.

I suspect that earmarking the payroll tax has helped discipline the program somewhat. In other words the programs may have grown faster if we didn't have that discipline.

I would agree that the argument for payroll-tax financing of medicare is much weaker than for the payroll tax financing of pensions, but I do think it would be a mistake to go to general revenue financing of hospital insurance just as a way out of this shortrun problem.

I think that whole issue should be judged on its own merits. If I am right that payroll tax financing exerts some sort of discipline, it may push us more quickly toward the kind of health insurance reforms that you have advocated and I am a fan of your basic approach to the whole thing.

Senator DURENBERGER. Thank you very much.

Senator ARMSTRONG. Gentlemen, we are indebted to you for your participation, even though you haven't agreed on every point. I think that the theme of your testimony is pretty clear; that is, we better get on with finding the solution, if we don't, we will all regret it later, and we ought to work out some kind of a package we can agree to and present to our colleagues.

That is certainly my feeling. Your testimony has been helpful.

Dr. Kaplan, I just want to make one kind of hitchhike observation on your comments about how people are feeling and about the call-ins from Pittsburgh.

I wasn't sure what point you were making. If the point was that you wish everybody felt better about the future of the social security program, I would respectfully disagree. I think it is wholesome for the public to understand that the fund is in trouble and that if we don't do something, they may not get their checks.

There is a popular assumption that Congress will always step in, shore up the system, and make everything turn out all right.

Indeed that is my own feeling up to a point. But, at some point, if we put off that decision too long, we lose control of the outcome.

I think, for example, of all the assurances that committees of Congress have heard from economists that inflation would not get out of hand.

In fact, I remember being told by economists that there was a tradeoff between unemployment and inflation. When one went up, the other went down.

Then all of a sudden it quit working that way. I want to say, I think we are going to save the system. I am dedicated to that end—my colleagues are also. We are going to make the hard decisions, but you know the Titanic did sink, the Hindenberg did burn, the stock market did crash, and inflation did burst into double digits, these disasters do occur, despite all assurances to the contrary.

So, I think the public should not be haunted by the problems facing social security but they should be genuinely concerned. We do have to take corrective action.

Dr. KAPLAN. I think what I heard expressed is more than concerned. What is now a 5 percent shortfall in taxes relative to benefits is made out to sound like the system is broke and almost irretrievable.

Senator ARMSTRONG. Well, I am told that there is a deficit of $1.5 trillion in the system over the customary 75-year period, with some peaks and valleys in the shorter run.

Dr. AARON. There is also GNP over that period of about $300 trillion.

So, I think it is important to put——

Senator ARMSTRONG. $3,000 trillion?

Dr. AARON. No; $300 trillion.

Senator ARMSTRONG. On another occasion I would like to invite you back to tell us what $1 trillion is. I lost track at $1 billion. [Laughter.]

It sounds like a very large amount of money to me.

I am reassured.

Dr. KAPLAN. No, the deficit in the system now is comparable to 1 year's gross national product. That is something to take very seriously. I think our remarks were addressed to that.

Senator ARMSTRONG. Just as a point of interest, I am advised that the $1.5 trillion is the amount of the deficit in 1981 dollars, not in current dollars at the end of the 75-year period. This is the unfunded amount left after subtracting expected revenues.

We are all familiar with the gross national product as an income measure. What is the gross worth of the economic assets of the country today?

In other words, what are the assets on a balance sheet today?

Dr. AARON. I don't have a number, but the value of our real capital stock really shouldn't be weighed on a balance with a debt we owe to ourselves.

We have real machinery and real homes and real factories out there. We owe the social security to each other. So that one person's debt is another person's asset. It is not comparable to think of the two together.

Senator ARMSTRONG. All right, duly noted. But what is it? Does anybody have a guess?

Dr. KAPLAN. $5 trillion.

Senator ARMSTRONG. $5 trillion?

Dr. KAPLAN. Yes.

Senator ARMSTRONG. Would be the total value of all the real assets?

If that is true and if we have a $1.5 trillion deficit here and we have a $1 trillion deficit represented by various kinds of Treasury obligations, then if there is a $700 billion deficit in the Federal employees pension fund, it is no wonder that the people of Pittsburgh are beginning to express concern.

I am as concerned as they are.

Unless there is something further, I thank you all for your participation.

[The statements of the preceding panel follow:]

DEMOGRAPHIC CERTAINTIES AND UNCERTAINTIES IN THE FUTURE OF SOCIAL SECURITY*

(Testimony before the Senate Subcommittee on Social Security and Income Maintenance Programs)

by

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PREFACE

This Note is a revised version of testimony prepared at the request of the Subcommittee on Social Security and Income Maintenance Programs of the U.S. Senate Committee on Finance and given at its July 7, 1981, hearings in Washington, D.C. The statement draws on research supported by Center Grant P50-HD12639 from the Center for Population Research, National Institute of Child Health and Human Development, DHHS.

The author thanks Rand colleagues William P. Butz, Ira S. Lowry, Kevin F. McCarthy, and Will Harriss, and Professor Ronald R. Rindfuss of the University of North Carolina at Chapel Hill for comments on an earlier draft. Views and conclusions expressed here are the author's own, not necessarily those of Rand or of agencies sponsoring its research.

SUMMARY

This testimony describes demographic changes that will affect Social Security financing over the long term: (1) the aging of the population (that is, the rise in the fraction of elderly people) from now into the next century; (2) the shift of wives into paid work outside the home; (3) lengthening of life expectancy; (4) changes in the average retirement age; and (5) uncertainties about future immigration.

The following conclusions are drawn:

1. We can foresee a sharp increase in the over-65 population (of whom a rising proportion will be widows), likely continuation of the shift of wives into the workforce, and a lengthening of life expectancy.
2. The long-term demographic outlook, however, is uncertain in important respects. Demographic "surprises" have occurred in the past; we should be prepared for more.
3. As long as Social Security payments are financed by intergenerational transfers instead of by the contributions of the recipients themselves, the system will be vulnerable to demographic shifts that legislation cannot fully anticipate. For example, Social Security projections appear to overlook an important source of instability associated with unforeseen swings in future fertility.
4. The element of demographic surprise can be reduced by continually reappraising the assumptions underlying projections of the numbers of donors and recipients.

Early warnings, however, are useful only if linked to a procedure for acting on them. Accordingly, my recommendations are:

1. To set up procedures for monitoring demographic trends more closely, especially to detect early warnings of significant departures from past trends.
2. To institutionalize a thorough and ongoing reappraisal of the demographic assumptions underlying long-range projections of Social Security's financing. The present assumptions about future fertility (as set forth in the 1981 Social Security Trustees' Report) are overly narrow in what they envision.

Both steps could be accomplished through interaction with demographers who have specialized expertise.

I. INTRODUCTION

The past half-century has witnessed major changes in long-term patterns of fertility, mortality, and labor-force participation. These changes have fundamentally altered the terms of the social compact between generations that is embodied in Social Security. By creating an imbalance between Social Security recipients and donors, demographic change has undermined support for intergenerational transfers, altered the consequences of existing legislation, and created constituencies for new laws.

My testimony has two purposes. The first is to describe the salient demographic changes and separate what we can confidently foresee from what must remain uncertain. The second is to link these changes to Social Security financing over the long run. I emphasize "long run" because these continuing demographic changes must be distinguished from other threats to the Social Security System's financial soundness--threats that result from inflation, unemployment, and the manner in which benefits and contributions are coupled.

My message can be summarized as follows:

1. Although we can confidently foresee some changes, the long-term demographic outlook is uncertain in important respects. Demographic "surprises" have occurred in the past; we should be prepared for more.
2. As long as Social Security payments are financed by intergenerational transfers instead of by the contributions of the recipients themselves, the system will be vulnerable to

demographic shifts--for example, unforeseen swings in future fertility--that legislation cannot fully anticipate.

3. The element of demographic surprise can be reduced, however, by continually reappraising the assumptions underlying projections of the numbers of donors and recipients.

In addressing these topics, I have drawn on the studies and expertise of my colleagues at The Rand Corporation's Population Research Center, which is supported by the National Institute of Child Health and Human Development (NICHD). The views and conclusions expressed here are my own, not necessarily those of Rand or of agencies sponsoring its research.

II. FIVE DEMOGRAPHIC TRENDS SHAPING THE SOCIAL SECURITY SYSTEM'S FUTURE FINANCING

Five aspects of demographic change bear centrally on the Social Security System's long-term financing:

1. The aging of the population (that is, the rise in the fraction of elderly people) from now into the next century. This trend will increase the ratio of prospective Social Security recipients to the number of workers paying into the system. Under present arrangements, that would mean collecting more dollars from the workforce to pay benefits to a growing fraction of retirees.
2. The shift of wives into paid employment outside the home. If it continues, this shift will increase payments into Social Security and in the future will entitle a progressively larger fraction of wives to benefits as retired wage-earners rather than as dependents.
3. Lengthening of life expectancy. This is one of two factors affecting the length of the benefit period, but a factor that constitutes a "given."
4. Changes in the average age at which workers retire. This is the second factor affecting the length of the benefit period, and one that is susceptible to the influence of policy.
5. Uncertainties about the future numbers, earnings, and retirement characteristics of immigrants. At this time, we can foresee neither their future contributions as wage-earners nor

the future Social Security benefit obligations they would impose as retirees.

All five aspects of demographic change will have far-reaching effects on the Social Security System's future financing. In what follows, I delineate each trend and discuss its background and possible future course.

1. "GRAYING" OF THE POPULATION'S AGE DISTRIBUTION

Wide fluctuations in U.S. fertility during this century have left an indelible imprint on the population's age structure. Owing to the unevenness of that structure, some age groups within the population will expand while others simultaneously will contract. This pattern of uneven changes for the various age groups will persist for many decades to come. Figure 1 illustrates why. It displays the predictable way in which the maturation of different-sized birth cohorts will affect the

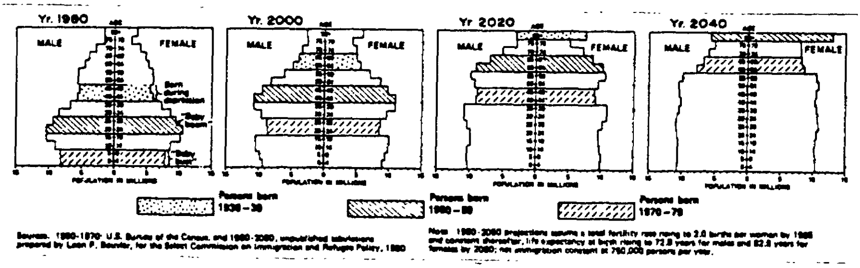

Fig. 1--How Cohort Maturation Will Affect Future Numbers of 60-to-69-Year-Olds

size of a given age group (for example, 60-to-69-year-olds) in future years. In the year 2000, for example, persons in their 60s will have come from the numerically small cohorts who were born during the 1930s Depression. In the year 2020, 60-to-69-year-olds will be replaced by the much larger "baby boom" cohorts; they, in turn, will be replaced around 2040 by the much smaller "baby bust" cohorts born since 1970.

The far-reaching implications of this process are now widely recognized. If fertility remains near its present level, and mortality conditions follow the Census Bureau's projected course of gradual improvement, the "graying" of the U.S. population will assume these proportions:

- The population aged 65 and older will increase from the current 11 percent to between 18 and 23 percent by the year 2035.
- People in their late 70s and 80s will constitute a larger fraction of this elderly population. People who are 75 and older currently make up 38 percent of the population over 65. That figure will rise to 47 percent by the year 2035.
- The proportion of elderly widows will rise, and they will face a longer widowhood. Women's life expectancy exceeds that of men by a growing margin, and because most women are younger than their husbands, more and more wives will outlive their spouses.
- The full force of these shifts will be concentrated in a relatively short period of intense change starting around the year 2010, when the baby-boom generation begins to turn 65. Beginning then, the growth of the elderly population will

accelerate sharply, shooting up 29 percent between 2010 and 2020 (vs. 9 percent during the 2000-2010 decade).

The overall impact of this "graying" of the population by 2035 will be: (1) an approximate doubling of the ratio of prospective retirees to prospective wage earners, and (2) a rising fraction of older persons over age 72 (hence exempt from today's Social Security earnings test).

The Social Security System's demographic imbalance originated in the post-World War II baby boom and worsened in the late 1960s, when Americans rejected the idea of large or moderate-size families to a degree that surprised most demographers. The total fertility rate,[1] which climbed to a baby-boom peak of 3.7 children per woman in the late 1950s, had fallen to 1.8 by 1975, where it has remained essentially unchanged.

The fertility trend in the next several decades will be important: It will govern changes in the number of working-age persons early in the next century, and may indirectly affect the number of wives paying into Social Security as wage earners during the remainder of this century. Presently, the total fertility rate stands at 1.88 children per woman; but demographers are hesitant to predict its future course, because uncertainties cloud the outlook and there are genuinely conflicting scholarly views on what causes the fertility rate to rise or fall over the long term.[2] The fertility rate could sink below 1.8 under various

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[1]The total fertility rate is the average number of children that would be born alive to a woman during her lifetime if she were to pass through all her childbearing years conforming to the age-specific fertility rates of a given year.

[2]For an overview of the forecasting "state of the art," see Gerry E. Hendershot and Paul J. Placek, eds., Predicting Fertility: Demographic Studies of Birth Expectations (Lexington, MA: D.C. Heath,

circumstances--for example, a substantial rise in women's wage rates, resulting perhaps from general economic recovery and growth. Indeed, the total fertility rate is already below 1.6 in several highly developed Western European nations--Switzerland, the Netherlands, and West Germany.[3] Observers also envision "rising fertility" scenarios, however, such as an extended period of prosperity that might produce another baby boom.

In any case, birth rates are likely to be more volatile than in the past. Because couples have acquired greater control over whether and when to have children in response to changing economic conditions, we are likely to witness unpredictable intermediate-term fertility swings and, as a result, variations in the size of future birth cohorts. Those

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1981). According to one view, fertility is now low (and likely to remain low) because the "opportunity costs" of women's time have risen. In effect, women should become more reluctant to bear children as their earnings prospects brighten. (See William P. Butz and Michael P. Ward, "The Emergence of Countercyclical U.S. Fertility," American Economic Review 69(1979): 318-328.)

A different view (but one that reaches a similar conclusion) stresses normative changes in women's roles, shifts in marital and familial patterns, and advancement toward a perfect-contraceptive society, all of which should attenuate rather than encourage high fertility. (See Charles F. Westoff, "Marriage and Fertility in the Developed Countries," Scientific American 239 [December 1978]: 15, 51-57, 198.)

Yet another view attributes each generation's childbearing to that generation's relative size (hence, economic fortunes) compared with the size of others. In large cohorts, there is a glut of young people in the labor market, job competition is intense, and young people are less willing to marry and have children. In small cohorts, there are relatively fewer young adults competing for jobs and optimistic couples increase their childbearing aspirations. This model projects a rise in the birth rate in the 1980s, owing to the smaller cohorts born in the 1960s. (See Richard A. Easterlin, Birth and Fortune [New York: Basic Books, 1980].)

[3]The fertility decline in Europe is discussed in Jean Bourgeois-Pichat, "Recent Demographic Changes in Western Europe: An Assessment," Population and Development Review 7(1), March 1981, 19-42.

variations, in turn, will continuously alter the balance of Social Security receipts and payments several decades thereafter.

The implications for Social Security financing are twofold. First, the System's financial outlook can appear to be sound or unsound, depending on one's long-term assumptions about fertility. The hazard here is that the choice of those assumptions may be governed more by transitory political expediency than by a realistic (and perhaps unpleasant) analysis of future prospects. Second, because the fertility rate is likely to fluctuate unpredictably around its long-term trend, the System needs a cushion for the intermediate-term "shocks" of future variations in cohort size.[4] Some type of "demographic shock-absorber" will be needed.

In light of these considerations, let us turn to the fertility assumptions underlying the projections on which the 1981 Social Security Trustees' Report is based.[5] Those assumptions establish a range for the total fertility rate extending from a "pessimistic" low of 1.7 births per woman to an "optimistic" high of 2.4, with an intermediate level of 2.1 births.[6] I question the wisdom of these assumptions on two grounds:

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[4]James A. Sweet and Ronald R. Rindfuss, "Predicting Fertility: Socio-Demographic Considerations," unpublished paper prepared for the Social Security Administration, March 1980.

[5]1981 Annual Report of the Board of Trustees of the Federal Old-Age Survivors Insurance Trust Fund and the Federal Disability Insurance Trust Fund, transmitted July 2, 1981, to The Speaker of The House of Representatives, pp. 32-33 and pp. 72-75.

[6]Ibid, pp. 32-33. In alternative I (the optimistic assumption), the total fertility rate (1.875 in 1980) is assumed to rise to 2.4 in 2005. In alternative II (the intermediate assumption), the total fertility rate is assumed to attain 2.1 by 2005. In alternative III (the pessimistic assumption), the rate is assumed to decline to 1.7 by 2005.

1. <u>If the intent is to foresee plausible levels of future fertility, this range is too narrow</u>. It is plausible that the total fertility rate might exceed 2.4 in the future (after all, it was as high as 3.7 late in the 1950s); more important, it may well sink below 1.7 for an extended period. I regard a future fertility rate of 1.7 as realistically possible, no matter how "pessimistic" that possibility may now appear.
2. <u>The Social Security projections overlook an important source of instability associated with unforeseen intermediate-term fluctuations in fertility</u>. The succession of different-sized cohorts will pose a continuing problem for Social Security financing; adaptive mechanisms will be required to cope with it.

Admittedly, this is a somewhat unsatisfying prognostication, but it reflects the uncertainties current among demographers. We have been surprised before, and we anticipate being surprised again.[7] By monitoring ongoing fertility trends more closely, however, it is possible to reduce the element of surprise--after all, babies born in 1981 will not join the workforce for nearly two decades, and a sustained rise in fertility might foreshadow a leveling off of wives' workforce participation.

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[7]We have been surprised before because historical (period) factors--wars, depressions, and even the Supreme Court's 1954 school desegregation ruling--have affected period fertility rates. Although demographers can predict with some confidence how fertility rates would respond to a future war, depression, or period of prosperity, those future events themselves cannot be foreseen.

2. THE SHIFT OF WIVES INTO PAID EMPLOYMENT

In the traditional American family, the husband was the sole income earner; the wife contributed to the family's economic well-being largely through home production tasks. Typically, then, her eligibility for Social Security benefits derived from her status as a dependent, not a wage-earner.

Events have long since outmoded the Social Security System's earlier underlying premise that households have a single breadwinner, of course. As of 1980, 50 percent of married women worked for pay, up from 24 percent in 1950.

This is a trend of profound significance, and more built-in demographic momentum is behind it than is generally recognized. With low fertility, an increasing proportion of couples have few or no children at any given point in their life course, a situation more compatible with wives' employment outside the home than the large families of earlier years. Surprisingly, though, the mothers of pre-school children have registered the sharpest rise in employment rates: from 12 percent in 1950 to 45 percent in 1980.

One impetus behind this trend is the change in how wives are ordering their careers as mothers and income earners: They are going to work earlier in life and continuing to work after children arrive. Another is the sharp rise in age-specific labor force participation rates for each succeeding generation of wives. Unfortunately, time does not allow me to elaborate on these points, but I do want to call to your attention a newly issued study, prepared at Rand's Population Research Center by my colleague Linda J. Waite. Her study, issued by The

Population Reference Bureau, is entitled U.S. Women at Work. I am furnishing a copy and ask that it be entered in the written record, to make it available to the Subcommittee.

Taken together, I believe these developments foreshadow higher labor force participation and attachment in the future--perhaps well above current Federal projections. Earlier generations of nonworking women are being replaced by more recent generations who, early in their adult life, have developed the foundations of lifelong careers in the workforce. In my opinion, many more of today's young wives, compared with their counterparts a decade or more ago, will be earning income in their older years and holding fulltime jobs.

The shift of wives into the workforce carries two important implications for the financing of Social Security. First, more wage-earners will mean more dollars paid into the system--the only question is, how many dollars? Second, in future years, many more women reaching retirement age will have worked long enough to qualify for Social Security benefits based on their payroll contributions. Since such women receive the higher of the two benefits for which they are eligible--either that of a retired worker or that of a dependent--much will hinge on the amount wives earn in the future.

How extensive will be the shift of wives into the paid workforce? Here, too, our vulnerability to "surprise" is apparent: Previous projections have persistently underestimated actual levels.[8] Ten-year projections materialized within only a few years. Even the current

[8]See discussion in Paul O. Flaim and Howard N. Fullerton, Jr., "Labor Force Projections to 1990: Three Possible Paths," Monthly Labor Review, Vol. 101, No. 12 (December 1978), pp. 25-35.

round of projections[9] may prove over-conservative, given the momentum of change built into the replacement of generations alluded to in Dr. Waite's study (U.S. Women at Work, pp. 7-9).

Once again, we are in a position to reduce the element of surprise: Demographers are now probably better equipped than ever before to monitor the trend, analyze its structure and, it is to be hoped, foresee its future course.

3. LENGTHENING OF LIFE EXPECTANCY

Demographers speak with greater confidence when they discuss the outlook for the lengthening of life expectancy. The uncertainties are smaller and projection techniques more sophisticated. Indeed, Social Security actuaries are well equipped to judge changing patterns of mortality and prospects for the future. Accordingly, I will merely highlight a few points:

First, older Americans are living longer.[10] As of 1978, remaining life expectancy at age 65 was 18.0 years for women and 14.1 for men (refer to Table 1). Those figures represent a gain since 1940 of 4.4 years for women and 2.0 years for men.

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[9]The latest BLS projections (which present civilian labor force participation rates for all women, married and unmarried) foresee a rise in that rate from 51 percent in 1979 to between 58 and 65 percent by 1995. See Howard N. Fullerton, Jr., "The 1995 Labor Force: A First Look," Monthly Labor Review, Vol. 103, No. 12 (December 1980), pp. 11-21.

[10]For a recent review, see Eileen M. Crimmins, "The Changing Pattern of American Mortality Decline, 1940-77 and Its Implications for the Future," Population and Development Review, Vol. 7, No. 2 (June 1981), pp. 229-254.

Table 1

Remaining Life Expectancy

(in years)

	1940	1968	1978
		At Birth	
Total	63.6	70.2	73.3
Men	61.6	66.6	69.5
Women	65.9	74.0	77.2
		At Age 65	
Total	12.8	14.6	16.1
Men	12.1	12.8	14.1
Women	13.6	16.3	18.0

Source: National Center for Health Statistics, and data cited in Jacob S. Siegel, "Recent and Prospective Demographic Trends for the Elderly Population and Some Implications for Health Care," in Suzanne G. Haynes and Manning Feinleib, eds., Second Conference on the Epidemiology of Aging (Washington: USGPO, 1980), pp. 289-314.

Second, older Americans are enjoying better health at a given age than their predecessors in past generations, and there are indications that the period of adult vigor may extend to a later chronological age than in the past.[11] Thus, older Americans also are remaining potentially productive longer.

[11]James F. Fries, M.D., "Aging, Natural Death, and the Compression of Morbidity," The New England Journal of Medicine, Vol. 303, No. 3 (July 17, 1980), pp. 130-135.

Finally, dramatic increases in life expectancy through major "breakthroughs" on specific causes of death seem unlikely, owing to the effect of competing risks. For example, a sharp reduction in cancer would still leave one vulnerable to cardiovascular diseases. If the aging process itself could be slowed through genetic engineering or immunologic breakthroughs, however, the outlook could change, perhaps lengthening considerably the period over which retirees would be eligible to receive Social Security benefits. Misjudging this possibility could prove to be an extremely expensive error.

4. CHANGING AGE AT RETIREMENT

The average age at which workers retire is a central parameter affecting the financing of Social Security. When workers retire at an older age, they stretch out the period during which they pay into Social Security and shorten the period for receiving benefits. In recent years, though, most workers (men in particular) have been doing just the opposite--retiring earlier instead of later--despite legislation minimizing mandatory retirement and overall improvements in health and productivity in their older years. From 1969 to 1979, for example, the proportion of men over age 55 who worked during the year declined from 64 to 52 percent, and the proportion of women with jobs dropped from 32 to 27 percent. Many workers have chosen to retire at an earlier age because of liberal pension plans, improved disability provisions, and increased Social Security benefits.

Strong arguments have been advanced in favor of stimulating a gradual rise in the average retirement age--one sure way to offset the deteriorating demographics of age structure. Without taking one side or the other on this hotly contested issue, let me note a more fundamental issue embedded in that debate. The traditional way of defining old age has been to mark it chronologically: You are old when you reach some agreed-upon age. The problem with a fixed retirement age, though, is that it becomes gradually outdated by its failure to keep pace with the improving health and productivity of successive generations who attain that age.[12] Today's 65-year-olds have a longer and prospectively healthier life span than their counterparts in earlier generations; tomorrow's 65-year-olds will enjoy an even longer and healthier old age. We should consider possible alternatives to the traditional definition of when "old age" begins.

5. UNCERTAINTIES ABOUT FUTURE IMMIGRATION

The U.S. will continue to feel the effects of the changes in immigration policy wrought by the 1965 reforms and the pressures to accept a rising flood of worldwide refugees. The 1965 law shifted the composition of immigration toward Asian and Latin American, rather than European, origins. The political, social, and economic conditions that have caused the large influx of immigrants and refugees are almost certain to continue during the 1980s, and the United States will remain a preferred destination for persons who are displaced or who seek to better their lives.

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[12]Jacob S. Siegel, "On the Demography of Aging," Demography, Vol. 17, No. 4 (November 1980), pp. 345-364.

The magnitude of legal immigration, a matter of deliberate policy, is dwarfed by that of illegal immigration, which cannot now even be measured, let alone predicted. Responsible estimates of the number of illegal immigrants living in the U.S. range from 4 to 6 million as of the mid-1970s, probably with substantial increases since then. Much of the illegal immigration to the U.S., however, may be offset by a substantial level of return migration.

The level of immigration--legal and illegal--in the future is anybody's guess. No less important, however, is the matter of composition: age, skill level, national origin, and so forth. These uncertainties pose important unanswered questions:

- How much are future immigrants likely to earn?
- What will be their family structure and composition (which determines the number of future dependents)?
- Will immigrants retain the age-specific work patterns of their countries of origin throughout their working lives, or will they adjust toward the then-prevailing pattern of U.S. retirement?
- How many immigrants will be around to collect Social Security benefits when they retire?
- How many of those retirement dollars will end up being spent in other countries?
- What will happen when those undocumented immigrants whose contributions presently are being credited to counterfeit or duplicate Social Security numbers retire and demand their benefits?

III. CONCLUSIONS AND RECOMMENDATIONS

In conclusion, let me turn to the broader implications of this changing and only partly foreseeable demographic context.

Our understanding of the trends outlined above has been advanced considerably in recent years, thanks in large part to the program of scientific investigation supported by NICHD's Center for Population Research. That understanding strengthens the basis on which demographers monitor and attempt to foresee those trends. Moreover, current population trends are delineated with greater precision and in greater detail than ever before. Through the statistical systems of the Bureau of the Census and Labor Statistics, and of other agencies, legislators now have at their disposal a wide array of technical indicators that can signal demographic "early warnings."

Certain aspects of the long-term demographic outlook nevertheless are shrouded in uncertainty. Demographic surprises have occurred in the past: Recent examples include the "surprisingly" steep fertility decline and the "surprisingly" rapid shift of wives into the workforce. There could be surprises in the future--for example, scientific "breakthroughs" that lengthen elderly life expectancy or, more likely, intermediate-term swings in future fertility.

As long as Social Security payments are financed on a "pay-as-you-go" basis, the system will remain sensitive to these unforeseeable shifts that cannot be entirely anticipated by legislation. The element of demographic surprise can be reduced through more effective use of existing capabilities to monitor these areas of demographic uncertainty.

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My recommendations to you are: (1) to set up procedures for monitoring demographic trends more closely, especially to detect "early warnings" of significant departures from the past trend; and (2) to institutionalize a thorough and ongoing reappraisal of the demographic assumptions underlying long-range projections of Social Security's financing. (For example, the present assumptions about future fertility are overly narrow in what they envision.) Both steps could be accomplished through interaction with demographers with specialized expertise to identify and quantify the demographic factors that affect the solvency of the Social Security Trust Fund. Such outside expertise is available in the demographic profession. Briefings and information fact sheets such as the one I have distributed can be prepared to meet specific Congressional needs upon request.[1]

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[1] "The Impact of Population Change on Social Security" (see Appendix) is based on a briefing for the Subcommittee on Social Security of the House Ways and Means Committee. The briefing was organized by the Population Resource Center, with technical assistance from the Population Association of America. Such information briefings are available upon request from the Population Resource Center.

APPENDIX

THE IMPACT OF POPULATION CHANGE ON SOCIAL SECURITY

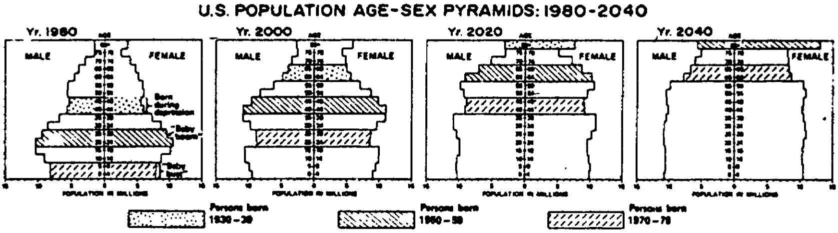
Some Demographic Indicators . . .

- The U.S. population is aging. Beginning around the year 2015, the population aged 65 and over will increase dramatically, by about 40% in 15 years.
- There are now 45 million women in the labor force. The lifetime labor supply and earnings of women are increasing rapidly, even faster than many experts anticipated.
- American males are retiring earlier. In 1947 nearly half of all men aged 65 and over worked. By 1978 the number was barely one in five.
- People are living longer. In 1950, the average person who reached age 65 lived to age 79. By 1978, the average 65-year-old could expect to pass age 81.

Some Implications for Policy-Makers . . .

- The aging U.S. population will cause a great strain on the social security system. While the nation has about 5 persons of "working age" (between 20-64 years) for each person 65 and over, it appears that this ratio will be cut in half, to about 2½ persons of working age for each elderly person, according to a recent report from Social Security.
- Social security retirement benefits are based on the 1930's premise that households have only one breadwinner. Studies indicate that in only 20 years, 80% or more of women reaching age 65 will have worked long enough to be entitled to social security based on their own payroll contributions.
- The social security system began at a time when retirement at age 65 or later was the norm. Now, "early retirement" is more popular, perhaps in part because the retirement system itself has become far more generous in the last 30 years. Also, the social security earnings test discourages some persons from working full-time past age 62.
- The social security trust fund pays out less money over a remaining lifetime to a person who delays retirement than to a person who retires at age 65 or earlier. As delayed retirement has become less and less common, the system has had to pay out larger sums in retirement benefits.

U.S. POPULATION AGE-SEX PYRAMIDS: 1980-2040



Sources: 1900-1970: U.S. Bureau of the Census; and 1980-2080, unpublished tabulations prepared by Leon F. Bouvier, for the Select Commission on Immigration and Refugee Policy, 1980

Note: 1980-2050 projections assume a total fertility rate rising to 2.0 births per woman by 1985 and constant thereafter, life expectancy at birth rising to 72.8 years for males and 82.8 years for females by 2080; net immigration constant at 750,000 persons per year.

This is an Executive Summary of a briefing for the Subcommittee on Social Security of the U.S. House of Representatives Committee on Ways and Means, December 2, 1980. It provides brief examples of demographic trends in the United States and points out some of the implications for policy decision-makers. The Summary is based on the presentations of the four participating experts Mr. Steven Sandell, National Commission for Employment Policy; Mr. Walter Shur, New York Life Insurance Company; Dr Richard Wertheimer, The Urban Institute; and Ms. Signe Wetrogan, U.S. Bureau of the Census.

The briefing was organized by the Population Resource Center with technical assistance from the Population Association of America, for the Subcommittee on Social Security of the U.S. House of Representatives Ways and Means Committee. This Summary was prepared by the Population Reference Bureau, Inc., Washington, D.C. Additional information may be obtained from the Population Resource Center (202) 546-5030, or the Population Reference Bureau (202) 785-4664.

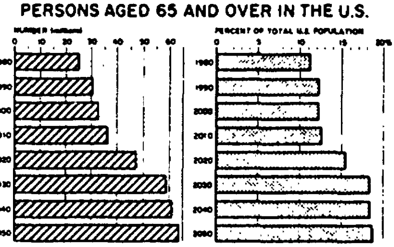
The Demographic Impact

Significant demographic changes raise questions about the validity of social security benefit structure and design. The social security system is in poor financial health in part because of the aging of the U.S. population, the changing face of the American household, improved life expectancy, earlier retirement, large increases in benefits, and slow economic growth combined with rapid inflation.

An Aging Population

Because of the large number of people born during the post World War II "baby boom" and the decline in fertility rates which followed in the late sixties and seventies, the U.S. population is growing older and will continue to place a financial strain on the social security system. The population aged 65 or over will increase dramatically, by about 40% in 15 years beginning around 2015.

PERSONS AGED 65 AND OVER IN THE U.S.



Source: Unpublished tabulations prepared by Leon F. Bouvier for the Select Commission on Immigration and Refugee Policy, 1980.

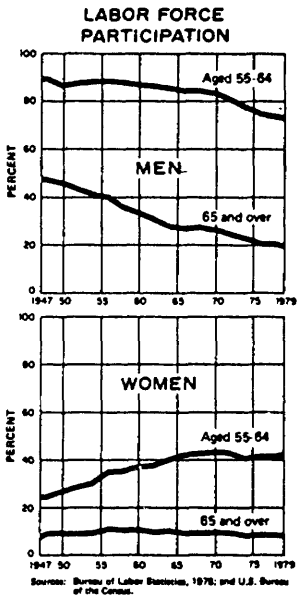
When the baby boom generation starts to swell the retired rolls, the number of working age people will actually decrease. Currently there are about 5 persons aged 20-64 for each person 65 and over. By 2010 there will be 4 persons and by 2040 there will be only about 2 1/2 persons of working age available to support each elderly person. These Social Security Administration projections assume that the total fertility rate will increase to 2.1 children per woman, but if the rate remains as it is now at 1.8 children per woman, or if there is a major breakthrough in the treatment of heart disease or cancer that would lengthen the life span, the dependency ratio would be even less favorable.

Whether fertility will increase and ultimately lead to an easing of the situation is subject to speculation. Some observers say that women will not go back to larger families because they now have the opportunity to pursue a role other than motherhood, while others relate low fertility to economic necessity or to higher female wage rates.

Even if the total fertility rate should increase to 2.5 children per woman, however, the number of persons aged 20 to 64 who will have to support one person 65 or over still declines, from 5 in 1980 to 3.3 in the year 2040.

Labor Supply of Women

The increasing labor force participation of women has an important impact on the balance of the social security trust fund and the cost of various proposals to reform the benefit structure, as well as raising questions about the inequitable treatment of women under the present system. In 1940, when social security monthly benefit payments were first made, most households had one breadwinner and one homemaker. Only 14% of married women were in paid employment. Now, about half work outside the home, and this proportion is projected to increase to about 60% by the 21st century.



Since an individual can only receive the higher of the two benefits for which he or she is eligible—either that of a retired worker or that of a spouse or survivor, the aggregate trust fund balance changes as more women earn benefits in their own right. As the lifetime labor supply of women increases, there is a decrease in the cost of dependents' or survivors' benefits.

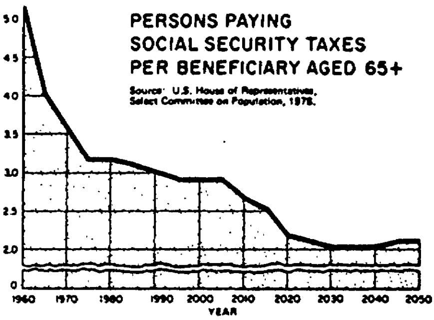
From an individual woman's perspective, the value of the spousal or survivor's benefit depends in part on what she would have received based on her own labor supply and earnings. Many employed women who qualify as a spouse or survivor find they receive no more in benefits than if they had never paid social security payroll taxes at all.

New studies show that, instead of 69 percent as previously predicted, possibly more than 80 percent of the women reaching retirement age at the turn of the century will qualify for benefits based on their own employment histories. Therefore, revised alternative projections of future labor supply and earnings should be used to estimate the cost of present and proposed benefit structures, such as earnings sharing and the inheritance of earnings credits.

Earlier Retirement

Men are retiring earlier, perhaps in part due to the retirement income system itself. The increases in social security benefits and eligibility are probably helping to shape older Americans' retirement plans and influencing the amount of work they do following retirement.

Also, until the recent change in the Age Discrimination in Employment Act, mandatory retirement rules forced many workers out of their careers at age 65. Employer pension benefit formulas entice many others out of their jobs at even earlier ages. Some may be discouraged by the social security earnings test which reduces benefits by 50 cents for every dollar earned above $5,000 a year by persons aged 65-71, or above $3,000 for workers 62-64.



The increase in the mandatory retirement age and persistent high inflation are both factors working against early retirement, however. In addition, fewer younger workers will be entering the labor market in the future, perhaps raising the demand for older workers.

Longer Life Span

LIFE EXPECTANCY

	1900[a]	1950	1978[b]
	LIFE EXPECTANCY AT BIRTH		
Total	47.3	68.2	73.3
Men	46.3	65.6	69.5
Women	48.3	71.1	77.2
	LIFE EXPECTANCY AT AGE 65		
Total	11.9	13.9	16.1
Men	11.5	12.8	14.1
Women	12.2	15.0	18.0

Source: National Center for Health Statistics, 1980

[a] Death registration area only.

[b] Excludes deaths of U.S. nonresidents.

People are living longer, Assuming an 8% inflation rate, a person who starts with retirement benefits of $300 a month at age 65 would receive $87,000 from social security over a remaining lifetime of 14 years (the 1950 life expectancy of a 65-year-old). But with a life expectancy of 16 more years (as it was in 1978), social security will have to dispense about $114,000, 30% more money. Further improvements in longevity will continue to put fiscal pressure on social security.

Statement of Henry Aaron*

Before the Senate Finance Committee

Subcommittee on Social Security and Income Maintenance Programs

July 7, 1981

*Henry Aaron is a Senior Fellow at the Brookings Institution and Professor of Economics at the University of Maryland.

The views expressed in this statement do not necessarily reflect those of Brookings staff or the University of Maryland staff members or the officers and trustees of the Brookings Institution. Dr. Aaron also served as Chairmaen of the 1979 Advisory Council on Social Security.

Mr. Chairman, thank you for the opportunity to testify before your committee today. My name is Henry Aaron. I am a Senior Fellow at the Brookings Institution and Professor of Economics at the University of Maryland. I served as Chairman of the 1979 Advisory Council on Social Security and before that as Assistant Secretary for Planning and Evaluation in the Department of Health, Education, and Welfare.

The immediate financial prospects of the social security trust funds will force this Congress to legislate some changes in the system during this session. The excess of the growth of prices over the growth of wages and relatively high unemployment are leading to the depletion of the retirement and survivors' insurance trust fund. At the same time, the disability and health insurance funds are expected to have sizeable surpluses. Whether the DI and HI surpluses and reserves are sufficient to offset the OASI fund deficits, without changes in benefits or taxes, depends on one's economic assumptions. It is absolutely clear, however, that, at a minimum, interfund borrowing or reallocation of tax rates is desirable to match up revenues and expenditures among the funds. Prudence requires other changes because it would be foolish to depend on realization of the Administration's rosy economic scenario.

The Short-Run Problem

Congress faces a choice between drastic cuts in benefits imposed by short-run financial conditions, but unjustified on other grounds, and structural changes in social security financing and benefits that would make the system less sensitive to short-run economic conditions than it now is. In an article that appeared in the Washington Star on June 28, 1981 I suggest social security policy appropriate for conservative assumptions about future economic events. That article is attached to my testimony and is submitted for the record.

There exists a variety of ways to protect social security from unanticipated economic fluctuations.

First, the proposal to index benefits to the lesser of the rate of growth of prices or of wages has been widely discussed. It would reduce greatly the sensitivity of social security to the kind of economic events recently encountered.

Second, Congress has contemplated granting the social security trust funds authority to borrow from each other and from the Treasury if reserves sink to unacceptably low levels. This authority should be granted, provided that explicit arrangements are made for repayment of such borrowings when economic conditions warrant tax increases and certainly within a stipulated number of years.

Third, it would be desirable to inject some general revenues into the social security system in a carefully limited manner, either to offset the effects of protracted high unemployment, either along lines proposed in 1977 by President Carter or to pay for part or all of Medicare hospital benefits as proposed by the last two Advisory Councils on Social Security, one appointed by President Ford and one by President Carter, and by the National Commission on Social Security.

Had any one of these three changes been enacted in 1977 there would be no short-run financial crisis today. Enactment of all three or any two of them would enable the continuation of social security benefits and payroll tax rates at approximately their current levels;

and they would preserve the financial balance of the system even in the face of very unfavorable economic developments.

The Long-Run Problem

In addition to this short-run financing problem and almost completely independent from it, social security faces a long-run financing problem that will affect the system in the next century. This problem is traceable to demographic events -- the decline in birth and death rates -- that will boost costs of presently legislated benefits beginning around the year 2005.

These difficulties are almost completely independent from the short-run financing problems caused by the recent failure of wages to rise faster than prices as has been customary in the United States. The slow growth of wages relative to price is attributable largely to the virtual disappearance of productivity growth, to the second round of OPEC price increases, and to drought-induced inflation in food prices. The short-run problem must be solved to assure that people now on the benefit roll or soon to enter them will receive promised benefits.

Once this problem is solved, the social security system will face a period of 30 years during which the cost of the system, measured as a percent of the wage base used to finance it, will be less than it is today. Thus, a 30-year financial interlude, as well as the nature of the issues raised, separates the long-run and the short-run problems facing social security.

This fact leads to the conclusion that it is intellectually dishonest, although it may be politically convenient, to use the short-run problems that the social security system faces as the basis for making changes in the system that are relevant more to the long-run problem. Attention should be paid to both of these problems. The short-run problem critically demands our attention. The long-run problem, potentially much larger, can be handled best if it is addressed now. It is important to recognize, however, that these problems are separate and require quite different solutions.

Against this background, I believe the Administration's proposals of May 12 are seriously lacking. In addition to muddying the quite separate short- and long-run problems, the changes proposed by the Administration would create serious anomalies. I outlined these shortcomings in testimony before the Select Committee on Aging of the House of Representatives on May 20 which I append to my testimony and submit for the record.

Among these shortcomings, these proposals would reduce benefits at age 62 by 43 percent in 1987 and deny any age 62 retiree in 1982 a benefit even as high as the official poverty threshold, no matter how much they earned. They would tighten eligibility for disability benefits significantly, although 70 percent of applicants are refused benefits and of those refused 80 percent never work regularly again. They would deny eligibility for disability benefits for a period of seven years after she returns to work to a woman who has a baby and stays home until the baby is 3 years old. They would cut all benefits for all retirees for the next 75 years by a formula that would leave the amount of the cut dependent, not on congressional decision, but on the caprice of inflation rates over the next five years.

Steps to Solving the Problems

Social security faces short-run problems that are urgent but easily solvable. It faces long-run problems that are much larger, but for which solutions can and should be gradually implemented. A balanced program of action that would solve each problem would consist of the following elements.

To deal with the short-run problem, Congress, in my opinion, should immediately provide for interfund borrowing and reallocate revenues among the three trust funds. In addition, it should authorize the trust funds to borrow from the Treasury under specified conditions and with carefully stipulated rules for repayment of these loans. It should base the annual adjustment in currently payable benefits on the lower of the consumer price index or a wage index rather than on the consumer price index alone. The time has come to pay for part of Medicare hospital insurance out of general revenues. I would also favor including in taxable income some fraction of social security benefits and the returning of resulting revenues to the trust fund; I recognize that this change is controversial, but this committee needs no reminder that Congress recently took the step, unthinkable until it was made, of subjecting part of unemployment insurance to income tax. Adoption of all or some of these changes would prevent any short-run financing problems under existing law with plausible fluctuations in economic activity until the next century.

To deal with the long-run problem, I would urge Congress to choose between two solutions, either of which is approximately sufficient to balance promised benefits with presently legislated tax rates over the next seventy-five years. A gradual increase from 65 to 68 in the age at which unreduced benefits are paid, beginning about the year 2000, would come close to eliminating the deficit. It would be necessary, in my opinion, to provide a special unemployment, disability, or unreduced early retirement benefit for workers age 65 to 68 who have become unemployed and cannot find work or who are engaged in physically taxing work which becomes excessively burdensome with age. Such a benefit would use some of the savings from an increase in the normal age of eligibility, but this change would come close to closing the long-run deficit.

Alternatively, Congress might elect to replace the present method of adjusting the formula used for calculating initial benefit entitlements. At present, this adjustment is based on the percentage increase in wages. Professor Hsiao and others have suggested that the adjustment be based on prices. I would support such a change, provided that its effective date were delayed until about 1995. There is no evidence that present benefits are excessive, and the principle that major changes in the benefit structure should be made only after potential recipients have had ample notice should be honored. Arguments on behalf of this change are set forth in the attached statement supplementary to the Report of the 1979 Advisory Council on Social Security, signed by me, former Chairman of the Council of Economic Advisors Gardner Ackley, two of the three business representatives on the Council, and one other public member; I submit that statement for the record. This change would be more than sufficient to solve the long-term financing problems of the social security system for the next seventy-five years.

In addition to these changes, other modifications in benefits would be desirable, but would not necessarily reduce benefits. Congress should improve benefits for high-wage workers and for long-service, low-wage workers, and it should reduce benefits for short-service workers. The report of the 1979 Advisory Council presented a revised benefit formula that accomplished all three goals at no additional cost. The time is ripe for the enactment of universal coverage, a move supported by every study group that has examined the question in recent years.

Taken together, these changes would put social security on sound financial footing in both the short- and the long-runs and would improve the ability of the system to serve as the basic retirement program for older Americans.

THE WASHINGTON STAR Sunday, June 28, 1981

HENRY AARON

Salvaging Social Security

The most casual newspaper reader cannot have failed to notice that the Social Security is in some kind of financial trouble. But the more carefully a reader studies the statements of supposed experts, the more likely he is to be confused about the character and size of the immediate financing problem that Social Security faces. Administration spokesmen croon jeremiads about the imminence of the biggest bankruptcy in U.S. history, a $100 billion deficit, and the need drastically and immediately to curtail benefits by as much as 40 per cent for some early retirees. Other experts claim that there is no problem whatsoever and that benefits need not be cut at all.

What is the ordinary citizen to make of such contradictory analyses and prescriptions?

The beginning of wisdom is the recognition that Social Security faces two problems that have almost no relation to each other. A long-run financing problem, that will affect the system in the next century, is traceable to demographic events – the decline in birth and death rates – that will boost costs of presently legislated benefits beginning around the year 2005.

These difficulties are almost completely independent from the short-run financing problems caused by the recent failure of wages to rise faster than prices as has been customary in the United States. The slow growth of wages relative to prices is attributable largely to the virtual disappearance of productivity growth, to the second round of OPEC price increases, and to drought-induced inflation in food prices. The short-run problem must be solved to assure that people now on the benefit rolls or soon to enter them will receive promised benefits.

Once this problem is solved, the Social Security system will face a period of 30 years during which the cost of the system, measured as a per cent of the wage base used to finance it, will be less than it is today. Thus, a 30-year financial interlude, as well as the nature of the issues raised, separates the long-run and the short-run problems facing Social Security.

This fact leads to the conclusion that it is intellectually dishonest, although it may be politically convenient, to use the short-run problems that the Social Security system faces as the basis for making changes in the system that are relevant more to the long-run problem. Attention should be paid to both of these problems. The short-run problem critically demands our attention. The long-run problem, potentially much larger, can be handled best if it is addressed now. It is important to recognize, however, that these problems are separate and require quite different solutions.

A large part of the confusion about the size of the short-run problem stems from the use of different economic assumptions.

For instance, the administration assumes that there will be a $29.2 billion shortfall in the Social Security trust fund reserves for old age and survivors insurance (OASI) by 1986, whereas the Congressional Budget Office calculates the deficit at $43.5 billion, and the most pessimistic assumptions put the shortage at $125.9 billion. For disability insurance, (DI), the administration anticipates $50.9 billion will be in that fund, the budget office is a shade lower with expectations of $47.7 billion, and pessimists put the total at $44.2 billion. Health insurance (HI) funds are anticipated by the administration at $46.2 billion in 1986; $40.1 billion by the budget office, and $41.5 billion at the pessimistic extreme. Thus, predictions of the total available in all three Social Security funds by 1986 varies from the administration's $67.9 billion, to the budget office's $24.3 billion, to a deficit of $40.3 billion by pessimistic standards.

These projections have three striking characteristics. First, the OASI trust fund has a large deficit under all assumptions. Second, the DI and HI trust funds have large surpluses. Third, economic assumptions clearly have an enormous effect on the size of the surplus or deficit in each of the funds. Fourth, whether the system as a whole has sufficient reserves through the end of 1986 to cover month to month imbalances between income and outgo (estimated to be about 9 per cent of next year's outlays) depends on one's economic assumptions. Under the administration's assumptions, reserves are sufficient; under CBO's they just fall short; under the pessimistic assumptions (projected by Data Resources Inc. in February) there is an overall deficit.

What is one to make of all of this? The first thing is that it makes no sense whatsoever to look at the individual trust funds separately if one wants to get some sense of the overall size of the short-run financing problem. The allocation of tax revenues to each of the funds and the accumulated reserves reflect past congressional decisions based on actuarial projections of the cost of each program. The Social Security actuaries have been scrupulous to warn users that their projections were not forecasts, but merely the extrapolations of the implications of the assumptions they employed. When the projections of reserves in one fund turn out unduly optimistic and those in another unduly pessimistic, we should take steps to even things out, by reallocating revenues or by interfund borrowing or both. To the extent that offsetting errors are resposible for the present problem, it would make no more sense to declare bankruptcy for Social Security than it would to declare oneself personally bankrupt, despite having a nice savings account because one had overdrawn one's checking account.

Borrowing Plan

Based on the administration's economic forecast, authorizing the OASI fund to borrow from the DI and HI funds or reallocating revenues from the latter to the former is sufficient to keep the system moving along nicely for many years. Even if one thinks that the president's program should be supported as the one most likely to succeed, however, one can acknowledge that it would be imprudent not to plan for the possibility that things will turn out less well than it supporters hope.

For symmetric, but opposite reasons, one should disregard the projections based on the DRI pessimistic assumptions. These assumptions imply something approaching economic calamity. DRI is no longer using these assumptions in its pessimistic forecast variant because events have been more favorable than those in its February projection. While economic events as pessimistic as these are not inconceivable, they are most unlikely. The operative question today is whether Congress should slash benefits or raise taxes enough to keep the Social Security financially sound even in the face of economic events that are possible, but improbable, or whether it should take other steps that would make the system more robust in the face of economic adversity.

If Social Security reserves are sufficiently large to assure continued payment of benefits through an extended period of economic adversity, the correct set of economic assumptions to use would be ones that reflect our best forecast of the likely future course of the economy. If events were less favorable, the contingency reserve would be put to its intended use, covering a temporary deficit. Reserves would obviate the need to cut benefits or to raise tax rates in order to sustain benefits during periods when economic events were less favorable than those underlying our projections. That was the arrangement under which Social Security operated until a few years ago. Recent economic events, however, have depleted reserves so much that they now are inadequate unless the economy performs better than it is reasonable to expect.

Henry Aaron is a senior fellow in economic studies at the Brookings Institution who served as chairman of the 1979 Advisory Council on Social Security.

See SOCIAL

Social Security's Woes Can Be Overcome

Continued

Reserves Battered

The underlying problem is that, without an adequate contingency reserve, the Social Security system is jerked about by two kinds of economic bad news, prevalent in recent years, that should have little effect on Social Security policy. In the short run, revenues are indexed to wage rates and benefits are indexed to prices; when an OPEC price increase or a drought-induced jump in food prices causes prices to rise faster than wages, the effect on the reserves is immediate and pronounced. The system is also sensitive to fluctuations in employment because employment levels are a major determinant of the wage base and have some effect on the number of benefit claims.

Thus, Congress now faces an important choice. If it acts to reduce the sensitivity of the Social Security system to these economic events, relatively small reductions in benefits or small increases in legislated tax rates will be sufficient to place the system on sound financial footing for the next several decades. The problems of the next century will remain and should be addressed soon; but next century's problems are distinct from today's and call for different solutions. On the other hand, if no steps are taken to reduce the sensitivity of Social Security to short-run economic adversity, there is a risk that economic events less favorable than our best forecasts will place the system in jeopardy again in the near future; only large tax increases or large benefit cuts for those now receiving or soon to receive them would absolutely preclude this unhappy possibility. These are really the only two choices Congress has.

Alternatives Assessed

Adding flexibility, small benefit and tax changes – There exist a variety of ways to protect Social Security from unanticipated economic fluctuations.

First, the proposal to index benefits to the lesser of the rate of growth of prices or of wages has been widely discussed. It would reduce greatly the sensitivity of Social Security to the kind of economic events recently encountered.

Second, Congress has contemplated granting the Social Security trust funds authority to borrow from each other and from the Treasury if reserves sink to unacceptably low levels. This authority should be granted, provided that explicit arrangements are made for repayment of such borrowings when economic conditions warrant tax increases and certainly within a stipulated number of years.

Third, it would be desirable to inject some general revenues into the Social Security system in a carefully limited manner, either to offset the effects of protracted high unemployment along lines proposed in 1977 by President Carter or to pay for part or all of medicare hospital benefits as proposed by the last two Advisory Councils on Social Security and by the National Commission on Social

Had any one of these three changes been enacted in 1977 there would be no short-run financial crisis today. Enactment of all three or any two of them would enable the continuation of Social Security benefits and payroll tax rates at approximately their current levels and they would preserve the financial balance of the system even in the face of very unfavorable economic developments.

Weeding Out Needed

The enactment of such provisions should not deter the Congress from weeding out low priority benefits. Such reductions combined with already legislated payroll tax rates and the buffers described above, would create a stable financial basis for the Social Security system for several decades.

These provisions should not stand in the way of a plan to build up contingency reserves gradually in the years ahead. Already legislated tax rates will lead to the accumulation of such reserves beginning in 1986. But it will take time for adequate reserves to accumulate. Until they do, it will be important to make sure that economic events, such as an OPEC price increase or a major crop failure, do not automatically produce a crisis in Social Security.

No added flexibility – If Congress does not adopt any of the three buffers described above, large cuts in Social Security benefits or increases in payroll taxes will be necessary to protect social security against unfavorable economic events. It is hard to see why we should raise payroll taxes now when we rightly are contemplating reductions in income taxes.

To return to the issue posed earlier – how big is the short-run Social Security financing problem – the answer is that its size is up to Congress. If Congress enacts the buffers described above, what exists is not a crisis in an sense, but a job of legislative reform and of weeding out benefits that are of relatively low social value. In the face of the widespread fear and handwringing about the imminent bankruptcy of Social Security, such a statement may smack of Panglossian refusal to recognize the gravity of the situation. It is, in fact, recognition of the fact that a problem that needs a solution has one

Outline of Testimony
of
Henry Aaron

Before the Select Committee on Aging
U.S. House of Representatives

May 20, 1981

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The views expressed in this outline do not necessaril; reflect those of Brookings staff or the University of Maryland staff members or the officers and trustees of the Brookings Institution.

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Mr. Chairman, I should like to make the following six points regarding the President's proposed reductions in social security benefits:

- The reduction in social security benefits sought by the Administration in its budget amendments and May 12 announcement would reduce benefits by more than twenty-three percent. These cuts are more than twice as large as necessary to close the long-run deficit under current law. If one agrees with the Administration's short-run economic forecast, nothing other than interfund borrowing is necessary to deal with the short-run financing problem.
- The reduction in benefits for early retirees would leave those who retire at age 62 in 1987 with benefits 43 percent smaller than those payable under current law. No age 62 retiree in 1982, single or couple, would receive a benefit as high as the official poverty threshold. Moreover, the abruptness of the proposed implementation of the cuts would reduce benefits for millions of persons on the eve of their retirement.
- The Administration proposes to eliminate age, education, and experience as criteria for determining disability. Of those who apply for disability, more than seventy percent are now refused -- up from fifty-three percent six years ago. Of those refused, eighty percent never work regularly again. Disability insurance is not unduly soft. On the basis of recent experience, there is no need to tighten the eligibility criteria.

- The proposed increase in the required proportion of recent quarters applicants for disability insurance must have worked to be eligible for benefits would have major effects on the eligibility of women. For example, a woman who quits work to have a baby and returns to work on her child's third birthday never loses eligibility under current law. Under the new proposals, this woman would lose eligibility when the child is two years old and would not regain it until seven years after she returned to work.
- The Administration proposes to reduce replacement rates because they are higher today than they were in 1972. However, the average $359.25 benefit paid at the end of 1980 does not seem to be too generous to many people. Moreover, the size of the cut depends on the actual rate of inflation and wage growth; if prices and wages rise 3 percentage points more per year than the Administration assumes, replacement rates will be cut fifteen percent on the average.
- Other methods of dealing with the short- and long-run problems of social security are at hand -- correction of the overindexing of benefits in the recent past, use of general revenues to pay for part of Medicare as urged by the last two advisory councils and the National Commission on Social Security, a gradual increase in the age at which unreduced benefits are paid starting in the year 2000, and taxation of part of benefits -- and the time has come to extend social security coverage to all workers. These steps would improve the structure of social security, give beneficiaries fair warning of planned changes, and put the system on sound financial footing for the next seventy-five years.

Supplementary Statement
On the Future Course of the Replacement Rate

By Mr. Aaron, Mr. Ackley, Ms. Falvey,
Mr. Porter and Mr. Van Gorkom

In 1977 Congress enacted a system for adjusting social security benefits over time which assures that workers with any given level of real earnings, who reach retirement in successively later years, will receive progressively higher real benefits. It chose this method of adjustment because it concluded that the ratio of social security benefits to wages—i.e., the "replacement rate" —for workers at any *given relative position* in the earnings distribution should remain the same in the future as it is today. An implication of this method of adjustment is that workers at any *given level of real earnings* will receive progressively higher benefits, through operation of the weighted benefit formula.

Based on the projections of the Social Security Administration, under present law, a single worker with average monthly earnings of $1,000 who retires in 1980 will receive a basic monthly benefit of $433 in 1980 dollars; a worker with the same real earnings history who retires in 1995 would receive $471, one who retires in 2025 would receive $570, and one who retires in in 2045 would receive $670 (all of the above expressed in 1980 dollars).[1] The justification advanced for such increasing benefits is that a worker who earns $1,000 per month is better off in 1980, *relative to other workers*, than would be a worker with the same real earnings in 2000, and much better off than a worker with the same real earnings would be in 2025 or 2045. We understand this argument, and it has some merit.

Our proposal would retain the present method of adjustment for the next 15 years, so that all workers approaching retirement age would have ample notice about the change in the benefit formula that we propose. But we recommend the enactment now of an alternative adjustment mechanism that would come into effect in 1995, and that would automatically assure successive generations of retirees who have the same real earnings history the same real benefit. Thus, retirees with average earnings of $1,000 a month in all years after 1995 would receive a benefit of $469 (in 1980 dollars). Enactment of this proposal would leave to successive Congresses the opportunity to decide whether workers with a given real earnings history should receive increased real benefits, and to impose the taxes necessary to pay for them. We support this modification in the benefit formula for two reasons.

Our first reason is based on our judgment that future Congresses will be better equipped than today's Congress to determine the appropriate level and composition of benefits for future generations. Beginning early in the 21st century, the ratio of social security beneficiaries to active workers is projected to increase sharply. The cost of OASDI benefits under present law will rise from 10.3 percent of covered payroll in 1980 to 12 percent in 2010 and 16.8 percent in 2030, and would average 16.3 percent over the period 2029 to 2053. The cost of benefits under the alternative formula we are here proposing would remain virtually unchanged at an average of 12.2 percent of payroll over the period 2029 to 2053. If this formula were adopted, we fully

[1] For single workers with average real earnings of $1,500 (in 1980 dollars), the basic benefit would be $538 in 1982, $631 in 1995, $730 in 2025, and $829 in 2045.

anticipate that later Congresses would indeed elect to increase real benefits as real wage levels rise over time. We doubt, however, that they would choose to do so in the precise way implied by the present method of automatic adjustment, nor that the average percentage increase would necessarily be the same as present law prescribes. Congress might elect to give more to certain groups of beneficiaries than to others, or to provide protection against new risks that now are uncovered. But precisely because we cannot now forecast what form those desirable adjustments might take, we feel that the commitment to large increases in benefits and taxes implied under current law will deprive subsequent Congresses, who will be better informed about future needs and preferences, of needed flexibility to tailor social security to the needs and tastes of the generations to come.

Our second reason is that, as per capita income rises, the case for increasing the amount of mandatory "saving" for retirement and disability through social security is far weaker than was the rationale for establishing a basic floor of retirement and disability protection at about the levels that exist today.

At levels of real income prevailing in the 1930s (or perhaps even the 1950s), it can well be argued that it was appropriate, indeed, highly desirable—perhaps even necessary for the preservation of our society—that government should, by law, have guaranteed to the aged and disabled and their dependents replacement incomes sufficient to avoid severe hardship, and to have required workers (and their employers) to finance this system with a kind of "forced saving" through payroll tax contributions. But as real incomes continue to rise, it is not so easy to justify the requirement that workers and their employers "save" through payroll tax contributions to finance ever higher replacement incomes, far above those needed to avoid severe hardship. Perhaps not all workers will want to save that much, or to save in the particular time pattern and form detailed by present law; some may prefer to save in quite different time patterns, or in forms involving quite different tradeoffs between risk and probable return. The case for government compulsion is not easily justified when it requires, as does present law, a maximum earner retiring in 2045 to guarantee himself an annual social security retirement income of $18,950 in 1978 prices, and to support, through a redistributive tax and benefit system, a retirement benefit for a minimum wage earner of $7,750 a year (in 1978 prices). The purchasing power of the benefit paid the minimum wage worker in 2045 is roughly what the *maximum* earner retiring in 1979 is guaranteed. This compulsion is especially questionable when we recall that, by that time, a combined payroll tax rate of around 16.5 percent on workers and employers will probably be required to support such benefits.

Some may argue that this generation need not make such a decision for its descendants. When the time comes, if the benefit level begins to seem unnecessarily high, it can be lowered. However, given the appropriate reluctance to alter benefit levels downward, except with a very long lead time, there is an obligation to act now, even though the first (extremely modest) difference in retirement benefits would only begin to occur for persons retiring after 1995. If, as 1995 approaches, people should decide to allow payroll tax rates to increase substantially after about 2005, so as to provide benefit levels close to those now in the law, it will be little problem to amend the law to provide income replacement at the now-scheduled levels.

THE SOCIAL SECURITY PROBLEM

Rudolph G. Penner*

American Enterprise Institute

Testimony prepared for the
Subcommittee on Social Security and Income
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*The views presented in this testimony are the author's and do not necessrily reflect the views of the staff, advisory panels, officers, or trustees of the American Enterprise Institute.

The Social Security Problem

Rudolph G. Penner
American Enterprise Institute

I would like to thank the Sub-Committee for this opportunity to testify on one of the more difficult problems facing our nation. The opinions expressed in this testimony are my own and do not necessarily reflect the views of the staff, advisory panels, officers, or trustees of the American Enterprise Institute.

In 1977, The Congress created a social security benefit structure that was too generous to be financed by the schedule of payroll tax rates enacted at the same time. At the time, the Congress knew that it was creating a deficit for the full, 75-year period traditionally used for social security planning purposes. In other words, the solution to the long-run problem was put off to the long run.

However, the Congress thought that the 1977 amendments. earmarked sufficient resources for social security to maintain financing at an adequate level for the rest of this century. Unfortunately, this belief was based on the assumption that real earnings in the U.S. would grow at rates not far below those experienced throughout our past history. In fact, because of a dismal productivity performance and the not unrelated need to transfer real income to foreign oil producers, real hourly wages in 1981 will be significantly below those of 1977 when the new law was passed. While other factors have played some role in depleting the social security trust funds, the lack of growth of real average hourly earnings is of overwhelming importance in explaining our current difficulties.

Since economic growth has been lower than expected, I believe it clear that we cannot afford the degree of generosity implied by the benefit structure created in 1977. It would certainly be perverse to respond to the current situation by raising payroll or income taxes on declining real hourly wages. (Real disposable income per capita has risen slowly since 1977, but mainly because each family on average now contains more workers.)

I also believe it important to minimize borrowing from the public under current circumstances since current spending and tax proposals are already likely to lead to very high deficits over the next five years. (Note that allowing OASI to borrow from the DI or HI trust fund or letting HI rely on general "revenue" financing results in the same need to sell bonds to the public as would direct OASI borrowing from the public since with interfund borrowing or general revenue financing, DI and HI funds would be holding fewer Treasury bonds and more bonds would therefore have to be absorbed by the private sector.)

Yet reductions in benefits must be tempered by the fact that recipients have made long-run work and savings plans on the assumption that benefits will be close to those promised. Therefore, benefit changes cannot be abrupt and must occur gradually unless reduced benefits will be replaced by benefits under other welfare systems for those least able to tolerate declines in real income.

That means two things. First, it will be very hard to avoid some short-run borrowing by the trust funds. Second, the fact that change must be gradual means that we must immediately being addressing the problem emerging in the early 21st century when the members of the baby-boom of the 1940's and 1950's retire. Indeed, this should have been done in 1977, because our current short-run problem pales in significance relative to the long-run problem and the long-run shortens every day.

Nevertheless, in an effort to minimize short-run borrowing, I would suggest the following actions,some of which accord with the proposals made by President Reagan in his March budget.

1. Eliminate the minimum benefit. This benefit is primarily of interest to fairly well-off individuals who worked most of their lives in the Federal government or in some other uncovered occupation. To the extent that the poor are affected, benefit reductions will be replaced by SSI.

2. Eliminate adult student benefits. Educational support from other programs will be available for those with modest incomes.

3. Eliminate the lump-sum death benefit while creating a similar benefit under SSI for low-income recipients.

4. Index the benefits of the retired population to the lower of a wage index or the CPI. SSI benefits should continue to be indexed to the latter. This proposal is also part of my preferred long-run solution and will be discussed in more detail later.

5. Postpone the date of cost-of-living increases from July 1 to September 1. This will result in a modest decline in real

benefits, but those benefits have recently risen unjustifiably because of upward biases in the CPI.

Unless we are extraordinarily lucky with the economy, these proposals are unlikely to cure the entire short-run problem and some borrowing will probably be required.

It is often suggested that additional revenues could be obtained by taxing one-half of benefits. This is a fair, reasonable proposal which seems to have no chance politically even if it is phased-in gradually. (It can be noted that no one living entirely on social security would be affected.)

On the other side, it is popular to propose spending more money by eliminating the retirement test. While this has much appeal, I do not believe that this is the time for money spending proposals. It would probably be feasible to remove the test and to solve the whole short-run problem with the taxation of one-half of benefits, but the two proposals should be considered as a package.

The long-run problem has two components. It has already been noted that the ratio of the retired to working population will begin to soar early in the 21st century. In addition, the current benefit formula implies that average real benefits per retiree will grow significantly between now and then. Under current law, a worker who worked at the maximum wage base throughout his or her career and who retires with a dependent spouse received a tax-free benefit of $11,155 in 1980. In the year 2030, a comparable worker will receive, tax-free, $26,714 in 1980 purchasing power under the trustees' intermediate assumptions. (With 5 percent inflation that will be over $300,000 in 2030 dollars.) In my view, there is no justification for such benefit growth in a mandatory pension system which at such benefit levels must only crowd out private pensions almost dollar for dollar.

It, therefore, seems reasonable to reduce the growth of average benefits in order to avoid tax increases beyond those scheduled by current law. This means that the ratio of benefits to lifetime earnings must be reduced over time. That does not mean that average real benefits must be reduced below current levels. With economic growth, average real benefits can continue to grow. It only means that their growth must be slowed below the rates implied by current law.

There are a number of ways that the ratio of benefits to lifetime earnings can be lowered and I do not feel strongly that any one approach is far superior to all others. However, the precise characteristics of the chosen approach will have important implications for inter and intra-generational income distribution.

Three major lines of attack can be identified:

1. There could be periodic discretionary actions, each slightly reducing the generosity of the formula which determines the benefits of future retireees. This would be politically difficult and the discontinuous nature of the approach is somewhat disturbing.

2. Retirement ages could be increased gradually. Retirement could still be allowed at age 62 but with fair actuarial reductions from the full benefits paid at, say, age 68. Thus, the replacement ratios for those retiring at ages 62 through 67 would be lower than implied by current law.

3. The indexing of the benefits of the currently retired and the formula determining the benefits of future retirees could be altered to slow the growth of average real benefits below the growth of average real earnings.

Obviously, the three approaches can be combined in an infinite variety of ways. As I stated previously, I have no strong preference regarding the approach taken. However, I do see certain advantages in the last approach.

I believe that indexing should be modified because I think that the approach taken in 1977, aside from being too generous, also implied some peculiar value judgments. That approach strives to insure that, on average, the ratio of benefits to pre-retirement earnings remains constant through time for each cohort of retirees. That is accomplished by indexing the width of the brackets in the benefit formula (or the "bend points") to average wages.

Once a person retires, benefits are held constant in real terms by indexing to the CPI. As a result, the retiree shares none of the benefits of economic growth after retirement and since retirements of 15 years are no longer uncommon, the long-term retiree falls further and further behind the standard of living of the rest of the population.

It seems to me that it makes more sense to follow an approach which starts the retiree off at a lower benefit level, but then lets the person have some share of subsequent increases in the general living standards of the working population.

In reforming indexing techniques, it is not practically possible to find one that will be fair to both tax paying workers and retirees for all time. It is not feasible to devise an index providing a perfect measure of inflation or wage growth and even if we could, the system will be hit with economic and demographic surprises which will, over time, change our notions of what is an adequate and affordable benefit level.

Therefore, we must resign ourselves to the fact that both indexing and discretionary actions will be necessary in the future. Since discretionary actions which increase benefits are less painful than those which lower benefits, the indexing part of the system should be downward biased, or in other words, the automatic part should provide lower expected benefits than we think that we shall be able to afford in the long run.

This can be accomplished by indexing both the bend points in the benefit formula and the benefits of the retired population to the lower of price or wage growth. To the extent that economic growth made higher benefits affordable or lower taxes possible, the growth dividend could be shared between the currently retired population, future retireees by widening bend points, and taxpayers by reducing some of the future tax increases scheduled in current law.

In any system which leaves part of the determination of future benefits to indexing, future economic events will play a large role in determining the relation between the living standards of retirees and the working population. A more certain reduction in replacement rates can be achieved by gradually extending the retirement age. Some extension may be desirable to complement the above indexing proposal.

I have not discussed the possibility of bringing Federal workers and other non-covered employees into the social security system. In my view, universal coverage is attractive, but not essential. It does have some undesirable properties.

In the presence of different retirement systems, it is not crucial to merge the systems. It is only necessary to reduce the potential for gaming the systems by switching occupations. This is not easy without universal coverage, but the problem can be mitigated by using various devices for arbitrarily reducing the ability of non-covered workers to exploit the progressive nature of the social security benefit formula when they work only part of their life in covered occupations.

Universal coverage has two disadvantages. First, it would initially provide receipts faster than outlays and may delude us into thinking that the social security system is healthier than it really is. Second, it would add another politically powerful group to the size and the influence of social security's constituency which already makes it difficult to change the system.

Statement by Robert S. Kaplan*

Before the Senate Subcommittee on Social Security

and Income Maintenance Programs

of the

Senate Finance Committee

July 7, 1981

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STATEMENT ON SOCIAL SECURITY

Introduction

I am very pleased to be here today to speak with the Senators and their staff on the problems of Social Security financing. These hearings show an awareness that there are significant problems with Social Security financing in both the short term and the long term. These are problems that will not go away by themselves. They need Congressional action, preferably this year, to address the financial difficulties of the system. The problems are not insoluble and prompt action will provide assurance to both workers and beneficiaries about the security of current and future benefits.

It is unfortunate that congressmen were led to believe that the 1977 Amendments to the Social Security Act were sufficient to place the system on a sound financial basis. In fact, those amendments did nothing to address the serious long term financial deficit in Social Security caused by the demographic imbalance that will arise early in the next century. Also, the failure of the 1977 amendments to reduce replacement ratios to 1972 levels left the system vulnerable to problems caused by a continuation of the decline in productivity in the United States and the effects of the inflationary policies followed during the late 1970's. Today there are no simple answers to solve the problems of short and long term deficits in the Social Security System. Anything that Congress does will make some people angry and a few people quite angry. But if Congress fails to act in a responsible manner this year, then many people will become very angry. They will be angry because of the continued financial deficits and the scheduled large tax increases in the Social Security System. In addition, current and future beneficiaries will remain highly uncertain about the security of their promised benefits.

The traditional answer for dealing with Social Security deficits has been to increase the taxes on current workers. The implementation of this policy has led to sharp increases in the Social Security taxes paid by all workers during the past decade. At a time when the administration is striving to reduce the share of federal expenditures as a percentage of the Gross National Product and to allow for more initiative in the private sector, a continuation of the higher tax strategy would run counter to the wishes of the American people as expressed in the last election. It would also prevent Congress from a careful re-examination of the benefit formulas and benefit levels that have evolved during the past 45 years, benefit changes that have yet to receive careful review, scrutiny, and re-evaluation by Congress after enactment. Congress has many options that will maintain the real level of benefits to current and future Social Security beneficiaries while at the same time curing the financial deficits of the system and eliminating the need to increase further the payroll tax rate on all workers. At present, large increases in the payroll tax rate are scheduled to be implemented during the next decade and these higher tax rates are still inadequate for financing the long term deficit of the system.

Solving The Short Term Problem

The current deficit of nearly $10 billion a year in the Social Security System has been caused by benefit levels increasing at a faster rate than the average wages on which payroll taxes are levied. The most obvious cause of this problem has been that benefit levels are indexed by the Consumer Price Index (CPI) which, because of its technical limitations and inadequacies, has been overstating the true rate of inflation in the economy. In addition, the Social Security indexing system was designed for an economy in which wages were increasing at a faster rate than prices. Because of the decrease in productivity during the past several years as well as the overstatement of the inflation rate by the Consumer Price Index, benefit levels have been increasing faster than the ability of the working population to pay the payroll taxes. There is an obvious solution to this problem. Benefit levels should not be allowed to increase at a rate faster than the ability of taxpayers to meet this burden. Therefore, benefit increases should be limited to the lower of wage increases or the inflation rate. Had this policy been in effect during the past several years, Social Security would not be in the financial difficulties that it now faces. This policy can be implemented immediately and should be recognized as a sensible scheme since the system cannot expand benefits at a rate faster than it is expanding its taxable earnings base.

A second action should be to obtain a better measure of the rate of inflation than is now available from the CPI. The CPI was not designed to serve as a measure of inflation for escalation of retirement benefits. It has many defects as an escalation index including the failure to recognize the substitution that occurs as consumers shift their expenditure patterns in response to changes in relative prices. Also, despite attempts to measure quality improvements, it is acknowledged by most observers that the CPI does not incorporate all of the benefits coming from improved quality and performance of products. It omits the benefits to consumers from the introduction of entirely new products in the marketplace.

Most seriously, the CPI's treatment of housing creates a large distortion in the true cost of housing to individuals. The use of nominal interest rates to compute the financing cost of housing grossly overstates the actual real cost to individuals for owning and purchasing homes. This overstatement also arises in the use of nominal interest rates to compute the financing costs of consumer durables such as automobiles, appliances, and all items purchased on installment sales. The only relevant financial cost for purchasing housing or other durables should be the real cost of capital, defined as the nominal interest rate less the anticipated inflation rate. This real interest rate is closer to 1 or 2 percent than it is to the 15 to 20 percent rates now used by the Bureau of Labor Statistics in preparing the Consumer Price Index.

Many of these problems with the CPI could be avoided by shifting to an alternative index such as the Gross National Product Deflator or, perhaps, the Personal Consumer Expenditure (PCE) component of the GNP Deflator. Had we been using, since 1975, the PCE index and the proposed rule to limit benefit increases to the lower of average earnings or the increase in the PCE, the system would have saved $7 billion in 1980 and more than $12 billion in 1981. Thus virtually all of the short term deficit in the Social Security System would have been eliminated by these measures.

A second option to consider for the short term deficit is to implement a gradual reduction in replacement ratios.* The replacement ratios increased unintentionally from 1972 to 1977 because of the error in the indexing procedure that was introduced by the 1972 Amendments which was subsequently corrected in 1977. This unanticipated increase in replacement ratios, caused by the defect in

* The replacement ratio is the ratio of the initial social security retirement benefit to the workers' most recent earnings. It provides a convenient summary measure of the level of social security benefits.

computing initial benefits, is contributing to the financial strain of the system. It would be sensible to gradually reduce the replacement ratios back to the 1972 level over the next five to ten years. This option was recommended by the Reagan administration and could be implemented by not fully adjusting for the increase in wages, the brackets used to compute the Primary Insurance Amount each year. In fact, because of increasing marginal tax rates during the 1970's, even the same replacement rates as the 1972 levels would be a significantly higher fraction of the most recent after-tax income of newly retired persons. During an inflationary period, when marginal tax rates are not adjusted, the tax-free nature of social security benefits becomes even more attractive and beneficial to recipients.

Replacement rates can be decreased gradually during the next several years without having the real benefits to future retirees be any lower than the levels of current retirees. Thus, the reduction will just limit some of the scheduled real increase in benefits now anticipated for future retirees.

The third option for dealing with the short term financial deficit is to implement universal coverage for all wage earners. This proposal has been discussed extensively and endorsed by all observers of the system except for representatives of federal workers and their unions. There is no logical or financial reason why these workers should be excluded from Social Security coverage apart from the political lobbying efforts of these excluded groups.

A combination of these three proposals - solving the over-indexing problem, gradually reducing replacement ratios during the next several years, and expansion of Social Security coverage to all workers - will solve the short term financial deficits of the Social Security system and obviate the need to implement the scheduled large increases in payroll taxes during the next decade. None of these policies will cut the benefits to any current beneficiary except perhaps, for civil service workers who would otherwise be receiving a windfall benefit from a dual employment record. The proposals will serve to limit some of the real increases to current and future beneficiaries, but mainly to eliminate benefit increases triggered by the measurement inadequacies of the CPI or when prices are rising faster than wages. It would enable Congress to retain options to expand social security benefits should the economic environment prove more favorable than we now anticipate. It is better to be conservative when forecasting the future since benefits can be increased easier than they can be decreased.

<u>How Not To Solve The Short Term Problem</u>

There are a number of options that have been discussed for dealing with the short term deficit that I believe are ill-advised and that I recommend not be implemented. One proposal, which I believe is part of the House Sub-Committee legislation, would reallocate funds from the Hospital Insurance (HI) Trust Fund to the OASDI Trust Fund. At present, the HI program is running a modest surplus and therefore provides additional funds that could bail out the OASDI system. Such a reallocation would be a big mistake. First it suppresses the real problem that benefit levels in the OASDI program are increasing faster than the tax base available to pay for them. It would, for a short time only, suppress the previously discussed problems of the defects in the CPI for adjusting benefits for inflation and the unintended increase in OASDI replacement rates that has occurred. It does nothing to either increase the taxes available to pay for Social Security programs or contain the increase in benefits for these programs in the future. Finally, while the HI Trust Fund is now running a modest surplus, actuarial projections show very large deficits occurring in this program starting in the 1990's. These large deficits in the HI program must also be looked at by Congress in the very near future, but certainly Congress should not aggravate these problems by eliminating the few resources now being accumulated in the HI Trust Fund to pay for the sharply increased benefits that will come due in several years. Attempting to solve the short term problems of Social Security financing by shifting funds from one trust fund to another would be viewed as just another example of fiscal legerdemain by Congress and a lack of will to solve the short and long term problems of the Social Security System. I definitely do not recommend this course of action.

A second proposal to deal with the short term financial problem is to infuse general revenues to supplement the payroll taxes. This proposal can be accomplished either by a complicated set of triggering events, as recommended by the Carter administration, or by shifting some or all of the financing of the Hospital Insurance Program from the payroll tax to general revenues. The problem with this proposal is that, as Congress knows all too well, there is no excess of general revenues. Despite the active efforts of the Reagan administration and Congress, the federal government is still running large deficits in its budget, deficits that would only be aggravated were $10-$30 billion of new financing to be required to bail out the Social Security System. As in the previous suggestion, the infusion of general revenues to the Social Security System does nothing to address the substantial problems of unintended benefit increases that have crept into the system. It would mask these problems, and more serious, once the link was broken between benefit increases on the one hand and the need to finance them with payroll taxes on the other hand, the fiscal discipline of the Social Security System would be seriously compromised. There would be even stronger pressure to increase benefit levels and to finance these increases by increasing the deficit of the federal budget rather than by increases in payroll taxes. This would not be a healthy development for Social Security and more broadly for the country at large.

The third course of action that I do not recommend is to change eligibility requirements or benefit levels over a short period of time. There should not have been much surprise to the wide-spread opposition to the Reagan administration proposal for sharply reducing the benefit levels for early retirees starting in 1982. Workers and their employers have done much planning for retirement benefits. It would be unfair and highly costly for there to be a sudden change in benefit levels or eligibility requirements. Such actions should be phased in slowly over a ten to twenty year period so that individuals and their employers have a chance to adjust to any new provisions. Increases in the retirement age or decreases in the benefits paid to early retirees are sensible alternatives to be considered for the long term financial deficit of the Social Security System. They are not good options for dealing with the short term financial problems of Social Security.

The Long Term Financial Deficit

The long term problems in Social Security have been extensively discussed and are well known to all observers of the Social Security System. The long term problem is caused by the demographic imbalance in the U.S. population resulting from the large percentage of the population born in the "baby-boom" years. When this cohort of individuals reaches its retirement age, the ratio of workers to beneficiaries will decline from its current level of more than 3 - 1 to a figure somewhat less than 2 - 1. This implies a more than 50% increase in the burden of future workers to support this cohort of retirees. Again, there is no simple answer to this problem caused by a demographic imbalance. Either the benefits to this cohort of retirees will have to be decreased somewhat relative to current projections, or the taxes of future workers will have to climb significantly, perhaps by 50% or more.

There are a variety of options that Congress has available to deal with this long term problem. It is important that some subset of these options be discussed and implemented soon so that current workers and their employers can develop retirement plans for the future. It would be irresponsible for Congress to delay acting on this problem for another 20-25 years. Because of the difficulty of reducing or limiting future benefit increases, it seems to take a short term crisis for Congress to even seriously consider further amendments to the Social Security System. Congress had one such opportunity in 1977 when it had to eliminate the double indexing problem introduced by the 1972 Amendments. At that time, Congress did nothing to deal with the long term financial deficit in the Social Security System. Congress has another opportunity before it this year because of the short term financial deficits now being incurred by the Social Security System. I hope that it does not also let this opportunity pass without dealing with the very serious long term financial deficit in the system.

The most obvious way for increasing the future ratio of workers to retirees is to gradually increase the retirement age over the next 20 to 30 years. Age 68 is usually referred to as the target retirement age to be achieved from this gradual increase. In order to accommodate workers who wish to retire early because of reasons of ill health or physically demanding jobs, a provision for reduced benefits should continue to be allowed for early retirement from ages 62 through age 68. This reduction in benefits should, at a minimum, reflect an actuarial fair computation including the effects of the favorable tax status of Social Security benefits. Thus, there would still be incentives for workers to stay in the labor force until age 68, but workers would have the option of retiring earlier and receiving a corresponding reduction in their benefit levels.

A second option is to gradually decrease the replacement ratios for future retirees while still insuring that the real benefits for future retirees will be at least as high as those who retired in the past. This can be accomplished by having the bracket amounts used to compute the Primary Insurance Amount rise less quickly than the increase in average wages. The present benefit formula will allow future retirees to receive initial benefits that are much higher in real terms (after adjusting for inflation) than the initial benefits of current retirees. It seems inappropriate, that at a time when Social Security faces a serious long term deficit, that the system should provide such large real benefit increases to future retirees.

A third possibility would be to include, as part of taxable income, that portion of Social Security benefits received in excess of contributions made by the worker. The tax-free nature of Social Security benefits is anomalous since the employer's share of Social Security taxes has already received a tax shield by being an allowable deduction from taxable income. The complete exemption of Social Security benefits from taxation appears to have been an administrative decision made at a time when tax rates were much lower than they are today. The tax-free nature of the benefits has become increasingly more valuable, especially to upper-middle and upper income individuals, as marginal tax rates have increased during the past 30 years. By taxing a portion of Social Security benefits, and allocating these taxes back to the Social Security trust funds, the effective cost of future Social Security benefits will be significantly decreased. This proposal has the desirable feature that low income individuals, for whom Social Security benefits are a primary means of support, will not have their benefits reduced because they will have liberal deductions and exemptions for their tax returns. Thus, the benefit reductions will fall mainly on those individuals who already have other forms of retirement income.

One simple way of implementing this plan would be to tax one-half of Social Security benefits to reflect the tax shield already granted for the 50% of total taxes paid by the employer. Again, if this proposal is adopted, it should be phased in gradually over a number of years in the future. For example, we could start in 5 to 10 years, by imposing a tax on 5% of Social Security benefits and gradually increase this percentage by five percentage points each year until after 10 years we have reached the point where 50% of Social Security benefits are taxed.

A fourth possibility for long term reform of the Social Security System may not actually be a large source of cost savings but would increase the equity of the system. There is a great deal of concern with the spouse benefit and, in particular, the effect of this benefit on the fairness of the Social Security system for secondary wage earners in the family. The treatment of spouses and secondary wage earners in the family is a complicated subject but one that has received attention and research. A particularly attractive proposal would have the income of a wage earner split between the wage earner and a spouse. This would enable a non-working spouse to obtain an earnings record in her or his own right. If this were done, the supplementary spouse benefit could eventually be phased out since each adult family member would be credited with an earnings record in his or her own name. The income splitting plan coupled with a phase out of the spouse beneficiary would make the system more equitable and could also produce some cost savings overall.

I strongly recommend that some combination of these four proposals

(i) a gradual increase in the retirement age

(ii) a gradual decrease in replacement ratios

(iii) taxing 50% of Social Security benefits

(iv) transition to an income splitting plan and gradual elimination of the spouse benefit

be examined and implemented to solve the long term financial deficit that currently exists in the Social Security System. The staffs of congressional committees and of various federal agencies have already investigated these possibilities and would be able to supply cost estimates for any or all of these proposals. Congress can choose from among these possibilities, the combination that seems most desirable in slowing the increase in benefit levels for the future so that the system can be returned to a sound financial basis.

<u>Conclusion</u>

At a time when there is great concern about the short and long term financial viability of the Social Security System, it is important that Congress act promptly and responsibly. It is only prudent that Congress take a conservative view of future economic and demographic conditions so that five or ten years from now we do not find ourselves again in a situation of financial crisis. That is why I have strongly urged that future benefit increases be limited to those that we are confident can be paid for with the existing tax structure. If future demographic and economic conditions prove more favorable than we now anticipate, Congress will have the option to grant ad hoc benefit increases to Social Security recipients. But I believe that it is very important that Congress retain this flexibility to grant benefit increases should future conditions prove favorable, rather than committing the country to a system in which it may prove difficult to pay for promised benefits. We need to obtain more evidence on the future growth of productivity in the economy, the implications of increases in longevity, and the method for dealing with the future deficits in the Hospital Insurance Trust Fund. Congress will do a great service to the Social Security System and to the American people by enacting benefit changes which assure that future benefit levels can be supported by the system without large increases in future taxes. This will provide assurance to current and future beneficiaries as well as to current workers. If, after five or ten years, we learn that Social Security beneficiaries are not sharing in real productivity gains of the economy, Congress would then be in a position to liberalize benefit increases so that beneficiaries would obtain a fairer share of favorable economic and demographic experience.

[Whereupon, at 4:15 p.m., the hearing adjourned, subject to the call of the Chair.]

[The following HHS fact sheet and questions and answers were subsequently supplied to the committee:]

U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

PROVISIONS OF THE ADMINISTRATION'S SOCIAL SOCIAL SECURITY PROPOSAL

I. Changes to encourage work between 62 to 65

Change Benefit Computation Point from age 62 to 65.

The benefit formula treats early retirement the same as waiting until age 65. After 65, there is an annual incentive to continue working. Early retirees at 62 get 80 percent of what they would get at 65.

Proposal would discourage early retirement by assigning zero value to the age 62-64 period, thus reducing benefits in such cases while rewarding those who elect to work until age 65. This returns the program to the formula used before the age of retirement for women was lowered to 62 in 1956.

Reduce Benefits for Early Retirement.

Workers electing early retirement at 62 now receive benefits equal to 80 percent of what they would receive if they delayed retirement to age 65.

Proposal would reduce early retirement benefits to 55 percent of the maximum, thus strongly encouraging workers to remain in the work force until age 65.

II. Change to reduce opportunity for windfall benefits

Eliminate Windfall Benefits for Non-Covered Employment

The benefit formula now makes it possible for a person, such as a retired Federal employee, who enters Social Security-covered employment for only a few years to receive disproportionately high benefits, in some cases exceeding those paid to low-wage earners who have spent a lifetime in covered employment.

Proposal would have formula take pension resources from non-covered employment into account in such cases, thus sharply lowering the Social Security benefit in such cases.

III. Changes to relate disability insurance closer to work history and medical condition

Require "Medical Only" Determination of Disability

Workers can now qualify for disability benefits on combinations of medical and non-medical factors, such as age, education and work experience. More than one-third of disability cases age 60 to 65 involve non-medical factors.

Proposal would limit qualification to medical factors alone thus restoring program to original purposes.

Increase Waiting Period to Six Months.

Under a 1972 liberalization of the program, the waiting period for disability benefits was reduced from six to five months on the assumption that ample funds would be available.

Proposal would restore the six-month waiting period previously in law. This conforms to the terms of most private disability insurance progams.

Require Prognosis of 24-Plus Months of Disability.

Workers now seeking disability benefits must show only that disability claimed will exceed 12 months or will result in death. The 12-month test, enacted in 1965, replaced a test of "long-continued and indefinite duration" in prior law.

Proposal would restore the original intent of the law, requiring that the prognosis of disability be of long duration, at least 24 months, a more reasonable definition of disability.

Increase Requirement for Insured Status to 30 Quarters.

Workers may now qualify for disability benefits even if they have been in the work force only 20 out of the past 40 quarters. Therefore a person could be out of covered employment for 5 years and still qualify.

Proposal would set the minimum at 30 out of the past 40 quarters, thus more closely tying benefits to the principle that they are replacement for wages recently lost.

IV. Changes to reduce welfare elements

Eliminate Children's Benefits in Early-Retirement Cases

Children under 18 or under 22 if in school are now eligible for benefits on the basis of a retired parent's wage record. Thus a retiree with a child receives a dependent's benefit, whereas a retiree with no children gets only his own benefit.

Proposal would end this inequity in early-retirement cases and thus encourage the worker to continue work until 65.

Extend Disability Maximum Family Benefit to Retirement and Survivors Cases

Benefits for families of retired and deceased workers can now actually exceed that worker's net take-home pay.

Proposal would extend the maximum limitation on benefits to families in disability cases enacted in 1980 to retirement and survivor cases. This would return the program closer to its original purpose as a "floor" of protection.

V. Other amendments for short term—Increase bend points by 50 percent instead of 100 percent of wage increases for 1982-87

In 1977, the "bend points" (dollar amounts referred to in the weighted benefit formula) were made subject to automatic wage indexing. This change was adopted in legislation intended in part to offset the cost impact of earlier legislation and the faulty benefit computation procedure adopted in the 1972 amendments. However, benefit levels today remain disproportionately high (by about 10 percent) compared with the pre-1972 levels.

Proposal would restore the traditional relative benefit levels for future beneficiaries by increasing the "bend points" by 50 percent (instead of 100 percent) of increases in average wage earnings for the years 1982-87, after which the 100 percent factor would be restored to the formula.

Move Date for Automatic Benefit Increases from June to September and Use 12-Month CPI Average

Under the 1972 amendments (as modified in 1974), annual Social Security benefit increase have been automatic each June (payable beginning in July). The increase is based on changes in the Consumer Price Index as measured between the first quarter of the current calendar year and the corresponding quarter of the preceding year, a provision which can unduly inflate or deflate the increase, depending on economic conditions in those quarters.

Proposal would correct the anomaly of having benefit increases initiated on the pre-1976 Federal Fiscal Year basis and change the CPI computation to cover a full year (July-June) period, thus making the measurement a more accurate reflection of economic trends and measuring living costs in a period ending closer to the initiation of benefit increases.

VI. Change in coverage

Extend Coverage to First Six Months of Sick Pay

Most sick pay is not taxed due to complex exclusion which forces employers to track sick pay on daily, even hourly basis, and leads some to unwittingly break the law.

Proposal would extend tax to all sick pay during first six months of an employee's illness. This would eliminate the administrative burden and would treat sick pay in the same way as vacation pay.

VII. Phaseout retirement earnings test by 1986

Under current law, 1981 Social Security benefits payable to persons aged 65 through 71 are reduced by $1 for each $2 of annual earnings in excess of $5,500, a level which rises each year in relation to average wage earnings. However, benefits are not reduced for those aged 72 and over (70 and over beginning in 1982).

Proposal would phase out the retirement test over a three-year period, permitting $10,000 in earnings in 1983, $15,000 in 1984, $20,000 in 1985 and unlimited earnings thereafter.

VIII. Reduce long-range social security taxes

Assuming enactment of these proposals, and those introduced in the Administration's Budget proposals, it will be possible to lessen the Social Security tax increase now scheduled for 1985 and to actually decrease Social Security taxes below the current level in 1990. (See chart below). Note that while an increase will again become necessary in 2020 due to the aging of the population, the rate will still be lower than the 1990-and-after rate schedule under current law.

TABLE 1.—SOCIAL SECURITY TAX RATES UNDER PROPOSAL

[Tax schedule in percent]

Period	Present law	Proposal: Under budget assumptions	Proposal: Under worst-case assumptions
1981	6.65	6.65	6.65
1982–84	6.70	6.60	6.70
1985	7.05	6.45	6.95
1986–89	7.15	6.45	7.05
1990–2019	7.65	6.45	6.45
2020 and after	7.65	7.55	7.55

TABLE 2.—COST ANALYSIS OF EFFECT OF VARIOUS SOCIAL SECURITY OPTIONS

Item	Short-range effect 1982–86 assumptions [1]		Percent of long-range effect [2]	
	Economic	Worst case	Payroll	deficiency
Status of present system, deficit	–$11.0	(–110.8)	–1.52	[3] (100)
Effect of budget proposal	35.5	(36.8)	.20	(15)
Status of program after budget proposals enacted		(–74.0)	–1.32	[4] (87)
Proposals:				
(1) Cover sick pay in first 6 mos	2.6	(2.6)	.02	(1)
(2) Change computation points for average indexed monthly earnings from age 62 to age 65	1.3	(1.4)	.39	(26)
(3) Increase bend points in primary benefit formula by 50 percent (instead of 100 percent) of wage increases, 1982–87	4.2	(4.7)	1.30	(86)
(4) Benefit rate of 55 percent of primary benefit for retired workers (and 27½ percent for spouses) at age 62	17.6	(20.3)	.85	(56)
(5) Eliminate benefits for children of retired workers aged 62–64	1.9	(2.0)	.02	(1)
(6) Disability maximum family benefit applicable to survivor and retirement cases	2.9	(3.3)	.10	(7)
(7) Eliminate windfall portion of benefits for persons with pensions from noncovered employment	.6	(.6)	.10	(7)
(8) Require "medical only" determination of disability (that is, excluded vocational factors)	7.7	(9.0)	.06	(4)
(9) Increase disability waiting period from 5 mos. to 6 mos	1.4	(1.5)	.03	(2)
(10) require disability prognosis of 24+ mos. duration (instead of 12+ mos.)	2.8	(3.4)	.07	(5)
(11) Require 30 QC out of last 40 quarters for disability benefits (instead of 20/40)	10.0	(11.5)	.21	(14)
(12) Move date for automatic benefit increases from June to September (and use 12-mo. average)	6.3	(27.8)	.14	(9)
(13) Raise retirement-test exemption for age 65+ to $10,000 in 1983, $15,000 in 1984, $20,000 in 1985, and eliminate test in 1986	–6.5	(–7.4)	–.14	(–9)
Total	[4] 46.4	(75.0)	2.86	(188)

[1] In billions. Figures in parentheses are based on "worst case" assumptions; other figures are based on the expected economic assumptions (those in the President's budget).

[2] Average cost over 75-year period, in percentage of taxable payroll. Figure in parentheses is long-range effect of this item as percentage of actuarial deficiency of present program.

[3] Amount necessary to restore financial soundness of program over the long range.

[4] Including effect of additional net income to hospital insurance program.

Note: Positive numbers indicate savings; negative numbers indicate added costs or amounts needed to meet cost of present programs.

TABLE 3.—ESTIMATED SHORT-RANGE EFFECT OF PROPOSAL AS COMPARED WITH PRESENT LAW, FUND RATIOS AT START OF YEAR[1]

[In percent]

Calendar year	Expected economic conditions		Worst-case economic conditions	
	Present law	Proposal	Present law	Proposal
1981	23	23	23	23
1982	21	22	21	22
1983	18	23	16	22
1984	16	25	[2] 6	19
1985	14	28	([3])	17
1986	16	20	([3])	18
1987	22	[4] 35	([3])	[5] 21

[1] Balance in combined Old-Age and Survivor Insurance Trust Fund, Disability Insurance Trust Fund, and Hospital Insurance Trust Fund at beginning of year as percentage of outgo from trust funds in coming year (that is, assumes availability of inter-fund borrowing).
[2] Funds have insufficient balance to pay monthly benefits (actually, this situation would occur several months earlier).
[3] Funds exhausted.
[4] By 1990, the fund ratio would be about 50 percent.
[5] By 1990, the fund ratio would be about 30 percent, and by 1995 it would be about 50 percent.

TABLE 4.—YEAR-BY-YEAR COST ANALYSIS OF PROPOSAL

[In billions of dollars]

Calendar year	Economic assumptions	
	Under expected	Under worst case
1981	0.9	0.9
1982	9.1	11.3
1983	11.8	16.2
1984	15.7	21.7
1985	20.5	28.1
1986	23.9	33.6
1981 to 1986	81.9	111.8

TABLE 5.—ILLUSTRATIVE BENEFITS FOR WORKERS RETIRING AT AGES 62 AND 65 UNDER PROPOSAL AND UNDER PRESENT LAW[1]

Earnings category[2]	Present law	Proposal
Age 62 at retirement in January 1982:		
Low	$247.60	$163.90
Average	372.80	246.80
Maximum	469.60	210.50
Age 65 at retirement in January 1982:		
Low	355.30	355.30
Average	535.40	535.40
Maximum	679.30	679.30
Age 62 at retirement in January 1987:		
Low	384.40	225.20
Average	580.70	348.30
Maximum	755.60	430.00
Age 65 at retirement in January 1987:		
Low	477.10	447.40
Average	719.00	691.90
Maximum	942.80	860.30

[1] Includes effect of (1) 55 percent benefit rate (instead of 80 percent for retirement at age 62, (2) age 65 computation point (instead of age 62) for all ages at retirement, and (3) increasing bend points in primary-benefit formula by 50 percent (instead of 100 percent of wage increases in 1982–87. Benefit amounts are for worker only. Worker is assumed to reach exact age shown in January.
[2] "Low earnings" are defined as the Federal minimum wage in each past year, and the 1981 minimum increased by the change in average wages in future years. Average earnings are defined as the average wage for indexing purposes in each year. Maximum earnings denote the contribution and benefit base in each year.

ASSUMPTIONS

(1) Worker entered covered employment in 1956 and worked steadily thereafter.
(2) Future earnings (for retirement in January 1987) follow trend under intermediate assumptions in 1980 Trustees Report.

ADMINISTRATION RESPONSES TO QUESTIONS SUBMITTED BY COMMITTEE

Question 1. What is the rationale or justification for each of the President's proposals, including interfund borrowing and variable tax rates (rates that may rise or fall)?

Answer. The Social Security system is facing the most serious crisis in its history—a major financing problem and a devastating erosion of public confidence in the system. Without change the Social Security trust fund deficit, could, under pessimistic economic assumptions, be as high as $111 billion during the next 5 years. This crisis can be effectively met only by taking actions which address the root causes of the problem.

The proposals are designed to do that by reducing welfare-oriented elements that duplicate other programs, eliminating windfall benefits, creating incentives to delay retirement and correcting past over-expansions in program benefits. The proposals will relate payments more directly to their intended purpose and ensure the future solvency of the trust funds. Moreover, they will resolve Social Security financing problems in both the short range and the long range without increasing the tax burden on current workers.

Change the benefit computation point from age 62 to 65 so that the averaging period would be extended to the year in which the worker reaches age 65: The computation closing point was first lowered to age 62 for women in 1956 when reduced benefits were made available to women workers at age 62. When reduced benefits were made available to men in 1961, this change was not made. The 1972 amendments inappropriately provided the age-62 computation point for men, instead of conforming the computation closing age for women to that for men. Restoring the basic period used in figuring a worker's earnings to age 65, rather than age 62, reinforces age 65 as the "normal" retirement age. To underscore the value of working at least to age 65, the proposal would include these three additional years in figuring the average earnings on which a worker's initial benefits are based.

Increase the permanent reduction made in benefits for early retirement at ages 62–64 so that persons retiring at age 62 would get 55 percent of what they would get at age 65, rather than 80 percent as now: This proposal should be looked at in terms of the incentive for deferred retirement that it would offer. For each additional year of continued work at age 62–64, an additional 15 percent of the basic benefit would be payable. A worker retiring at age 63 and 8 months would receive 80 percent of what he or she would get at age 65. Also, additional earnings during this period may increase the average earnings on which the worker's benefits are based.

Eliminate "windfall" benefits for persons who have been in noncovered employment for most of their working lifetimes, but who acquire sufficient covered employment to qualify for Social Security benefits: This proposal would remove the unintended advantage that Social Security now provides for persons who have substantial pensions from noncovered employment by eliminating the heavy weighting from their benefits. The weighting in the current benefit formula is intended for long term, low-wage workers.

Change the Social Security definition of disability so that eligibility for disability insurance (DI) benefits is limited to those individuals who are disabled on the basis of medical factors alone and increase the prognosis-duration requirement from 12 months to 24 months: These changes would help to retrun the Social Security program to its original intent. Originally, nonmedical, vocational factors (such as age, education, and work experience) were not considered in determining whether a person was disabled. The 12-month prognosis-duration requirement was added to the law in 1965.

The elimination of vocational factors in making disability determinations is also expected to result in more accurate, uniform, and consistent disability determinations on a nationwide basis and to simplify the decisionmaking process. Evaluating vocational and other nonmedical factors is very subjective, which makes it difficult to reach consistent decisions in all cases, can lead to error in determining whether a person is disabled, and may increase the number of appeals. Now, about 75 percent of allowances are based on medical factors alone, but if both awards and denials are considered, the present policy requires an evaluation of nonmedical factors in about 50 percent of all cases. These changes would not apply to the SSI disability program.

Increase the Social Security disability insurance (DI) waiting period from 5 to 6 months: This proposal would make the disability waiting period the same as was provided under the original disability insurance program in 1957. The current 5-month waiting period often results in a duplication of benefits because the majority of DI beneficiaries have protection under a variety of short-term disability plans. Those disabled people in need can qualify for SSI disability payments during the waiting period since there is no waiting period under SSI.

Require that a person must have 30 quarters of coverage in the 40-quarter period preceding disability in order to qualify for Social Security disability insurance (DI) benefits: Under present laws, which requires that a person have 20 quarters of coverage in the 40-quarter period preceding disability, people can qualify for DI benefits even though they do not have a substantial recent attachment to the covered work force. For example, a person can be out of employment covered under Social Security for as much as 5 years and still qualify for benefits if he or she becomes disabled.

The Administration's proposal to substitute the 30-out-of-40-quarter requirement for the current 20-out-of-40 test will help to bring Social Security DI program back into line with its basic purpose—to pay benefits only to workers who have a strong and recent attachment to the covered work force and who, directly as a result of becoming disabled, have lost earnings on which they depended to support themselves and their families.

Eliminate child's benefits for early retirement: The proposal is in keeping with the efforts to remove the incentives for early retirement and to encourage individuals to stay in the work force until they reach age 65.

Further, compared with workers of similar age who have no dependent children, workers with eligible children in early retirement cases have an advantage under present law in that the unreduced benefits payable to their children offset the effect of the reduction for early retirement in their own benefit.

Extend the disability maximum family benefit to retirement and survivor cases: The 1980 disability amendments changed the maximum family benefit, so that Social Security benefits for the disabled worker's family would not exceed the lesser of 85 percent of the worker's average indexed earnings or 150 percent of the worker's benefit amount (but not less that 100 percent of the worker's benefit). This limitation would more nearly assure that family benefits based on the worker's earnings would not exceed his or her previous net take-home pay. Applying the same maximum on family benefits to old-age and survivor cases would similarly assure that benefits for these cases would not be excessive in relation to the worker's previous take-home pay.

Base the annual adjustments of the formula bend points on 50 percent, rather than 100 percent, of the annual wage increase for the next 6 years: This proposal, which would phase in gradually over the next 6 years, would correct for past over-expansions of general benefit levels by ultimately reducing replacement rates—the ratio of the initial benefit to the earnings immediately before retirement—for future beneficiaries by an average of about 10 percent. Thus, the replacement rate for an average worker would be reduced from about 42 percent to 38 or 39 percent.

Shift the effective date for the payment of the automatic cost-of-living increase from July to October—the beginning of the fiscal year: This change would correct the anomalous situation that occurs because Social Security operates on the pre-1976 fiscal year calendar.

Conform Supplementary Medical Insurance premium period to the Federal fiscal year: The change would keep the timing of increases in Supplementary Medical Insurance premiums consistent with the timing of automatic increases in Social Security cash benefits provided under the previous section. These increases have been simultaneous throughout the period over which the law has provided for automatic increases in Social Security benefits.

Remove the exclusion from Social Security coverage of sick pay made under an employer's plan or system during the first 6 months the employee is off work if the payments are made from the employer's regular wage or salary account: Under present law, sick pay within the 6-month period is taxed and credited only if it is not made under a plan or system established by an employer. This change should simplify the reporting of FICA taxes and wages by employers. Some employers have complained about the difficulty and expense of keeping records of sick pay for as little as one hour at a time, so that the sick payments can be excluded from Social Security wage reports. Also, some employers do not understand current law and incorrectly report sick pay as wages—or, conversely, fail to report sick pay that is not paid under a plan or system.

Phase out the earnings test for people age 65 and over by increasing the exempt amount to $10,000 in 1983, $15,000 in 1984, and $20,000 in 1985, and by eliminating the test entirely for those age 65 and older in 1986: Under current law, if the earnings of a beneficiary aged 65 to 72 (age 70 in 1982) exceed an annual exempt amount ($5,500) in 1981 and $6,000 in 1982), Social Security benefits are reduced $1 for each $2 earnings above that amount. The Administration's proposal to phase out the earnings test will remove a strong disincentive for people age 65 and over to continue working. In effect, the present test operates as a 50 percent tax on earnings above the exempt amount, and such earnings are further reduced by Federal, State, and local income taxes, as well as the expenses connected with working. Senior citizens should not be penalized because they choose to remain in or reenter the work force, thereby continuing to contribute their valuable skills to the Nation's productive effort, while supplementing their Social Security benefits.

Interfund borrowing between OASI and DI trust funds and from HI trust fund: The OASI trust fund is expected to experience cash flow problems in 1982, while the income and the assets of the DI and HI trust funds are growing. Interfund borrowing will help to solve the immediate problem in OASI by permitting borrowing from the surplus in the other two funds. Because statutory tax rates for the three individual funds must be set based on economic and demographic projections which, by their very nature, cannot precisely anticipate actual future experience, imbalances betwen the funds are likely to occur from time to time. Interfund borrowing provides a safety mechanism which can prevent serious imbalances as long as total trust fund assets and income are adequate.

Adjustments in tax rates: Enactment of the Administration's Social Security reform proposals, along with the budget proposals, would, even under worst-case assumptions, permit a reduction of the scheduled increase in Social Security tax rates for 1985 and allow a decrease in the tax rate for 1990 below the level of current law. While an increase will again be necessary in 2020 due to the aging of the population, the rate will be lower than the currently scheduled 1990-and-after rate. Moreover, if the actual performance of the economy is better than that projected under the pessimistic assumptions used to develop the President's package of Social Security reform proposals, the bill provides for further reductions in Social Security tax rates below those proposed in this section.

Further adjustments of tax rates by reason of balance in OASI and DI trust funds: The proposal provides a mechanism for gradually modifying Social Security tax rates to maintain an adequate contingency reserve level in the OASI and DI trust funds. It would permit small periodic adjustments in the tax rates scheduled in law in order to maintain the trust funds at a level equal to about 50 percent of the amount needed to pay one year's benefits. It could go into effect only when the combined balances in the OASI and DI trust funds have grown to exceed 55 percent of the prior year's outlays and are larger than at the close of the preceding year. Thus, its initial effect could not only be to decrease taxes. In the longer range, it would permit gradual increases or decreases in taxes as needed to maintain adequate trust fund levels, thereby obviating any need for the Congress to make periodic, minor tax rate changes.

Question 2. Do any of the provisions affect people who are 62 or older before January 1, 1982?

Answer. The Financial Reform Amendments would have virtually no effect on the 36 million beneficiaries now on the rolls or the several million persons now aged 62 or over who are eligible for benefits but still working. The sole impact of these proposals on such persons would be a three-month delay in the automatic cost-of-living increase scheduled for July 1982.

Question 3(a). Aside from Government employees and employees of nonprofit organizations, would anyone else be affected by the "windfall benefits" provision?

Answer. No, the proposal would only affect the Social Security benefits of retired or disabled workers (and their families) who reach age 62 or become disabled after 1981 and receive a pension based on noncovered employment in Federal, State, or local government or with a nonprofit organization. Survivors of such workers would get benefits based on the regular computation rules used today; their benefits would not be subject to reduction under the proposal.

Question 3(b). What would be the effect of this provision on social security benefits for some representative individuals?

Answer. The Primary Insurance Amounts under present law and under the proposal[1] for a worker who attains age 65 in early 1985 and retires then are as follows (for various earnings levels):

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[1] Under the proposal, the PIA for the worker above would be equal to the higher of (A) 32 percent of the first $1,396 of AIME, plus 15 percent of remainder (replaces 90 percent factor applicable to first $232 of AIME with 32 percent factor) or (B) present-law PIA minus half of the pension based on noncovered employment. The initial calculation is made as of age 62; the amounts shown are at age 65 and reflect cost-of-living increases beginning with the year the worker reaches age 62. The foregoing benefit formula is derived from that which is estimated to be applicable under present law for the 1982 cohort.

AIME[1]	PIA under present law	PIA under proposal if pension from noncovered work is:		
		$269 or more	$200	$150
$100	[2]$116	$41	$41	$41
150	173	62	62	77
200	231	82	103	135
400	337	164	209	241
[3] 187	414	241	286	318
600	420	247	291	323
800	502	329	373	405
1,000	584	411	456	488
[4] 1,093	622	449	494	526
1,200	666	493	538	570
1,400	747	575	619	651
1,600	786	613	658	690
[5] 1,708	807	634	678	710

[1] The average indexed monthly earnings is the amount on which the PIA computation is based; it is the average of the worker's career covered earnings after they have been indexed to reflect average nationwide wages prevailing prior to age 60.
[2] Amount assuming that there is no minimum PIA.
[3] AIME for worker who always earned the Federal minimum wage.
[4] AIME for worker who always earned the average earnings.
[5] AIME for worker who always earned the maxumum covered earnings.

Note: These calculations are based on the intermediate assumptions in the 1980 Trustees Report, modified to reflect recent experience.

Question 4. What proportion of new awards would not be made as a consequence of each of the disability provisions?

Answer. Under the Social Security program as it would be modified by the President's proposals, an estimated 250,000 workers would become newly entitled to disability insurance benefits in the first full year of operations under the proposals. Under present law, the corresponding number is estimated to be 400,000.

The reduction attributable to each of the disability proposals, as a percentage of the 400,000 persons who would become entitled under present law, is shown below:

	Percent
All disability proposals	38
Adding currently insured status as a requirement	9
Requiring "medical only" determination of disability	13
Requiring disability prognosis of at least 24 months	5
Requiring 30 quarters of coverage out of last 40 quarters instead of 20 out of last 40	11

The estimates shown for each successive proposal take account of interaction with preceding proposals. Since the estimates represent the effect in the "first full year" (i.e., the annual effect on an ongoing basis), the one-time effect of the increase in the waiting period from 5 months to 6 months is not reflected. The effect of the megacap is not reflected, because it would not affect entitlement to benefits.

Question 5. Concerning the elimination of children's benefits for early retirees:

a. What proportion of new awards would not be made as a consequence of this provision?

Answer. An estimated 1 percent of workers who retire before age 65 will wait until age 65.

b. What proportion of workers who retire early have dependent children?

Answer. 5-6 percent.

Question 6. What is the likely effect on benefits of changing the computation points for calculating the AIME? Illustrate.

Answer. The effect depends on the regularity of the past work record. If earnings were about the same relative amount in each past year since 1950, there would be little effect, but there would be significant effects if there were any gaps in the earnings record or much lower earnings in some years than in others.

The table below illustrates the effect on steady workers who reach age 62 or 65 in 1987 for various earnings levels (amounts shown do not include the effect of either the proposal to change the bend-point adjustment procedure or the proposal to change the early-retirement reduction factor):

Age at retirement	PIA		Percent decrease
	Present law	Proposal	
Average earner:			
62	$581	$581	0
65	719	717	3
Low-wage earner:			
62	387	385	.5
65	479	476	6
Maximum earner:			
62	760	752	1.0
65	946	934	1.2

Note Long-range economic assumptions based on intermediate assumptions in 1980 trustees report

The proposal has more effect on retirees who have a gap in their past earnings. For example, if for the preceding cases there had been zero earnings in 1951-55, the results would be as follows:

Age at retirement	PIA		Percent decrease
	Present law	Proposal	
Average earner:			
62	$581	$544	6.3
65	719	717	.3
Low-wage earner.			
62	384	365	5.0
65	477	473	.9
Maximum earner.			
62	756	729	3.5
65	943	929	1.4

Note Long-range economic assumptions based on intermediate assumptions in 1980 Trustees Report

Question 7. As in the table 5 of the HHS fact sheet:

(a) Illustrate the benefits for workers retiring at ages 62 and 65 in 1992.

(b) For each of the examples, illustrate the effect on benefits of a change in bend points alone.

Answer. The attached table presents examples of monthly benefits payable to steady workers under present law, under the Administration's Social Security financing proposals, and under the proposal to change bend points alone, for workers retiring at 62 or 65 in 1982, 1987, and 1992.

ESTIMATED MONTHLY BENEFIT AMOUNTS FOR SELECTED EXAMPLES OF WORKERS RETIRING IN FUTURE YEARS UNDER PRESENT LAW, UNDER THE ADMINISTRATION'S SOCIAL SECURITY FINANCING PROPOSALS, AND UNDER THE PROPOSAL TO CHANGE BEND POINTS ALONE

Example [1]	Estimated monthly benefit amount		
	Present law	Administration's proposals [2]	Bend point proposal only [3]
Worker retiring at age 62 in January 1982 with:			
Low earnings	$248	$164	$244
Average earnings	373	247	369
Maximum earnings	470	310	458
Worker retiring at age 65 in January 1982 with:			
Low earnings	355	355	355
Average earnings	535	535	535
Maximum earnings	679	679	679
Worker retiring at age 62 in January 1987 with:			
Low earnings	384	225	347
Average earnings	581	348	543
Maximum earnings	756	430	652
Worker retiring at age 65 in January 1987 with:			
Low earnings	477	447	452
Average earnings	719	692	694

Footnotes at end of table.

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ESTIMATED MONTHLY BENEFIT AMOUNTS FOR SELECTED EXAMPLES OF WORKERS RETIRING IN FUTURE YEARS UNDER PRESENT LAW, UNDER THE ADMINISTRATION'S SOCIAL SECURITY FINANCING PROPOSALS, AND UNDER THE PROPOSAL TO CHANGE BEND POINTS ALONE—Continued

Example [1]	Estimated monthly benefit amount		
	Present law	Administration's proposals [2]	Bend point proposal only [3]
Maximum earnings	943	860	874
Worker retiring at age 62 in January 1992 with:			
Low earnings	520	311	469
Average earnings	786	485	735
Maximum earnings	1,054	609	913
Worker retiring at age 65 in January 1992 with:			
Low earnings	631	565	569
Average earnings	953	890	891
Maximum earnings	1,285	1,098	1,116

[1] Benefit amounts are for worker only. Worker is assumed to reach exact age shown in January. "Low earnings" are defined as the Federal Minimum Wage in each past year, and the 1981 Minimum increased by the change in average wages in future years. "Average earnings" are defined as the average wage for indexing purposes in each year. "Maximum earnings" denote the contribution and benefit base in each year. In each example, the worker is assumed to have covered earnings only during the period 1956 through the year before retirement.

[2] Under this proposal, the computation point for determining benefits would be changed gradually from age 62 to age 65 (but indexing of earnings would continue to be to age 60 only). In addition, the proposal would provide benefits of 55 percent of PIA at age 62 (grading to 100 percent at age 65) for workers reaching age 62 in 1982 and later, and would increase PIA-formula "bend points" by 50 percent of average wage increases in 1982-87.

[3] These examples reflect only the effect of increasing PIA-formula "bend points" by 50 percent of average wage increases in 1982-87.

Question 8. Using the information in these same tables (page 8, and including 1992), illustrate the effect of these provisions on replacement rates.

Answer. The attached table presents estimated replacement ratios for steady workers retiring in 1982, 1987, and 1992 under present law and under the Administration's Social Security financing proposals.

ESTIMATED REPLACEMENT RATIOS FOR SELECTED EXAMPLES OF WORKERS RETIRING IN FUTURE YEARS UNDER PRESENT LAW AND UNDER THE ADMINISTRATION'S SOCIAL SECURITY FINANCING PROPOSALS

Example [2]	Estimated replacement ratio [1] (percent)	
	Present law	Administration's proposals [3]
Worker retiring at age 62 in January 1982 with:		
Low earnings	45.8	30.1
Average earnings	34.6	22.9
Maximum earnings	20.3	13.2
Worker retiring at age 65 in January 1982 with:		
Low earnings	64.4	63.0
Average earnings	49.1	48.1
Maximum earnings	28.9	28.3
Worker retiring at age 62 in January 1987 with:		
Low earnings	45.3	27.3
Average earnings	34.4	21.7
Maximum earnings	20.6	11.7
Worker retiring at age 65 in January 1987 with:		
Low earnings	55.4	51.4
Average earnings	42.2	39.9
Maximum earnings	25.3	22.7
Worker retiring at age 62 in January 1992 with:		
Low earnings	45.1	27.4
Average earnings	34.4	21.7
Maximum earnings	20.8	12.0
Worker retiring at age 65 in January 1992 with:		
Low earnings	54.4	47.9
Average earnings	41.5	37.9
Maximum earnings	25.2	21.1

Footnotes at end of table.

[1] Replacement ratio is defined as benefits payable for the first year of retirement divided by earnings in the last year before retirement.
[2] Ratios are for worker only Worker is assumed to reach exact age shown in January "Low earnings" are defined as the Federal Minimum Wage in each past year, and the 1981 minimum increased by the change in average wages in future years "Average earnings" are de[illegible] as the average wage for indexing purposes in each year. "Maximum earnings" denote the contribution and benefit base in each year. In each [illegible]nple, the worker is assumed to have covered earnings only during the period 1956 through the year before retirement
[3] Under this proposal, the computation point for determining benefits would be changed gradually from age 62 to 65 (but indexin[illegible] of earnings would continue to be to age 60 only) The proposal would also provide benefits of 55 percent of PIA at age 62 (grading to 100 [illegible] at age 65) for workers reaching age 62 in 1982 and later, and would increase PIA-formula "bendpoints" by 50 percent of average wa[illegible]creases in 1982-87 In addition, the annualized benefit amounts used to compute the replacement rates reflect the effect of the proposed [illegible]ange in the effective month of future cost-of-living increases from June to September.

Question 9. Are any of the savings figures on page 6 (of the HHS Fact Sheet) net of changes of SSI costs?

Answer. No. The Social Security proposals were developed because of the short-range and long-range financing problems of the Old-Age and Survivors Insurance Trust Fund. The short-range estimates shown on page 6 of Fact Sheet included only the effects of the proposals on the three trust funds that are financed by payroll taxes—the OASI, Disability Insurance, and Hospital Insurance Trust Funds. The long-range estimates, covering the next 75 years, included only the e[illegible]ts on the combined OASI and DI Trust Funds. (Long-range estimates for the HI [illegible]rust Fund are not projected beyond a 25-year period.) The changes in costs to the Supplemental Security Income program would, of course, have offsetting effects on total budget outlays, but not on the reduction in outgo from the trust funds.

The increase in costs for the Supplemental Security Income and Aid to Families with Dependent Children program would be relatively small. They will be shown in the answer to Question 22.

Question 10. What assumptions do you make about the long-term effect of the President's proposals on the retirement decision of the elderly?

Answer. It has been assumed that two of the President's proposals would have significant effect on the age at which workers begin receiving monthly retirement benefits in the future. First, reducing the benefit rate from 80 percent to 55 percent of PIA for those who begin receiving retirement benefits at age 62 has been assumed in the long run to result in deferred entitlement for about one fourth of all persons who begin receiving retirement benefits before age 65 under current law. Second, phasing out the earnings test for persons age 65 and older has been assumed to result in the long run in prompt entitlement at age 65 for virtually all eligible persons who begin receiving retirement benefits after reaching age 65 under current law. Under current law about 7 percent of male and 4 percent of female eligible workers aged 65 to 69 are projected to have benefits withheld due to the earnings test.

Questions 11 and 20. What are the fiscal year savings associated with each proposal (by year, fiscal years 1982-86)?

Answer. The attached tables show the estimated reductions in OASDI benefit payments for each of the Administration proposals, by fiscal year. Table 1 is based on the economic assumptions in the President's Budget, while Table 2 is based on the "worst-case" assumptions. It should be noted that the total savings for fiscal years 1981-86 shown in Table 2 total about $97 billion, which is comparable with the $111 billion shown in the HHS News release of May 12, because the latter figure is for calendar years 1981-86 and thus includes three more months (and a full year of savings for the change in the method of adjusting benefits for CPI increases).

TABLE 1.—ESTIMATED REDUCTION IN OASDI BENEFIT PAYMENTS FOR THE ADMINISTRATION'S SOCIAL SECURITY LEGISLATIVE PROPOSALS, FISCAL YEARS 1981-86, BASED ON THE PRESIDENT'S 1982 BUDGET ASSUMPTIONS

[In billions]

Item	1981	1982	1983	1984	1985	1986	Total 1981-86
A. Effect of budget legislative proposals on OASDI benefits	$0.1	$2.7	$3.9	$4.8	$5.4	$5.8	$22.7
B. Proposal: [1]							
1. Cover sick pay in first 6 months [2]		.3	.4	.5	.6	.7	2.5
2. Change commputation point for AIME from age 62 to age 65		([3])	.1	.1	.3	.5	1.1
3. Increase PIA formula bendpoints by 50 percent (instead of 100 percent) of wage increase in 1982-87		([3])	.2	.5	1.1	1.9	3.6

Footnotes on following page.

TABLE 1.—ESTIMATED REDUCTION IN OASDI BENEFIT PAYMENTS FOR THE ADMINISTRATION'S SOCIAL SECURITY LEGISLATIVE PROPOSALS, FISCAL YEARS 1981–86, BASED ON THE PRESIDENT'S 1982 BUDGET ASSUMPTIONS—Continued

[In billions]

Item	1981	1982	1983	1984	1985	1986	Total 1981–86
4. Pay benefit rate of 55 percent of PIA for retired workers (and 27½ percent for spouses) at age 62		.3	1.5	3.2	4.7	6.1	15.8
5. Eliminate benefits for children of retired workers aged 62–64		([3])	2	.4	.6	.6	1.8
6. Apply DI family maximum to OASI cases		.1	.4	.6	.7	9	2.7
7. Eliminate "windfall portion" of benefits for persons with pensions from noncovered employment		([3])	1	.1	1	2	5
8. Require "medical only" determination of disability (i.e., exclude vocational factors)		2	.9	1.4	2.0	2.5	7.0
9. Increase DI waiting period from 5 to 6 months		.1	3	3	.3	.3	1.3
10. Require disability prognosis of 24 plus months (instead of 12 months)		([3])	.3	6	.8	.9	2.6
11. Require 30 quarters of coverage out of last 40 quarters for disability benefits (instead of 20/40)		.2	.8	1.7	2.7	3.5	8.9
12. Move date for automatic benefit increase from June to September (and use 12-month average)		3.5	1.8	1.0	5	1	6.9
13. Raise retirement test exempt amount for age 65 plus to $10,000 in 1983, $15,000 in 1984, $20,000 in 1985, and eliminate test in 1986			–.5	–1.1	–1.6	–2.6	–5.8
Subtotal (effect of B proposals)[4]		4.5	5.9	8.2	11.4	13.9	43.9
Total effect (A and B)[4]	.1	7.2	9.8	13.0	16.8	19.7	66.6

[1] Except where noted, amounts shown are estimated reductions in OASDI benefit payments

[2] Represents additional social security tax income, including 111

[3] Amounts shown represent net effect of all applicable proposals after interaction. Figures shown for individual proposals include the effect of interaction only with the Budget Proposals, and not with other proposals in section B

Note: These estimates are based on the economic assumptions underlying the President's Economic Recovery Plan

TABLE 2.—ESTIMATED REDUCTION IN OASDI BENEFIT PAYMENTS FOR THE ADMINISTRATION'S SOCIAL SECURITY LEGISLATIVE PROPOSALS, FISCAL YEARS 1981–86, BASED ON "WORST-CASE" ASSUMPTIONS

[In billions]

Item	1981	1982	1983	1984	1985	1986	Total 1981–86
A. Effect of budget legislative proposals on OASDI benefits	$0.1	$2.7	$4.1	$5.3	$6.2	$7.0	$25.4
B. Proposal:[1]							
1. Cover sick pay in first 6 months.[2]		.3	.4	5	.6	.7	2.5
2. Change computation point for AIME from 62 to 65		([3])	1	2	3	.6	1.2
3. Increase PIA formula bendpoints by 50 percent (instead of 100 percent) of wage increases in 1982–87		([3])	2	.5	1.2	2.3	4.2
4. Pay benefit rate of 55 percent of PIA for retired workers (and 27½ percent for spouses) at age 62		.3	1.6	3.5	5.5	7.3	18.2
5. Eliminate benefits for children of retired workers aged 62–64		([3])	.2	.4	.6	.7	1.9
6. Apply DI family maximum to OASI cases		.1	.4	.7	.8	1.1	3.1
7. Eliminate "windfall portion" of benefits for persons with pensions from noncovered employment		([3])	.1	.1	.2	.2	.6
8. Require "medical only" determination of disability (i.e., exclude vocational factors)		.2	1.0	1.6	2.3	3.1	8.2
9. Increase DI waiting period from 5 to 6 months		.1	.3	.3	.3	.4	1.4

Footnotes at end of table.

TABLE 2.—ESTIMATED REDUCTION IN OASDI BENEFIT PAYMENTS FOR THE ADMINISTRATION'S SOCIAL SECURITY LEGISLATIVE PROPOSALS, FISCAL YEARS 1981-86, BASED ON "WORST-CASE" ASSUMPTIONS—Continued

[In billions]

Item	1981	1982	1983	1984	1985	1986	Total 1981-86
10. Require disability prognosis of 24 plus months (instead of 12 months)		(³)	.3	.7	.9	1.1	3.0
11. Require 30 quarters of coverage out of last 40 quarters for disability benefits (instead of 20/40)		.2	.8	1.8	3.0	4.0	9.8
12. Move date for automatic benefit increase from June to September (and use 12-month average)		5.5	6.1	5.8	6.1	5.9	29.4
13. Raise retirement test exempt amount for age 65 plus to $10,000 in 1983, $15,000 in 1984, $20,000 in 1985, and eliminate test in 1986			−.5	−1.2	−1.9	−3.0	−6.6
Subtotal (effect of B proposals) [4]		6.5	10.2	13.3	18.2	23.0	71.2
Total effect (A and B) [4]	.1	9.2	14.3	18.6	24.4	30.0	96.6

[1] Except where noted, amounts shown are estimated reductions in OASDI benefit payments.
[2] Represents additional social security tax income, including HI.
[3] Less than $50,000,000.
[4] Amounts shown represent net effect of all applicable proposals afeter interaction. Figures shown for individual proposals include the effect of interaction only with the budget proposals, and not with other proposals in section B.

Note: These estimates are based on the "worst-case" economic assumptions that were used to develop the administration's financing proposals.

Question 12. What proportion of recipients will be benefited by the phasing out of the retirement earnings test? What proportion of this group are primary workers, as opposed to secondary beneficiaries?

Answer. In 1977, over a million out of about 22 million beneficiaries age 65 or older (4.5 percent) were directly affected by the earnings test, in that they had earnings withheld because of the test. Of these, almost all (983,000) were retired workers. Most of the rest were survivors (31,000) and a few (8,000) were other, mainly auxiliary, beneficiaries. Of the retired workers, 240,000 have auxiliary benefits paid on their accounts to either spouses or children or both. In these cases at least one other person could have been directly affected by the earnings test.

Indirect effects, as well as direct effects, might be expected if the earnings test were to be phased out. Some workers would be motivated to add to their earnings, and others might postpone retirement. At present, over 80 percent of those 65 and older earn nothing. Of the rest, about ⅔ earn below the exempt amount. Some (around 200,000) earn very close to this amount, and might be expected to increase their earnings if the test were eliminated. There would undoubtedly also be a number of workers who would return to work from retirement, or would postpone retirement, but no evidence exists on which to base an estimate.

Question 13. Why did the Administration fail to propose universal Social Security coverage as has been recommended by recent study and advisory groups?

Answer. Today about 90 percent of the Nation's jobs are covered under Social Security. The major groups not covered are Federal employees (who are mandatorily excluded from coverage by the Congress) and State and local governmental employees and employees of nonprofit organizations (who may be covered on a group basis at the option of the employer). The most serious problem from Social Security arising from the lack of coverage for these groups is that some employees get "windfall" benefits. The present benefit formula now makes it possible for some employees who work only a few years in covered employment to receive very high Social Security benefits in relation to the Social Security taxes they have paid. In many cases, the workers also receive pensions based on their noncovered employment. This problem would be largely solved by the Administration's proposal to reduce disability and retirement benefits paid to a worker (and his or her family) if the worker was receiving a pension based on noncovered work as a governmental or nonprofit employee.

The issue of mandatory coverage for governmental and nonprofit employees is a complex one. There are several problems which should be addressed before mandatory coverage is proposed. For example, many governmental and nonprofit employees are already covered under retirement systems and oppose Social Security coverage because they fear it would mean decreased protection under the plans and/or increased costs. It is difficult to develop a coverage plan that would respond to employee fears about reduced retirement system protection and yet would not increase costs for State and local government employers and their employees. The Administration is continuing to examine these issues, however.

Question 14. Has the Administration considered the effect, on younger workers, of their proposals to discourage retirement at age 65?

Answer. Yes, the Administration has taken younger workers into consideration. Younger workers have voiced two major concerns about the Social Security program—that there won't be any funds left when they are ready to retire and that the Social Security tax burden on them is substantial. The Administration's proposals guarantee that funds will be there even under adverse economic circumstances and provide for a reduction of the tax burden on all workers. Younger workers would be in a position to adjust their personal career and financial plans to take account of the changes in Social Security like the change in retirement incentives.

In addition, the Administration's program for economic recovery is designed to stimulate productivity and economic growth. In so doing, it will create new job opportunities for younger workers.

Question 15. What will be the impact of the reform package on private pension? One pension consultant has claimed that employers pension costs could increase by about 7 percent.

Answer. No one can say precisely what the impact will be. Each plan's sponsor will have to decide for itself what changes, if any, it would want to make in its plan to adjust for the adoption of the Adminstration's proposals. In the absence of formal changes in plan provisions most plans would not be affected by the Administration's proposal. This is true because most plans are not integrated with Social Security or are integrated in a way that would not be directly affected by the Administration's proposals.

Question 16. The Administration has been accused of "overkill" in the extent of its social security proposal. The package allegedly cuts much more than is considered necessary to protect the system's fiscal integrity. How do you respond to that charge?

Answer. The package is designed to solve the financial problems of the Social Security program and to allow for a reduction in the Social Security taxes workers and their employers pay.

The savings estimates for these proposals were made using the worst-case economic and actuarial assumptions. We do not believe it is wise to base Social Security financing plans on "best guess" future costs assumptions and face the possibility of having to come back in a few years, as has happened in 1977 and again this year, asking the Congress for further changes because economic conditions proved to be much more adverse than the assumptions anticipated.

If future experience turns out to be more favorable than our worst-case assumptions indicate, the trust fund reserves will begin to build up and we will be able to reduce the tax rates for employees and employers even further.

Question 17. Short-range status of funds.—Show the status of funds on a calendar year basis, 1981 through 1990, for OASI, DI, and HI separately, (1) under present law, and (2) assuming enactment of the social security budget proposals and financing proposals under both sets of economic assumptions.

Answer. The requested trust fund projections are shown in the attached tables for calendar years 1981–86. The economic assumptions on which the estimates are based were not projected beyond 1986.

Table 1.—Estimated operations of the OASI, DI and HI trust funds under present law, based on President Reagan's Revised 1982 Budget assumptions, calendar years 1980-86

(Amounts in billions)

Calendar year	Income: OASI	Income: DI	Income: OASDI	Income: HI	Income: Total	Outgo: OASI	Outgo: DI	Outgo: OASDI	Outgo: HI	Outgo: Total
1980	$105.8	$13.9	$119.7	$26.1	$145.8	$107.7	$15.9	$123.5	$25.6	$149.1
1981	122.7	17.0	139.7	35.3	175.0	126.7	17.9	144.6	29.5	174.1
1982	132.8	23.9	156.7	40.4	197.0	144.3	19.5	163.9	34.2	198.0
1983	145.8	27.4	173.1	45.2	218.3	160.2	20.9	181.1	39.4	220.5
1984	159.7	30.7	190.4	50.0	240.4	174.7	22.2	197.0	45.3	242.3
1985	180.3	38.8	219.1	56.5	275.6	188.8	23.6	212.5	51.8	264.3
1986	196.8	43.5	240.3	65.7	306.0	202.4	25.2	227.5	58.9	286.5

Calendar year	Net increase in funds: OASI	DI	OASDI	HI	Total	Funds at end of year: OASI	DI	OASDI	HI	Total	Assets at beginning of year as a percentage of outgo during year: OASI	DI	OASDI	HI	Total
1980	-$1.8	-$2.0	-$3.8	$0.5	-$3.3	$22.8	$3.6	$26.5	$13.7	$40.2	23%	35%	25%	52%	29%
1981	-4.0	-.9	-4.9	5.8	.8	18.8	2.7	21.5	19.5	41.0	18	20	18	47	23
1982	-11.5	4.3	-7.2	6.2	-1.0	7.3	7.1	14.3	25.7	40.0	13	14	13	57	21
1983	-14.4	6.5	-7.9	5.8	-2.2	-7.1	13.5	6.4	31.5	37.9	5	34	8	65	18
1984	-15.1	8.5	-6.6	4.7	-1.9	-22.2	22.0	-.2	36.1	35.9	-4	61	3	69	16
1985	-8.6	15.2	6.6	4.7	11.3	-30.8	37.2	6.4	40.8	47.3	-12	93	(1/)	70	14
1986	-5.6	18.4	12.8	6.8	19.5	-36.4	55.5	19.2	47.6	66.8	-15	148	3	69	16

1/ Between 0 and -0.5 percent.

Note: Estimates for 1982 and later are theoretical since the OASI trust fund would become depleted in the latter half of 1982 when assets become insufficient to pay benefits when due.

Social Security Administration
Office of the Actuary
March 12, 1981

Table 2.—Estimated operations of the OASI, DI, and HI Trust Funds under the program as modified by the President's Social Security proposals, based on the President's Revised 1982 Budget economic assumptions, calendar years 1980-86

(Amounts in billions)

Calendar year	Income: OASI	Income: DI	Income: OASDI	Income: HI	Income: Total	Outgo: OASI	Outgo: DI	Outgo: OASDI	Outgo: HI	Outgo: Total
1980	$105.8	$13.9	$119.7	$26.1	$145.8	$107.7	$15.9	$123.5	$25.6	$149.1
1981	122.7	17.0	139.7	35.3	175.0	126.1	17.8	143.9	29.3	173.2
1982	139.8	17.5	157.4	40.4	197.8	138.4	17.3	155.7	33.6	189.3
1983	157.3	17.8	175.1	45.3	220.4	153.4	16.9	170.3	38.8	209.1
1984	175.8	17.8	193.6	50.3	243.8	167.1	15.7	182.8	44.3	227.1
1985	201.8	18.2	219.9	56.9	276.9	179.2	14.9	194.1	50.3	244.4
1986	222.0	19.9	241.9	66.3	308.2	192.0	14.7	206.7	56.6	263.3

Calendar year	Net increase in funds: OASI	DI	OASDI	HI	Total	Funds at end of year: OASI	DI	OASDI	HI	Total	Assets at beginning of year as a percentage of outgo during year: OASI	DI	OASDI	HI	Total
1980	-$1.8	-$2.0	-$3.8	$0.5	-$3.3	$22.8	$3.6	$26.5	$13.7	$40.2	23%	35%	25%	52%	29%
1981	-3.4	-.9	-4.2	6.0	1.8	19.4	2.8	22.2	19.7	41.9	18	20	18	47	23
1982	1.4	.2	1.7	6.9	8.5	20.8	3.0	23.8	26.6	50.4	14	16	14	59	22
1983	3.9	.9	4.8	6.5	11.3	24.7	3.9	28.6	33.1	61.7	14	18	14	69	24
1984	8.7	2.1	10.8	5.9	16.7	33.4	6.0	39.4	39.0	78.4	15	25	16	75	27
1985	22.6	3.2	25.8	6.6	32.5	56.0	9.2	65.2	45.6	110.8	19	40	20	78	32
1986	30.0	5.2	35.2	9.7	44.9	86.0	14.5	100.5	55.3	155.8	29	63	32	81	42

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Table 3.--Estimated operations of the OASI, DI, and HI Trust Funds under present law, based on "worst case" economic assumptions, calendar years 1980-86

(Amounts in billions)

Calendar year	Income					Outgo				
	OASI	DI	OASDI	HI	Total	OASI	DI	OASDI	HI	Total
1980	$105.8	$13.9	$119.7	$26.1	$145.8	$107.7	$15.9	$123.5	$25.6	$149.1
1981	122.7	17.0	139.7	35.3	175.0	126.7	17.9	144.6	29.4	174.0
1982	132.7	23.9	156.7	40.3	196.9	147.7	20.0	167.7	34.4	202.2
1983	143.0	27.1	170.2	44.7	214.8	171.5	22.4	193.9	40.5	234.4
1984	159.7	31.3	191.0	50.8	241.8	196.4	24.8	221.2	47.9	269.1
1985	184.9	41.0	225.9	59.2	285.1	222.6	27.4	250.0	56.2	306.2
1986	205.1	47.3	252.3	70.6	322.9	249.0	30.1	279.1	65.4	344.5

Calendar year	Net increase in funds					Funds at end of year					Assets at beginning of year as a percentage of outgo during year				
	OASI	DI	OASDI	HI	Total	OASI	DI	OASDI	HI	Total	OASI	DI	OASDI	HI	Total
1980	-$1.8	-$2.0	-$3.8	$0.5	-$3.3	$22.8	$3.6	$26.5	$13.7	$40.2	23%	35%	25%	52%	29%
1981	-4.0	-.9	-4.9	5.8	1.0	18.8	2.7	21.6	19.6	41.2	18	20	18	47	23
1982	-15.0	3.9	-11.1	5.8	-5.2	3.9	6.6	10.5	25.4	35.9	13	14	13	57	20
1983	-28.5	4.8	-23.8	4.2	-19.6	-24.7	11.4	-13.3	29.6	16.3	2	30	5	63	15
1984	-36.8	6.5	-30.2	2.9	-27.3	-61.4	17.9	-43.5	32.5	-11.0	-13	46	-6	62	6
1985	-37.7	13.6	-24.1	3.1	-21.0	-99.2	31.6	-67.6	35.5	-32.0	-28	65	-17	58	-4
1986	-43.9	17.2	-26.8	5.2	-21.5	-143.1	48.8	-94.3	40.8	-53.6	-40	105	-24	54	-9

Note: Estimates for 1982 and later are theoretical because the OASI Trust Fund would become depleted in the latter half of 1982 when assets become insufficient to pay benefits when due.

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Table 4.—Estimated operations of the OASI, DI, and HI Trust Funds under the program as modified by the President's Social Security proposals, based on "worst case" economic assumptions, calendar years 1980-86

(Amounts in billions)

Calendar year	Income: OASI	Income: DI	Income: OASDI	Income: HI	Income: Total	Outgo: OASI	Outgo: DI	Outgo: OASDI	Outgo: HI	Outgo: Total
1980	$105.8	$13.9	$119.7	$26.1	$145.8	$107.7	$15.9	$123.5	$25.6	$149.1
1981	122.7	17.0	139.7	35.3	175.0	126.2	17.8	144.0	29.2	173.2
1982	140.1	17.5	157.6	40.4	198.0	140.1	17.4	157.5	33.8	191.3
1983	154.9	17.6	172.5	44.9	217.4	161.0	17.7	178.7	39.9	218.6
1984	177.2	18.1	195.3	51.1	246.4	183.7	17.3	201.0	46.9	247.9
1985	209.4	19.0	228.4	59.8	288.2	207.2	16.8	224.0	54.7	278.7
1986	235.2	21.5	256.7	71.4	328.1	232.1	16.6	248.7	63.0	311.7

Calendar year	Net increase in funds: OASI	DI	OASDI	HI	Total	Funds at end of year: OASI	DI	OASDI	HI	Total	Assets at beginning of year as a percentage of outgo during year: OASI	DI	OASDI	HI	Total
1980	-$1.8	-$2.0	-$3.8	$0.5	-$3.3	$22.8	$3.6	$26.5	$13.7	$40.2	23%	35%	25%	52%	29%
1981	-3.5	-.8	-4.3	6.1	1.8	19.4	2.8	22.2	19.8	42.0	18	20	18	47	23
1982	(1/)	.1	.1	6.6	6.7	19.4	2.9	22.3	26.4	48.7	14	16	14	59	22
1983	-6.1	-.1	-6.2	5.0	-1.2	13.2	2.8	16.0	31.4	47.4	12	16	12	66	22
1984	-6.5	.8	-5.7	4.2	-1.5	6.7	3.7	10.4	35.6	46.0	7	16	8	67	19
1985	2.2	2.3	4.4	5.1	9.5	8.8	5.9	14.7	40.7	55.4	3	22	5	65	17
1986	3.1	4.9	8.0	8.4	16.4	12.0	10.8	22.8	49.0	71.8	4	36	6	65	18

1/ Less than $50 million.

Note: Under the interfund borrowing provision in the President's proposals, loans from the HI and DI Trust Funds would be made to the OASI Trust Fund so that OASI benefits can be paid on a timely basis.

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Question 18. Long-range status of OASDI funds.—Prepare two tables like table 26 in the 1980 Trustees' Report on OASDI comparing OASI and DI estimated expenditures (expressed as a percentage of payroll) 1981-2005 annually and every 5 years thereafter through 2055 with the scheduled tax rates under present law: (1) under present law; and (2) assuming enactment of the social security budget proposals and financing proposals.

Answer. The following two tables compare estimated OASDI expenditures with present law scheduled tax rates. The first table includes projected expenditures assuming enactment of the Administration's proposals. The second table refers to present law expenditures as projected under the Alternative II assumptions of the 1980 Trustees Report.

ESTIMATED EXPENDITURES OF OASDI SYSTEM ASSUMING ENACTMENT OF ADMINISTRATION PROPOSALS AND COMPARISON WITH PRESENT LAW SCHEDULED TAX RATES, CALENDAR YEARS 1980-2055

[As percent of taxable payroll]

Calendar year	Estimated expenditures			Scheduled tax rate[1]	Difference
	OASI	DI	Total		
1980	9.48	1.39	10.87	10.16	−0.71
1981	9.90	1.38	11.28	10.70	−.58
1982	9.45	1.21	10.66	10.80	.14
1983	9.39	1.01	10.40	10.80	.40
1984	9.25	.89	10.14	10.80	.66
1985	9.13	.75	9.88	11.40	1.52
1986	8.95	.70	9.65	11.40	1.75
1987	8.74	.70	9.44	11.40	1.96
1988	8.55	.70	9.25	11.40	2.15
1989	8.37	.70	9.07	11.40	2.33
1990	8.17	.70	8.87	12.40	3.53
1991	8.08	.70	8.78	12.40	3.62
1992	7.99	.70	8.69	12.40	3.71
1993	7.90	.70	8.60	12.40	3.80
1994	7.84	.71	8.55	12.40	3.85
1995	7.78	.71	8.49	12.40	3.91
1996	7.67	.73	3.40	12.40	4.00
1997	7.57	.74	8.31	12.40	4.09
1998	7.48	.76	8.24	12.40	4.16
1999	7.41	.78	8.19	12.40	4.21
2000	7.34	.80	8.14	12.40	4.26
2001	7.27	.82	8.09	12.40	4.31
2002	7.19	.84	8.03	12.40	4.37
2003	7.16	.86	8.02	12.40	4.38
2004	7.14	.88	8.02	12.40	4.38
2005	7.14	.91	8.05	12.40	4.35
2010	7.60	1.00	8.60	12.40	3.80
2015	8.56	1.05	9.61	12.40	2.79
2020	9.84	1.07	10.91	12.40	1.49
2025	11.02	1.04	12.06	12.40	.34
2030	11.75	.99	12.74	12.40	−.34
2035	11.90	.97	12.87	12.40	−.47
2040	11.69	.99	12.68	12.40	−.28
2045	11.64	1.01	12.65	12.40	−.25
2050	11.71	1.01	12.72	12.40	−.32
2055	11.80	1.00	12.80	12.40	−.40
25-yr averages:					
1980 to 2004	8.22	0.79	9.02	11.85	2.85
2005 to 2029	9.21	1.02	10.23	12.40	2.17
2030 to 2054	11.75	1.00	12.76	12.40	−.36
75-yr average: 1980–2054	9.74	.94	10.68	12.22	1.54

[1] OASDI combined employer-employee tax rate.

Note: Estimates are based on Alternative II and taxable payroll are described in the text of this report.

ESTIMATED EXPENDITURES OF OASDI SYSTEM UNDER ALTERNATIVE II AND COMPARISON WITH SCHEDULED TAX RATES, CALENDAR YEARS 1980–2055

[As percent of taxable payroll]

Calendar year	Estimated expenditures			Scheduled tax rate [1]	Difference
	OASI	DI	Total		
1980	9.48	1.39	10.87	10.16	−0.71
1981	9.94	1.39	11.33	10.70	−.63
1982	9.97	1.35	11.32	10.80	−.52
1983	9.91	1.29	11.21	10.80	−.41
1984	9.86	1.26	11.11	10.80	−.31
1985	9.79	1.22	11.02	11.40	.38
1986	9.74	1.20	10.94	11.40	.46
1987	9.68	1.17	10.85	11.40	.55
1988	9.60	1.16	10.75	11.40	.65
1989	9.48	1.14	10.63	11.40	.77
1990	9.39	1.13	10.52	12.40	1.88
1991	9.38	1.13	10.51	12.40	1.89
1992	9.37	1.13	10.50	12.40	1.90
1993	9.36	1.13	10.49	12.40	1.91
1994	9.35	1.14	10.49	12.40	1.91
1995	9.35	1.14	10.49	12.40	1.91
1996	9.28	1.17	10.45	12.40	1.95
1997	9.22	1.20	10.41	12.40	1.99
1998	9.16	1.23	10.39	12.40	2.01
1999	9.12	1.26	10.38	12.40	2.02
2000	9.08	1.29	10.37	12.40	2.03
2001	9.03	1.33	10.36	12.40	2.04
2002	8.98	1.36	10.34	12.40	2.06
2003	8.96	1.39	10.36	12.40	2.04
2004	8.99	1.43	10.42	12.40	1.98
2005	9.02	1.46	10.48	12.40	1.92
2010	9.75	1.62	11.36	12.40	1.04
2015	11.09	1.70	12.79	12.40	−.39
2020	12.82	1.73	14.55	12.40	−2.15
2025	14.40	1.68	16.08	12.40	−3.68
2030	15.37	1.60	16.98	12.40	−4.58
2035	15.59	1.57	17.16	12.40	−4.76
2040	15.31	1.59	16.90	12.40	−4.50
2045	15.23	1.63	16.86	12.40	−4.46
2050	15.33	1.63	16.96	12.40	−4.56
2055	15.45	1.61	17.07	12.40	−4.67
25-yr averages:					
1980 to 2004	9.42	1.24	10.66	11.85	1.19
2005 to 2029	11.92	1.65	13.57	12.40	−1.17
2030 to 2054	15.37	1.61	16.98	12.40	−4.58
75-yr average: 1980 to 2054	12.24	1.50	13.74	12.22	−1.52

[1] OASDI combined employer-employee tax rate.

Note: Alternative II and taxable payroll are described in the text of this report.

Question 19. Long-range status of HI fund. Prepare two tables like table 8 in the 1980 Trustees' Report on HI comparing HI estimated expenditures (expressed as a percentage of payroll) 1981–2000 with the scheduled tax rates under present law: (1) under present law; and (2) assuming enactment of the social security budget proposals and financing proposals.

Answer. The attached table contains estimates of the annual costs of the Hospital Insurance program under present law and under the program as modified by the 1982 Budget proposals and the Social Security financing proposals.

ESTIMATED YEAR-BY-YEAR COST OF THE HOSPITAL INCURANCE PROGRAM, 1981-2000 [1]

	Scheduled tax rates (percent)	Present law expenditures (as a percent of taxable payroll)	Proposed law expenditures [2] (as a percent of taxable payroll)
Calendar year:			
1981	2.6	2.25	2.24
1982	2.6	2.34	2.31
1983	2.6	2.44	2.40
1984	2.6	2.52	2.47
1985	2.7	2.62	2.56
1986	2.9	2.76	2.67
1987	2.9	2.90	2.81
1988	2.9	3.06	2.95
1989	2.9	3.20	3.08
1990	2.9	3.36	3.23
1991	2.9	3.52	3.37
1992	2.9	3.68	3.53
1993	2.9	3.85	3.68
1994	2.9	4.00	3.81
1995	2.9	4.14	3.95
1996	2.9	4.29	4.09
1997	2.9	4.44	4.22
1998	2.9	4.58	4.35
1999	2.9	4.72	4.47
2000	2.9	4.86	4.60

[1] Expenditures are based on OMB mid-session review assumptions blended into the intermediate assumptions of the 1980 Trustees Report, modified to include the effects of Pub. L. 96-499.

[2] As per [1]. Also includes recommendations of the work group and effects of recommended legislation in the Reagan budget with the exception of the pro competition initiative.

Note: Neither column includes an allowance for trust fund building and maintenance.

Question 20. Fiscal year savings.—Prepare a table showing the financial effect of the budget proposals and the individual other proposals for fiscal years 1982 through 1986; show the total for the five years as well as the total effect (taking into account interaction) for each year separately.

Answer. See answer to question 11.

Question 21. Number of people affected.—Prepare a table showing the number of people affected by each of the proposals (1) in 1982; and (2) in the year that the proposal has fully phased in.

Answer. The attached table contains estimates of the number of persons affected by each proposal in 1982 and in 1986. Most of the proposals will be fully phased in by 1986.

ESTIMATED NUMBER OF INDIVIDUALS AFFECTED BY THE PRESIDENT'S SOCIAL SECURITY FINANCING PROPOSALS, CALENDAR YEARS 1982 AND 1986

Proposal	Calendar year— 1982	1986
1. Cover sick pay in first 6 months	10,000,000	10,000,000
2. Change computation point for AIME from age 62 to 65	600,000	2,000,000
3. Increase PIA formula bendpoint by 50 percent (instead of 100 percent of wage increases in 1982-87	1,100,000	3,200,000
4. Pay benefit rate of 55 percent of PIA for retired workers (and 27½ percent for spouses) at age 62	700,000	1,300,000
5. Eliminate benefits for children of retired workers aged 62-64	40,000	110,000
6. Apply DI family maximum to OASI cases	250,000	450,000
7. Eliminate windfall portion of benefits for persons with pensions from noncovered employment	20,000	30,000
8. Require medical only determination of disability (that is, exclude vocational factors)	80,000	100,000
9. Increase DI waiting period from 5 months to 6 months	500,000	650,000
10. Require disability prognosis of 24 plus months (instead of 12 months)	40,000	50,000
11. Require 30 quarters of coverage out of last 40 quarters for disability benefits (instead of 20/40)	85,000	110,000

ESTIMATED NUMBER OF INDIVIDUALS AFFECTED BY THE PRESIDENT'S SOCIAL SECURITY FINANCING PROPOSALS, CALENDAR YEARS 1982 AND 1986—Continued

Proposal	Calendar year— 1982	1986
12. Move date for automatic benefit increase from June to September (and use 12-month average)	36,000,000	38,000,000
13. Raise retirement test exempt amount for age 65 plus to $10,000 in 1983, $15,000 in 1984, $20,000 in 1985, and eliminate test in 1986		800,000

Notes.—1. The figures shown above are not additive. 2. The estimates take account of interaction with the President's Budget proposals. Items 8-11 take account of interaction among themselves, as well as with the President's Budget proposals. 3. Figures for calendar year 1986 include only individuals first entitled in 1986 except for items 1, 12, and 13.

Question 22. Impact on other programs.—Show separately the budgetary impact in each of the fiscal years 1982 through 1986 of the Social Security budget and financing proposals on: (1) SSI; (2) AFDC; (3) Medicaid; (4) Medicare; and (5) Food Stamps.

Answer. The effect of the budget and financing proposals on the five programs of interest is detailed below:

I. *Budget Proposals.*—Two of the Social Security budget proposals will have a budgetary impact on the SSI program.

[In millions of dollars]

	Fiscal year— 1982	1983	1984	1985	1986
Eliminate minimum benefit (effective date July 1981)	+300	+300	+400	+400	+400
Currently insured status (effective date July 1981)	+7	+15	+33	+40	+50

No estimates have been made of the impact of the Social Security budget proposals on the other four programs.

II. *Financing Proposals.*—These estimates reflect the impact of the Social Security financing proposals as they were drafted on June 16. If some of the detailed specifications of these proposals are altered in the final stages of the drafting process, their budgetary impact on other programs may change also. The estimates are based on an effective date of January 1982.

SSI.—The financing proposals are estimated to have the following effect on SSI expenditures:

Fiscal year:	*Millions*
1982	−$106
1983	+56
1984	+168
1985	+282
1986	+387

The impact on SSI expenditures reflects the effects of the following proposals adjusted for interaction effects.

(1) AIME computation to age 65.
(2) Reduce early retirement benefits.
(3) 24-month prognosis for DI.
(4) Medical only determination for DI.
(5) DI 6-month waiting period.
(6) 30/40 DI insured status.
(7) Increase bend points by 50 percent of wage increase.
(8) Move COLA to September.

AFDC.—The financing proposals are estimated to have the following effect on AFDC expenditures:

Fiscal year:	*Millions*
1982	+$18
1983	+47
1984	+56
1985	+63
1986	+69

The impact on AFDC expenditures reflects the effects of the following proposals adjusted for interaction effects.

(1) 24-month prognosis for FI.
(2) Medical only determination for DI.
(3) 30/40 DI insured status.

Medicaid.—The financing proposals are estimated to have the following effect on Medicaid expenditures:

Fiscal year:	*Millions*
1982	+$4
1983	+9
1984	+18
1985	+29
1986	+43

The impact of Medicaid expenditures reflects the effects of the following proposals adjusted for interaction effects.

(1) AIME computation to age 65.
(2) Reduce early retirement benefits.
(3) 24-month prognosis for FI.
(4) Medical only determination for DI.
(5) DI 6-month waiting period.
(6) 30/40 DI insured status.
(7) Increase bend points by 50 percent of wage increase.

Medicare.—The financing proposals are estimated to have the following effect on Medicare expenditures:

Fiscal year:	*Millions*
1982	0
1983	0
1984	$80
1985	280
1986	550

The impact on Medicare expenditures reflects the effects of the following proposals adjusted for interaction effects.

(1) 24-month prognosis for DI.
(1) Medical only determination for DI.
(1) DI 6-month waiting period.
(1) 30/40 DI insured status.
(1) Eliminate child's benefits for early retirees.

In addition to these effects, HI Trust Fund income will be increased by an estimated $100 million annually as a result of changes in the treatment of sick pay.

Food Stamps.—The financing proposals are estimated to have the following effect on Food Stamp expenditures:

Fiscal year:	*Millions*
1982	+$2
1983	+2
1984	+2
1985	+2
1986	+2

The impact of Food Stamp expenditures reflects small effects of several proposals adjusted for interaction effects.

Question 23. Interfund transfer.—Assuming enactment of the budget and financing proposals, show separately for each year 1981 through 1995 the estimated transfers in and out of each trust fund if there were authority for interfund transfers (1) in dollars, and (2) as a percentage of taxable payroll.

Answer. On the basis of the economic assumptions underlying the President's 1982 budget, interfund loans would not be required if all of the Administration's budget and financing proposals were enacted. On the basis of the "worst-case" assumptions, interfund loans would be required by the OASI Trust Fund in calendar years 1984–86. The requested estimates, based on the "worst-case" assumptions, are shown on the attached table. The "worst-case" economic assumptions were not projected beyond 1986; however, all the loans made to the OASI Trust Fund in 1984–86 would be repaid by June 1986.

AMOUNTS OF INTERFUND TRANSFERS AMONG THE OASI, DI, AND HI TRUST FUNDS UNDER THE INTERFUND BORROWING PROVISIONS IN THE ADMINISTRATION'S SOCIAL SECURITY PROPOSALS ON THE BASIS OF THE WORST-CASE ASSUMPTIONS

[Dollar amounts in billions]

Calendar year	OASI		DI		HI	
	Amount borrowed	Amount repaid	Amount loaned to OASI	Amount repaid by OASI	Amount loaned to OASI	Amount repaid by OASI
1984	$6.9	$1.9	$3.8	$1.5	$3.1	$0.4
1985	6.5	8.9	3.2	2.6	3.3	6.3
1986	2.6	6.1	1.9	5.3	.7	.8
Total	16.0	16.8	8.9	9.4	7.1	7.4
AMOUNTS AS PERCENT OF OASDI TAXABLE PAYROLL						
1984	0.4	0.1	0.2	0.1	0.2	(1)
1985	.3	.4	.2	.1	.2	.3
1986	.1	.3	.1	.2	(1)	(1)

[1] Less than 0.5 percent.

Note: The above estimates assume that (1) loans are made at the beginning of any month as necessary to make benefit payments when due, (2) payment of interest on outstanding debt is made semiannually at the end of June and the end of December, and (3) potential repayments of principal from the OASI Trust Fund are made at the end of June based on any excess of assets in the OASI Trust Fund at the end of June over benefit payments due for payment from the fund at the beginning of July. All loans, including interest, are repaid by the end of June 1986.

Question 24. Increased trust fund revenues.—The various financing proposals would provide a strong incentive for persons to continue working between ages 62 and 64; elimination of the retirement test also can be expected to lead to some persons continuing to work after reaching age 65 who would otherwise have retired. What are the short-run and long-run estimates of increased trust fund revenues which would come about from enactment of the budget and financing proposals?

Answer. Increases in work activity for significant numbers of aged persons have been assumed for the President's proposal that would phase out the earnings test for persons age 65 and older and for the proposal that would reduce the benefit rate from 80 percent to 55 percent of PIA at age 62. The improvement in the long-range actuarial balance of the OASDI program due to increased revenues from additional work (net of the partly offsetting cost of higher average that would come as a result of the additional work) has been estimated to be 0.01 percent of taxable payroll for phasing out the earnings test and 0.02 percent of taxable payroll for reducing the benefit rate at age 62.

Question 25. Implications of age 65 computation point without adjustment of age 60 indexing point.—The Administration proposal would raise the computation point to age 65 on the theoretical justification that workers should be required to use their earnings in the years between age 62 and 65 (and will, perhaps, use zero years if they do not remain in the work force past age 61.) The premise behind this change would seem to be that those individuals who do work past age 61 will generally have a higher benefit amount because of those earnings. However, the validity of this premise is open to some question. The 1977 Amendments adopted a benefit computation system which counts earnings at an inflated (indexed) value rather than at face value. For essentially administrative reasons, however, that legislation provides that earnings will be indexed only to age 60 (and earnings after age 59 will not be indexed at all). This tends to discount the relative value of earnings after age 59 and increase the likelihood that individuals "required" by the age 65 computation point to continue working to age 65 will not have their post-62 earnings used in their benefit computation. (This will be the case if the absolute value of their post-62 earnings is less than the indexed value of three years which under present law would be dropped out as low years.)

A contrary argument can be raised on the basis of the general observation that in individual's wages tend to rise from year to year so that the people affected may well have absolute wages in the years 62 to 65 which are higher than their indexed wages from earlier years. That general observation, however, may not be valid. The Consultant Panel on Social Security in its 1976 report for the Finance Committee found wage patterns to be somewhat more erratic than was commonly believed. Most pertinently, the Panel found: "After age 55 the growth rate seems to fall below the general average." (p. 52)

It would be possible to remove some of this concern by modifying the treatment of earnings in the years 62 to 65 to give them comparable treatment to earnings prior to age 60. For example, all retired workers could be given a single recomputation at age 67 in which the absolute value of wages earned in the year of attainment of age 62, 63, and 64, would be inflated by the wage growth in the economy between that year and age 65. (The value of earnings in prior years would not be modified; that is, for years prior to age 59 values remain indexed to age 60, and age 60-61 earnings would be unindexed.) Since this kind of a change would increase benefits payable to the affected workers, there would be a cost which would have to be absorbed by the system.

What would be the cost of implementing the above modification? If the percentage factors in the benefit formula were modified so as to exactly offset that cost, what would be the revised benefit formula?

Answer. Under current law a retired worker's earnings for years before age 60 are indexed (inflated) to the year the worker attains age 60. The fact that earnings for years after 60 are not indexed (deflated) to the year of age 60 increases both the likelihood that such earnings will be used in computing the PIA and the value of such earnings if used.

If earnings for years of age 62, 63, and 64 were indexed (inflated) to the year of age 65, both the likelihood and value of using such earnings in computing the PIA would increase further under either current law or the Administration proposal. This would of course increase the incentive to work at these ages.

The specific proposal outlined in this question would result in indexing earnings for years of age 62, 63, and 64 to the year of age 65 for the purpose of benefit recomputations at age 67 (while continuing to index earnings before age 60 to the year of age 60 and to provide no indexing for earnings in years of age 60, 61 and after age 64). The long-range OASDI cost of this proposal is estimated to be 0.02 percent of taxable payroll under either current law or the Administration proposal. This estimate is based on the Alternative II assumptions of the 1980 Trustees Report.

A reduction of the percentage factors in the PIA formula of about 0.16 percent for persons eligible in 1982 and later would reduce OASDI long-range cost by about 0.02 percent and taxable payroll, the amount necessary to roughly offset the cost of the modification described above. This would result in PIA factors of 89.86 percent, 31.95 percent, and 14.98 percent instead of the current law factors, 90 percent, 32 percent, and 15 percent respectively.

Question 26. Impact of changing definition for disability insurance but not for SSI.—The Administration proposal would make 2 very significant changes in the disability definition for DI but not for SSI. This would obviously lead to some shifting of costs saved in DI into SSI as individuals newly excluded from DI qualified for SSI. Beyond this obvious result, however, there is some reason for concern that the movement to a 2-definition system would in practice lead to broadened SSI eligibility increasing the cost of that program with spill-over implications on the Title II disability program.

In explaining the reasons for the precipitous growth of the disability program in the 1960's and 1970's, a 1977 study by the Social Security actuaries cited as one cause: "the difficulty of maintaining a proper balance between sympathy for the claimant and respect for the trust funds in a large public system." The Administration proposal would remove whatever restraining influence the element of "respect for the trust funds" may have in the application of the present disability definition. At the same time the proposal would limit the population affected by it to those categories of individuals who are most likely (because they are neediest) to elicit the sympathy of those who apply that definition. In addition, it is not unreasonable to project developments such as administrative specialization in which the better (more careful) adjudicators would tend to gravitate to the more prestigious DI program.

Please provide an analysis by the social security actuaries of the above considerations including an analysis of any spill-over impact on Title II. (In consideration of the 1979 and 1980 disability legislation, the Social Security Administration actuaries projected a significant spill-over on DI of a change in the law which ostensibly affected only the SSI program. Although the situation was not identical, the same type of consideration would seem to hold. That is, to the extent there is any loosening of the SSI program, some disabled people who are managing to continue working will be encouraged to test the system. In doing so, it will be discovered that they in fact meet the social security disability definition on the basis of medical factors alone. Once that is established, they will then stop working and rely on the DI program. In addition to this type of factor, there may be grounds for considering the extent to which adjudicators and particularly judicial adjudicators will be willing to accept the conclusion that a single individual can be disabled under one title of the Social Security Act and not disabled under a different title).

Answer. The President's proposals would change the DI definition of disability by requiring a 24 month prognosis (instead of the current 12 month prognosis) and by considering only medical factors (not including the vocational factors in current law). The estimated savings for the DI trust fund due to these provisions would be slightly greater if the provisions also applied to SSI. This "spill-over" impact from the SSI program is assumed to occur because of the requirement for an SSI applicant to file concurrently for any possible OASDI benefit, not because of any expectation of lax administration.

Any proposal which results in a less restrictive definition of disability for SSI (than for DI) will, because of the requirement for concurrent filing by an SSI applicant, cause some persons to apply for DI benefits who would not otherwise apply. Some of these additional applicants will be awarded DI benefits thus producing a "spill-over" impact on DI.

This "spill-over" is assumed to be weaker than that assumed about two years ago regarding a proposal that would liberalize the SGA for SSI without modifying the SGA for DI. The stronger "spill-over" effect assumed then reflected the fact that the situation would have been more under the control of the recipient than would be the case under the President's proposal to make the DI definition stricter.

Question 27. Long-range tax schedules.—The Administration proposal assumes that tax-rates will be reduced in a manner which will keep trust fund balances from rising much above 50 percent of one-year's benefits. (1) If that were assumed without the countervailing assumption of any increases in tax rates not scheduled in present law, what would be the long-range actuarial balance of the program under the proposal? (2) If that were assumed and tax rates were also assumed to rise as necessary to maintain that 50 percent balance throughout the 75-year valuation period, what would be the tax rates applicable in each year of that period? (Please provide the answers to these two questions under the 3 sets of assumptions in the most recent trustees' report).

Answer: (1) The long-range OASDI actuarial balance under the Administration's proposal, with automatic adjustment of the tax rate (both downward and upward), but never going above the rate scheduled in present law is estimated to be a deficit of 0.03 percent of taxable payroll. The OASDI Trust Fund balance becomes negative in 2042 under this basis.

(2) Attached is a schedule of tax rates, and corresponding beginning of the year OASDI Trust Fund ratios, for 1980-2054. These estimates assume enactment of the Administration's proposal (including automatic adjustment both downward and upward in the tax rate), and also that tax rates are allowed to exceed those scheduled in present law.

NOTE.—These estimates are based on the intermediate set of assumptions from the 1980 OASDI Trustees Report. No calculations have been done for the Administration's proposal on the basis of the optimistic or pessimistic assumptions from that report.

Question 28. Replacement rate tables.—Provide a table showing at 10 year intervals from 1980 through 2050 projections of the following items for workers retiring at age 62 and at age 65 at low earnings levels, average earnings levels, and high earnings levels: Replacement rate and annual benefit amount in constant (1980) dollars. Provide this information for present law and for the Administration proposal. Also, for the same years, provide a projection of OASDI expenditures as a percentage of GNP under present law and the proposal.

OASDI EMPLOYEE-EMPLOYER COMBINED TAX RATES AND BEGINNING OF THE YEAR TRUST FUND RATION [1] AS DERIVED BY APPLICATION OF THE AUTOMATIC TAX RATE CHANGE PROPOSAL

[In percent]

	OASDI	
	Combined tax rate	Trust fund ratio
Year:		
1980	10.16	22
1981	10.70	19
1982	10.80	15
1983	10.80	16
1984	10.80	19
1985	11.20	25

OASDI EMPLOYEE-EMPLOYER COMBINED TAX RATES AND BEGINNING OF THE YEAR TRUST FUND RATION [1] AS DERIVED BY APPLICATION OF THE AUTOMATIC TAX RATE CHANGE PROPOSAL—Continued

[In percent]

	OASDI	
	Combined tax rate	Trust fund ratio
Year		
1986	11.20	37
1987	11.20	53
1988	10.80	72
1989	10.40	89
1990	10.00	105
1991	9.60	118
1992	9.20	128
1993	8.80	134
1994	8.40	137
1995	8.00	136
1996	7.60	131
1997	7.60	122
1998	7.60	114
1999	7.60	107
2000	7.60	100
2001	7.60	94
2002	7.60	87
2003	7.60	82
2004	7.60	76
2005	7.60	[1] 70
2006	7.60	63
2007	7.60	55
2008	8.00	45
2009	8.40	39
2010	8.80	37
2011	9.20	38
2012	9.60	41
2013	10.00	45
2014	10.00	52
2015	9.60	56
2016	9.60	54
2017	10.00	49
2018	10.40	46
2019	10.80	44
2020	11.20	44
2021	11.60	45
2022	12.00	48
2023	12.00	52
2024	12.00	54
2025	12.00	54
2026	12.00	52
2027	12.40	49
2028	12.80	49
2029	12.80	50
2030	[1] 12.80	[1] 51
2031	12.80	50
2032	13.20	50
2033	13.20	52
2034	13.20	55
2035	12.80	57
2036	12.40	56
2037	12.40	52
2038	12.80	49
2039	13.20	48
2040	13.20	52
2041	12.80	55
2042	12.40	56
2043	12.40	54

OASDI EMPLOYEE-EMPLOYER COMBINED TAX RATES AND BEGINNING OF THE YEAR TRUST FUND RATION [1] AS DERIVED BY APPLICATION OF THE AUTOMATIC TAX RATE CHANGE PROPOSAL—Continued

[In percent]

	OASDI	
	Combined tax rate	Trust fund ratio
Year:		
2044	12.40	51
2045	12.80	48
2046	13.20	49
2047	13.20	52
2048	12.80	56
2049	12.40	56
2050	12.40	54
2051	12.80	46
2052	13.20	45
2053	13.60	48
2054	13.60	54

[1] Defined as the beginning of the year trust fund balance divided by the previous year's outgo.

Answer. The six tables which follow show replacement rates and benefit amounts in 1980 dollars for steady workers retiring in 1980 through 2050 (in 10-year intervals). Tables 1 and 2 show values for workers retiring at age 65. Tables 3 and 4 show values, after reduction for age, for workers retiring at age 62. Tables 5 and 6 show values before reduction for age for workers retiring at age 62. Tables 1, 3, and 5 are for projected benefits assuming enactment of the Administration's proposals. Tables 2, 4, and 6 are based on present law.

Projection of OASDI expenditures as a percentage of GNP under present law and under the Administration's proposals are as follows:

[In percent]

	Present law	Administration's proposals
Calendar year:		
1980	4.79	4.79
1990	4.55	3.84
2000	4.35	3.41
2010	4.59	3.47
2020	5.66	4.24
2030	6.36	4.77
2040	6.09	4.57
2050	5.89	4.42

Note: Estimates of both OASDI expenditures and GNP are based on the alternative II assumptions of the 1980 trustees report.

TABLE 1.—REPLACEMENT RATES FOR STEADY WORKERS AGE 65 AT RETIREMENT ASSUMING ENACTMENT OF THE "SOCIAL SECURITY REFORM AMENDMENTS" IN 1981 [1]

Year	Annual benefit amount in 1980 dollars			Replacement rate		
	Low	Average	Maximum	Low	Average	Maximum
1980	[2] 3,859	[2] 5,862	[2] 7,437	[2] 64.0	[2] 51.1	[2] 32.5
1990	3,289	5,133	6,281	48.2	38.0	21.2
2000	3,988	6,267	8,170	48.0	38.2	21.8
2010	4,719	7,533	10,571	47.7	38.5	23.3
2020	5,531	8,902	12,988	47.3	38.5	24.2
2030	6,523	10,518	15,488	47.2	38.5	24.4
2040	7,708	12,428	18,376	47.2	38.5	24.5
2050	9,107	14,684	21,716	47.2	38.5	24.5

[1] Based on the alternative II assumptions of the 1980 trustees report. Workers are assumed to have been born in January.
[2] "Old law" PIA tables apply.

TABLE 2.—REPLACEMENT RATES FOR STEADY WORKERS AGE 65 AT RETIREMENT UNDER PRESENT LAW [1]

Year	Anual benefit amount in 1980 dollars			Replacement rate		
	Low	Average	Maximum	Low	Average	Maximum
1980	[2] 3,859	[2] 5,862	[2] 7,437	[2] 64.0	[2] 51.1	[2] 32.5
1990	3,735	5,632	7,513	54.7	41.7	25.3
2000	4,506	6,820	9,666	54.2	41.5	25.7
2010	5,325	8,176	12,357	53.8	41.8	27.1
2020	6,243	9,660	14,963	53.4	41.8	27.8
2030	7,364	11,414	17,809	53.3	41.8	28.0
2040	8,702	13,486	21,032	53.3	41.8	28.1
2050	10,281	15,935	24,925	53.3	41.8	28.1

[1] Based on the alternative II assumptions of the 1980 trustees report. Workers are assumed to have been born in January.
[2] "Old law" PIA tables apply.

TABLE 3.—REPLACEMMENT RATES FOR STEADY WORKERS AGE 62 AT RETIREMENT ASSUMING ENACTMENT OF THE "SOCIAL SECURITY REFORM AMENDMENTS" IN 1981 [1]

Year	Annual benefit amount after reduction in 1980 dollars [2]			Replacement rate [2]		
	Low	Average	Maximum	Low	Average	Maximum
1980	2,758	[3] 4,112	[3] 5,236	45.8	[3] 35.8	[3] 22.9
1990	1,862	2,925	3,529	27.3	21.7	11.9
2000	2,281	3,603	4,697	27.5	21.9	12.5
2010	2,690	4,311	6,058	27.2	22.1	13.3
2020	3,167	5,095	7,448	27.1	22.1	13.8
2030	3,738	6,020	8,883	27.1	22.1	13.9
2040	4,417	7,112	10,539	27.1	22.1	14.1
2050	5,218	8,404	12,454	27.1	22.1	14.1

[1] Based on the alternative II assumptions of the 1980 trustees report Workers are assumed to have been born in January
[2] Includes reduction due to early retirement.
[3] December 1978 PIA table applies

TABLE 4.—REPLACEMENT RATES FOR STEADY WORKERS AGE 62 AT RETIREMENT UNDER PRESENT LAW [1]

Year	Annual benefit amount after reduction in 1980 dollars [2]			Replacement rate [2]		
	Low	Average	Maximum	Low	Average	Maximum
1980	2,758	[3] 4,112	[3] 5,236	45.8	[3] 35.8	[3] 22.9
1990	3,081	4,639	6,150	45.1	34.4	20.7
2000	3,749	5,689	8,091	45.1	34.6	21.5
2010	4,418	6,799	10,310	44.6	34.7	22.6
2020	5,201	8,034	12,486	44.5	34.7	23.2
2030	6,140	9,494	14,863	44.4	34.7	23.4
2040	7,255	11,218	17,602	44.4	34.7	23.4
2050	8,572	13,254	20,800	44.4	34.7	23.4

[1] Based on the alternative II assumptions of the 1980 trustees report Workers are assumed to have been born in January
[2] Includes reduction to 80 percent of PIA due to early retirement
[3] December 1978 PIA table applies

TABLE 5.—REPLACEMENT RATES FOR STEADY WORKERS AGE 62 AT RETIREMENT ASSUMING ENACTMENT OF THE "SOCIAL SECURITY REFORM AMENDMENTS" IN 1981 [1]

Year	Annual benefit amount before reduction in 1980 dollars [2]			Replacement rate [2]		
	Low	Average	Maximum	Low	Average	Maximum
1980	3,448	[3] 5,140	[3] 6,545	57.2	[3] 44.8	[3] 28.6
1990	3,385	5,317	6,416	49.6	39.4	21.7
2000	4,147	6,551	8,540	49.9	39.9	22.7
2010	4,891	7,839	11,015	49.4	40.1	24.2
2020	5,758	9,263	13,541	49.2	40.1	25.2
2030	6,797	10,945	16,151	49.2	40.1	25.3
2040	8,030	12,931	19,162	49.2	40.1	25.5
2050	9,488	15,280	22,644	49.2	40.1	25.5

[1] Based on the alternative II assumptions of the 1980 trustees report. Workers are assumed to have been born in January.
[2] Includes reduction to 80 percent of PIA due to early retirement.
[3] December 1978 PIA table applies.

TABLE 6.—REPLACEMENT RATES FOR STEADY WORKERS AGE 62 AT RETIREMENT UNDER PRESENT LAW [1]

Year	Annual benefit amount before reduction in 1980 dollars			Replacement rate		
	Low	Average	Maximum	Low	Average	Maximum
1980	3,448	[3] 5,140	[3] 6,545	57.2	[3] 44.8	[3] 28.6
1990	3,851	5,799	7,688	56.4	43.0	25.9
2000	4,686	7,111	10,114	56.4	43.2	26.9
2010	5,523	8,499	12,887	55.8	43.4	28.3
2020	6,501	10,042	15,608	55.6	43.4	29.0
2030	7,675	11,867	18,579	55.5	43.4	29.2
2040	9,069	14,022	22,003	55.5	43.4	29.3
2050	10,715	16,568	26,000	55.5	43.4	29.3

[1] Based on the alternative II assumptions of the 1980 trustees report. Workers are assumed to have been born in January.
[2] The 20 percent actuarial reduction is not included and thus "benefit amount" here is equal to the PIA.
[3] December 1978 PIA table applies.

SOCIAL SECURITY FINANCING AND OPTIONS FOR THE FUTURE

THURSDAY, JULY 9, 1981

U.S. SENATE,
SUBCOMMITTEE ON SOCIAL SECURITY,
AND INCOME MAINTENANCE PROGRAMS,
COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2 p.m., room 2221, Dirksen Senate Office Building, Hon. William L. Armstrong (chairman) presiding.

Present: Senators Armstrong, Dole, Danforth, Durenberger, Symms, Long, Moynihan, Boren, and Bradley.

Senator ARMSTRONG [chairman, presiding]. The committee will come to order.

I apologize to our colleague, Senator Chiles and the others who we have kept waiting. I have already explained to him and explained to the staff and the other witnesses who are waiting, that along with other members of the committee, I was unavoidably detained.

We are sorry for being unintentionally discourteous.

We are extremely glad to welcome this afternoon, the senior Senator from Florida, our colleague and friend, Lawton Chiles.

I do not yet know the direction of his testimony, but from my prior conversations with him about the social security issues, I know he has given this matter a great deal of study, over a long period of time, and has shown great statesmanship and leadership on this issue.

So, Senator Chiles, we welcome you. We thank you for coming. I again apologize for the delay.

Senator Chiles.

STATEMENT OF HON. LAWTON CHILES, A U.S. SENATOR, FROM THE STATE OF FLORIDA

Senator CHILES. Thank you, Mr. Chairman.

I want to congratulate you for the fact that you are holding these hearings. I think they are certainly timely. This committee has a unique opportunity, and a responsibility, to restore public confidence in our social security system.

I applaud your efforts to fully evaluate the problems before us. I know your choices are not easy ones. I am delighted to know that you know that these choices must be made and that they need to be made now on a timely basis.

I have a more lengthy statement that I would like to include in the record, if I might.

Senator ARMSTRONG. Please do.

[Senator Chiles' statement follows:]

Testimony of Senator Lawton Chiles

Before the Senate Finance Committee

At Hearings on

Social Security Financing and Options for the Future

Thursday, 2:00 p.m.	2221 Dirksen S.O.B.
July 9, 1981	Washington, D.C.

I appreciate the opportunity to testify today.

This Congress, and this Committee, have a unique opportunity -- and a responsibility -- to restore public confidence in the Social Security system.

My own Committee memberships in the Senate have provided me with valuable insight into the problems of the Social Security system as well as possible solutions. As a member of both the Budget and Appropriations Committees, I am keenly aware of the need to reduce Federal spending and cut the high inflation that plagues all Americans. As former chairman of the Special Committee on Aging, and now ranking minority member, I hear daily from elderly persons who must struggle to live on a fixed retirement income.

I applaud this Committee's efforts to thoroughly evaluate the problems before us. I know the choices you face are not easy ones. I believe, however, that Congress must make some of these choices now.

With this in mind, I introduced the Social Security Reform Act of 1981 (S. 484) in February. My bill is comprehensive, with a combination of measures to address social security's short-term cash-flow crisis and the serious long-term deficit facing the system.

Before introducing my bill, I took four days of testimony before the Committee on Aging on "Social Security: What Changes Are Necessary?" Witnesses included national experts on social security and representatives from several of the major organizations of older Americans. This year, under the leadership of Senator Heinz, the Aging Committee has conducted three additional days of hearings.

I came to the conclusion that major changes in social security would be necessary to keep the system solvent and to keep the promise which has been made to all workers.

I also concluded that, in the interest of fairness to all, Congress should act now to keep the system solvent over the long term.

Younger workers and retirees both want to see the system restored to soundness. Both are willing to sacrifice, if necessary. But we must be careful to balance the interests of both so the generations are not set against each other in conflict.

I saw three choices:

- o To cut current benefits;
- o To raise Social Security taxes again; or
- o To raise the age of eligibility for retirement.

After weighing these options, I decided that a gradual phase-in of a rise in the eligibility age was the least unfair -- and the most positive -- choice for the long term.

Such a change will adequately prepare for the next century when the post-World War II baby boom retires, and will avoid the need for benefit cuts or more increases in the payroll tax.

As proposed in my bill, the new age would begin to phase in starting on January 1, 2000. Eligibility then would be age 65 plus one month, and the age would increase by one month for each four months until age 68 is reached in the year 2012. The age for reduced benefits would increase in a similar manner from 62 to 65.

Age 65 for Medicare would not be changed, and there would be no changes to the disability program. No current retiree would be affected at all. No current worker having reached his 45th birthday by the end of 1979 would be affected at all.

Both the President's Commission on Pension Policy and the National Commission on Social Security have made a similar recommendation.

This choice is the least unfair because it wouldn't phase in until the next century, thereby giving younger workers ample time to prepare for the change.

It is positive because it recognizes the improved health and economic contributions of older Americans. Life expectancy at age 65 has risen approximately three years since social security began. Social security benefits would still be provided over the same proportion of an average person's life.

To resolve the short-term cash flow problem, I proposed inter-fund borrowing coupled with a prospective phase-out of the student and minimum benefits.

Interfund borrowing would be authorized when any one of the three trust funds (Old Age and Survivors Insurance, Disability Insurance, and Health Insurance) falls below 25 percent of one year's outlays. This would be authorized immediately but would cease in 1990. Funds borrowed would have to be paid back with interest.

To help meet the gap expected during the 1984 to 1985 period, even with interfund borrowing, I proposed that Congress eliminate the minimum benefit effective immediately -- but only for new retirees. My concern was that no beneficiary now receiving the minimum benefit would have benefits reduced in any way. The "special" minimum benefit which provides additional protection for workers with many years of contribution at very low wages would not be changed at all. In the future, others who receive the minimum benefit would have their benefits calculated to reflect the coverage they have actually earned.

I also proposed that the student benefit be phased out beginning in August, 1981. Any student who had already started school and was receiving social security benefits would be able to finish their schooling as long as they were eligible. However, no new students would be brought into the program.

My bill also contains a number of proposals to help prepare workers -- and employers -- for later retirement. Effective in 1986, I would eliminate completely the social security earnings limitation for workers over 65. The age would gradually rise to 68 by 2012.

The earnings limitation, which currently reduces social security benefits $1 for every $2 earned over $5,500 a year, acts as a strong disincentive to continued employment after age 65. I would prefer removing this earnings limit completely immediately, but believe it is not wise to do so until the Old Age and Survivors trust fund gets past the critical cash flow problem.

As an additional incentive for work after 65, I propose eliminating the social security payroll tax for all workers over 65 -- as well as their employers -- effective immediately. As the age of full retirement phases in to age 68, this tax break would phase upwards in a similar manner.

For the employer, this is a direct economic incentive to hire and retain older workers. (For a worker age 65 earning over $30,000, the savings to the employer in reduced payroll contributions is almost $2,000 per year.) For the older worker, it means more take-home pay during the years just before retirement. This provision also would help to address a projected shortage of younger workers by 1990.

Because this provision would reduce income to the trust funds, my bill provides for the lost revenue to be made up by general revenues. It is difficult to predict the cost to the Treasury of this measure, but the Congressional Budget Office has estimated about $1 billion a year in the short term. This estimate does not take into account, however, the additional Federal income tax which would be generated by those choosing to work longer under this plan. I would expect, over time, the effect would be to cancel out or even increase general revenues.

Effective immediately, I would also remove age 70 or over as the permissible age for mandatory retirement in the private sector.

This Committee has already taken some actions to solve the short-range funding crisis. I would urge you to act immediately on granting authority for interfund borrowing.

But we still have the same three options before us for the long term: to cut benefits, to raise taxes, or to raise the retirement age.

What disturbs me is that we run the risk of making decisions of major significance without acting according to an underlying set of principles.

I have felt, in the Budget Committee and on the Senate floor, that there is a tendency to look at the budget figures and make decisions based on how to get from here to there on a ledger sheet. That will not do. We must have a set of consistent criteria to use to judge the merits of differing social security proposals.

The elements of my bill are based on such a set of principles. I believe they remain valid and I would urge this Committee to consider all proposals with these principles in mind:

1) Our goal should be to make the system sound within the current tax structure. That means no additional increases in social security taxes -- and that benefits should not be cut more than necessary to achieve actuarial soundness.

The Administration's proposals violate this principle by suggesting benefit reductions far in excess of what is needed, achieving a savings of 3.6 percent of taxable payroll over the long term, while only 1.82 percent is needed.

2) There should be no precipitous changes in the basic structure of social security. Current beneficiaries should be protected from any large changes in their benefits, because workers make long-term plans for retirement. Once an older person leaves the work force for a year or more, he or she cannot usually return.

Any changes in the way we approach early retirement, or a change in the age for full retirement, should be phased in very slowly and leave adequate time to plan.

If economic disincentives for later retirement are to be eliminated from the social security system, we must also make sure that older workers are able to stay in the work force. The work force itself must be given time to adjust.

A long phase-in period for change can help meet these needs. We can also help spur this process by providing specific incentives to employers to keep older workers, such as the tax incentive I have proposed in my bill.

I have not agreed with the changes the Senate has already approved in the social security minimum benefit for this same reason. I recognize that this Committee made an effort to protect those current recipients of the minimum benefit who would have little or no other sources of retirement income, but I believe any changes should be made prospectively.

3) A "safety net" for those who are really unable to work beyond age 62 -- or 65 -- must also be preserved if we make changes in early retirement. We must be careful what we do with the social security disability program. Many necessary changes have already been made to provide safeguards against abuse of its basic intent, but I would urge this Committee not to go too far. An adequate and fair disability system is a necessary companion to changes in early retirement under the old age and survivors system.

4) Social security is a wage-based system, not a welfare system, and should be kept that way. It is important to maintain parity between active and retired workers. This means keeping the basic benefit structure and maintaining the current replacement rate.

Congress acted wisely in 1978 when it froze the replacement rate at 42 percent of a retiree's 30-year average earnings by "decoupling." Retirees no longer receive the benefit of double adjustments for inflation through the indexing of wage histories as well as automatic indexing of benefits.

We are not in a position to increase the replacement rate, but a further adjustment downward would not be fair. I would remind the Committee that the 1978 law reduced long-term costs by 25 percent.

The Administration's proposal to reduce the replacement rate by 10 percent through the technical sounding device of changing the "bend points" is simply a 10 percent cut in the basic benefit structure. It is a cut that is not necessary to restore soundness if we phase in a later retirement age.

Some proposals to make COLA adjustments, such as using the lower of wage or price indexing, would also violate the principle of maintaining parity between active and retired workers. We know that the wage index tends to lag behind inflation. A year or two after a big inflationary jump, wages exceed prices. Going to the lower of the two indices would deny the retiree the catch-up which the worker gets.

These are the basic principles underlying the proposals in my bill -- not going beyond the existing tax structure, no large changes without time for adjustments, an adequate disability system to act as a safety net for necessary early retirement, and preservation of parity between active and retired workers.

The Administration and others have made different proposals. However this Committee chooses to proceed, my purpose here today is to urge you to adopt these basic principles as a way of evaluating all proposals before you.

My discussions with both younger workers and retirees have convinced me that they both want to see the social security system restored to soundness.

Younger workers are still willing to contribute at current tax rates, but they want to see that they will get benefits when their turn comes. Retirees are willing to see the system tightened up to make it sound, but they do not want to see social security used as a vehicle for balancing the Federal budget or cutting taxes.

Restoring public confidence in social security requires us to balance these two views. We must not set the generations against each other in political conflict.

In practical terms, that means trimming benefits or delaying retirement so that outlays do not exceed current revenues to the trust fund.

But it places a floor as well as a ceiling on spending: we must not act more than the minimum necessary to achieve actuarial soundness. We must leave our tax and spending reduction efforts to the general revenue portion of the budget.

If we are clear that this is the path we have chosen, I believe that the American people will respond favorably to the choices made.

Senator CHILES. I did read with interest, Mr. Chairman, the newspaper accounts of your hearing yesterday. I have to say I was somewhat surprised to see that Secretary Schweiker was still pushing the administration plan.

I thought that we pretty well agreed that that balloon had gone up and had come down, and that we were going to work something else out from there.

I hope that is still the consensus we have.

We had a pretty good vote in the Senate, 96 to 0. That vote seemed to say that "Congress would not precipitously or unfairly penalize early retirees," the ones that were ready to retire at age 62 or 68, now. And that "Congress would enact reforms necessary to insure the short-term and long-term solvency of the social security system, but would not support reductions in benefits which exceed those necessary to achieve a financially sound system and for the well-being of all retired Americans."

I really think that is a good basis, that resolution, and I hope that is where the administration will be with us, as we begin to try to put together a plan.

I have said this to you, privately, and I now express it to you publicly. I don't think this should be a partisan issue, as such. I think we ought to be able to put together a bipartisan plan, because we certainly all have the same motives in what we are trying to do here.

In an effort to address these problems, having been chairman of the Aging Committee, last year, I held some 4 days of hearings, listening to all the statistics that were then coming in, and that was the first time we were getting the news of the problems that we had.

Having in mind trying to do something about both the short-term and long-term problems, I introduced a comprehensive reform bill, in February, S. 484.

I concluded from the hearings that I held, that major changes would be necessary to keep the trust fund solvent and to keep the promise we had made to all workers.

I also concluded, in the interest of fairness to all, that Congress ought to address the long-term problem now, as well as the short-term problem.

To deal with that long-term problem, I saw really three basic choices, to cut benefits, to raise social security taxes again, or to raise the retirement age.

There is a fourth possibility that I left out, Mr. Chairman and that is one I notice you commented on yesterday, and that is that we could infuse massive doses of general revenue.

Senator ARMSTRONG. Did you want to endorse that suggestion today?

Senator CHILES. Well, using a deficit to fund a deficit, unless you could make it up on the volume, Mr. Chairman——

[Laughter.]

Senator CHILES [continuing]. I don't know how well that would work.

Senator ARMSTRONG. Senator, for the benefit of anyone who may not have heard what my comment was, it was to the effect that suggesting social security borrow from the general fund was somewhat like suggesting that Amtrak bail out Conrail.

I share your feeling that it would be more or less preposterous.

Senator CHILES. Well, so, I really reduced my choices to three: That was to cut current benefits, to raise social security taxes, or to raise the retirement age.

Younger workers and retirees both want to see social security restored to soundness. Both are willing to sacrifice if necessary, but I think we have to be careful to balance the interests of both so that generations are not set against each other in conflict.

I decided that a gradual phase in of a rise in the retirement age was the least unfair, and the most positive, choice for the long-term problem.

I proposed in S. 484, to begin phasing in age 68 for full retirement, in January 2000.

Eligibility would then be 65 plus 1 month and the age would increase by 1 month each 4 months, until 68 would be reached in 2012.

The age for reduced benefits would gradually increase from 62 to 65, in the same way.

Basically, that is going to give someone who is going to be retiring at a later age approximately 30 years to get ready and plan for the fact that we are going to be increasing that retirement age.

Age 65 for medicare would not be changed and there would be no change in disability.

No current retiree, or any worker who had reached age 45 by the end of 1979, would be affected at all.

To me this was the least unfair, because the long notice and phase in time gives the younger workers ample time to prepare.

It is positive because it recognizes the improved health and economic contributions of older Americans.

Life expectency at age 65 has risen 3 years since social security began. Benefits would still be provided over the same proportion of the average person's life.

I also propose three measures to help prepare workers and employers for later retirement.

Effective in 1986, I would eliminate entirely the social security earnings limitation for workers over 65, with a gradual rise to age 68 beginning in the year 2000, parallel with the change in full retirement age.

The earnings limitation acts as a strong disincentive to continued work after 65.

I would like to do that before 1986, but because of the cash-flow problem, I think that is about the earliest that you could actually make that change.

Two, would be to eliminate the social security payroll tax for all workers over 65, as well as their employers, effective immediately.

This tax break would also phase up to age 68, as again, changes are made around the year 2000.

This is a direct, economic incentive to employers to hire older workers. For a worker earning over $30,000 an employer would save almost $2,000 a year in reduced payroll contributions.

For the older worker, it means more take-home pay.

I think, Mr. Chairman, we have to start thinking of ways of keeping our work force longer on the payroll, not only for what it will do for the social security trust funds, but what we actually have to do for the country because of the demographic changes.

We are seeing less and less of a work force coming in and we are seeing more and more of our population shift into the older quadrant.

We have to begin to do something about that to encourage people to work longer. The whole thrust over the last 25 years was to try to get people to retire sooner.

Now we really need to change that thrust and to do that, I think we are going to have to make some economic incentives to do this.

Revenue lost to the social security trust fund by this proposal would be made up in this instance, by general revenues. The CBO estimates the short-term cost to be about $1 billion a year. That does not take into account, however, the additional income tax generated by those choosing to work longer.

Over time, it looks like the effects would be to cancel out the cost or even increase general revenues. You are going to have more people working for a longer period of time and they are going to be paying their general income tax on that provision.

The CBO says you will have to score that as an initial loss, but it would be made up. That would be similar to what we have done on the job credits bill, where we made provisions like that.

I would also remove age 70 as the permissible age for mandatory retirement.

I see no reason why we should allow any legal age discrimination.

We held hearings, again, in the Aging Committee. We had some of the major corporations of this country who have no mandatory retirement age. They virtually destroyed the myths that are out there that once someone reaches age 65 they become accident prone, or that you can't teach the old dog new tricks, or that older workers start having higher absences.

In fact, they said that for their workers who wanted to work longer, who had the incentive and wanted to work longer, they found that their accident rate was better, their absentee rate was better, their loyalty to the company was better. And they even were able to retrain some older workers and to move some into more flexible time scheduling They felt it was a way of keeping some of their best workers.

To resolve the short-term problem, I propose interfund borrowing, authorized when any one of the three trust funds fall below 25 percent of 1 year's outlays, coupled with a prospective phase out of the student and minimum benefits.

This committee has already taken some actions to solve the short-term funding problem. I urge you to act immediately on the interfund borrowing authority.

We still have the options before us for the long term.

My concern, Mr. Chairman, is that we sometimes make decisions of major significance without acting according to a set of underlying principles.

In the Budget Committee and on the floor, I sometimes feel there is a tendency to make decisions based on only how we get there from here, on a ledger sheet. I think we need to have better criteria to judge the merits of prospective social security proposals.

I would like to present four basic principles to you which, if adopted and followed, I believe would mean the results of your work would be accepted by the American people.

One, would be to make the system sound within the current tax structure. That means no additional increase in social security taxes. But it also means that benefits would not be cut more than absolutely necessary to achieve actuarial soundness.

The administration proposals would violate this principle by reducing benefits far in excess of what is needed.

Their proposals would save 3.6 percent of payroll when only 1.5 to 1.8 percent is necessary. Even the new trustee report says that the long-term gap is only 1.8 percent.

Two, would be to make no abrupt changes in the basic structure of social security. Current beneficiaries should be protected from large changes, because workers make long-term plans for retirement.

I don't think it is realistic to expect an older worker to return to work once he has left. Any major changes should be phased in very slowly and leave as much time as possible to plan.

Employers, as well as the workers, need to be given time to adjust to any changes we make.

Three, to preserve a safety net for those who are really unable to work beyond age 62, if changes are made in early retirement under old age and survivor's insurance.

I think we need to watch and see that we do preserve that safety net. We must be careful what we do with disability insurance.

Many necessary changes have already been made to protect against abuse of its basic intent. I would urge you not to go too far. An adequate and fair disability system is a necessary companion to changes in early retirement.

Four, to keep social security as a wage-based system. It is not a welfare system. It has not been in the past.

I think it is very important to maintain parity between active and retired workers. That means keeping the basic benefit structure and maintaining the current replacement rate.

We froze the replacement rate in 1978, at 42 percent of a retiree's average 30-year earnings, by decoupling.

Retirees no longer receive double adjustments for inflation through indexing of wage histories as well as indexing of benefits. I remind you that the 1978 law also reduced long-term costs by 25 percent.

We are not in a position to increase the replacement rate, but a further adjustment downward, I also think, would not be fair.

The administration proposals reduced replacement rate by 10 percent by their "bend point" changes. I really don't think that is necessary if we go to a longer retirement age in the out years, as I suggested in my bill.

Going to the lower of the wage or price indexing for COLA's also would violate parity between active and retired workers. The wage index lags behind inflation, but after an inflationary jump, wages exceed prices. So a retired worker would be denied the catch up that an active worker actually gets.

These are the four basic principles that I tried to use in the bill that I introduced. The administration has made very different proposals. However you choose to proceed, I urge you to adopt these basic principles as a way of evaluating all of the proposals before you.

Younger workers and retirees both want to see social security sound. Workers are willing to contribute at current tax rates, but they want to get benefits when their time comes.

Retirees are willing to see the system tightened to keep it sound, but they don't want to see social security used to balance the budget or to cut taxes.

Restoring public confidence means balancing those two views, I think. In practical terms, that means trimming benefits or delaying retirement so outlays do not exceed current revenues to the trust fund.

But, it also places a floor on spending. It means not acting more than the minimum necessary to achieve actuarial soundness.

I think we should leave tax and spending reduction efforts to the general revenue portion of the budget.

If the American people believe that that is what you are doing, I am certain they are going to accept the decisions you come out with.

Thank you for the opportunity to testify before you.

Senator ARMSTRONG. Senator Chiles, we thank you for a very thoughtful statement. I do not personally agree with everything you have recommended, but I must say that, in my opinion, what you have recommended and the guidelines you have set forth have are very close to what I think the ultimate solution will be.

I think you have done us a service not only by the substance and the scholarship of your proposal, but also by the tone in which you have presented it.

Let me just respond before I yield to other members of the committee for their questions and observations on a couple of the points you raised.

First of all, I applaud your call for a bipartisan approach. I agree with that entirely. I am confident that the administration feels that way, from my discussions with them.

Within the last 3 or 4 hours I have been in touch by telephone with some of our counterparts in the House. I am confident the kind of spirit that you have called for will in fact develop and we will be able to put together a package along the lines you have suggested.

I particularly want to compliment you for your suggestion about the gradual increase in the age of first retirement.

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I want to address a question to you about that and about all of your proposals. It is a question that you may not expect because it doesn't go to the technical aspects of the dollar impact of what you are recommending, but really to the political repercussions.

It is well known that the subject of social security reform, to the extent that it involves discipline or some scaling down of anticipated future benefit increases, is thought by people in political office to be a very hot, controversial, potentially explosive subject.

It is my understanding that you represent a State which has one of the highest, if not the highest, proportion of retirees, and I presume social security recipients.

Yet, for a long time, you have been out front and identified as a leading proponent of this kind of reform.

May I just ask, for my own interest and that of other Senators, what has the political fallout of this been?

How have your people responded?

Do you sense that this is something that is politically feasible or is it going to be a Kamakazee effort of some kind?

Senator CHILES. Well, I could make a couple of observations on that.

One, I still don't have any cointroducers on the bill that I introduced in February. [Laughter.]

So, I have to say that my observations are my own, and not shared by other Senators, perhaps.

My bill began to look better though, after the administration bill was introduced. That would be the second observation that I would make.

Third though, Mr. Chairman, people in my State, and I suspect people in every State, know that this system is sick. They know that without doing something to it, it is going to flounder. I think they are prepared to take the medicine if the medicine is going to be fairly administered. I think that is the greatest concern.

As I look through those options that I talked about earlier—raising taxes, cutting benefits, adjusting the retirement age—the least undesirable of those options was the third one, gradually raising the retirement age.

I have discussed this with a lot of young and blue-collar workers who were continually saying to me, "What in the world are you doing?" especially when the January 1 tax increase went into effect. "Here you made a tremendous increase in my taxes again."

A worker who is paying on the first dollar that he earns in his payroll tax which again, is more unfair than the general tax where he has his exemptions and deductions. In fact, many of our workers pay more money in the payroll tax than they do in income tax.

"But, what are you doing? You are raising this tax and I know and you know there is not going to be anything there left for me when I get ready to retire."

So, being able to say to them, "Look. You are going to have to work a little longer. We are going to try to give you some help by virtue of retirement plans and other things, but at least when you get there, there is going to be a sound retirement system for you when you get there."

I think it is something you can sell.

As I say, I have been going all over my State attempting to sell this since I introduced the bill in February. I think it is salable.

Senator ARMSTRONG. Well, I do compliment you. I think the actuarial questions are important and the economic issues have to be addressed, but what we are really looking at when we talk about social security reform is the question of political leadership and political courage.

Senator CHILES. Well, I think that is exactly right, because whatever you are talking about, you have to get a majority of votes in both Houses in order to be able to effect the changes.

Senator ARMSTRONG. That's right.

Senator, I have a number of other questions, but we are going to follow pretty closely the time restrictions.

So, I will yield now to early bird, Senator Danforth.

Senator DANFORTH. Thank you, Mr. Chairman. I have no questions.

Senator ARMSTRONG. Senator Long.

Senator LONG. No questions.

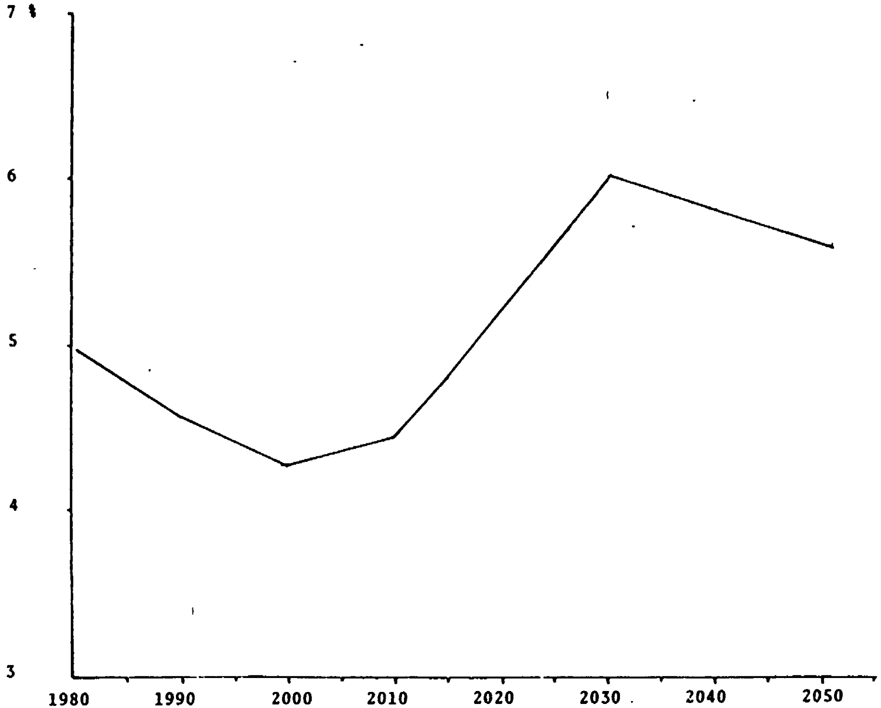
Senator MOYNIHAN. Mr. Chairman, is it possible to put a Democratic chart up there? [Laughter.]

I would appreciate that.

Senator ARMSTRONG. Please do. We are art lovers here. So we would be glad to see what you have.

[Senator Moynihan's chart displayed:]

Social Security as percent of GNP



Source: 1981 Social Security Trustees Report

Senator MOYNIHAN. Thank you, Mr. Chairman.

Senator DOLE. Is that political terrorism you were talking about?

Senator MOYNIHAN. This is terrorism. I would like to show this to our friend and colleague, Senator Chiles. He has said this system should not be used for any other purpose.

We have been hearing that there is a crisis. We had four crises and one bankruptcy in two pages of testimony, yesterday, Senator Chiles.

Here is a 75-year projection of the portion of gross national product that will be consumed by social security benefits under the administration's economic projections.

For the next 40 years social security benefits as a proportion of the gross national product go down. It goes down, down, down, and then when the baby boom generation retires, right in here the year 2015, it begins to go up.

[Indicating.]

Senator MOYNIHAN. Now we have to prepare for that middle third of the 20th century, but we don't have to do it in an atmosphere of crisis.

You put your legislation in the beginning of this year. You have been working on it for a long time. We have a real problem, but we don't have a bankruptcy on our hands.

Senator CHILES. I think that the short-term problem is the one that people talk about as the crisis. I think it is very easy to solve and I think this Congress is going to solve it.

I think the more serious problem is the one that is out there. I think the most serious part of that problem is the crisis in confidence that the system now has and the fact that people young and old are losing confidence.

All of the columns and statements that are written just add to that. That is why I think it is very critical that we address that problem, I think this year, and certainly this Congress.

But, I think it is not a problem we cannot address. It is not a problem that does not avail itself of a solution. I think it is one this Congress should and will address.

Senator MOYNIHAN. I much agree with you.

Senator CHILES. I don't think there is any cause for panic.

Senator MOYNIHAN. I would like to hear the chairman say there is no cause for panic. We have a problem in the middle of the 21st century. We can solve it.

We have a short-term problem. We can save it by managing public affairs and not terrorizing each other with terms like "bankruptcy." That is why people are frightened. They are not actuaries and they say, "My God, the social security system is bankrupt."

This type of politics terrifies them. If we do something, benefits needn't be reduced. We can deal with the 75-year problem in an orderly way and why not do it now.

I thank you. There is no grounds for panic.

Senator ARMSTRONG. Senator Moynihan, I am relieved to learn you are not terrorized by the data that has been submitted. It never crossed my mind you would be. [Laughter.]

But, I would like to point out to you that the chart you have put on the wall is really not the part which is alarming to a large group of people. It is the proportion of the payroll devoted to social security that is alarming.

Tomorrow, I will ask staff to draw us a chart which will project out into the future, not the cash-benefit payout, but the proportion of the payroll that will be paid out. It is not going to terrorize you, but it will be a curve that will look a lot like chart No. 3, that is, it will be going right up like a skyrocket.

Senator MOYNIHAN. If that is the problem, there is no problem with social security. It is overfunded, not underfunded.

Senator ARMSTRONG. Well, I don't want to take the time of other members to draw this out now, Senator. I will be happy to discuss it with you at length on another occasion.

But the Senator from Florida made the very telling point about the potential generational conflict. One of the reasons why there is a growing generational chasm is because of the sensation on the part of younger workers that too high a proportion of their earnings are being used to finance this program.

The projected rise in the social security tax, if you plot it into the future, is a very sharp curve.

While I don't think it is a cause for terror, the Senator from Colorado never suggested that it was.

I do think it is a cause for concern and prompt action. On that, I believe we are now in agreement.

Senator MOYNIHAN. Well, we will receive your data and see them and we will learn whether we are in agreement.

Senator ARMSTRONG. Art lovers, return tomorrow. [Laughter.]

Senator DURENBERGER. Senator Chiles, do you find this as thoughtful as your own presentation? [Laughter.]

I want to ask you just one question, because you have obviously committed a lot more of your own time and effort and concern to this issue than a lot of us have.

If I were to put a chart up there on health care costs in this country, I think it could easily rival, in terms of its growth, any of the chairman's charts.

As I look at the purpose of social security, I find a large part of it provides cash income security to a variety of people, for a variety of purposes.

The one major part of social security that is not cash, is the hospital portion of social security called part A, of medicare.

When you look at the total costs to the elderly population of this country for health care, I think in the most recent year it approximates something close to $100 billion out of the $240 billion health care cost in this country.

But only about 30 percent of that is covered by the payroll tax through the part A portion of social security.

I would like your observations on the appropriateness of continuing the tax payroll, to provide for the hospital or a portion of the hospital costs to the elderly and to cover only about 30 percent of the total health care cost.

Senator CHILES. I introduced my bill S. 484 before we had all of the tax proposals from this committee and we were talking about making some tax cuts. We were trying to find ways to benefit all the workers by a tax cut.

So, I proposed to finance a portion of the health insurance with general revenue. But I was going to use that portion to reduce the payroll tax. At that time, I felt the payroll tax, and I still do, is highly inflationary and that a reduction of that payroll tax would actually cut inflation too, while we worry about many tax cuts being inflationary.

So, I was going to use that as a way of rolling back the payroll tax, to keep the increases at the 1981 level of 6.65 percent or below until 1990.

I want to make it very clear, I do not feel we should ever use the general revenue to bail out the problems of the social security system.

Senator DURENBERGER. I agree with you on the bailout notions. That is why I asked you, someone who has been around here a lot longer than I have, why is it we have singled out of all of the health care needs of the elderly, why have we singled out hospitals or why should we single out hospitals to finance out of payroll taxes.

Senator CHILES. I don't think anyone could tell you any real rational reason that was done. No one thought costs were going to escalate the way they did. It was a convenient collection method.

Senator ARMSTRONG. Senator Dole.

Senator DOLE. I want to thank Senator Chiles for his contribution to the committee.

As I understand it, you believe we can meet the short-term needs just by interfund borrowing; is that correct?

Senator CHILES. Yes, with the cuts that have already been made. You cut the minimum, you cut the college scholarships. Under my proposal, I was going to cut those out prospectively, in the future, but not cut benefits for those now receiving them, as you have done now.

I think you basically have come down to the fact that you can meet the short-term crisis with interfund borrowing.

Now, I will mention that a number of people are now talking about a fairly large cushion that should be in the trust fund.

If you want to talk to a cushion of 50 to 75 percent of 1 year's outlays, no, you won't meet that. But, to me, I don't see any reason you have to have that large a cushion between now and the year 1986 when the worst of the problem comes.

Yes, let's build a cushion in the out years. I think that is a good thing to do. But I don't see why we should go cut somebody's benefits more, so you can say you have a cushion.

I think what we want to do is get by this crucial time, in 1986, and even if we squeak by or get by, that is all we need to do and then we will build a cushion after that.

I think you virtually have enough cuts now.

If you had to do something else, I would say that probably taking the CPI out to 15 months would be the most viable of the things you could do.

Senator DOLE. You would not dip into general revenues. It has been estimated by some that if the economy performs poorly, we are going to need $60 billion to $80 billion in excess of interfund borrowing over the next 5 years.

It has been suggested by some that if that were true, we would just take it from general revenues. You are a member of the Budget Committee. Do we have that money available?

Senator CHILES. Well, using the CBO projections, which were more pessimistic than the administration, the most they are talking about needing after the cuts that we now made, the most would be $1 billion a year.

I don't see that you have to——

Senator MOYNIHAN. A billion dollars a year between now and 1986?

Senator CHILES. That is right, $1 billion per year.

Senator MOYNIHAN. For 5 years.

Senator CHILES. Yes. So, I don't think you have to do anything that drastic to get that kind of money. I don't think that problem is as great as this one we are talking about on the longer term.

Senator DOLE. Well, I think you clearly identified in your statement some of the difficult choices. I think it is safe to assume we are not going to increase social security taxes.

I think it is also fairly safe to assume that we are not going to get into general revenues. So, we really have just one other alternative, in some phased in way, to reduce the growth of benefits. I am not certain just where.

Senator CHILES. Well, then I think you are left with cutting benefits or stretching out the retirement age.

And, having seen what happened with the administration's proposal, I don't think cutting benefits is something that this Congress is prepared to do. I hope we are not.

Senator DOLE. I think you are referring to phasing in benefit reductions as opposed to cutting benefits.

Senator Chiles, Well, I say that—cutting people who are going to retire next year.

Senator DOLE. Right.

Senator CHILES. Because that is what the proposal——

Senator DOLE. That was much too abrupt. I think that was a mistake. I think the administration concedes that it was a mistake. We believe that with effort, yours and that of other Republicans and Democrats, we can work out a solution. If it is all going to be political terrorism, though, we probably can't.

Senator ARMSTRONG. Thank you, Senator Chiles. We appreciate your——

Senator MOYNIHAN. Mr. Chairman, I wonder if I could just ask the Senator one more question.

Senator ARMSTRONG. Of course.

Senator MOYNIHAN. Because——

Senator ARMSTRONG. Another chart.

Senator MOYNIHAN. Yes. [Laughter.]

Senator DOLE. That counts against your time, the walk up there. [Laughter.]

Senator MOYNIHAN. I think we are getting a moment of reason here. We don't want political terrorism.

Senator DOLE. It will get you on the nightly news, but it won't solve the problem. [Laughter.]

Senator MOYNIHAN. All right. Who started it?

There is a basic fact that for the next three decades or more, as a percentage of our gross national product, social security benefits are going to be declining.

We heard yesterday the simple point that retirees under this system don't benefit from—don't take part in—any national economic growth. Their payment levels are merely indexed to keep real value the same.

You have said that the Congressional Budget Office estimates that, with the measures the committee and the Senate have already taken, we need over the next 5 years perhaps $1 billion a year.

After which the system gets to be built up on its own.

Senator CHILES. Because of the January 1 tax increase.

Senator MOYNIHAN. Yes, sir, $1 billion a year is one seven-hundredth of our budget. It is a large amount, but not enough to cause panic. There is no reason for older people to panic. We are not going to cut their benefits, and there is no reason for young people to think their benefits aren't going to be there. They are going to be there.

If we think we have a bankrupt system, we ~~won't~~ right it. If we think we have a manageable system, we can right it.

Senator DOLE. The question was——

Senator MOYNIHAN. Thank you, sir.

Senator CHILES. I think it can be solved in a number of ways. I would hope personally, we would not infuse general revenue funds. I think that would be a bad practice.

Senator MOYNIHAN. You would agree that if we had to the amount would not be large.

Senator CHILES. I think the problem is small enough that we can deal with it in a number of ways. It won't be that difficult a problem.

I always felt the difficult problem was the one that is lurking out there, beginning after the year 1990 and starts coming in around the year 2000. That is the one I have always been afraid that, that this Congress would say, "Let's let some other Congress solve that one." And, because of the crisis in confidence, that is the one I think is more important we deal with now.

We are going to deal with the other one. The gun is at our head on the short-term problem.

I am confident we can deal with it.

Senator MOYNIHAN. I thank you very much.

Let me make just one last point. The real onset is the year 2015.

Senator CHILES. The worst of the problem, yes. But it starts building up a little before that.

Senator ARMSTRONG. Thank you, Senator Chiles.

The committee is now pleased to hear from a panel, including Mr. James R. Swenson, chairman, Social Insurance Subcommittee, of the American Academy of Actuaries.

And, Mr. A. Haeworth Robertson, vice president of William M. Mercer, Inc., and former Chief Actuary of the Social Security Administration, 1975 to 1978.

Gentlemen, we are very happy to have you with us. Hopefully you are going to tell us how we got into this fix, whether we really are in a fix, whether we should be mildly concerned or grossly alarmed, and where we go from here.

Mr. Swenson, would you begin?

STATEMENT OF JAMES R. SWENSON, CHAIRMAN, SOCIAL INSURANCE SUBCOMMITTEE, AMERICAN ACADEMY OF ACTUARIES

Mr. SWENSON. Mr. Chairman and distinguished enators, on behalf of the American Academy of Actuaries, thank you for this opportunity.

I request that the written statement be made part of the record, and would like to summarize that statement at this time.

The academy recommends that both short and long-term financial balance be achieved now, to restore public confidence in the program.

While the short-term financing problems of the program require immediate action, the long-term problems pose an even greater challenge to the program.

Because of demographics, total benefit costs are projected to increase to between 22 percent and 38 percent of payroll by the year 2030.

Despite scheduled increases in future tax rates, a 75-year deficit averaging 1.8 percent of payroll is projected for OASDI benefits and a deficit averaging 3.5 percent of payroll is projected for the HI program.

Proposals to gradually increase the retirement age from 65 to 68 would reduce the OASDI deficit by slightly more than 1 percent of payroll.

Mandatory universal social security coverage would reduce that deficit by one-half percent of payroll and would also help to solve the more immediate short-term cash flow problems.

Those short-term problems would be substantially alleviated if proposals permitting interfund borrowing were enacted.

However, the margins protecting the program from adverse economic conditions are inadequate and other changes are warranted as well.

Safety valve type provisions are needed to protect the program from adverse economic conditions. For example, if the 1977 social security amendments had provided that benefit increases be based upon the smaller of wage or price increases, the program would not now be confronted with cash flow problems.

Actuarial projections of the degree of the short-term problem largely depend upon the economic assumptions. Unfortunately, it is impossible to accurately predict future economic conditions.

Therefore, adequate reserve margins are needed.

Two advisory councils and the national commission on social security have recommended trust fund balances ranging from 75 percent to 125 percent of annual outlays.

These are reasonable long-range objectives for the program. However, it is not realistic to expect these reserve levels to be attained during the next 5 years.

If a safety valve provision limiting benefit increases is enacted, it is my judgment that a minimum reserve level of 25 percent of annual outlays would be adequate as it would permit time for a subsequent legislative action, if needed.

Maintenance of this 25 percent minimum reserve level would require approximately $65 billion of additional taxes or benefit reductions to be spread over the next 5 years based upon projections employment economic assumptions I personally believe to be reasonable for short-term planning purposes.

Please realize that subsequent legislative action may be necessary. However, current enactment of legislation providing a safety valve and further producing $65 billion of additional revenues or savings, would allow sufficient time for such action.

If you wish to reduce the possibility of having to take further action, then current legislative changes should be based upon pessimistic actuarial assumptions.

It is my opinion that the pessimistic assumptions developed by Data Resources, Inc., are not unreasonably pessimistic.

The current financing problems of the program illustrate the continuing need for independent, professional actuarial analysis.

ERISA requires that valuations of private plans be certified by a qualified actuary, and a similar actuarial certification is required for pension plans covering Federal employees.

The American Academy of Actuaries recommends that the Social Security Act be amended to enable the public to enjoy the same benefits of professional actuarial certification.

This recommendation has also been made by the National Commission on Social Security.

In conclusion, the Academy hopes that this testimony has been helpful. We would welcome the opportunity to be of further assistance as you proceed with your important deliberations.

Senator ARMSTRONG. We thank you very much.

We will ask you to stand by when we hear from Mr. Robertson. Then I am confident there will be questions from the committee.

Mr. Robertson.

STATEMENT OF A. HALWORTH ROBERTSON, VICE PRESIDENT, WILLIAM M. MERCER, INC.

Mr. ROBERTSON. Thank you, Mr. Chairman, distinguished Senators.

I am pleased to have been asked to appear before you today as you consider the present and long-range problems of social security.

Despite the widespread concern being expressed about social security's financial problems, relatively few people appreciate the extent of those problems or their imminence.

Some people are still suggesting that social security's financial problems are minor, that they are temporary.

I believe the financial problems are significant now and that they will continue to grow and worsen until they become unmanageable during our lifetime.

I would call your attention to my own graph, on page 6 of my written statement. It indicates that the total cost of social security (Old Age, Survivor's, and Disability Insurance and Hospital Insurance and SMI) has grown from two-tenths of 1 percent, in 1940, to a little over 1 percent in 1950, and now is about 14 percent of taxable payroll.

That chart also indicates that the cost for the entire social security program is going to grow to somewhere between 20 and 40 percent of taxable payroll, during our lifetime.

Social security is a program of future promises and we should do our utmost to keep those promises. Social security has promised to pay certain benefits. It has promised to collect certain taxes. We cannot keep both sets of promises.

We are either going to have to increase the taxes above those that we promised to collect or we are going to have to decrease the benefits below those we promised to pay.

In deciding which promises to keep, and which ones to break, we must consider not only the persons who receive the benefits, but also the persons, the working taxpayers who pay the taxes, that make the programs possible.

In the short run, at least for the next 5 years or so, in my opinion, we have no choice except to honor the promises to pay the benefits as scheduled.

Therefore, we must break our promises about taxes and we must collect more taxes than we have currently scheduled.

One exception is the cost-of-living adjustment. I think we can legitimately break that promise to a certain extent, because the way the cost-of-living adjustments are operating now, we are being more fair to the social security beneficiary than we are to the active working taxpayer who is paying taxes.

This means that during the next 5 years, we may have to collect as much as 5 to 10 percent more in taxes than we have already scheduled, more than we promised that we would collect.

This will be a burden. I don't think it will be an intolerable burden. It is the only honorable course to follow, as I see it.

The long run is another matter. We must stop trying to figure out ways to pay for the present program, and we must change the social security program. Social security may be suitable for people now retired. It may be suitable for people retiring in the next few years.

It is totally inappropriate for the bulk of the nonretired population.

The projected high money costs are not one of the major deficiencies of social security. Social security has many deficiencies, but the cost isn't one of them.

When we talk about changing social security the first thing most of us do is go out and ask an elderly person what he thinks of the change. That is not of whom we should be asking the question, because their benefits are not going to be changed very much, if at all.

We should ask the young people.

Who are they? Who is this post-World War II baby boom we keep talking about? It is 135 million people less than age 35. They make up 65 percent of the population that is currently under age 65.

In other words, 65 percent of the population that is not yet retired still have enough time to make plans for their own generation that will suit their needs.

These young people will begin reaching their sixties 25 years from now in the year 2006. It is today that we need to set the general framework for their retirement benefits. How much they will be, the source, what age they will commence.

The only reverence we owe all of these past decisions we made for present beneficiaries is to fulfill the promises we made to date to our older population.

It is entirely reasonable therefore for us to give serious consideration to a completely new type of system for the 65 percent of our population not yet retired, but still under age 35.

Thank you, Mr. Chairman. My written statement has been submitted for the record. It is more complete. I can't resist reminding you that I have a more complete statement in this red book, "The Coming Revolution in Social Security." [Laughter.]

Senator DOLE. Here it is.

[Senator Dole holds up a book.]

[Laughter.]

Senator MOYNIHAN. The red book. [Laughter.]

Mr. ROBERTSON. Each of you gentlemen has a copy. If I may say so, I would commend it to you and your staffs, because I believe it is the only document that has in a single source, the long-range financial status of social security. I believe it is the only document that also has some articulation of some of the current dissatisfactions of the youth with the present system.

Thank you, sir.

Senator ARMSTRONG. Thank you, gentlemen.

Mr. Robertson, Senator Moynihan has presented to us a graph showing the social security cash benefits as a percentage of gross national product. I don't know if you were in the room when we were discussing earlier whether this was the appropriate measure of the cost and burden on the economy and so on.

But I note that in your statement, you attempt to relate the burden of social security not to the payout of benefits but to the payroll tax.

Why is the payroll tax, in your judgment, a more relevant measure?

You note that instead of being a gentle curve as shown on that graph, that it has risen from less than two-tenths of 1 percent, to about 14 percent today, and I think I heard you say between 20 and 40 percent of payroll.

Mr. ROBERTSON. Yes, sir.

Senator ARMSTRONG. At some future date.

Mr. ROBERTSON. Yes, sir.

Senator ARMSTRONG. How could that be? How could we imagine a tax of that level and what are the consequences?

Mr. ROBERTSON. How can we imagine it and what are the consequences?

Senator ARMSTRONG. How could that be? How could you square that?

Mr. ROBERTSON. I think it is perfectly reasonable to look at costs as a percentage of the payroll. It is also perfectly reasonable to look at them as a percentage of the GNP.

I would like to have an emendation of Senator Moynihan's chart so it would include the cost of medicare, HI and SMI, because when the taxpayer pays his social security taxes it includes 1.30 percent of his taxable payroll for hospital insurance.

Medicare today costs roughly a third of what the cash benefits cost. In the future it is estimated that medicare costs will eventually be about 40 percent of the total cost of social security.

So, for one thing, if medicare were included in the chart, it would rise considerably above the level that is shown.

One reason for comparing costs with payroll is that most of the program is currently financed out of a payroll tax. So we think of it that way. We pay 6.65 percent of our taxable payroll now in taxes.

If you want to know what this present program would cost, if we continue to finance it out of a payroll tax split equally between employee and employer, we would take roughly half of these figures that I have here which means the ultimate payroll tax under the present program will be somewhere between 10 and 20 percent of payroll, if the program continues and if we continue our present retirement age patterns.

Senator ARMSTRONG. Mr. Swenson, a brief question for you. Could you comment on whether or not, in your view, the actuarial assumptions used by social security policymakers in the past have been valid?

Mr. SWENSON. The assumptions which were selected at various points of time were best estimates at that point of time.

Unfortunately, the history of the past decade has proved that most of the assumptions have been overly optimistic in the sense that actual economic conditions have proved to be worse than those which were expected.

Quite frankly, I do not contend that this is a problem deliberately created by persons who were setting policy or selecting those assumptions. If I had been selecting assumptions in 1977, I would not have selected assumptions which would have projected a real wage loss of 3.1 percent in 1979, and a real wage loss of 5 percent in 1980 as actually experienced by the economy.

But as I stated in my testimony, it is impossible to accurately predict economic conditions.

Therefore, I think it is necessary really to employ a range of assumptions to give policymakers a good idea of what would happen under various alternative sets of conditions.

Senator ARMSTRONG. Is that why you recommend a 25-percent reserve ratio, just to smooth out those fluctuations?

Mr. SWENSON. Well, I recommended that there should be a minimum reserve in the next 5 years of 25 percent combined with a safety valve provision. The safety valve provision would add considerably to a smoothing of the economic fluctuations if that safety valve limited benefit increases when real wage losses occurred.

Senator ARMSTRONG. Thank you.

Senator Danforth.

Senator DANFORTH. Thank you, Mr. Chairman.

Gentlemen, as we approach the social security problem how far down the road would you advise we look? Would it be responsible on our part just to take care of the short-term problem or should we be cognizant of the situation 30 or 40 or 50 years down the road?

Mr. SWENSON. I personally believe that you should be addressing both the short- and the long-term problems. There are two distinctive problems.

The short-term problem is one that has largely been created by adverse economic conditions, that is unexpected adverse economic conditions.

The long-term problem, however, is one of demographics. I would agree with Senator Moynihan that this is the more severe of the problems.

Senator DANFORTH. We should address the long-term problem now?

Mr. SWENSON. Yes; it is proper to address the long-term issue now, because adequate time is needed to enable people to plan in accordance with whatever changed circumstances are necessary.

Senator DANFORTH. Do you agree with that, Mr. Robertson?

Mr. ROBERTSON. Yes, sir, I do. The nature of a pension promise, is that of a long-term promise, a deferred promise. I was almost overwhelmed when I came in by the youth of the people in the back of the room.

This baby boom generation is between zero and 35. Just 25 years from now, they are going to be reaching their sixties.

It is now that people need to be planning and our institutions need to be planning.

Senator DANFORTH. In fact, the most frequent question that I get from constituents on social security is: "Will it be there when I retire?"

Let me ask you another question. In your view, you are both actuaries. I listened, along with Senator Armstrong, very carefully to your testimony. You talked about social security benefits as a percentage of payroll.

Is it relevant? I am sure anything Senator Moynihan presents is relevant. I must say, I don't understand the nature of the relevance of considering social security as a percentage of gross national product. You didn't mention it in your testimony.

You indicated, Mr. Robertson, that it is interesting to consider it, but how much attention should we give and why, to social security as a percentage of GNP?

Mr. SWENSON. I personally believe that it is proper to look at social security as a percentage of payroll. That is the manner in which it is financed.

There are certain elements that are included in the gross national product that do not enter the social security program.

Federal employees 'wages, for example, would not be included in the payroll. However, they would be included in the gross national product.

So, to the extent there are certain elements in the economy included in the gross national product that are not properly included in payroll, it is somewhat deceptive.

Senator DANFORTH. You are saying that the benefits of social security are financed by a payroll tax and therefore social security, in judging the health of social security, the relationship between benefits and payroll is the significant figure, not the relationship between benefits and the entire GNP.

If social security benefits were financed by taking a percentage out of the gross national product or financed by general revenue, then it might be significant.

But, as long as it is financed out of payroll, it is not a very significant figure.

Isn't that a fair statement?

Mr. SWENSON. I would characterize that as a fair statement, although again, let me emphasize the point, that there is some relevancy in comparing it to gross national product, but again, there are some illusory aspects that are involved as well.

Incidentally, just one further comment. Those projections, I believe, are based upon economic assumptions which the administration is employing currently. Those assumptions anticipate a return to the type of real wage growth that we enjoyed during the 1960's.

While I certainly hope that our economy does indeed return to that real wage growth pattern, I am not certain we should be counting on it.

Senator DANFORTH. How about you, Mr. Robertson.

Mr. ROBERTSON. I believe we should look at the cost of social security both as a percentage of covered payroll and as a percentage of the gross national product.

The percentage of gross national product is an indication of how much of our total goods and services we are producing, that we are allocating to nonproducers, to put it crudely.

If we would take the figure I have or that anybody has that shows costs as a percentage of payroll, and if you multiply them by about 40 percent to 50 percent, depending on the time period, you will convert it to the gross national product.

The payroll I think is 40 to 50 percent of the gross national product. It changes gradually over the years.

I think it is fair to look at both of them. But I don't think it is fair to look at a chart that shows social security costs, but leaves out medicare.

Senator DANFORTH. Thank you.

Senator ARMSTRONG. Senator Moynihan.

Senator MOYNIHAN. Thank you, Mr. Chairman.

Allow me to make the statement that, we would have done but the trustees, who produced the data from which we produced that curve, did not produce it for hospital insurance. Had they done it, we would have put it up there.

Mr. ROBERTSON. Well, I have been trying to get somebody to ask the trustees to produce those figures for medicare. Maybe you could ask them to do that next year.

Senator ARMSTRONG. Senator Long.

Senator LONG. Thank you Mr. Chairman.

Let me just thank both witnesses. I am particularly pleased to have Mr. Robertson here to give us his thoughts. I think I will find time to read your book before we find a solution to this problem. [Laughter.]

Senator MOYNIHAN. Mr. Chairman, I have a question, one each for our two distinguished panelists.

Mr. Swenson, it is an intriguing proposition when you say that the American Academy of Actuaries strongly urges that the Social Security Act be amended to enable the American public to enjoy the same benefit of professional actuarial certification as is required for private pension funds and pension plans covering Federal employees.

Would you talk a moment about that?

Mr. SWENSON. Surely.

Senator MOYNIHAN. I described the Federal pension. I didn't know there was an actuarial certification for it. There are a lot of things I don't know about that.

Mr. SWENSON. Yes, basically what is being proposed is that actuaries be able to exercise their judgment independent of any political pressures in selecting methodology and assumptions which are most appropriate in making projections for the social security program.

Senator MOYNIHAN. Once a year we would get a report from the trustees and we would get a report from a board of actuaries. That says the system is or is not solvent. Now mind you, a pay-as-you-go system has different questions than a funded system, but it is nonetheless auditable; is that your point?

Mr. SWENSON. Yes.

Senator MOYNIHAN. These taxes will produce these revenues and they will match these benefits.

Mr. SWENSON. Yes.

Senator MOYNIHAN. I would like to say to my colleagues that this is an idea which we should talk about. We don't want to politicize this system, although it is so large as to make some elements of political choice inevitable.

Mr. Robertson, I wanted to ask you, sir, you said that I think you particularly chose this because you knew the chairman would want to hear you say that social security has many deficiencies, but cost is not one of them.

I take it that some of your views is that, has to do with Professor Friedman's critique about the degree to which—in their book, Freedom to Choose, by Milton and Rose Friedman they refer to this kind of—they say the social security system trespasses upon almost every aspect of our personal lives by imposing an unnecessary straightjacket of behavioral standards. When to retire. How much to earn between ages 62 to 72. When to divorce. [Laughter.]

Wait until my wife finds that out. [Laughter.]

Whether to remarry, as well as when and to whom and so on. The Friedmans say this loss is a loss of freedom and the "present demoralizing situation under which some people, the bureaucrats administering the programs run other people's lives."

Now, I am not saying that is not so. I take it that is a matter of real concern.

Mr. ROBERTSON. Yes, sir, it is. For those of you who have a book, on page 274 you will find chart 22A that tells you whom you can marry or not marry without having your benefits adjusted adversely from social security. It is quite a formidable chart. [Laughter.]

Social security sometimes we view as a pension plan, death benefit plan. It is not really that. It is a very sophisticated mechanism for dividing the population into those who work and produce and those who aren't working.

How many of you know people who once they reach 62, 65, quit working and give as the excuse they will lose their social security benefits?

I talked to a widow the other day who announced she was not going to remarry, although I hadn't even proposed. She was not going to remarry because she would lose the benefits she is getting now and would not be able to send her children through college and so forth.

If we really examine this program, we see that it puts a lot of limits on how we should behave if we want to maximize the advantage it has to us.

The other thing that I have in mind is the 65 percent of the nonretired population that is under age 35.

Now, what benefits are appropriate for them. Certainly not a benefit that assumes that there is a male breadwinner and a female homemaker and two children and the wife never enters the labor force. That is not suitable for this generation.

Senator MOYNIHAN. That will not have been their experience.

May I just say that these are legitimate questions that have been raised in an attractive and important way. I think we of this committee should not ever forget that we are doing more than bringing in some taxes in order to make some benefits. We are doing a lot to almost everyone's lives.

Some may have a different view from Friedman's or Robertson's, but they raise questions that cannot be ignored and I thank you.

Senator ARMSTRONG. Senator Durenberger.

Senator DURENBERGER. Thank you, Mr. Chairman.

I wonder if both of you would operate on the assumption that the Freedom Plan which I have read, is long range and from what we have heard here today, some adjustments in benefit computation is the short range, and talk briefly about what changes in benefit computations ought to take place in the short-range.

We heard the CPI zero it in lately, because for the last couple of years it was much higher than the wage index, since wage earners were holding down their demands to help fight inflation.

But, if you go back to the old days, before we adopted it, it looks like my predecessors were much more generous than the CPI would have been.

Then, also comment on the President's recommendations regarding the decrease in the change in bend points.

Mr. SWENSON. Let me first mention that I am representing the American Academy of Actuaries and that is a professional organization comprised of individuals who hold varied and diverse political views.

So, I think it would be inappropriate for me to either endorse specific proposals, but let me just say that the choice seems to be between increasing taxes or reducing benefits.

I have given you a professional judgment that if a safety valve were enacted, an additional $65 billion worth of savings either in increased taxes or in reduced benefits would provide adequate margins, although not absolute certainty that subsequent legislative action would be required.

As far as the bend point recommendation, that is a very technical recommendation. It would result in a lowering of the social security replacement ratios by somewhere in the neighborhood of 5 to 8 percent, depending upon the income of the individual.

It is my understanding that the recommendation was made in part at least to offset some of the overindexation of benefits that took place when, in 1972, the benefit formula was double indexed to inflation.

Senator DURENBERGER. Would you recommend some attention to the administration's recommendation?

Mr. SWENSON. I certainly think that attention has to be given to all of the recommendations that have been made. There certainly is no lack of recommendations on how to either increase taxes or to reduce benefits.

Certainly, there are wide variety of proposals and again, as I said, I would not want to posture a position on behalf of the American Academy of Actuaries with respect to specific proposals——

Senator DURENBERGER. Mr. Robertson, you are free to posture.

Mr. ROBERTSON. Yes, and I guess I am representing only myself today, so I can't dodge that at all.

I personally don't think any changes ought to be made in benefits in the course of payment. I don't think any reductions ought to be made in benefits that are going to be payable to people who first become eligible for them for the next several years, because the whole nature of these promises is such that people make their plans around them.

Private employers set up their pension plans and other fringe benefit programs around social security. We should never make any abrupt changes in social security benefits.

The only exception is the CPI problem. For the last 8 or 9 years the average CPI change in social security has been about 9 percent a year.

So, 35 million people or so get a 9-percent increase every year in their benefits, not taxable. How many of the hundred million working people have had a 9-percent increase in their net take-home pay for each of the last 8 or 9 years? Not very many.

So, what we are doing is we are shifting part of America's goods and services over toward the retired people.

One important point I think on the bend point calculations and the proposed administration changes in benefits is that it is generally alleged that they have overreacted, that they provided for more saving than is necessary. That is not true, because they did not take into account the high future cost of medicare.

If we would include the projected deficits under medicare, we would find that the administration's proposals still leave a significant deficit in the future.

So I come back to medicare that many of you have mentioned, and which I mentioned several times. We should make certain we are looking at the cost of medicare in the future when we are evaluating proposed solutions.

Senator ARMSTRONG. Senator Dole.

Senator DOLE. I just have a couple of questions. Mr. Robertson, I have read your book. I think I will have time to read it again before we finally come to grips with some of the issues.

The one thing I remember in reading the book, something you stressed over and over, was the general lack of information or misinformation about the system itself.

That is why when anyone talks about any change in the social security system, red flags appear. Recipients are concerned. They are frustrated. They think we are about to do something that is going to reduce their benefits.

As you indicated, people 25 years of age, do not know what we are about to do to them.

If there were more balance in the way we approached the problem, it might be helpful.

Do you think that by being so complex, a whole set of myths have developed about social security—like "I paid for it, it is mine," and "some people shouldn't have it, they don't deserve it, they don't need it."

Would you comment on that?

Mr. ROBERTSON. Yes, sir. I think that the system is so complex that we can never expect the general public to understand what they can reasonably expect to receive in benefits in the event of their retirement, death, disability or sickness.

Not understanding what they are going to get, but realizing they are paying higher and higher taxes will lead them to have greater and greater expectations and to look more and more blindly to the Government to completely satisfy any needs that they may have in the future.

That is the situation we have gotten into now I think as the result of the last few years.

People more or less are blindly assuming that they are entitled to retire in their early sixties and get an adequate pension from the Government. That is because we haven't really explained to them clearly what they should be expecting from social security.

Senator DOLE. Now do you have any recommendations that we might better articulate that so we can start through some educational process, better understanding the program?

Mr. ROBERTSON. Well, this sounds like an administrative nightmare, but anybody who has a private pension plan has to furnish an annual benefit statement to the employees telling them what they could expect to receive if they retire, die, become disabled.

I think social security ought to have periodic benefit statements to the people that pay the taxes telling them what they could expect to receive in benefits.

The maximum tax this year is $1,975. Anybody who pays $1,000, $1,500, $2,000 a year in taxes, I think is entitled to know what he or she is getting for it and what benefits they can expect to receive.

Not only as a moral obligation, because they are paying the taxes, but more importantly, so they can make their own personal plans to supplement social security. Because if they don't make plans to supplement it, then when they get toward their retirement years, they will be assuming that they are going to be taken care of completely by social security.

Senator DOLE. You can request the information now; is that correct?

Mr. ROBERTSON. Well, you can request information and you will get notification back that you paid taxes on a certain amount of income for each of the last 3 years, and also for prior years, but that is all you know. You don't know anything except the income on which you pay taxes.

Senator DOLE. You think it is possible, that there could be some periodic notice or information made available to those in the working force that might be helpful for planning for the future?

I don't know whether that is an administrative nightmare. I assume it would be perceived that way by the Social Security Administrator.

Mr. ROBERTSON. I think it is possible. If it is not possible then we have too complicated a system.

Senator DOLE. You just punch it out and send it out every year or two.

Mr. ROBERTSON. Or every couple of years. It will cost some money and it will raise the administrative costs. But I think it is worth it. I think it would enhance the program considerably if we spent more money explaining to people what they are getting for their taxes.

Senator DOLE. Thank you.

Senator ARMSTRONG. Senator Boren.

Senator BOREN. Thank you, Mr. Chairman.

First of all, I would say I am not surprised that Mr. Robertson has presented us with a book that has many insights in it that are worth reading, since he is a product of the University of Oklahoma. So, I think that is not surprising, Mr. Chairman. [Laughter.]

I would like to ask just a couple of questions. I noticed several places in your statement you talk about the need to make the system more flexible. You talk about the rigid division of people into the categories of active and inactive.

We have had—I have introduced a bill, along with others, that would increase the outside earnings limitation and raise that limitation.

Also, we had a statement from Dr. Henry Aaron that suggested we might distinguish between blue collar workers and white collar workers in terms of required retirement age under the theory that we should encourage office workers, for example, those who are not performing hard, physical labor, to stay in the labor force longer, but that it would be unfair to make the same requirement of say construction workers who simply would not be able to, because of the physical burdens, to prolong their working number of years.

Are these the kinds of things that you are thinking about when you talk about moving toward greater flexibility and not drawing such a strong line or sharp delineation between those we would call inactive and those we would call active, in terms of social security or retirement benefits?

Mr. ROBERTSON. Well, I had several things in mind. Of course, I do have a proposed new social security system here which is based on the premise that the Federal Government should not be telling everybody the age at which they should retire and no longer work, should not be telling them what benefit they should have in retirement and what their standard of living should be, and that the Government ought to be providing minimums and then the individual can fill in around that. That is part of it.

Now the earnings limitation question you mentioned is really an interesting one, because this earnings limitation, such as we have now, in effect gives us a flexible retirement age.

If you don't retire, you don't get the benefits. So, if we would leave that alone and keep a flexible retirement age, we automatically would have an increasing effective retirement age in the future that would be quite acceptable, I would think.

But we can't do that because people have come to think of the program as something that they made contributions for into the trust fund, under an insurance program and they have an earned right to these benefits.

Then, when you say "You can't have the benefits because you are still working." They will say, "No, I bought and paid for that."

So, we have led ourselves into this where we have so much pressure to do away with the earnings limitations, which was a good feature because it gives us that flexibility which we need.

So, it is partly those things about the flexibility. Of course, there is much more. I guess that there is not time to go into that now.

Senator BOREN. What about the distinction, would you favor drawing a distinction between any kind of—of course, you are talking about changing the whole concept of a required retirement age, but building in flexibility, depending upon the type of work that was done, realizing that some people simply cannot prolong the type of work they have been doing while others could?

Mr. ROBERTSON. No, I can't conceive of that being a practical way to regulate people.

I think what we have to recognize is that everything we do, whether it is through social security or through any other institution, should be concerned with figuring out ways to utilize our most important asset, the human resources that we have, throughout a longer proportion of their active healthy working lifetime.

You can't be a heavy laborer your whole life, but you can do something your whole life. We need to spend more time and effort tailoring jobs to people. The second career didn't come into our language until about 15 years ago. Now we talk about second, third, fourth careers. That is what we are going to have to have. So we are going to have to have more training and retraining and matching up of people with jobs that are suitable.

Senator BOREN. Thank you.

Senator ARMSTRONG. Senator Bradley.

Senator BRADLEY. Thank you, Mr. Chairman.

I would like to ask Mr. Robertson or Mr. Swenson how, in their view, this large misconception about social security developed.

The hardest thing that I have to explain to people is that this isn't an insurance program, that they don't have an earned right, that they haven't paid into a pension system.

It seems to me that social security predated pensions as we know it so how did this evolve into such mass confusion.

Where was the rhetoric that this was an insurance policy originate?

Mr. SWENSON. Basically, when the program was originally created, it was my understanding they tried to describe the program as being comparable to an insured type program.

I agree with you wholeheartedly that it really is not an insurance program. It is an intergenerational transfer program.

I believe the rhetoric was perpetuated over a number of years, largely because the program being funded on a pay-as-you-go basis, with an ever-expanding base paying taxes into the program, gained tremendous popularity and being able to tell people that they were paying, buying their own benefits, using rhetoric such as premiums rather than taxes, or contributions rather than taxes, all helped to perpetuate the insurance myth and gain public acceptance for the program.

I defer to Mr. Robertson, who I think has done a very good job in his book, of describing that very problem.

Mr. ROBERTSON. Yes, sir. Pages 108 and 109. [Laughter.]

I laid the blame partly on the Government. It was not a nefarious scheme, I think, but it was convenient to talk about contributions and trust fund and insurance.

All that just makes you think you are getting what you pay for, and you are not. It also makes the taxes more palatable if you think you are getting what you pay for.

That is why the taxes are getting less and less palatable. Now that taxes are going up, more people are asking questions. They are saying, "I don't get what I pay for."

As a nation we may get what we pay for, but not as an individual. This isn't an individual savings plan.

So, I think it is partly the rhetoric. I think it is partly the fault of the people for not asking more questions. It was because they were getting more than they were paying for and maybe they didn't want to ask the questions.

How many elderly people do you know who received 10 and 15 times as much in benefits as they paid in taxes? Well, they are not going to raise any questions.

And, until the last year or two, I think the media has not spent the time and effort to understand the program or report on it accurately.

I think they have been doing a much better job the last couple of years, but they still have a long way to go to characterize this program the way it is.

Senator BRADLEY. But when social security was first created, it wasn't supposed to be a program covering disability benefits or a program for medical care. It was simply a pension program.

Now, in your view, has the addition of those two components substantially complicated the explanation process here?

Mr. ROBERTSON. Oh, I am not sure that it has, that it complicated the explanation process. More often than not people don't really realize the value of the medicare benefits and disability benefits they are getting.

Senator BRADLEY. How would you tell people about that value? I have a group of senior citizens and they say, "Well, I want my pension, but I don't want that. I am not disabled or I haven't been sick. I haven't had to go to the hospital."

Mr. ROBERTSON. Page 22 of my book details how the benefit expenditure is broken down into retirement benefits, disability benefits, and survivors benefits.

I think one of the simplest explanations is to say that roughly half the benefit payout is for old-age pension and the balance is for these other kinds of benefits.

You may not realize it, but you are getting extremely valuable protection there.

A young man who is a maximum wage earner can die today and get a death benefit for his wife and children of over $200,000 out of this system.

Senator BRADLEY. May I ask, Mr. Robertson, was your book provided to each member of the committee?

Mr. ROBERTSON. To each Member of the Congress. If you didn't get one——

Senator ARMSTRONG. Your staff is enjoying it. [Laughter.]

Senator BRADLEY. I am sure it is good bedtime reading, you know. [Laughter.]

Thank you.

Senator ARMSTRONG. Senator Symms.

Senator SYMMS. Thank you, Mr. Chairman.

Mr. Robertson, on page 13, of your testimony, you say the result is an unfunded accrued liability in 1979, of some $6 trillion. Therefore, the Nation had a hidden liability in 1979, seven times the national debt or $43,000 for every adult between ages 20 and 65.

That is absolutely an astonishing figure. Now I am in a situation in the middle. My dad receives social security and my son complains about paying it.

What can you say to the 20-year-old worker today about this $6 trillion, unfunded liability and how can you tell him he will ever get his name to the top of the chain letter in good faith?

Mr. ROBERTSON. Well, I think one significance of this trillion dollar liability is this. Many people say, "We are tired of the system. Let's change. Let's get something else." That would be possible. But if we do change and if we do make good on promises we have made for people who are already getting benefits, for people who have already been in the system for a few years and who have earned or accrued certain benefits, then we are talking about $6 trillion that has to be paid one way or the other.

So, if we satisfy our obligations with respect to benefits already accrued, we have to keep paying high taxes for a long period of time.

The youngsters today will get to the top of the chain letter and the only trouble is if we keep retiring in our early 60's, we are going to have to pay such tremendous taxes in the interim, that we will decide that is not what we want to do.

Senator SYMMS. Well, the young worker though, if you tell him today that he is say 25 today, that he is going to have to be paying in today, we had that chart up here yesterday that pointed out that by the year 2030 it will be two people paying in and one taking out.

So, on today's standards, it would be that each worker would have to put in $175 a month to pay in enough so that people could get $350 a month the people are taking out. If you just use today as the case.

Is there any way that those of us here in Congress after we make this first fix so this fund won't run out of money could come back in with legislation after a careful year or so that where the person puts this money in and it starts drawing interest and it belongs to them, so it really would be an insurance program instead of a chain letter?

And pull this thing out. Is this possible?

Mr. ROBERTSON. Yes, sir; that is possible.

Senator SYMMS. How would you recommend doing that?

Mr. ROBERTSON. In essence that is what I am saying in the part 4 of this book, that we place more emphasis on individualism, place more emphasis on relating benefits to the taxes paid by an individual so that they can see the connection between what they are saving and what they are getting. I think the program then would be much more acceptable.

Senator SYMMS. What would you think about the idea, and I suggested this, when Secretary Schweiker was down here, that we put on a check every month when the person gets their check you put on there how much money they paid in and how much they have taken out.

I would make another suggestion and say when you have taken out twice as much as you put in, plus interest, that it would be time to go down to see the Social Security Administrator at the local office and demonstrate a need for any continued benefits after that.

There are a lot of people that get social security that take out a lot more than they get in. But the workers today are never going to be able to do that.

Mr. ROBERTSON. Well, I could not really endorse that proposal for today's plan because today's social security program is not based on an individual's receiving benefits that have very much to do with his taxes.

So, I wouldn't want to say if you received twice what your taxes have been, then you won't get any more.

Senator SYMMS. Well, I wouldn't say you wouldn't get any more, but at least you could justify how much more you received or maybe that would be a poor suggestion. I just threw it out as an idea. I am not saying I advocate that.

Mr. ROBERTSON. I think the principle is good. I think that we should clarify the program so that people can see the connection between what they pay and what they get for the part of the program that works that way.

For the part of the program that doesn't work that way, let's identify that so that we don't keep mixing the program up.

Senator SYMMS. Well, you are talking about raising the—you mentioned we have to have more people working so we need to encourage more productivity in the country and have more people producing and less people consuming.

Mr. ROBERTSON. Right.

Senator SYMMS. To keep the national productivity up. I happen to agree. I do think that older citizens often times are the best workers because they are smarter by then. They have more experience. They have more knowledge. They know how to do their jobs better.

But, if you start trying to sell this program to the young worker today, and say, "We are going to raise your retirement age to 68." Now, Mr. Swenson, you are an actuary; is that correct?

Mr. SWENSON. Yes, I am.

Senator SYMMS. OK. Doesn't the actuary tables show that this young worker probably will live to be 72?

How do you sell this to the young people and tell them that they are going to pay this massive tax all their life and then they have to work and they will be lucky if they get 4 years of it?

Mr. ROBERTSON. I would like to give a couple of figures on that.

When social security was adopted in the 1930s, a male who was 65 years old had another 12 years to live, on the average.

A female had 13 years.

If we look at today's youth, people under age 35, baby boomers, when they reach 65, in the next century, a male will expect to live 16 years, not 12 years like we used to. A female will expect to live 22 years, not 13 years.

So, we are talking about a whole different environment in the future and people living a lot longer and being in better health. The thing we have to do when we talk about higher retirement ages, is make sure we have communicated that. We are talking about a different group of people retiring at a different time. We are not talking about people who retire the next 5 years, 10 years.

We get confused when we talk about higher retirement ages. Everybody thinks it is going to apply across-the-board to everyone immediately. That is not the way it would be.

Senator SYMMS. You are talking about phasing it in 1 year at a time, one quarter at a time, something like that?

Mr. ROBERTSON. Yes. And not starting for quite some time. Not starting for about 20 years, actually.

Mr. SWENSON. I would just like to say that I think there is an acute need really to educate the public as to the nature and purpose of the program so that the young people are able to ratify the program and understand as Senator Bradley has said, that there are some benefits that young people receive, in addition to the benefits they can expect to receive as a retiree.

The issue of funding social security is an extremely complex issue. The academy does not have a position with respect to that.

The President's Commission on Pension Policy however stated our retirement income systems are dangerously dependent on pay-as-you-go funded systems. They were recognizing the fact that the demographics of this country really offer a time bomb of potential intergenerational conflict.

It is becoming increasingly clear that the days in which each generation could look forward to gaining far more in benefits than they paid in in contributions are coming to an end because of the demographics.

Therefore, I do think that more emphasis has to be placed on private pensions and individual savings to supplement what the social security program will be able to afford in the future.

Senator SYMMS. Thank you.

Thank you, Mr. Chairman.

Senator ARMSTRONG. Thank you, Senator Symms.

Thank you gentlemen. We appreciate very much your participation this afternoon.

[Statements follow:]

CONGRESS OF THE UNITED STATES

UNITED STATES SENATE

SENATE FINANCE COMMITTEE

SUBCOMMITTEE ON SOCIAL SECURITY

AND INCOME MAINTENANCE PROGRAMS

HEARINGS ON SOCIAL SECURITY FINANCING AND

OPTIONS FOR THE FUTURE

JULY 9, 1981

Testimony

of

James R. Swenson

Chairman

Committee on Social Insurance

of the

American Academy of Actuaries

AMERICAN ACADEMY OF ACTUARIES
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STATEMENT TO THE SUBCOMMITTEE ON SOCIAL SECURITY AND
INCOME MAINTENANCE PROGRAMS,
SENATE FINANCE COMMITTEE, UNITED STATES SENATE
BY
JAMES R. SWENSON, CHAIRMAN OF THE
COMMITTEE ON SOCIAL INSURANCE
OF THE
AMERICAN ACADEMY OF ACTUARIES

July 9, 1981

SUMMARY OF STATEMENT

- The American Academy of Actuaries recommends that both short and long term financing issues be addressed at this time to restore financial balance and public confidence in the program.
- The long term financing problems pose an even greater challenge to the program because of demographics.
- Because of demographics, unless changes are made in the program, total Social Security costs are projected to increase to between 22% and 38% of payroll once the baby boom generation has fully retired.
- It is important to realize that the long term deficit projected for the HI program is approximately twice as large as the deficit projected for the OASDI program.
- A gradual future increase in retirement ages to age 68 would eliminate approximately two-thirds of the long term OASDI deficit.
- Mandatory, universal Social Security coverage would eliminate approximately one-third of the long term OASDI deficit.
- Interfund borrowing would substantially alleviate the short term cash flow problems. However, other steps are required as well to protect the program from adverse economic conditions.

A "safety valve" provision providing that benefit increases be based on the lesser of wage or price increases would help protect the solvency of the program from the consequences of adverse economic conditions.

- It is impossible to accurately predict economic conditions. More emphasis should be placed on actuarial projections based on pessimistic assumptions.
- Adequate reserve margins are necessary to protect the solvency of the program. A reasonable long term objective would be a reserve ratio of between 75% and 125% of annual outlays as recommended by two Advisory Councils and the National Commission on Social Security.
- An economically and politically realistic minimum reserve ratio objective for the next 5 years would be 25% of annual outlays combined with enactment of a "safety valve" provision limiting benefit increases to the lesser of wage or price increases.

Maintenance of the 25% reserve ratio objective would require $65 billion of additional taxes or benefit reductions to be spread throughout the next five years based upon assumptions I personally believe to be reasonable for short term planning purposes.

The American Academy of Actuaries strongly urges that the Social Security Act be amended to enable the public to enjoy the same benefit of professional actuarial certification as is required for private pension plans and for pension plans covering federal employees.

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July 9, 1981

Mr. Chairman and distinguished Senators of the Subcommittee, my name is James R. Swenson. I am the Chairman of the Committee on Social Insurance of the American Academy of Actuaries. On behalf of the Academy, I wish to thank you for the opportunity to discuss financing issues affecting the Social Security program.

The American Academy of Actuaries is a professional organization of actuaries which was formed in 1965 to bring together into one organization all qualified actuaries in the United States and to seek accreditation and greater public recognition for the profession. It includes members of three founding organizations -- the Casualty Actuarial Society, the Conference of Actuaries in Public Practice, and the Society of Actuaries.

Requirements to become a member of the Academy can be summarized under two broad headings: (1) education and (2) experience. At the present time, the education requirements for membership can be satisfied by passing certain professional examinations given either by the Casualty Actuarial Society or the Society of Actuaries or by becoming an "enrolled actuary" under the Employee Retirement Income Security Act of 1974 (ERISA). The experience requirement consists of three years of responsible actuarial work.

As of the end of 1980, the Academy membership exceeded 6,200. The Academy is unique as the national actuarial organization for actuaries in all areas of specialization. These actuaries have a variety of types of employment, including insurance organizations, consulting firms, academic institutions, and government. A large majority of those individuals who have satisfied the education and experience requirements of the Academy have, in fact, joined the Academy.

The Academy is active in the development of guides to professional conduct and standards of practice required of members in their professional practice. The Academy is also active in government relations, liaison with other professions and public relations.

Actuarial science involves the evaluation of the probabilities of uncertain future events, often over long periods of time, and the financial impact which these events involve. The computation of financial values for insurance and pension programs in both the public and private sectors is a major application of actuarial techniques.

The actuarial nature of the financing arrangements for Social Security has been recognized since the inception of the program in 1935. In recognition of the extreme importance to society of maintaining the financial integrity of the Social Security system the Academy formed its Committee on Social Insurance several years ago. The Committee includes some of the most eminent actuaries in the United States with a wealth of experience in both the public and private insurance and pension programs.

Since I am representing a professional organization comprised of individuals who hold diverse political views, this statement will not generally favor or oppose specific legislative proposals. Instead, the statement will discuss the actuarial projections involving the Social Security program and the financial implications of various alternatives to assist you in your important deliberations.

It is apparent that legislation needs to be enacted to resolve the predicted short term financing problems of the OASI portion of the program. The Academy believes that it is equally important that long term financing issues be addressed at the same time to restore financial balance to the program and to foster public confidence in the program.

While the short term financing problems of the program require immediate action, the long term financing problems pose an even greater challenge to the program. Since the Social Security program is an intergenerational transfer program, funded essentially on a pay-as-you-go basis, the demographic influences of increasing life expectancy combined with the post World War II baby boom and subsequent baby bust will require either substantial increases in future payroll tax rates or significant benefit reductions.

Official actuarial projections prepared for the 1980 Trustees' Report predict OASDHI benefit costs ranging from 20% to 36% of payroll by the year 2030. The cost of Medicare's Supplementary Medical Insurance program, which is financed primarily by general revenues, will require an additional intergenerational transfer equal to approximately 2½% of payroll by that year. In addition, long term actuarial projections based upon the 1980 intermediate assumptions indicate that OASDI benefit disbursements will exceed scheduled taxes by an average of 1½% during the next 75 years.

Since the financial viability of the program depends upon the willingness and the capability of persons who are working to pay taxes sufficient to support promised benefits, those benefit promises must be kept at levels that are reasonable and affordable. This requires that significant long term changes to the program be enacted so that future generations will not be faced with a burden they will be unable or unwilling to support. Such changes should be enacted now so that those affected will have adequate time to plan accordingly.

In this context, it is noted that the recent Administration proposals were criticized because they produced more savings than needed to restore long term financial balance to the OASDI program. While this is true based upon the 1980 intermediate assumption projections, these additional long term savings would be required to help offset the even larger deficits expected to develop in the Hospital Insurance program.

Proposals to increase the age at which full Old-Age benefits are to be paid would reduce the tax levels required to be paid by future generations of workers. For example, proposals to gradually increase the retirement age from 65 to 68 would generally eliminate approximately two-thirds of the 1½% 75 year OASDI financing deficit. To further assist you in your deliberations, it should be noted that today life expectancy at age 68 is greater than it was at age 65 in 1935 when the latter age was selected as the original retirement age under the program. Moreover, actuarial projections indicate that by the year 2000, individuals in their early 70's are expected to have the same life expectancy as individuals age 65 had in 1935.

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As you are aware, Universal Social Security Coverage has been recommended by many commissions, advisory panels and study groups. Universal Coverage would help restore financial balance to the program for both the short and long term future. For example, approximately one-third of the 1½% 75 year OASDI financing deficit would be eliminated if Universal Coverage were required.

If Universal Social Security Coverage is enacted, it is important that the benefit structure of existing programs be coordinated with the Social Security program. This will pose a complex problem, but the actuarial profession is prepared to offer assistance so that the coordination can be accomplished in a rational manner. If Universal Social Security Coverage is not enacted, the actuarial profession has suggested methods to remedy the unintended "windfall benefit" situation.

There are a variety of alternatives available to solve the short term financing problems. Those problems would be substantially alleviated if proposals permitting inter-fund borrowing were enacted. However, the margins protecting the program from adverse economic conditions would be inadequate and other changes are warranted as well.

Actuarial projections of the degree of the short term problem largely depend upon the economic assumptions employed in those projections. Unfortunately, it is impossible to accurately predict future economic conditions. In 1977 it would have been unrealistic to predict, as "best estimates," economic conditions as adverse as those that prevailed during the past two years. The actual economic conditions were even worse than pessimistic estimates being made at that time.

Therefore, it is necessary to provide adequate margins to protect the program from the consequences of unexpected adverse economic conditions. The current margins are inadequate. Those margins should be large enough to permit adequate time for legislation to be enacted to maintain the financial viability of the program.

In addition, "safety valve" type provisions are highly desirable to protect the program from adverse economic conditions. For example, if the 1977 Social Security Amendments had provided that benefit increases be based upon the smaller of wage or price increases, the program would not now be confronted with cash flow problems. Unfortunately, tax revenues have failed to keep pace with CPI indexed benefit payments because of negative "real wage" growth. The CPI increase exceeded the average wage increase by 3.1% in 1979 and by 5.0% in 1980. This is the primary cause of the immediate cash flow problems.

If future benefit increases were limited to the smaller of wage or price increases, this would provide the program with substantial protection from adverse economic conditions. Under favorable economic conditions, benefits would continue to be fully indexed to CPI measured price increases. However, if economic conditions prove unfavorable, the benefit increases would be limited to wage increases thereby providing protection when it is needed most.

For example, actuarial projections based upon pessimistic economic assumptions forecast earlier this year by Data Resources Incorporated would require $111 billion of additional taxes or benefit reductions over the next five years to enable the program to make benefit payments. Limiting the benefit increases to the lesser of wage or price increases would provide $35 billion of this total amount needed according to projections made by the Office of the Actuary.

The relative unpredictability of the economy indicates that more emphasis should be placed on actuarial projections based upon pessimistic assumptions. It should be noted that such projections indicated the potential for short term cash flow problems shortly after the 1977 Amendments were enacted. Virtually no publicity was given to that fact at the time.

It is my personal opinion that the previously mentioned DRI pessimistic assumptions are not unreasonably pessimistic. As a matter of fact, none of the future DRI "real wage" loss assumptions are as substantial as the actual "real wage" losses that occurred in the last two years. In addition, it should be noted that since 1972 there has been only one year during which there was more than a 1% "real wage" gain.

Current legislative changes should provide adequate reserve margins as well as "safety valve" provisions. Even with these margins and provisions, there is a good chance that subsequent legislative action would be required if "best estimate" forecasts are used as the basis for legislative action because of the unpredictability of the economy.

A minimum reserve of approximately 12% to 14% of annual outlays is essential to meet cash flow requirements. Additional reserves are needed to permit time for legislative action if actual economic conditions are worse than expected. Two Advisory Councils and the National Commission on Social Security have recommended reserve ratios ranging between 75% to 125% of annual outlays.

These are reasonable long range objectives for the program. They are not redundant when it is recognized that the reserve ratio was 80% in 1973 and had fallen to 24% as of the end of 1980.

It is not politically realistic to expect these reserve levels to be attained during the next five years. Therefore, a judgment must be made about an economically and politically feasible minimum reserve level that would permit time for subsequent legislative actions should it become necessary. It is my judgment that a minimum reserve level of 25% of annual outlays is essential to protect the program and its recipients. This minimum reserve level leaves very little margin of protection from adverse economic conditions and therefore, requires enactment of a "safety valve" provision limiting benefit increases to wage increases when "real wage" losses occur.

Based upon actuarial projections employing former President Carter's 1982 Budget economic assumptions, which I personally consider to be reasonable economic assumptions for short-term planning purposes, maintenance of this minimum reserve level would require approximately $65 billion of additional taxes or benefit reductions to be spread throughout the period from 1982 to 1986. Again, please realize that subsequent political action may be required to protect the program, but current enactment of legislation providing a "safety valve" and further producing these additional revenues or savings would allow sufficient time for such action. If you wish to reduce the probability of having to take subsequent political action, then current legislation should be based on more pessimistic assumptions such asthe DRI assumptions.

The current financing problems of the program illustrate the continuing need for independent, professional actuarial analysis. The Office of the Actuary of the Social Security Administration and the actuaries employed in the Health Care Financing Administration are uniquely qualified to provide such analysis. They must be given the latitude to select a range of appropriate assumptions independent of "official" economic forecasts.

It should be noted that the Employee Retirement Income Security Act of 1974 (ERISA) requires that valuations of private pension plans be certified by qualified actuaries. A similar actuarial certification is required by P.L. 95-595 for pension plans covering federal employees. In each situation, the actuary must certify that the assumptions used are reasonable in the aggregate, representing the best estimates of anticipated experience, and that methodology is proper. The American Academy of Actuaries recommends that the Social Security Act be amended to enable the public to enjoy the same benefit of professional actuarial certification for the Social Security program. This recommendation has also been made by the National Commission on Social Security.

Consistent with this recommendation, the Board of Directors of the American Academy of Actuaries has adopted the following resolution:

> "Whereas actuarial projections and cost estimates based on work of the highest professional quality and integrity have been an important force for fiscal prudence in the historical development of social insurance programs; and
>
> "Whereas the growth of these programs and their commitments to future generations of beneficiaries makes it more important than ever that these programs be managed in a fiscally prudent manner;

"Therefore, be it resolved that this organization believes that it is in the best interests of the public that (1) the actuaries who are responsible for the projections and cost estimates be free to use their best professional judgment and expertise independent of pressures for political expediency, and (2) the actuaries ultimately responsible for their work be required to issue an opinion letter accompanying the appropriate annual report stating whether the actuarial assumptions used in the projections contained therein are (a) in the aggregate reasonable taking into account the experience and expectations of the plan and (b) represent their best estimates of anticipated experience under the plan."

Attached to this testimony is a proposed amendment to the Social Security Act. This amendment would require a statement of opinion by the Chief Actuary of the Social Security Administration and the Chief Actuarial Officer of the Health Care Financing Administration that the techniques and methodology used in preparing the actuarial status of the Trust Funds and the cost estimates and the assumptions used with respect to such Funds are reasonable and conform with generally acceptable actuarial principles.

In conclusion, the Academy hopes this testimony has been helpful, and we would welcome the opportunity to be of further assistance as you proceed with your important deliberations.

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PROPOSED AMENDMENT

Section 201(c) of the Social Security Act is amended by adding at the end thereof the following new sentence:

"Such report shall also include a statement by the Chief Actuary of the Social Security Administration expressing his or her opinion: (1) that the techniques and methodology used in preparing the actuarial status of the Trust Funds are in accordance with generally accepted actuarial principles; and (2) whether the cost estimates and the assumptions on which they are based are in the aggregate reasonable for the purpose for which they are intended taking into account the experience and expectations of the program, including a statement of the governmental sources of the assumptions used therefor, where appropriate."

(b) Section 1817(b) of such Act is amended by adding at the end thereof the following new sentence:

"Such report shall also include a statement by the Chief Actuarial Officer of the Health Care Financing Administration expressing his or her opinion: (1) that the techniques and methodology used in preparing the actuarial status of the Trust Fund are in accordance with generally accepted actuarial principles; and (2) whether the cost estimates and the assumptions on which they are based are in the aggregate reasonable for the purpose for which they are intended taking into account the experience and the expectations of the program, including a statement of the governmental sources of the assumptions used therefor, where appropriate."

(c) Section 1841(b) of such Act is amended by adding at the end thereof the following new sentence:

"Such report shall also include a statement by the Chief Actuarial Officer of the Health Care Financing Administration expressing his or her opinion: (1) that the techniques and methodology used in preparing the actuarial status of the Trust Fund are in accordance with generally accepted actuarial principles; and (2) whether the cost estimates and the assumptions on which they are based are in the aggregate reasonable for the purpose for which they are intended taking into account the experience and the expectations of the program, including a statement of the governmental sources of the assumptions used therefor, where appropriate."

(d) The amendments made by this section shall be effective on January 1, 1982.

CONGRESS OF THE UNITED STATES
UNITED STATES SENATE
COMMITTEE ON FINANCE
Subcommittee on Social Security
and Income Maintenance Programs

HEARINGS ON
SOCIAL SECURITY FINANCING
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OPTIONS FOR THE FUTURE

July 9, 1981

Testimony
of
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STATEMENT TO THE
COMMITTEE ON FINANCE
UNITED STATES SENATE
Subcommittee on Social Security
and Income Maintenance Programs

by

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Mr. Chairman and distinguished Senators of the Subcommittee, my name is A. Haeworth Robertson. From 1975 to 1978 I served as Chief Actuary of the Social Security Administration. I am currently Vice President of William M. Mercer, Incorporated, an international firm of employee benefit consultants.

I am pleased to have been asked to appear before your Subcommittee as you consider the present and future problems of Social Security. My commentary is based on material taken from <u>The Coming Revolution in Social Security</u>, a full-length book, which I have recently written, dealing with Social Security's problems and proposed reforms (published in May 1981 by Security Press, Box 854, McLean, Virginia 22101).

Summary of Principal Points

1. Despite the concern being expressed about Social Security's financial problems, relatively few people appreciate the extent of these problems or their imminence. Even Social Security's Trustees continue to ignore the high future cost of Medicare: the annual financial reports of the Board of Trustees present cost projections for only twenty-five years for the Hospital Insurance portion of Medicare and for only three years for the Supplementary Medical Insurance portion.

2. The total cost of Social Security (OASDI, HI, and SMI), expressed as a percentage of taxable payroll, has risen continuously from 0.19% in 1940, to 1.17% in 1950, and to 13.63% in 1980. Costs will continue to rise in the future to somewhere between 20% and 40% of taxable payroll during the lifetime of today's youth if there are no changes in the program or the prevailing retirement age patterns.

3. As serious as these financial problems are, we should be more concerned about the subtle and intangible costs, not the obvious money costs. We should gain a fuller appreciation of the net effect of the influences being wrought by the Social Security program on our present and future lives.

4. Although Social Security may be suitable for persons now retired or those retiring in the next few years, it is totally inappropriate for the bulk of the nonretired population. Social Security has a number of major deficiencies. The projected high future money costs

are not one of those deficiencies; the costs are only a manifestation of one of the basic underlying problems.

5. The post-World War II generation of approximately 135 million persons now under age 35 comprises 65 percent of the total population that is less than age 65. Accordingly, at least 65 percent of the population that is not yet retired is still young enough to adjust to any retirement policy they decide is appropriate for them. These young persons will begin reaching their sixties just twenty-five years from now in the year 2006. It is today that a general framework should be constructed regarding the retirement of this generation--the type and level of benefits to be provided, the source of benefits, the approximate age at which benefits will commence, and so on. In making these choices we need not be influenced unduly by decisions made in the past for different generations of people living under different circumstances. The only reverence we owe these past decisions is to fulfill the promises made to date to our older population.

6. It is entirely reasonable, therefore, for us to give serious consideration to a completely new type of social insurance system for the relatively young segment of our population, even if we continue the present system for the older segment of the population. Significant change is possible if we really want such change.

Introduction

Most people are aware that Social Security is having financial problems now and that these problems will worsen sometime in the distant future. Not many people appreciate the extent of Social Security's future financial problems or their imminence. There are several reasons for this lack of awareness.

For one thing, the long-range Medicare costs are virtually ignored, yet they are estimated to account for approximately 40 percent of the total cost of Social Security early in the next century. Since its benefits are paid "in kind" and not in cash, Medicare's value--and its cost--does not seem to be fully appreciated. Although seldom thought of in this way, Medicare benefits are equivalent to a lifetime annuity--in an indeterminable, but increasing amount--for the aged and disabled. Despite the high future cost of Medicare, the annual financial reports of the Board of Trustees present cost projections for only twenty-five years for the Hospital Insurance portion of Medicare and for only three years for the Supplementary Medical Insurance portion. Perhaps the theory is that "What we don't know won't hurt us."

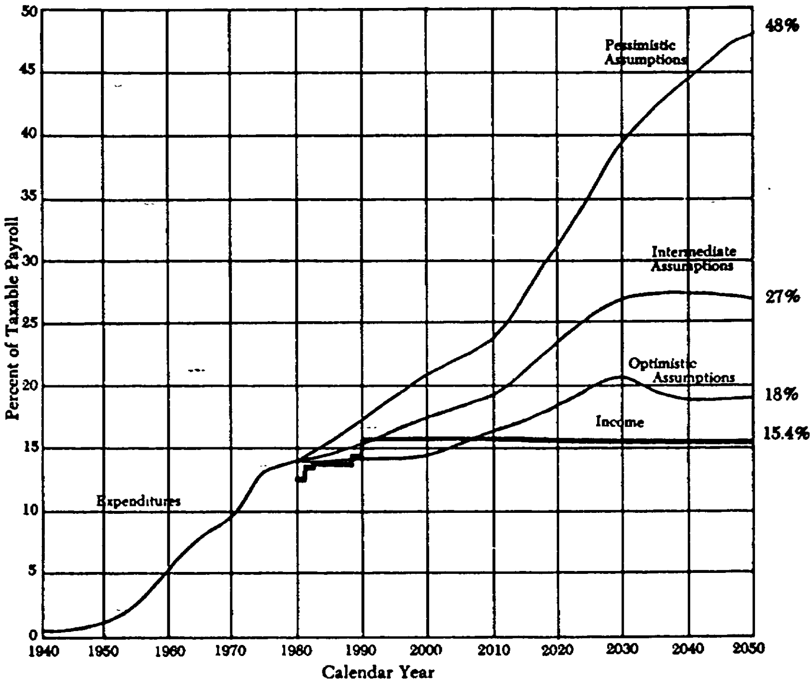
Even when long-range cost estimates are officially made available, they are not usually given proper attention and emphasis. Long-range projections for the monthly cash benefits portion of Social Security are currently prepared under alternative sets of assumptions about the future--optimistic, pessimistic, and intermediate--in order to portray the broad range within which future costs may fall and to emphasize that the future is indeterminable. Unfortunately, only the intermediate costs are given any publicity. An examination of the intermediate cost projections is a sobering exercise; a look at the pessimistic cost projections is downright frightening.

The Money Cost of Social Security

The following chart presents the expenditures for benefits and administration of the entire Social Security program (Old Age, Survivors, and Disability Insurance and Medicare--Hospital Insurance and Supplementary Medical Insurance) as a percentage of taxable payroll. Although the Supplementary Medical Insurance (SMI) program is not financed by payroll taxes, its cost is shown for comparative purposes as a percentage of Social Security taxable payroll. Participation in SMI is optional and is financed by premiums paid by the enrollees, and by general revenue.

Actual past expenditures from 1940 to 1980 are shown; projected future expenditures are shown based upon the optimistic, intermediate, and pessimistic assumptions used by the Trustees in preparing their 1979 financial reports. The scheduled future income from taxes and SMI premiums is also shown. (The actuarial projections prepared since 1979 are not significantly different from those shown in the chart.)

Projected Expenditures for Old-Age, Survivors, Disability, Hospital and Supplementary Medical Insurance Programs Combined under Alternative Demographic and Economic Assumptions, and Legislated Income, Expressed as a Percentage of Effective Taxable Payroll



The chart speaks for itself and is a rather dramatic illustration that:

-- Costs have risen continuously in the past from 0.19% of taxable payroll in 1940, to 1.17% in 1950, and to almost 14% in 1980.

-- Costs will continue to rise in the future; it is only a question of how much. Will it be to 18%, or 27%, or 48%? My opinion is that future costs will be closer to those indicated by the pessimistic assumptions than by the optimistic assumptions.

-- Present tax rates and even the scheduled future tax rates will be inadequate in the next century under each of the scenarios depicted. The total payroll tax rate, which is currently 13.30 percent (6.65 percent from the employers and 6.65 percent from employees), will probably rise to about 25 percent and perhaps to 40 or 50 percent within the lifetime of today's youth.

-- Anyone who thinks there are no significant financial problems ahead and that the future will take care of itself is engaging in wishful thinking and has a false sense of security.

<u>The Real Cost of Social Security</u>

As serious as this financial problem is, it is not the most important Social Security problem that is confronting the nation in the immediate future; neither is the program's mismanagement, inappropriate benefits, unfair treatment of participants, or any of the other charges directed at it by critics. Social Security's main problem is the widespread lack of understanding of the program--its basic rationale, the type and level of benefits it provides, the method of financing, the significance of the high future cost, and the tenuous relationship between taxes paid and benefits received by an individual. The average individual does not know what Social Security is all about and does not know what to expect from Social Security. Should he expect it to meet all of his needs (and those of his dependents) in the event of old age, disability, death, or sickness? Or should he expect it to be merely a floor of protection in meeting these needs, a floor upon which he and his employer should build through supplemental private saving and insurance and some form of retirement program? Apart from his expectations, what type and level of benefits does Social Security actually provide in meeting these various needs? Most people don't know.

Because of this lack of understanding of Social Security, very few people comprehend the pervasive impact it is having on our social and economic structure. Social Security is not merely responding to our economic security needs; it is shaping and even creating those needs. Indeed, it is exacerbating the needs it purportedly exists to resolve. We would be astonished if we had a full appreciation of the net effect of the influences being wrought by the Social Security program on our present and future lives, individually and collectively as a nation. It is these subtle and intangible costs, not the obvious money costs, with which we should be most concerned.

Deficiencies of Present Social Security

I would suggest that the major deficiencies of our Social Security system may be summarized as follows. It is noteworthy that the projected high future money costs are not listed as a problem--they are only a manifestation of one of the basic underlying problems.

-- Social Security is so complex that the average person will never know what benefits to expect, and will never know how much responsibility to assume for himself and his family. This will lead to the individual's looking blindly to the government, hat in hand, for whatever benefits Big Brother is dispensing at the time. The inevitable result will be erosion of initiative, individuality, and self-respect, as well as the loss of any sense of freedom of choice and control regarding a vital aspect of our lives.

-- Social Security trespasses upon almost every aspect of our personal lives by imposing an unnecessary straightjacket of behavioral standards: when to retire, how much to earn between ages 62 and 72, when to divorce, whether to remarry (as well as when and to whom), and so on. It destroys the flexibility needed for us to manage our lives as we see fit. In their book Free to Choose[1], Milton and Rose Friedman refer to this kind of loss

[1] Milton and Rose Friedman, Free to Choose: A Personal Statement, Harcourt Brace and Jovanovich, New York, 1979, p. 123.

of freedom as "the present demoralizing situation under which some people--the bureaucrats administering the programs--run other people's lives."

-- Social Security is in effect a rigid mechanism for dividing the population into two groups: those who work and produce goods and services, and those who are inactive but still share in such production. The particular division fostered by Social Security may have been appropriate in the past, but it will not be appropriate for tomorrow. Specifically, the early sixties will not be a proper age to divide the active from the inactive population as the baby boom of yesterday becomes the senior boom of tomorrow. A flexible system is needed that will permit this separation into active and inactive groups of persons to be self-adjusting with the changing times--changing proportions of old and young, improved health at older ages, longer lifetimes, more women in the paid work force, and so on. (The projected high future costs of Social Security are simply an indicator of this inappropriate division of the population into two groups.)

-- Social Security discourages personal saving, including private pension plans, retards the capital formation necessary for a strong economy, and thus reduces national productivity growth that would improve the standard of living for all--active and retired alike.

-- Social Security is structured to reward life patterns (e.g., male breadwinner and female homemaker, and lifelong marriages) that are becoming much less representative of modern life. Social Security is not flexible enough to accommodate the changing role of the family unit; and, in particular, of women as they move toward independence and equality. The roles of men and women will continue to evolve and will never again be as stereotyped as they once were.

-- Social Security combines the elements of individual equity and social adequacy (welfare, as it is wont to be called) and effectively hides any connection between the taxes an individual pays and the benefits he receives. Yet, all the while the public has been told there _is_ such a connection between taxes and benefits (through the rhetoric of "contributions" paid to a "trust fund" under an "insurance" program to acquire an "earned right" to specified benefits). Indeed, the public's belief that they were buying their own benefits with their own contributions was an important element in the extraordinary public acceptance of Social Security until the mid-1970s--when they began to find out that was not the way it worked. A clear understanding of how the taxes are used and a belief that the program is fair and equitable are essential when taxes are at today's levels.

Can Social Security Be Changed?

In my opinion, it is not a question of whether Social Security can be changed, it is only a question of how and when it will be changed. Change is inevitable. It is just a matter of whether it will arise from a clearheaded appraisal of our existing system or from the existing state of frustration and bewilderment. My reasoning is as follows.

There is widespread lack of understanding among the public about what Social Security is intended to be and how it works. An important cause of this misunderstanding has been years of government rhetoric that has led people to believe that their Social Security benefits were "bought and paid for" by their own "contributions". President Franklin D. Roosevelt set the tone for this rhetoric when he responded to a visitor who complained about the economic effect of the Social Security payroll tax:

> I guess you're right on the economics, but those taxes were never a problem of economics. They are politics all the way through. We put those payroll contributions there so as to give the contributors a legal, moral, and political right to collect their pensions....With those taxes in there, no damn politician can ever scrap my social security program.[2]

2 Arthur M. Schlesinger, Jr., The Age of Roosevelt, vol. 2, The Coming of the New Deal (Houghton-Mifflin, 1959), pp. 308-9

Social Security is not a program that grants benefits equal to taxes--neither on an individual basis nor on a group basis. If individuals paid taxes equivalent to the value of their benefits, some employees would pay taxes of less than 2 percent of their wages and others would pay more than 26 percent (matched by employer taxes) just to obtain old-age, survivors, and disability benefits. There is virtually no relation between an individual's taxes and his benefits. On a group basis, the discrepancy between taxes and benefits is just as great. Persons who have participated in Social Security the past forty years or so have received benefits (some of which have only been accrued and will be paid later) worth five times as much as was paid in taxes. The result is an unfunded accrued liability (in 1979) of some $6 trillion; therefore, the nation had a hidden liability in 1979 of seven times the national debt, or $43,000 for every adult then between ages 20 and 65.

Although this misunderstanding of the nature of Social Security was convenient in gaining its public acceptance and although it made the payment of ever-increasing taxes ("contributions") more palatable for awhile, in the end it has created a monumental dilemma. If public misunderstanding is allowed to persist, confusion and disappointment will worsen because Social Security will continue to fall short of most of the public's expectations, and this will result in a frenzied cry for change. On the other hand, if the misunderstanding is eliminated the public will most probably not like what it sees and thus will demand significant revision. In either event, there is a big change on the horizon. There is a coming revolution in Social Security.

In considering any revision in Social Security an extremely important factor is the long-term promises, express or implied, that have been made to millions of Americans who have paid Social Security taxes in the past. Monthly cash benefits are being paid at the rate of more than $100 billion per year to 35 million people--retired and disabled workers and their dependents, widows and orphans, and dependent parents. One of every seven Americans is receiving monthly Social Security benefit checks. Millions of people who are just a few years from retirement have built their plans around the present Social Security program. Furthermore, over 100 million people have worked and paid Social Security taxes in the past and have some expectation of future benefits.

But these facts do not mean Social Security cannot be changed. It can be changed and it can be changed significantly. We are often too quick to agree that Social Security is so large and complex and that it has been in existence so long that it will be difficult, if not impossible, to make substantial revisions.

Consider the following important statistics--numbers not called to our attention by those who insist that Social Security should not and can not have major revisions. The post-World War II generation, approximately 135 million persons under age 35, now comprises 65 percent of the total population that is less than age 65. In other words, at least 65 percent of the population that is not yet retired is still young enough to adjust to any retirement policy they decide is appropriate for them. These young persons will begin reaching their sixties just twenty-five years from now in the year 2006. It is today that a general framework should be constructed regarding the retirement of this generation--the type and level of benefits to be provided, the source of benefits, the approximate age at which benefits will commence, and so on. In making these choices we need not be influenced unduly by decisions made in the past for different generations of people living under different circumstances. The only reverence we owe these past decisions is to fulfill the promises made to date to our older population.

It is entirely reasonable, therefore, for us to give serious consideration to a completely new type of social insurance system for the relatively young segment of our population, even if we continue the present system for the older segment of the population. Significant change is possible if we really want such change.

Remember this astonishing statistic: 65 percent of the present population that is not yet retired is less than age 35. This youthful population of 135 million persons has had more influence on our way of life than any group of youngsters in modern history. Are they not entitled also to decide the groundrules that will apply to their retirement, provided only that they not disturb the promises already made to our older population?

Senator ARMSTRONG. I want to welcome a panel consisting of Mr. Robert Ball who is well known of course, to Senators. He is a former Commissioner of the Social Security Administration. He appears today not only in that capacity as a former Commissioner, but also as Chairman of the Advisory Committee of the Save Our Security organization.

Also, Mr. Jacob Clayman, president of the National Council of Senior Citizens.

Gentlemen, thank you for your patience. Welcome. We are delighted to have you with us. We are looking forward to your testimony and the insights you have to bring to bear on this.

STATEMENT OF ROBERT BALL, CHAIRMAN OF ADVISORY COMMITTEE, SOS; FORMER COMMISSIONER OF SOCIAL SECURITY, 1962-73

Mr. BALL. Thank you, Mr. Chairman. As you suggested, I am in the rather unique position of representing a coalition of nearly 100 organizations.

Senator ARMSTRONG. Mr. Ball, I know just how that is to represent a coalition of diverse interests.

Excuse me. Please continue.

Mr. BALL. Those organizations have a joint membership of between 35 and 40 million people, and it is about evenly divided between those who are now contributing to social security and those who are getting benefits.

The existence of this coalition gives the lie to the people who are saying that we are in a big problem of the people contributing having one idea and those receiving another.

We are all in this together. No one stays young. The young worker has the same stake in developing a sound and keeping a sound social security system as do the people now getting benefits.

Mr. Chairman, in the very limited time available, I have to be, of course, very selective on what I chose to talk about. I assume that both the long statement that I prepared and the summary which is also too long for the 5-minute limitation will be included in the record.

Since the coalition that I represent, is opposed to the administration's idea of cutting social security benefits, and is opposed to other types of cuts that have been suggested such as cuts for those who apply for benefits prior to age 68 or changes in the cost-of-living adjustment designed to reduce benefits, I feel an obligation to focus on the financing situation of social security. Why do we think it is possible to maintain the benefit levels that have been promised and not seek social security cuts, when there is all this talk of bankruptcy and general gloom and doom?

I think it is helpful, Mr. Chairman, in thinking about social security financing to divide the discussions into three time periods.

The first is the short-term period that has been discussed by previous witnesses, particularly Senator Chiles, and here, although there is a critical problem that needs to be met, it is a relatively small problem and easily manageable.

It seems to me that the administration has way overstated the situation as far as the short-term problem is concerned with talk of bankruptcy around November 3, 1982.

That is just not the case if you will allow one change in the law. That is the authority from one fund to borrow from the other.

Under that approach, under the administration's own economic assumptions there is nothing else that needs to be done for the next 5 years.

Now, I think that is too optimistic. But if you take the CBO alternative assumptions—much more pessimistic assumptions—and you consider the fact that both Houses of Congress have already passed cuts, which includes hospital insurance and interest, which improves the position of the funds by about $30 billion over the next 5 years, then the CBO much more pessimistic assumptions also makes it unnecessary to do anything other than interfund borrowing for at leas the next 5 years.

Under present law, there is a problem under CBO projections, in 1986, not sooner, with interfund borrowing, but with the cuts that have been agreed to there is no problem at that time.

Now, Mr. Chairman, nevertheless, we believe that it would be important to have standby authority that goes beyond that. Although it might never need to be used, it would be desirable to have authorization to borrow from the general fund, on a back-up basis, for at least a short-term period, perhaps for 10 years.

Now that is a minimal plan, related only to the short term.

In the middle term, I think it needs to be stressed that as far as cash benefits under social security is concerned, Senator Moynihan's chart is exactly correct. Whether expenditures are related to gross national product or to covered payroll, they follow the same curve.

In the middle period between about 1985 and into 2005, at least the demographic situation is favorable to social security; that is when the baby boom generation is paying in. With any productivity increases costs fall somewhat between now and early in the next century. It is not dramatic, but expenditures fall somewhat as a percentage of either covered payroll or as a percentage of gross national product.

Then you have the third period about which I think there can be real differences of opinion—and that is the red light, Mr. Chairman. I would be glad to talk about the third period in response to any questions.

Senator ARMSTRONG. Thank you.

Mr. Clayman.

STATEMENT OF JACOB CLAYMAN, PRESIDENT, NATIONAL COUNCIL OF SENIOR CITIZENS

Mr. CLAYMAN. I have difficulty in clearing my throat in 5 minutes. Let me try.

I was intrigued by the conversation this afternoon concerning the crisis in confidence and the importance of public attitudes. Even your question, Mr. Chairman, about the possible political consequences of cutting social security.

Let me address myself to it quickly, as I know the people whom our organization represents in this country and they are elderly.

We get many letters. We get many telephone calls. We have meetings all over the country. Every time there is a crisis of a genuine nature, telephones ring, the letters roll in. They are coming in now.

I sense from what I hear and what I see, that our people, the elderly, are undergoing a period of psychological trauma, a time of uncertainty and fear that their Government, indeed, even this Congress will do them in.

Maybe they shouldn't believe that, but many of them do as a matter of fact, indeed, of the people we represent, most of them do.

I reported in my written testimony, a conversation with one such older person who at age 63, and disabled, felt uncertain that he would survive the cuts in social security. His telephone call indicated a genuine deep and abiding anxiety that a psychiatrist might comment on if he were to talk to him as I did.

I can understand why this is so. I can understand this reaction. Almost every week, indeed, even before the Presidential inauguration, every week, sometimes 2 days a week, a new urgent alarm is sounded, a fresh crisis, a frantic prediction of imminent bankruptcy or death of social security.

I must confess, it reminded me a bit of the Perils of Pauline, the movies that I used to watch as a kid. Every week a new crisis.

But the oldsters that I know, the ones that I represent here today, they read the same newspapers you and I read. They watch the same TV shows that you and I watch. I must tell you that it strikes fear in their consciousness that the economic security which they anticipate in social security is in the gravest peril and will fail them in their hour of need.

If the administration seeks to bewilder, to strike terror in the hearts of the people I know, the elderly, then the administration has succeeded. The psyche of American elderly, in my judgment, from what I have seen, and I see more elderly than most in the things I do every day, are in a more fearful state than I have ever known them to be in my time.

They are worried that their Government may disown them. They are worried that their Government will disown the commitment made by it and honored now for 46 years. And just by way of understanding their bewilderment, for 46 years, no President, no Congress has ever laid heavy hand on the Social Security Act. Not Harry Truman. Not Eisenhower. Not Kennedy. Not Johnson. Not Nixon. Not Ford. Not Carter, except, I must say in one situation. I can't give him a clean bill of health as far as our senior citizens are concerned.

I suspect I should abide by that red light. If that is so, I have some other things to say, but I will try to get them in somehow.

Senator ARMSTRONG. Mr. Clayman, we are grateful for your consideration, but please feel free to complete your thought. Then I will recognize Senators for their questions.

Mr. CLAYMAN. If it is the will of Congress and the administration to do serious damage to social security, it won't be easy. I think there will be a price that will have to be paid.

I just got a report from a meeting in Peoria, a couple of hundred senior citizens wanted to discuss social security problems with Congressman Michel who comes from that district, a very conservative district, a quiet community, Peoria. They all together sang a song. This is no place to sing it. But let me read the words.

"Our eyes are"—this is to the tune of the Battle Hymn of the Republic, "Our eyes have seen the horror of the coming of the cuts." Incidentally, this is their own composition. "Robert Michel says we'll be OK, but that's a bunch of guff. We've come today to let him know we cannot stand these cuts. Hands off social security."

And then the second stanza. "We have worked hard to make a living to secure our senior years." And that is deep in the gut of every elderly person that I know. "But Ronnie Reagan's policies darn near have us in tears. Bob Michel better listen up, he's getting on in years. Hands off social security."

That is a typical piece of old fashioned American humor, and also with an undercurrent of grief and anxiety.

The only point I want to make, because maybe this is the most important point I can make—social security cannot be cut without exacting a very heavy political price.

Senator ARMSTRONG. Thank you.

Questions from the committee.

Senator Long.

Senator LONG. Let me ask Mr. Ball about one possibility that you didn't discuss, Mr. Ball.

What if we just took the attitude that in the short run during this next 5 years, we would just pay out as much as we take in? How much would we have to reduce the cost-of-living in order to clear the hump? There is a short period in which you say there is going to be a problem. We could just modify the cost-of-living increases, if we have to, to stay on the basis of not paying out more than what we are taking in.

How much lower than the present law increases would it have to be? What percentage would it have to be?

Mr. BALL. Are you allowing for borrowing from one fund and the other?

Senator LONG. Suppose we said, all right, we will let you borrow from one fund and give to the other; we are not going to raise the tax. But we would not pay out more than we are taking in.

How much would we have to reduce the benefit increases if we did that?

Mr. BALL. Well, Senator Long, that depends, of course, on your economic assumptions. If you take the favorable economic assumptions that the administration has——

Senator LONG. As I understand it, if you take the assumptions of the administration, you would not need to worry about any reductions, right?

Mr. BALL. Actually, there will be about a $15 billion increase in the combined funds during the 5-year period under their assumptions.

But let's take the CBO, a much more pessimistic assumption.

Senator LONG. That is what the Congressional Budget Office thinks is really going to happen.

Mr. BALL. Yes. Well, it is their alternative assumption that they used as testimony before the Senate Committee on Aging.

Senator LONG. That is the assumption Mr. Reagan said you couldn't trust because it was too pessimistic?

Mr. BALL. No. I think he would want it as pessimistic as possible for social security. They are doing it two ways. They say for general budget purposes they have very optimistic economic assumptions. But on social security they are arguing that you should assume a very pessimistic situation, even more pessimistic than CBO.

Senator LONG. I don't think you can have it both ways. It seems to me you ought to take one assumption or the other.

Mr. BALL. I am not the right one to argue with about that.

Senator LONG. The administration had one assumption that justified a big tax cut.

Mr. BALL. Yes.

Senator LONG. If you buy that assumption then everything is great; no problem. But I don't think they can have it both ways, in one case to assume things are going to be great and in the other case, at the same time, assume we are going to hell in a hand basket. I don't think you can assume both things at one and the same time.

Now the CBO assumption was one that for purpose of the tax cut Mr. Reagan thought should be denounced, because, as I understand it, he felt they were being pessimistic and people of little faith, thinking the economy wasn't going to do any better than that.

Mr. BALL. Assuming their assumptions, Senator Long, over the next 5 years, with just present law, then there would be a problem even with interfund borrowing in fiscal year 1986, the last year.

But, if you assume the cuts in the reconciliation package, then there is no problem throughout the 5 years under the CBO assumptions either.

They drop down to combined funds equal to 12 percent of the next year's outgo in fiscal 1986, and as you know, the critical point is 9 percent.

Now that is pretty close to the line, but nevertheless, on their assumptions interfund borrowing would be sufficient.

So, I think to be safe, to guarantee the payment, one probably ought to have some standby authority in case something even more pessimistic than CBO were to happen.

I would argue that it is not unreasonable—it would be a relatively small amount if any trust would be needed—to provide a limited standby authority to borrow from general revenue with repayment at interest at a later point. As shown by the curve in the chart that Senator Moynihan put up, and it is the same curve if expenditures are shown as a percent of payroll, the present period of some difficulty is followed by a period where cash benefit expenditures drop, relatively.

The later period, just following on this, is relatively good for social security cash benefits and a loan could be repaid.

Senator LONG. I know that.

You aren't answering my question——

Mr. BALL. No, I was just getting to that. You had two questions.

Senator LONG. What kind of cut would it take, I mean supposing things don't go too well and we do have to cut, supposing we said we just don't have enough money coming in to pay all the benefits, like a private company?

Mr. BALL. I think a private company would borrow under these circumstances and they would borrow against a very good prospect just down the road.

I don't think they would violate a compact that they had with their customers. They would borrow to tide over a period caused by a short-term economic situation

I am talking only about the short-run and this middle period. We have a long-range question to discuss later.

Senator LONG. But in terms of percentage, by about what percentage would we fail to make it, what percentage would we have to borrow against income?

Mr. BALL. Right. Senator, I am not trying to avoid your question. I say it depends entirely on your economic assumptions. Under both Reagan assumptions and CBO assumptions you would never have to borrow and you would never have to cut benefits in that period. That would be OK.

But I am saying I wouldn't want to rely on that. I wouldn't want to rely even on the CBO assumptions entirely.

Your alternative of actually cutting people's benefits because of a short fall, seems to me unacceptable.

Social security needs to be dependable so that people can count on it. They make their plans based on it. Private pensions build on the idea that every pensioner will get a social security benefit. People's savings are built on social security.

I think it would be much preferable to have limited authority to borrow during such a short period rather than to think in terms of cutting benefits in an extreme situation.

Senator LONG. Here is the point I want to get to. Mr. Ball, you and others in position to advise the Congress, both you as a Social Security Commissioner and people on the social security advisory group, advised us we could afford these big social security benefit increases and annual cost of living adjustment, and we went along with that on the theory we could afford to do all that.

Now, having done all that, we had to raise the tax. I am not complaining about that, even though I caught the very devil about the last tax increase bill. If that is still not enough the thought occurs to me that if in some short interim period this is not going to be enough to pay all this, how much would we have to fall short in order just to say that we are sorry, in all good faith, but good people like Bob Ball advised us we could afford it, and we can't afford quite this much. How much shortfall would it have to be?

Mr. BALL. I hope you are not going to put it that way, Senator.

Senator LONG. Well, I think we ought to at least think about it.

Mr. BALL. It seems to me that what we are talking about here in the short run is a completely unanticipated situation in which prices have outpaced wages for a length of time that has never happened in our history, and we have had a high level of employment at the same time. That was not anticipated. Absolutely correct.

It is not expected certainly that that sort of a situation is going to continue on indefinitely.

To get beyond this hump, interfund borrowing—given the fact you have already taken action on sizeable cuts—should be enough for this 5-year period.

You are asking me, well supposing it isn't. Would I think that the thing to do was then cut benefits just to get by for that short period.

My answer is, no. I think it would be much better to borrow to fully pay what has been promised and then in the next period you will be in a position to pay back the general revenue.

Senator LONG. Thank you.

Senator ARMSTRONG. Senator Moynihan.

Senator MOYNIHAN. Mr. Chairman, I think we have heard powerful testimony from Mr. Ball and also from Mr. Clayman. I would like to see if we can't state the problem once again. Mr. Ball, you did not say anything different, in essence, from what Senator Chiles said earlier.

You said that if you take the administration's economic assumptions for the next 5 years, then there is no financial problem in social security.

Mr. BALL. If you allow interfund borrowing, Senator.

Senator MOYNIHAN. Of course.

Mr. BALL. You do have to make that change in the law.

Senator MOYNIHAN. Yes. If you take the Congressional Budget Office assumptions, you only get a problem in the last year, 1986, the one year problem.

Mr. BALL. Under present law——

Senator MOYNIHAN. But, given the changes already made in the law in this committee and by the Senate, we will save some $35 billion in the next 5 Given the President's assumption or the CBO assumption, there is no problem in the next 5 years.

Mr. BALL [continuing]. Given interfund borrowing and the cuts in reconciliation. Now, my own view, Senator, is that to be absolutely sure, even in the short run, you ought to have standby authority.

Senator MOYNIHAN. Right.

Mr. BALL. For borrowing from general revenue funds.

Senator MOYNIHAN. But this is the dimension of the problem we are dealing with. We might have to borrow a little money 5 years from now, after which the funds build for a long period, some 20 years, I think.

Mr. BALL. Senator, in the period between say 1985 and 1990, that 5-year period, it is not quite as clear cut.

Senator MOYNIHAN. The hospital insurance will——

Mr. BALL. Well, let's put hospital insurance aside, as I would like to comment on that separately, if I could, in a moment.

But, in the cash benefit program, in the 1985 to 1990 period, again you have a question of what economic assumptions you use. Although I think we are fairly safe during that period, with the cuts made and using CBO estimates and with interfund borrowing, it may be kind of tight in say 1988, 1989, in that area.

I didn't want to leave you with the impression it was all rosy from there on. But from 1990 to 2005 you have two things that are greatly helping to build up the social security cash fund.

One thing is that there were low birth rates in the 1930's. Those born in the 1930's are becoming 65 in 1995 to 2005. There is relatively little growth in the aged population then, and moreover, as we said before, the baby boom generation is paying in. So that relatively that is a very good period for financing social security. Also there is a scheduled rate increase in 1990.

Senator MOYNIHAN. You would agree that this is not a time to panic the public with talk of crisis?

Mr. BALL. Absolutely.

Senator MOYNIHAN. We can handle this. Any insurance fund, business, can handle this kind of cash flow problem by good planning and temporary arrangement, so long as there are good long-term prospects. And there is just no point in acting otherwise.

Mr. BALL. I think that is absolutely right. I think it is important not to mix up——

Senator MOYNIHAN. The mid-21st century.

Mr. BALL. The middle period, the early period and the later period.

Senator MOYNIHAN. Right.

Mr. Clayman, then I would like to say to you, sir, I am sure you are right, that people have been terrorized when they hear these things. Now what do old persons who haven't made a study of this thing know about bend points and actuarial progressions and all such matters?

All they know is they thought they had the social security and now they are being told it is bankrupt. It is not. Don't you feel that?

Mr. CLAYMAN. They still don't fully comprehend the magnitude of the situation. Had they understood the budget process, very few Americans did, there would have been the same kind of avalanche in our mail, an outpouring of sentiment that happened and caused the Senate to behave as it did.

But they didn't know. Some of us were pleading for less speed, but apparently the strategy was all boilers steamed up and straight ahead and the hell with everything.

Senator MOYNIHAN. Well, sir, I think I can assure you of one thing. The proposals made on May 12, by the administration, to cut by 40 percent the retirement benefits to someone entering the system next January, at age 62, those proposals will not be enacted.

If it takes a weary 7 months before it turns out to be so, that will be necessary. But they will not pass. We will not let them.

Mr. CLAYMAN. If I may with a quick sentence, the same will be so with regard to deferring retirement until 68. Even if it doesn't apply, as it wouldn't, to those who are now retired. Keep in mind that the elderly of America are fathers and grandfathers, and mothers and grandmothers. They feel as strongly about those people, members of their family, their flesh and blood, as they think of themselves even sometimes more so.

If one makes the easy assumption that you mustn't do it now to those on the rolls because they will be too vigorous a political reaction, I say that there will be the same kind of reaction if Congress tries it simply by deferring it to the future. It won't work politically, in my judgment.

I will do every darn thing I can to see that it doesn't work politically.

Senator MOYNIHAN. Mr. Clayman, we are going over to vote on a resolution—we are simply told it is the Violent Crime Resolution. That may pass. But this violent crime will not.

Senator ARMSTRONG. Gentlemen, we are going to recess for a few minutes. It would be my hope you could bear with us for perhaps 8 or 10 minutes until I am able to return. I have a question or two. The discussion has been very soothing and I am reassured by what Senator Moynihan has said and what you have said, that maybe we can forget the whole thing.

But, I would like to reflect on that while I go over and back.

[A short recess was taken.]

Senator ARMSTRONG. The hearing will come to order.

Gentlemen, I won't keep you long. You are authorities on the social security system. I am not. You know more about it than I ever will.

Mr. Ball, it is my impression that over the last decade or more, you have been one of the most influential, if not the most influential, person in formulating and shaping policy for social security and helping to advise on setting benefits and so on.

So, I take very seriously the testimony you have presented.

It is, however, substantially more optimistic than that which has been presented by others, including the trustees.

Is that a fair characterization of your attitude? Are you generally more optimistic about the condition of the trust funds and their projected future operations?

Mr. BALL. Senator, I don't want to parry with you. I have a real problem with the question. I don't know what the administration and the trustees views on this short term are. It all depends on two things. What economic assumptions you use and how quickly you want to build up the contingency reserve.

Senator ARMSTRONG. Mr. Ball, have you seen the recent trustees' report?

Mr. BALL. Yes, I have.

Senator ARMSTRONG. Well, as you know, there are five projections.

Mr. BALL. Right.

Senator ARMSTRONG. For the first time in history, all of the projections, from the most optimistic to the most pessimistic, show there will be a shortfall, a technical insolvency, I guess, in the trust fund next year.

There is no dispute about that in your testimony I don't believe. You haven't raised that issue.

Mr. BALL. Mr. Chairman, under their assumptions, the Reagan economic assumptions, taking all three funds together, if you assume interfund borrowing.

Senator ARMSTRONG. Yes.

Mr. BALL. There is a buildup of $15 billion more in the trust funds in the next 5 years. That is my problem in answering your question. That is more optimistic than I am.

I would follow the CBO projection. The CBO projections which are much more pessimistic than those are closer to what they call IIB, in the trustees' report.

Now using IIB, if you have interfund borrowing, it is true that with present law exactly as it is, there is a problem in the fifth year, fiscal year 1986.

But, without endorsing them, and I certainly hope I didn't give this committee the impression that I favor the cuts that were put in the reconciliation version of the Senate bill; personally I think they were wrong.

But, nevertheless, if they are going to come out of a reconciliation conference with a level of cuts—not those particular cuts—but if the conference comes out with a level of cuts of around $30 billion for the next 5 years, that needs to be taken into account.

If you take those into account, even though I am opposed to them, then even under the CBO projection or IIB, there is not a problem for this 5 year period or more.

Now, I think even so that is too close. I am trying to answer how pessimistic am I. I am pessimistic enough to say that I think it would be desirable and important that, in addition, you authorize as a standby provision, borrowing from the general revenue even in a minimal plan. This is just a minimal plan for 5 years or so.

I am not saying that is the best plan. Personally, I would favor something more fundamental and taking action that would rebuild the contingency reserves faster than a minimal plan.

In my longer testimony, I suggested two ways that would be acceptable to us and that would not involve cutting benefits.

So, I——

Senator ARMSTRONG. What reserve ratio were you suggesting?

Mr. BALL. Well, in the long run, over time I would certainly like to see a 50 to 60 percent of the next year outgo.

The issue here though is how soon do you have to do it. Is it critical that it be built up in the next 5 years.

The administration has a plan which does all of these things. It deals not only with the first 5 year shortfall, but in addition they need enough money to have a benefit liberalization for those who continue to work.

Under their plan they do cut benefits enough, under their assumptions, to also build up the contingency reserves significantly.

Senator ARMSTRONG. Well, I wasn't trying to pin you down particularly as to when, but as to what your target was and whether 50 or 60 percent is in reach.

Mr. BALL. Yes, in the long run.

Senator ARMSTRONG. I don't want to mischaracterize your attitude.

Mr. BALL. Yes.

Senator ARMSTRONG. I don't want to put words in your mouth.

Mr. BALL. Yes.

Senator ARMSTRONG. I have gained the impression, not only today, and in reading your testimony, but over a long period of time, that you are more relaxed about the long-term outlook than some other people are.

Mr. BALL. Oh, that is certainly true.

Senator ARMSTRONG. Characterizing that as optimistic may not be the right word, but historically, you simply have not associated yourself with those who thought there was great danger in this huge unfunded liability and so on.

You have generally, I think, taken the position that the future is a long way off, that things do tend to take care of themselves, and adjustments can be relatively minor or put off altogether.

Mr. BALL. Senator, I was willing to go along with your characterization of me up to the last sentence or so.

I am not willing to just go along thinking things will take care of themselves. I have devoted my entire adult life to working in this program and studying it. I am not at all willing to just let things go along.

I am saying that the alternative to actions that I think should be taken are not short term bankruptcy. I think there should be actions taken that would do better than this minimal plan that I have described.

But the minimal plan prevents any reduction in near term benefits. And that, if the Congress wants to do it, is enough.

Now I have suggested two other things in the testimony that our coalition would support, that would build up the fund sooner. I think either one of those would be a better way to go than the minimal plan. But I am also saying that is not essential.

Now that doesn't necessarily make me not care about the long-range future.

Senator ARMSTRONG. No, I certainly didn't attribute that attitude to you and didn't intend to. I think I have established what I wanted to establish which is that somewhere along the opinion scale you are more optimistic than some of our other witnesses.

Mr. BALL. Certainly more than Mr. Robertson who testified before. If I could say a word about the use of medicare——

Senator ARMSTRONG. I thought you were going to mention his book again. [Laughter.]

Mr. BALL. I should have brought my book. I think I gave it to every member of the committee, but it was back in 1978.

Senator ARMSTRONG. Please do.

Mr. BALL. At some point, I think to really complete the record—because I started on it two or three times—I do need to say something about the attitude of our coalition and myself toward the long-range problem and——

Senator ARMSTRONG. Please take a moment to do that and then, would you also supply for the record, a list of the organizations that comprise the coalition.

Mr. BALL. I would be happy to, sir.

[The following list was subsequently supplied by Mr. Ball:]

SAVE OUR SECURITY COALITION—ORGANIZATION MEMBERS

A. Philip Randolph Institute
Action Alliance of Senior Citizens
Advocates for the Handicapped
AFL-CIO
American Association of Homes for the Aging
American Association of University Professors
American Association of University Women
American Federation of State, County and Municipal Employees
American Foundation for the Blind
American Jewish Committee
American Veterans Committee
Americans for Democratic Action
Associated Actors and Artistes of America
Association for Retarded Citizens
Big Wheels
Center for Community Change
Center for Independent Living
Communications Workers of America
Concerned Seniors for Better Government
Council of State Administrators of Vocational Rehabilitation
Democratic Socialist Organizing Committee
Disabled American Veterans
Disabled in Action of Pennsylvania
Disabled Resources Committee
Economic Opportunity Commission
Federation of Senior Citizen Clubs and Organizations
Food Research and Action Center
Gray Panthers
International Association of Machinists and Aerospace Workers
International Ladies Garment Workers Union
Joseph P. Kennedy Jr. Foundation
Legal Research and Services for the Elderly
Metropolitan N.Y. Coordinating Council on Jewish Poverty
Monmouth County Office of the Handicapped
National Association for Human Development
National Association for the Advancement of Colored People
National Association of Private Residential Facilities for the Mentally Retarded
National Association of State Mental Health Program Directors
National Association of State Universities and Land Grant Colleges
National Black Catholic Lay Caucus
National Caucus and Center on Black Aged
National Center for Urban Ethnic Affairs
National Coalition for Older Women's Issues
National Conference of Catholic Charities

SAVE OUR SECURITY COALITION—ORGANIZATION MEMBERS

National Consumers League
National Council of Catholic Women
National Council of Churches
National Council of Jewish Women
National Council of LaRaza
National Council of Negro Women
National Council of Senior Citizens
National Council on the Aging
National Education Association
National Farmers Union
National Indian Council on Aging
National Multiple Sclerosis Society
National Organization of Social Security Claimants Representatives
National Retired Teachers Association and American Association of Retired Persons
National Senior Citizens Law Center
National Society for Autistic Children
National Urban Coalition
National Urban League
National Women's Political Caucus
New Horizons
Ohio Coalition of Senior Citizen Organizations
Ohio Rehabilitation Services Commission
Older Women's League
Operation Overcome of Lackawanna County
Operation Overcome of the Anthracite Region
Operation Overcome of the Lehigh Valley
Paralyzed Veterans of America
Pennsylvania Alliance of the Physically Handicapped
People United for Self Help
Power, Inc.
Rehabilitation Institute—Center for Independent Living
Retired Teachers Chapter, UFT
Senior Citizens Task Force/United Planning Organization
Seniors for Adequate Social Security
Student Services for the Handicapped
Texas Planning Council for Developmental Disabilities
The Workmen's Circle
UAW International Union
UAW Retired and Older Workers Dept.
United Cerebral Palsy Associations
United Presbyterian Church
United States Catholic Conference
University of the District of Columbia Institute of Gerontology
Washington Armed Services Committee
West Virginia Developmental Disability Planning Council
Western Gerontological Society
Westside Community for Independent Living
Wisconsin Council on Developmental Disabilities

Mr. BALL. I had in my opening summary remarks commented on the short term and the middle range, saying that the short term was manageable as we said on a minimal basis, although that may not necessarily be the best way.

On the middle range, using Senator Moynihan's chart, you have exactly the same type of curve if you take expenditures as a percent of covered payroll, so that after the short term here is a period up until about 2005, 2010 where the financing situation for cash benefits under social security is favorable—that declining line in there.

Now it is important though that I comment on the medicare situation since if you leave that out, then you are subject to the argument, "what happens to medicare?"

Well, the medicare situation is quite clearly good on a year-by-year basis, at least up until the end of the 1980's.

Then, depending on what assumptions you use, there may or may not be trouble during the 1990's in the medicare program.

Of course, if you project in medicare a continuation of a rate of increase in hospital costs more than increases in wages on into the future, medicare is going to need more money.

So is Blue Cross. So is any commercial insurance company. It is a question of are we going to continue to allow hospital costs to rise indefinitely, compounded, more than wages increase.

If we are, of course we will have huge costs in medicare. I don't think we will do that. I don't think that Blue Cross and private insurance can stand up to that any more than medicare.

I just wanted to add, that as far as I know, no private insurance, group plans, or individual insurance, in the health field, guarantees or makes estimates about what they are providing will last some 75 years into the future.

I would just like to record that I think it is ridiculous. I think that 25 years is probably too long to talk about hospital costs as a percentage of payroll. But certainly 75 years is.

You get these huge overwhelming 25, 30, 35 percentage of payroll costs only if you make long-term hospital cost estimates on the assumptions I described.

What the hospital system is going to be like in this country and how we handle the cost of it for the elderly and others seems to me a wide open question when you talk about the next century.

On the long range costs for care benefits, Senator, that I had asked permission to continue on for just a moment, I think it is important that we distinguish—now I am talking about the next century, beyond 2005 when the baby boom generation becomes of retirement age—I think it is very important to distinguish between what we really know and what is the result of certain assumptions that we make that are arguable.

What we really know is that there will be a huge increase in the number of older people in the next century. Those people have already been born. We know there is going to be increased longevity. If you apply that to a population already born you get a big increase in the absolute number.

Now the question of whether that produces greatly increased costs for social security and whether those costs will be harder to bear in the next century than present costs is more doubtful.

The question of whether it presents major increasing cost for social security depends on the size of the future work force.

The key question is the relationship. How big is this group of older people going to be compared to the work force? In these charts and in the material presented in the trustees' report, there is no distinction made between what we really do know and the future size of the work force about which we have to make certain assumptions.

The size of the work force depends on hard-to-determine assumptions: fertility rates, immigration rates, labor force participation rates, by women, by men, by older people and so on.

My own guess is that the costs will increase somewhat in the next century. But it is not of the same degree of certainty and certainly the size of the increase is not known as it is when we say there are going to be larger numbers of older people.

So, I am just asking for some skepticism. When you see projected for you that now 3.2 workers pay in for every social security beneficiary, that is correct. But don't take it as if it is an absolute fact that it is going to turn into 2 to 1 in 2025. That relationship is based on a whole series of assumptions that may or may not turn out to be the case. It may be 2.5 not 2. That would make a big difference.

Senator ARMSTRONG. It might be 1.75?

Mr. BALL. It is conceivable.

The question I would raise then. Supposing this scenario does work out, that it is 2 to 1 producing higher costs as a percentage of payroll, is that necessarily a bigger burden on workers at that time than what is being paid today for current workers.

This question has two dimensions. One is, the very assumptions that lead to the conclusion that there will be an increase in the proportion of the elderly compared to those that work, results in many, many fewer children relative to the work force.

So, it is not correct to have a picture in one's mind of each worker in the future having a huge increase in the load of nonworkers that have to be supported from his work.

The truth is that if the number of elderly increases relative to those at work, the same scenario greatly decreases the number of children in relation to those of working age. We have a shift in the composition of the dependency load, more older people, fewer children but not an overall increase.

The other point is, any kind of increase in productivity, and I think few of us would settle for the idea that America has given up on productivity increases, will increase real wages in the future.

So that the burden of any given level of social security contribution will be less by reason of an increase in real wages.

So I am making three points about the long run that make me not willing to say that you ought to slash benefits now in anticipation of a situation that might occur in the year 2025.

One is we don't really know that the costs are going to be increased very much.

Two, if they are, the ability to bear that cost, for two reasons, will be easier than a comparable cost would be today.

Senator ARMSTRONG. Thank you, Mr. Ball.

Senator Dole, Mr. Ball was uncomfortable with my characterization of him as an optimist. I leave it to you to determine whether or not that was a fair appraisal of his attitude. He seems to have a very sunny disposition.

Senator DOLE. I am reminded that in 1976, you were arguing for general revenue contributions in the long run. But you indicated you had some reservations, because of the current pressures at the time. I think this was a comment made before the Joint Economic Committee. You were quoted as saying, "It seems to me that we best meet the financing deficit for social security for at least the next 25 years or so without turning to the general Treasury."

I think the pressures are just as great today as they were in 1976. I am wondering how the coalition reconciles that statement with today's recommendations.

Mr. BALL. Well, unfortunately, Senator Dole, the coalition doesn't have to reconcile its position with my previous statements.

Senator DOLE. Do you feel the same way?

Mr. BALL. As far as I am concerned, I have favored as a matter of general policy, some financing from general revenue to the total social security system just as did the founders of social security. That is my fundamental and basic position. Partly financed from employees, partly from employers, and partly from general revenue.

I recognize however, that this is not going to happen, certainly not in the near future. I have come therefore, I hope with some sense of practicality, to the view that the most that could be hoped for in that direction is the sort of a proposal that Barber Conable, Congressman Conable and Congressman Pickle have proposed, where you would take half of the medicare program from general revenue and move some of the social security taxes going to medicare over to the cash benefit program.

I would think—the chairman and I were talking earlier about short term problems in social security. I was saying this could be met without the sort of a thing I am talking about now, but I don't feel it is necessarily best to meet the short-term problem by a mimimal plan.

I would prefer doing what Congressmen Conable and Pickle suggest, and that would result in an increase in contributions for the cash program and general revenues going to medicare. Such a plan would build up the trust fund; the contingency fund, much like the administration wants to do through the device of very big benefit cuts.

Senator DOLE. In your testimony, you indicated the administration's disability and early retirement proposals would affect everyone. You ware not talking about those who are already 62 and retired. You are not——

Mr. BALL. No; I am talking about all contributors, Senator. If I didn't make that clear, I am sorry.

Senator DOLE. Right.

Mr. BALL. I intended to say that all contributors to the system lose by a reduction in protection from the system.

Senator DOLE. Maybe that was my misunderstanding. But for 36 million people already receiving benefits, I wouldn't want them to think they would be affected by those proposals.

Mr. BALL. Not those. They are affected by the dropping of the minimum benefit. By the postponement for 3 months of the cost of living adjustment, by the student benefit change and so on.

Senator DOLE. No, I think it is fair to say we have a different view than you have.

I still believe we must try, if possible, to come to some bipartisan agreement on how we are going to patch this thing up. Maybe we have patched it up too often. I think I have heard Senator Armstrong refer to patching up the balloon.

You would argue that it is not necessary. Others would argue that it is. We have to sort out all the different arguments and try to come to some rational judgment which would be certain to preserve the system.

Mr. BALL. Yes.

Senator DOLE. It is not going to be an easy political choice. I am not talking about partisan politics, but just the broad sense.

We have to bear in mind that in 1977 we thought we were doing something that would last us until the year 2030.

What did we do? We imposed six tax increases on workers. Four of them haven't even been felt yet. Now, we are back here again.

Two days ago, I asked Dr. Aaron, Dr. Penner and Dr. Kaplan for their views on what we should do. They each had different views, they thought they could come together with an approach but we might be able to accept.

I am hoping we are going to be able to consult with both you and Mr. Clayman as we try to come to grips with a rather touchy issue.

Mr. BALL. Senator Dole, could I respond to just one comment you made on the question of the 1977 amendment and the scheduling of further tax increases and now we are in the same problem.

That is really not a quite correct characterization, in my view.

When the 1977 amendments were put in, there remained an imbalance in the social security trust fund, the cash funds, 1½ percent of payroll, occurring mostly in the period from 2025 to 2050.

That is about the same deficit that the Trustees found in 1980. In 1981 it has been reduced, according to the trustees, using the Reagan economic assumptions. It has now been reduced to 0.93 percent. This is the long-range deficit according to one of two intermediate estimates.

Their other intermediate estimate has risen slightly above the 1.50 estimates at the end of the 1977 amendments. It is 1.80.

So although it is quite correct that we have been in a short-term situation here due to the very bad economic performance over the last few years, it would not be quite correct to characterize the 1977 amendments as having failed to reduce the long-range deficit of social security. For the long range the estimates still show the effect much as you thought you were doing at the time.

In the 1981 report you came out just about the same place now as you were at the end of the 1977 amendments.

Senator DOLE. Thank you.

Senator ARMSTRONG. Gentlemen, we thank you very much.

Senator MOYNIHAN. Mr. Chairman, before Mr. Ball and Mr. Clayman leave, may I say that I have here petitions with 17,000 names, the result of the efforts these gentlemen have made. It shows their concern for the matter and demonstrates the concern felt by so many Americans. I thank you very much.

Senator ARMSTRONG. Thank you gentlemen. We appreciate your participation in the committee's deliberations.

[Statement follows:]

SOCIAL SECURITY FINANCING AND PROPOSALS FOR BENEFIT CUTS

Committee on Finance
Subcommittee on Social Security and
Income Maintenance Programs
U.S. Senate

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SUMMARY OF STATEMENT BY ROBERT M. BALL

1. SOS represents about 100 organizations with 35 to 40 million members more or less evenly divided between contributing workers and social security beneficiaries. Those getting benefits now and those now contributing have the same stake in an adequate and dependable social security system.

Short-Term Financing

2. The Administration is exaggerating the short-term social security financing problem:

   a. The short-term problem is entirely in old-age and survivors' insurance (OASI) and is caused by the highly unusual economic conditions of the recent past--wage increases falling behind price increases, accompanied by higher levels of unemployment. Since benefits increase automatically with prices and since income is tied to payroll levels, the contingency funds in OASI are very low. This temporary situation tied to bad performance of the economy does not justify permanent, long-term reductions in social security protection as proposed by the Administration, nor talk of 1982 bankruptcy, nor invocation of possible shifts in worker-beneficiary ratios which will occur, if at all, in the next century.

   b. The size of the short-term problem in OASI depends on the performance of the economy in the near term. Under Reagan economic assumptions and those used by Congress in the first budget resolution, there is no real problem. Reallocation of the overall social security tax rate between OASI and DI (under present law, too much of the rate has been allocated to DI and too little to OASI) and short-term borrowing by OASI from HI is enough. The combined social security funds grow by $15 billion over the next five years under these assumptions.

   Under the Congressional Budget Office alternative--much more pessimistic economic assumptions, the combined funds under present law fall below the necessary beginning-of-the-year level of 9 percent of the year's expenditure in F.Y. '86, although this is not the case if one assumes a level of social security benefit cuts equal to the Senate version of the Reconciliation Bill (a lower level than in the House version).

3. If the Congress wishes, it can deal with the short-term problem by reallocating rates between OASI and disability insurance (DI) and borrowing from hospital insurance (HI). Such a minimal solution should also include at least limited back-up authority to borrow from the general fund because of the possibility that the Reagan economic assumptions are too optimistic. (Some have argued that since HI is estimated to be short of funds in the 1990's, it should not lend money to OASI now. But lending money at proper interest does not worsen the financial condition of the HI fund. HI has excess funds now and OASI has excess funds in the 1990's, both because growth of the aging population slows down substantially--birth rates in the 1930's were low--and because of a 1990 scheduled increase in social security taxes.)

Middle-Range Financing
(Approximately 1985-2005)

4. In general, conditions in 1985-2005 can be expected to be favorable to financing cash benefits under social security--the age group 20-64 will grow enough (the baby-boom generation will be of working age) to offset increases in the number of persons over 65. Even small increases in productivity will cause OASDI expenditures to drop somewhat as a percentage of GNP or covered payroll. Under one of the trustees' intermediate assumptions (much more pessimistic than the Reagan assumptions), expenditures as a percent of GNP drop from 4.98 percent next year to 4.38 percent in 2005 and as a percent of covered payroll from 11.44 to 11.09.

5. Any HI financing problem in the rest of this century (none under some assumptions but problems in the 1990's under others) is related to the possibility of continuing increases in hospital costs that considerably exceed increase in wages. There is no demographic problem. Of course, if in the 1990's hospital costs rise as much in relation to wages as in the recent past, Medicare will need more money--so will Blue Cross and private commercial health insurance and none of these plans will be "bankrupt" in any usual sense of the term. If this happens, HI, under the minimal plan, may well be borrowing from OASDI in the 1990's.

Long-Term Financing

6. There will be a big increase in the absolute number of people over 65 from about 2005 to 2035. This is certain. They have already been born and increasing longevity assures this result.

7. For social security financing, however, it is the ratio of those getting benefits to those at work that is important, and the size of the work force depends on many uncertain factors--fertility rates, labor force participation rates of older people and women, immigration rates, etc. Social security expenditures as a percent of covered payrolls will probably increase somewhat in the next century (although this is not certain) but the size of the increase is unpredictable, to some extent susceptible to policy decisions, and may be small. Some increase in the cost of caring for the elderly in the next century, measured as a percent of GNP, say, is a low price to pay for the slowdown in population growth. A return to large-scale population growth would reduce the relative cost of caring for the aged but would have much larger long-range social costs in terms of pressure on the environment and the quality of life.

8. A long-run increase in social security costs is not likely to be a bigger economic burden because of at least some productivity increases and because under the same assumptions that produce an increase in the size of the older population relative to the work force,there will be fewer children to support.

Alternatives to a Minimal Financing Plan

9. If the Congress wishes to rebuild the social security contingency funds in the near term and go beyond solving the short-term financing problem, there are two approaches that do not involve cutting benefits that we find acceptable:

   a. Most SOS organizations enthusiastically support financing one-half of HI out of general revenues as proposed by Congressmen Pickle and Conable and shifting some Medicare taxes to OASI. (Others support this approach only as a last resort, if necessary to avoid benefit cuts.)

   b. Another possibility is to offset social security taxes in the individual income tax and at the same time move up the presently scheduled 1990 OASDI rate (6.2 percent) to 1982. (A net savings to taxpayers of about $8 billion.)

The Administration's Proposed Benefit Cuts

10. SOS opposes the Administration's social security budget cuts which will soon be considered in the conference on the Reconciliation Bill, particularly the cuts applied to those already receiving benefits such as those who have been getting the minimum benefit. These cuts violate the compact between the contributing worker and his government and the beneficiary and his government.

11. SOS opposes the Administration's recommendations for a long-term reduction in the scope of social security--an overall reduction of 23 percent, with a reduction of over 40 percent for those applying for benefits at age 62 and a reduction of one-third in the protection provided against the risk of long-term total disability. We are particularly concerned about the fact that little attention has yet been paid to the huge slashes proposed in disability insurance.

12. These proposals go way beyond the long-run need described by the Administration (and the description of the need may be exaggerated). The 75 year deficit for OASDI is projected at 0.93 percent of payroll under the Reagan economic assumptions and 1.83 percent under an intermediate set. The proposals save 3.06 percent of payroll.

13. The Administration proposals are designed not only to meet the short-run OASI deficit they have been talking about, but also to rapidly build up the contingency reserves, to produce enough excess of income over outgo to cover the cost of liberalizing benefits for those at work, to reduce social security taxes, and to accomplish all this under such pessimistic economic assumptions that there would be almost no real wage growth over the next five years.

    It is perhaps more than coincidental that two overriding goals of the Administration would be furthered by the approach they have elected to take to social security financing:

    a. Because of the present method of accounting, any excess of income over outgo in social security helps balance the overall budget, even though by law social security funds can be spent only for social security benefits and administrative expenses. (SOS favors returning to the practice in effect prior to F.Y.'69 of keeping social security financing entirely separate from the general budget and thus removing the temptation to cut social security to help the appearance of the general budget.) According to the Reagan Administration economic assumptions, the social security cuts would contribute nearly $100 billion to budget balancing over the next five years.

    b. The benefit cuts would produce a much smaller, less adequate social security program for the long run and further the Administration's goal of reducing the role and size of Federal programs.

<u>Other Proposed Benefit Cuts</u>

14. SOS opposes changes in the COLA designed to give beneficiaries less than a full cost-of-living adjustment.

15. SOS opposes reducing benefits for people who apply for benefits before age 68--both the Administration proposal to cut benefits for those applying between 62 and 65 and the proposals that would raise the age of eligibility for full benefits from 65 to 68.

Conclusion

Cutting social security benefits is unnecessary and wrong. The Administration has been exaggerating the seriousness of a quite manageable shortfall in OASI financing in the near term, apparently in the hope of persuading Congress to make major and permanent cuts in the social security program. It is difficult to escape the conclusion that the Administration in proposing these cuts has more in mind than social security. Slashing social security benefits would make a major contribution to their goal of balancing the general budget and, for the long run, would make a major contribution to their goal of reducing the size and scope of Federal programs.

SOCIAL SECURITY FINANCING AND PROPOSALS FOR BENEFIT CUTS

Robert M. Ball

Committee on Finance
Subcommittee on Social Security and
Income Maintenance Programs
U. S. Senate

July 9, 1981

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

My name is Robert Ball. From April 1962 until March 1973 I was Commissioner of Social Security, serving under Presidents Kennedy, Johnson and Nixon. Prior to becoming Commissioner I served for approximately 20 years in various positions in the Social Security Administration and its predecessor organization, the Social Security Board, and for the ten years prior to becoming Commissioner I was the top civil servant in the Social Security organization. Since leaving the government I have continued my deep interest in social security and have written and lectured extensively on the subject. I am the author of Social Security: Today and Tomorrow, published by Columbia University Press, and was a member of the most recent statutory Advisory Council on Social Security.

I am testifying today on behalf of a Coalition of some 100 organizations with a combined membership between 35 and 40 million adults, about equally divided between those who are currently contributing to the social security system and building protection for themselves in later years and those who are currently receiving social security benefits. This Coalition, formed to defend and improve the social security program, is known as "Save Our Security," (SOS). I_ includes labor unions, senior citizens' groups, groups representing the disabled, church groups and social welfare groups. The Coalition is opposed to the cuts in social security protection proposed by the Reagan Administration and is also opposed to various other benefit cuts now under consideration.

Because major benefit cuts are put forward by the Administration as the best way of preventing "social security bankruptcy," it is important first to examine the general financial status of the system.

The Financial Status of the Social Security System

It is useful to think about social security financing in three time periods: an immediate critical situation in the old-age and survivors' insurance fund growing out of the economic conditions of recent years, a middle period covering roughly the period from about 1985-2005, and finally the remainder of the 75-year period over which actuarial cost estimates are made.

The old-age and survivors' insurance fund (but not disability or Medicare) will require additional income, at least during the next few years. The contingency reserves for this fund have been drawn down to low levels. Prices have been exceeding wages causing higher than expected benefit increases under the automatic provisions, and income has bee.i less than expected since income is determined by wage levels and the level of unemployment. This near-term problem is one caused entirely by economic conditions and, contrary to what one sometimes reads in the popular press, has nothing to do with an increasing number of older retired people as compared to the number of younger people at work. This short-term problem does require action soon but it can be quite minimal if Congress so chooses, or it can be action which is designed to substantially build up the depleted contingency reserves.

The situation in the middle period is quite different, although here, too, there is no demographic problem. During this period the large number of children born in the period following World War II--the so-called "baby-boom"--will be paying into the social security system and offset the increase in the number of people over 65. In other words, the relationship of payers-in to takers-out of the social security system remains relatively stable over the next 30 years. With even modest increases in productivity, the result is that, under most assumptions, social security expenditures as a percentage of covered payroll or as a percentage of GNP drops somewhat during this period.

When the "baby-boom" generation starts to reach retirement age about 2005 the situation may change. According to an intermediate set of assumptions in the official cost estimates there is a long-range deficit of about 1.8 percent of payroll (only 0.93 percent of payroll under the Reagan economic assumptions). This deficit occurs largely from 2025 to 2050. Although it has frequently been said that the 1977 amendments did not reduce the social security financing deficit as expected, this is not true of the long-range cost. The 1977 amendments did not solve the short-range problem because recent economic conditions were not foreseen, but the long-range deficit was estimated in the 1980 trustees' report to be about the same as was predicted immediately after the passage of these amendments. (In the 1981 report, just released, according to the central set of assumptions, the long-range deficit is projected to be slightly larger, 1.82 percent of payroll as compared to 1.52 percent of payroll.)

I have attached to this statement a discussion of some of the factors that affect social security costs in the long run. (Appendix A.) Suffice it to say here that it is clear the absolute number of people over 65 will greatly increase in the period from 2005 to 2030; they have already been born and the application of reasonable mortality rates to the population--including a substantial allowance for improved mortality--will produce a very big increase. This is certain. What is much less certain is the size of the labor force, and it is the relative size of the older retired population to those at work that determines the effect of demography on social security costs.

To summarize Appendix A: There is no reason to expect that in the long run the economic burden of supporting the present social security law will be greater than it is today. (1) The official estimates assume a much smaller work force compared to the size of the retired group; but in fact it is not at all clear whether, and to what extent, there will actually be an increase in the ratio of those drawing benefits to those paying in. (2) The total number of dependents per worker--old people and children--will not increase in comparison with the recent past; there will be more older people, but fewer children. (3) It can be expected that the real wage level will be much larger in the long-range future than it is today--perhaps even twice as high by 2025 after social security taxes--so that any increase required in social security contributions would be easier for workers in the future to bear.

(4) Under present law, social security benefits, as a percentage of gross national product, show a drop between now and the early part of the next century and a relatively small increase thereafter. (5) Finally, the decrease in the part of workers' compensation subject to social security taxes may well have been exaggerated.

The Extent of the Short-Term Financing Problem

Since the Administration is proposing huge cuts in social security protection primarily on the rationale of a near-term threat of "bankruptcy" it is particularly important to examine the short-term financing situation.

Social security has four separate trust funds which, by law, are kept entirely separate from each other. The old-age and survivors' insurance (OASI) fund, the disability insurance (DI) fund, the hospital insurance (HI) fund, and the supplemental medical insurance (SMI) fund. SMI benefits are financed from a combination of general revenue, which now pays 70 percent of the cost, and the current premiums of beneficiaries, which now pay 30 percent of the cost, and are not supported by social security taxes. The other three funds are financed by social security tax deductions from workers' earnings, matching taxes paid by employers, and tax payments by the self-employed. The division of social security taxes among these three funds at any one time results from past congressional judgment based on technical advice furnished primarily by the Social Security actuaries. The division of the tax among the funds has been changed frequently to reflect the most recent estimates of the costs of these programs. The division of the tax among the funds can be changed by Congress at any time without any effect on overall tax rates or at the very least the law can be changed to allow borrowing among the funds. For the purpose of judging the short-term financial health of social security, therefore, it is reasonable to look at all three funds together. It should not be a matter of concern, for example, that the last time the rates were set, too much of the tax was allocated to DI and too little to OASI. This mistake is easily corrected.

Whether there is any short-term financing problem when one looks at all three funds together depends on the economic assumptions used. Under the Administration's assumptions and the similar assumption underlying the first congressional budget resolution, there is no problem. OASI alone is predicted to have difficulty, beginning in F.Y.'84, but the deficit is more than made up for by the surplus in DI and HI. In fact, the trust funds, taken as a whole, grow by about $15 billion over the next five years, and according to the Congressional Budget Office (CBO) projections would never fall below a start of fiscal year balance of about 18 percent of the next year's outlays. (Nine percent is the minimal balance needed to meet cash flow needs throughout the year.)

Under the alternative, much more pessimistic, economic assumptions adopted by CBO, the combined funds, under present law, exceed the 9 percent balance through F.Y. '85 but drop to about 7 percent at the beginning of F.Y. '86. With the level of benefit cuts in the Senate version of the reconciliation bill (considerably lower than the level of cuts adopted by the House) the combined funds never drop below 12 percent during the entire five years.

A reallocation of the social security tax rates between OASI and DI and authority for inter-fund borrowing would, therefore, very likely be sufficient to meet the social security financing problem for the next five years. However, to guard against the possibility of a protracted period of extraordinarily bad economic performance it would be wise to provide for at least a limited stand-by authority to borrow from the general fund.

Some have expressed reservations about authorizing the HI fund to lend money to the OASI fund on the ground that the HI fund itself may be under-financed in the 1990's. However, lending at interest will not weaken the long-range financing of HI, and fortunately while short of money in the 1980's, when HI has an excess of income over outgo, OASI is well financed in the 1990's when HI may well need to have loans repaid. OASI is in a good position to repay loans in the 1990's both because the number of elderly do not increase very much in that period and because of a scheduled tax increase beginning in 1990.

Thus, considering the three social security funds together, there is really no justification to talk of bankruptcy on November 3, 1982, as Mr. Stockman did recently before the House Ways and Means Committee, and to argue, as the Administration is, that the only reasonable alternative to such "bankruptcy" is a long-range reduction in social security protection of some 23 percent.

A case can certainly be made for strengthening social security financing by building up the contingency funds and not merely providing sufficient income to cover expenditures during the next five years, but the case is not helped by asserting that the alternative is bankruptcy. The minimal action already described, although not necessarily the best approach, is certainly a feasible approach.

Alternative Proposals for Strengthening Social Security Financing

So far I have discussed only a minimal approach to short-term social security financing. Another possibility is to accept the Administration's view that the trust funds should be quickly built up and the financing of the system greatly strengthened for the very long run as well as for the short term. This can be done without cutting protection if the Congress wishes to pursue this course.

On the other hand, there is much to be said for more fundamental changes which would build up the contingency reserves and avoid any possibility of once again having the social security system face financial difficulty.

Partial General Revenue Financing

Rather than cutting promised social security protection, the Coalition believes that it would be desirable to start making general revenue contributions to the social security program. Eventual government contributions to social security were a part of the original design for the program and have been endorsed by several

Advisory Councils and other groups since. There are several reasons for funding part of social security costs out of general revenues. The general taxpayer benefits from social security by the reduction of the tax burden of assistance and relief programs, by the contribution that social security makes to the general welfare, and by the reduction of the burden on sons and daughters of direct support of the elderly. Moreover it is desirable to have at least part of the cost of benefits which exceed the value of contributions--such as those paid to the first generation of retirees, those receiving the weighted benefit formula, and those receiving dependents' benefits--borne in part by the more progressive sources of general revenue rather than entirely by contributions based on earnings.

Although the Coalition favors partial general revenue funding for the entire social security program, it recognizes that there is more support for introducing general revenues into the hospital insurance part of Medicare than into the cash program. Although some members of the Coalition support with enthusiasm the proposal to pay for half of hospital insurance out of general revenue, with a consequent shift of some of the social security taxes now going to Medicare over to the cash benefit program, other members do so only as a last resort. All greatly prefer this approach to benefit cuts.

Another possibility would be to provide for social security taxes being offset in the computation of the personal income tax--either as an adjustment, a reduction similar to present treatment of State and local taxes (but with a revised zero bracket taking the social security tax into account), or as a partial credit--and at the same time provide for an increase in the social security tax rate for 1982 of 0.80 percent. The combined effect of an adjustment and such a social security tax increase would be an overall tax reduction of about $8 billion (counting both the social security tax increase amounting to about $12 billion and the personal income tax adjustment for social security taxes amounting to at least $20 billion).

Under present law, the employer deducts his share of social security taxes as a business expense, while the employee pays a social security tax and then pays an income tax on that social security tax. The plan would fix this inequity. The resulting social security tax rate for the cash benefit program, 6.20, moves to 1982 the ultimate rate in present law, now scheduled to begin in 1990. Moving up this rate will build a large contingency reserve for social security.

Since the combined effect of the two pieces of this proposal is a net reduction in total taxes paid by individuals, it could form a part of the tax relief planned for individuals in the 1981 tax reduction bill. Employers would be required to pay nearly $12 billion more in social security taxes under this plan, and the part of the increase which would not be offset as a business deduction needs to be compensated for in the business tax reductions to be provided by the tax bill.

Although social security taxes would have been increased under this approach, it would have been as part of a package which, on into the future, would not only make good on social security promises for present and future beneficiaries, but because of the treatment of the social security tax in the personal income tax would reduce the social security tax burden for individuals as compared with what it is today.

The tax reduction helps most those with earnings below about $32,100 which is the approximate maximum amount of earnings subject to social security taxes in 1982.

It would be desirable to also increase the refundable earned income credit so that social security taxpayers who have such low incomes that they do not pay personal income taxes are, nevertheless, helped by the plan. The change provides plenty of income for social security well into the next century, including building up the reserves, and it does so without benefit cuts and without hurting the programs financed from general revenue. (The latter is true because the plan does not decrease general revenues below what they would otherwise be, but substitutes one form of income tax reduction for a part of an income tax reduction that would be made anyway.)

The Administration's Proposals for Benefit Cuts

As part of its budget proposal, the Administration included social security cuts over the next five years of $35.5 billion. Some of these cuts reduce benefits for people already receiving them--the minimum benefit proposal, for example,--and seem to us to be a serious violation of the government's obligation to people who have been counting on social security benefits. We will do whatever we can to prevent these proposals from taking effect. We believe these cuts are unnecessary and wrong.

In addition, the Administration has proposed a new series of cuts amounting to $46.4 billion over the next five years--cuts that would do much more damage to social security protection over the long run than the budget proposals.

Now let me turn to the specifics of the Administration's proposals. The Administration has proposed permanent cuts in social security protection that amount to an overall reduction of 23 percent, reductions of about one-third for the disabled and over 40 percent for those forced to apply for benefits at 62. Although the cuts affect those who are forced to take their social security benefits early and those who are totally disabled particularly harshly, the level of promised benefits is sharply reduced for just about all present contributors. In the material that immediately follows I will comment on these additional benefit cuts. I have grouped the description of the proposals into three categories: those that will affect just about everyone now contributing; those that fall with special harshness on people who are forced to take their benefits before age 65; and those who are totally disabled.

Cuts That Will Affect Just About Everyone Now Contributing

The Administration has proposed that beginning in 1982 automatic cost-of-living benefits be paid in October instead of July and that they be based on a cost-of-living comparison over a full year rather than between two calendar quarters of the year as at present. According to the Administration's estimates, these changes will result in a reduction in benefits of $6.3 billion for the five-year period, 1982-86. Most of the cuts in the first five years will be borne by those now getting social security benefits, but the Administration projects a long-term loss in benefit protection for this change equal to 0.14 percent of payroll. This is the equivalent today of about $2 billion a year but the loss is projected on average for every year over the 75 years for which estimates are made.

It is, of course, true that current contributors are affected by all permanent cut-backs in protection. The severe reduction in the protection furnished by the disability insurance program and the severe reduction in retirement protection between the ages of 62 through 64 affect everyone; everyone's insurance coverage would be reduced. However in this section I will concentrate on four proposals that will reduce what current contributors get even though they never have to apply for disability benefits or retirement benefits prior to age 65.

The 1977 amendments to the Social Security Act provided that the protection of current workers will be kept up to date with the level of wages automatically. (Once on the rolls, as is generally known, benefits are kept up to date with the cost of living as measured by the consumer price index.) In essence, the automatic provisions which keep benefit protection up to date with wages provide for a stable replacement rate--that is, a constant relationship between the benefit paid and the wages earned by the beneficiary shortly before the benefit rate is computed. Thus, just as an example, next year the worker earning average wages (about $15,000) will receive an initial benefit under the 1977 formula of a little less than 42 percent of recent earnings, providing the worker had been earning at the average rate over his or her career and retired at age 65. A couple would receive half again as much. Under the automatic provisions, this so-called "replacement rate" stays the same in the future, and in the year 2000 or 2025, while the dollar amount of benefits will have greatly increased, the "replacement rate" of approximately 42 percent for the worker regularly earning average wages will be the same. The provision resulting in a stable "replacement rate" applies also, of course, to workers earning lower than average wages and those earning higher than average wages. A major proposal of the Administration is to reduce this "replacement rate" for just about everyone now contributing to the system. The cut for the average worker would be about 9 percent (4 percentage points) with the "replacement rate" dropping to 38 percent.

The "replacement rates" provided by present law are not excessive. In the great majority of cases those earning average and below-average wages have only social security to look to as their retirement system. While many of those earning above-average wages will also have some income from a private pension, the combination of social security and the private pension seldom reaches an amount sufficient at the time of retirement to provide a level of living comparable to that earned while at work. And after retirement the private pension income is eroded by inflation. (This is true since the social security "replacement rate" drops for higher-paid workers, reaching a "replacement rate" of 28 percent for the maximum earner.)

• Another proposed change would importantly reduce family protection for current contributors. The maximum amount payable on a single wage record (that is, for a family of survivors or a family made up of a retired worker with dependents) would be limited to 150 percent of the worker's own benefit, whereas today the maximum payable on a single wage record for survivors or families of retired workers can be as high as 188 percent of the worker's benefit. The proposal eliminates additional benefits for many families that have more than one dependent or more than two survivors. In addition, benefits payable to a family would be limited to 85 percent of the indexed lifetime social security earnings if this limitation produced lower benefits than 150 percent of the worker's benefit.

Present law does not pay excessive benefits to families if the ratio of benefits to earnings is measured, as it should be, by the recent or highest earnings of a worker. The argument that in a relatively small number of cases total monthly benefits exceed the worker's lifetime monthly average of earnings seems irrelevant. The new family maximum proposed for survivors' and retirement benefits would be the same as the lower maximum provided for disability benefits by the 1980 amendments.

The Administration would also reduce benefits for just about everyone by averaging earnings over three additional years.

Although affecting practically all current contributors, this provision reduces benefits particularly for those who for one reason or another are out of the labor force during some part of the time over which average earnings are computed, particularly married women with children, people with employment handicaps, and disadvantaged groups generally. It has a particularly harsh effect on people forced to take benefits at age 62, since the three years of zero earnings between 62 and 65 reduce the average on which their benefits are based or require such people to use up three of the five drop-out years that could otherwise be applied to low earning years prior to 62.

Cuts That Fall with Special Harshness on People Who Are Forced To Take Their Benefits before Age 65

The Administration has proposed reducing benefits for people applying for benefits at age 62 by over 40 percent . The result would be that the benefits payable to the average worker taking benefits at 62 would be about 19 percent of recent earnings instead of about 33 percent today. No one applying for a social security benefit at 62 would receive a benefit equal to the poverty level. They would make this reduction by combination of provisions. First, of course, the provisions previously discussed which affect just about all present contributors would also affect those who apply for benefits at 62. The "replacement rate" would be lower, the maximum amount payable on a single wage record would be lower, and for this group, computing average earnings over three additional years would be particularly harsh. But there are, in addition, two special provisions aimed at those applying for benefits before 65.

Those taking benefits at 62 would get only 55 percent of the amount payable at 65--which would have already been reduced--as compared with 80 percent today. A spouse would get only 27 1/2 percent of what was payable to the worker at 65 as compared with 40 percent today. The 80 percent rate in present law was designed to be an actuarial reduction--that is, the lower rate payable beginning at 62 over a longer life expectancy, taking interest into account, results in the same total benefits paid at a higher rate over the shorter life expectancy from age 65 on. I have been unable to discover what the 55 percent reduction is based on.

It should be made clear that the reduction to 55 percent of the amount paid at age 65 permanently reduces benefits to this level over the lifetime of the recipient, just as the reduction to 80 percent does today; there is no increase when one reaches 65. It should also be made clear that there are also reductions for those who apply for benefits between 62 and 65. The reduction from the benefit rate at 65 to 55 percent of that rate at 62 is graded-in over the intervening years.

The Administration has also proposed that benefits for the children of workers who apply for benefits before 65 be eliminated entirely. This has not been taken into account in calculating the over 40 percent benefit cut.

Since, typically, women marry men who are about three years older, these proposals have a devastating effect on the retirement plans of many couples even if the man waits until 65 to claim benefits. To avoid a major loss of benefits, a working wife will have to postpone filing until she is 65 and her husband is 68.

Administration spokesmen have presented these extraordinarily severe slashes in benefits for those who apply prior to 65 as if they were an incentive feature designed to encourage people to work longer. Leaving aside the question of whether such punitive slashing of benefits can be correctly labeled an "incentive," the unfortunate fact is that a great majority of people who are out of work and claim benefits at age 62 do so because they are in ill health or because their job has disappeared. In a study conducted by the Social Security Administration, over 70 percent of the men in this category applied for benefits for these two reasons, 57 percent because of health and 14 percent because the job had been discontinued. Only 22 percent were in good health, had a job and voluntarily retired. 1/

A One-Third Cut in Disability Protection

Disability insurance protection under social security was substantially reduced by the 1980 amendments to the Social Security Act. The administration of the program has also become increasingly restrictive. Today about 70 percent of all applications for

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1/ Reaching Retirement Age, Research Report #47, U.S. Dept. of Health, Education and Welfare, Social Security Administration, Office of Research and Statistics, U.S. Government Printing Office, Washington, 1976, table 4.7, p.47.

disability insurance are disallowed. Those receiving benefits are having their cases reviewed much more frequently than in the past. This part of the social security program does not have a financing problem. According to the estimates of the Board of Trustees it is adequately financed for the full 75 years over which the estimates are made.

Nevertheless, the Administration is proposing a series of benefit slashes in the disability program that are even more severe than those recommended for the old-age and survivors' insurance program and amount to about one-third of the protection now provided. It needs to be remembered, first of all, that the general reduction in "replacement rates" that was previously discussed applies also to disability insurance and that all the individual cuts aimed specifically at the disability program are on top of that reduction.

It should be remembered, too, that the proposed changes in the disability insurance program will make it much more difficult for workers between age 62 and 65 to become eligible for total disability benefits. In other words, an even larger number of those out of work at 62 for health reasons will have to apply for the greatly reduced retirement benefits because, if the new proposals pass, many who under present law would be eligible for disability benefits would no longer be eligible. So once again the age 62 to 65 group is greatly disadvantaged.

To a very considerable extent, the social security disability program is a program for older people. Approximately half the beneficiaries are age 55 or more and three-fourths are aged 50 or more. To be eligible they must be unable to engage in any substantial gainful activity. It is, of course, not surprising that as people grow older more of them will meet this test, but the point is that the disability insurance program, to a considerable extent, is an alternative to a lower general eligibility age for retirement benefits. Disability insurance singles out those who can't work and limits the benefit payments to them.

The disability change that will affect the older worker particularly is the elimination of all factors in adjudication other tha those that are medical. Under present law, disability determinations are made by looking at the whole person. In addition to strictly medical factors, the determination takes into account experience, training and age. Thus conditions that are considered completely disabling may be different for a professional person and an uneducated worker who can do only unskilled heavy labor, and may be different, also, for a 35 year old and a 63 year old. The proposal would eliminate those differences so that present adjudicative standards that are somewhat less strict for older people would be made more severe.

There are two proposals in the disability area which will make ineligible many totally disabled people who can get benefits under present law. These new provisions would require a much stricter test of recent employment. When the disability insurance program first became law, an individual to be eligible had to have worked not only during five years out of the last ten, the test today, but also during a year and a half out of the last three years. This test of very recent employment was removed from the program because it became clear that many totally disabled individuals who had contributed substantially to social security were being barred from benefits unfairly. Many total disabilities do not occur at a precise moment in time. Unlike the person disabled in an automobile accident or by a stroke say, a worker may suffer from a degenerative illness that gets gradually worse. Since the definition of disability for social security purposes is very strict--inability to engage in any substantial gainful activity--a worker may be significantly disadvantaged in the labor market for a considerable period of time before he or she meets the definition. Thus it was not unusual to find workers with any one of a number of progressive diseases, such as emphysema or multiple sclerosis, who had a history o intermittent employment over a considerable period before a final determination of disability could be made. Thus there was a "catch-22" situation in which the person was not quite disabled enough to qualify, but had such difficulty keeping a job that when he or she did become disabled enough, it was no longer possible to meet the test of recent earnings. The Administration now proposes to restore this test and, in addition, make the test of recency even harder to meet by requiring that the individual work seven and a half years out of the last ten, instead of five years out of the last ten as under present law.

The Administration also proposes two other cut-backs in disabili benefits. At the present time in order to get a social security disability benefit, a worker must be totally disabled for a full six months and then is paid for that sixth month. The disability must also be one which is expected to last for a total of at least 12 months or to result in death. The Administration proposes to require that a worker be totally disabled for a full seven months with a payment for the seventh month and that the disability be one which is expected to last for at least 24 months or result in death.

Taken together, and on top of the reduction in benefit amounts that apply to disability as well as to all other parts of the program, the recommendations amount to a gutting of the disability insurance program.

Other Benefit Cuts under Current Consideration

In addition to the Administration's proposals for benefit cuts, there has been discussion of various ways of cutting back on the cost-of-living adjustment (COLA) for those receiving benefits and discussion, also, of the possibility of reducing benefits for those who retire before age 68. The SOS Coalition is opposed to both of these proposals.

Modification of the COLA

It is doubtful that the use of the Consumer Price Index as the measure for the COLA has produced excessive increases for social security beneficiaries. First of all,these increases do not maintain benefit purchasing power fully because these increases are provided long after rising prices. A January 1981 study by the Office of Management and Budget (Report on Indexing Federal Programs) states that, "Since 1975, social security recipients have experienced a 3.4 percent decline in real benefit levels due to the lengthy lag time in adjusting benefits during a period of accelerating inflation."

Second, the elderly, as compared to younger consumers, spend more of their income in three categories of expenditures which have experienced the most rapid price inflation: food at home, fuel and utilities, and out-of-pocket medical expenses. A study by Data Resources Inc. shows that between 1970 and 1979, the Bureau of Labor Statistics all-urban Consumers' Price Index (CPI) rose an average of 7.2 percent compared to 8.3 percent for food at home, 9.4 percent for fuel and utilities, and 7.9 percent for medical care. These costs have risen at a composite rate of 8.4 percent per year versus a CPI rate since 1970 of 7.2 percent per year.

It may be that the current CPI tends to overstate increases in housing costs. From the point of view of social security beneficiaries, however, for every overstatement in the general CPI, there is probably at least one understatement in another expenditure category.

Reducing Benefits for Those Who Retire before Age 68

SOS is completely opposed to this proposal. This is just another way of cutting benefits. Benefits would be paid at 65 but the amounts would be substantially lower than would be called for by present law, and the amounts now payable at 65 would not be payable to anyone who claimed benefits prior to 68.

The proposal in its usual form would start to grade in many years in the future and is apparently designed to reduce a deficit in the social security system now estimated to occur in the period 25 to 75 years from now. (See Appendix C to learn why SOS believes that the official long-range cost estimates are not a sufficient basis for concern about the long-range financing of the present social security system.)

As the social security program is now set up, there is a very flexible approach to retirement. A person can retire with full benefits at age 65 or later, or with reduced benefits at a younger age. Under present law, beginning in 1982, benefits will be increased 3 percent between age 65 and 70 for each year retirement is postponed, and benefits will be payable at age 70 whether one continues to work or not. These arrangements give people a choice that should continue.

Even in the long-range future there will be large numbers of people who will be forced to give up their jobs before age 68 because of ill health or because the job disappears. Under this proposal such people would get lower benefits. This age group is the very one being asked to pay larger social security contributions over their working lifetime.

SUMMARY AND CONCLUSIONS

The Administration has chosen to present the social security financing problem as one which calls for massive benefit cuts as the most reasonable alternative to "the most devastating bankruptcy in history on or about November 3, 1982," coincidentally the time of the next congressional election. This is certainly not the case. The minimal action of inter-fund borrowing, depending on the economic assumption used, might in itself be enough to meet the near-term shortfall in the OASI fund, and if stand-by authority to borrow from the general fund were also authorized, the short-term financing problem would be sufficiently met.

The Administration apparently has objectives in mind that go beyond the short-term OASI problem. The Administration wishes, also, to build up the contingency reserve rapidly to produce enough excess of income over outgo to increase benefits for people who are still working, and to cut social security taxes, and they want to accomplish all this assuming extremely pessimistic economic conditions over the next five years--conditions so pessimistic that almost no real growth in the economy is forecast. Moreover the Administration proposals would reduce the long-range protection of the system by a great deal more than would be necessary to fully cover the long-range deficit now officially estimated for the system over the full 75 years for which the estimates are made--a reduction of 3.06 percent of payroll as compared to a deficit of 1.83 percent of payroll.

Two other goals of the Administration are furthered by their approach to social security financing:

1. Excess income over expenditures for social security reduces the overall deficit in the unified budget. In other words, the Administration objective of reaching a balanced budget is clearly helped by massive social security cuts. Under the Administration's assumptions, their proposals would result in nearly $100 billion of excess income over outgo during the next five fiscal years--$15 billion excess without changing present law and an additional $81.9 billion from the proposals--$81.9 billion net, from $88.4 billion in benefit cuts minus $6.4 billion from increasing benefits for those who work after 65.

2. The Administration is quite frank about another objective. By 1990, the proposed one-fourth cut in benefit protection would allow lower social security contributions than the rates being paid today. Thus under the guise of restoring health to a system about to collapse, the Administration proposes to reduce its financing and permanently reduce the protection provided, ending up with a much smaller, much less adequate social security system. This result fits in with the objective of reducing government activity and helps them toward their goal of reducing all Federal expenditures to 19 percent of GNP as compared to 22-23 percent today.

In poll after poll the American people have said that they do not want social security reduced. They have said, instead, that if necessary, they are willing to pay more for social security rather than have the benefits reduced.

Administration spokesmen have also been hinting at the possibility of social security reductions that go beyond their current proposals.

In testifying before the full Select Committee on Aging on May 21, 1981, Secretary Schweiker said in response to a question,

> "Why not consider some of the pure welfare aspects and consider them in general revenue. In fact, this disability program was started before we had SSI (Supplemental Security Income), which is a similar program. We have another safety net there. Our point is we shouldn't use two safety nets."

This was not an inadvertence. Secretary Schweiker repeated much the same comment during his interview on "Meet the Press" the following Sunday.

In view of the Administration's expressed desire to reduce or eliminate "the welfare aspects" of the social security program, one wonders what is coming next for disability insurance. Now the fact is, of course, that disability insurance is not a welfare element in the social security system. It is very much like a large-scale group insurance disability program. The benefits are derived from past earnings and contributions just as in the case of survivors' insurance under social security or retirement insurance. It is not some sort of add-on but an inherent part of the protection against the loss of earned income as a result of the risks which social security systems throughout the world provide for the contributing population--loss of earnings because of retirement in old-age, total disability or death.

But what is going on here? Mr. Stockman, in his testimony before the Ways and Means Committee on May 28, 1981, refers to ". . the system's continued ability to deliver on its promise of basic income protection for America's retired and disabled workers," leaving out altogether the survivors' insurance part of social security. His statement reaffirms support for disability insurance while ignoring survivors' insurance, while Secretary Schweiker seems to think of disability insurance as a "welfare element in social security," and expresses doubts about whether you should have both disability insurance and a supplemental program based upon need, Supplemental Security Income . Secretary Schweiker apparently does not include disabilitv insurance in defining the basic purposes of the social security system, and Director Stockman apparently does not include survivors' insurance.

The SOS Coalition is strongly opposed to reductions in overall social security protection. Social security benefits are certainly not too high. Payments made at the beginning of this month averaged approximately $374 a month for retired workers alone, $640 for retired couples, $413 for disabled workers alone, $812 for disabled workers and their families, $342 for aged widows or widowers, and $870 for young survivor families.

The Social Security Compact

We believe there is a compact between the contributing worker and his government to provide the protection promised.

The social security system today pays monthly benefits to 36 million retired older people and totally disabled people, their dependents, and to the survivors of deceased workers, mostly widows and motherless and fatherless children. About 115 million workers will contribute to the system this year, building protection for themselves and their families.

The system is our most successful anti-poverty program, keeping some 14 to 15 million persons out of poverty. At the same time, it is much more than an anti-poverty program. Social security is the base on which just about everyone in the United States builds protection against the loss of earned income because of retirement in old age, total disability and death. Every private pension plan in the United States is based on the assumption that the pensioner will also receive a social security benefit, and individuals saving on their own count on social security as a base for their efforts. One of the most important characteristics of the social security system is that there is no means test, as there is in a relief or an assistance program, so that private pensions and what one saves on one's own can be added to the basic social security protection.

We have in this country now a four-tier approach to retirement income: a nearly universal, wage-related, contributory, compulsory social security system; private pension plans covering about half of those currently employed (mostly above-average earners); individual voluntary savings; and underlying the whole a residual means-tested program of Supplemental Security Income. These four tiers are not competing, but are complementary. The social security system is by far the most important of the four tiers, and for private pension planners and individual savers to act effectively the social security program must be dependable; these other tiers are based on the predictability and dependability of the basic system.

The social security system provides good protection. Benefits are paid not only in the case of retirement but because of total disability or death. Over four and a half million children get a benefit every month, for example. The protection is well worth the cost. Protection for contributing workers is kept up to date with rising wage levels before they apply for benefits and with prices thereafter. The system is inflation proof and tax free.

This protection arises from a compact between the contributing worker and his employer and the government. Social security promises, stretching into the distant future, grow out of the earnings in covered employment that people have performed in the past and out of the social security payments that have been made. As in any group insurance and most pension plans, the amount of the protection is not related solely to the amount of previous earnings and specific contributions, but whether one gets a benefit at all and how much the benefit will be is related importantly to past earnings and contributions. Thus, benefits are paid as an earned right as well as a legal right. It is not surprising that the country is reacting with outrage to proposals that would violate the compact between the contributing worker and his government.

Conclusion

The Administration proposals for deep, deep cuts in social security and the acceptance of social security cuts in the first budget resolution of the Congress reemphasize the importance of separating social security financing and organization from the general budget and departmental structure.

We believe that institutional changes in the way social security is handled are needed in order to assure people that the program will continue to operate as an independent group insurance and retirement program, protected against the short-term policy swings of elected officials and political appointees and protected against the use of social security for budget purposes.

In the interests of protecting social security's long-term commitments, the separateness of social security financing should be made unmistakably clear. The purpose of the annual budget is to make choices among expenditures, giving preference in the budget period to one expenditure over another, and also to determine who pays what and how much for the expenditures. Social security promises--stretching into the distant future, resting on past earnings and contributions, and with separate financing--are not a proper part of this essentially competitive process. The obligations of social security should be "uncontrollable," because they are the product of an agreement to furnish certain protection in return for certain contributions (See Appendix B for a fuller dission of removing Social Security from the unified budget and setting up the administration of social security under a bi-partisan board.)

Finally, Mr. Chairman, as a Coalition of organizations whose members are about evenly divided between current contributors and current recipients of social security benefits, we are proof, if proof were needed, that workers have a common interest with the retired, disabled, and surviving families of deceased workers in sound planning for income insurance. Everyone who is fortunate enough to live until retirement will need a regular, permanent income to replace the earnings that were previously the main source of support. We are all headed in the same direction--no one stays young. Also, any worker may become totally disabled before retirement, or he may die and leave surviving dependents. Planning for income security is not primarily a matter in which those at work help those who are not. We are all planning together for the kind of protection that we all need.

Appendix A

Factors Effecting Long-Run Costs

In discussing the social security cost implications of the future demography of the United States it is of the first importance that we be clear in distinguishing between those matters we can be quite certain about and those matters which are more speculative. The broad outline of the growth in the absolute number of the elderly population over the next 50 years is quite certain--perhaps a 600,000 a year average increase in the number of those over 65 for about 15 years in the future, then a considerable slowing down in the rate of increase for ten, followed by a huge increase, averaging well over a million a year for the following 25 years, and then a more or less leveling off for many years after 2030. The people who will become 65 between now and 2045 have already been born, and the application of expected mortality rates (which include a substantial allowance for improved mortality) to the existing population produces the results described. In other words, give or take a few million, the number of people over 65 will rise from 26 million today to 35 million by 1995, rise relatively slowly for the next ten years, and then be followed by a huge increase in just a 25-year period from about 37 million in 2005 to 65 million in 2030, with the number over 65 leveling off after that.

It is a fact that for approximately the next 15 years large numbers of people will be reaching age 65 because birth rates were relatively high in the period from 1915 to 1930. It is also a fact that the number over 65 will not increase very much for the ten years after 1995 because of the low birth rates during the great depression. And it is a fact that the baby-boom generation of post World War II will be paying into the system until after the year 2000, and that it does not start to reach 65 until the early part of the next century. Since there continues to be a major growth in the 20 to 64 year old group between now and about 2005, the increase in the absolute number of those over 65 for the next 15 years does not cause a demographic problem for social security, and between 1995 and 2005 there is little increase in the number of the elderly. Thus, over the next 25 years, as already stated, demographic changes are not likely to be adverse to social security financing.

There is a widely held belief, however, that shortly after the turn of the century, just at the time the number of elderly starts to increase so rapidly, the number of people paying into the social security system will come to a virtual halt and remain stable for many years. It is the possibility of this relative growth in the number of retirees compared to those at work that causes concern about the long-range financing of social security.

Indeed there may be such an increase in the proportion of those drawing out of social security as compared to those paying in, but it is by no means of the same order of likelihood as the increase in the

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absolute number of the elderly. The decline in the number paying into social security depends upon a series of assumptions that are quite uncertain. Some of the most important of these assumptions are that we will continue to have low birth rates, immigration rates in the next century limited to the present legal level of about 400,000 a year, a major increase in disability rates over those being experienced today, and a work force that retires at about the same age as the work force today. These are the assumptions made in the last trustees' report and they may or may not turn out to be the case.

In addition, the trustees' report assumes that there will be a continued compounded increase in the proportion of workers' compensation paid in fringe benefits as compared to wages, so that higher social security taxes which apply only to wages will have to be higher than would be the case if the trend toward more and more fringe benefits were to moderate. Yung-Ping Chen, the Research Director of the McCanan Foundation for Research in Economic Security, has pointed out that if wages and salaries were to remain at 84.2 percent of total employee compensation as they are today, then the pay-as-you-go social security tax rate would be considerably less than presently estimated. This is true because the 1980 estimates assume that wages as a proportion of total worker's compensation will have dropped from 84.2 percent in 1980 to 71.5 percent in 2020, to 67.4 percent in 2035, and 62.2 percent in 2055.

Taking all of these assumptions together, then, on a strictly pay-as-you-go basis (no reserves), there would need to be a contribution rate for the cash benefit program (assuming it is entirely self-financed as it is today) from 2025 on of about 8 1/2 percent of earnings as compared to 6 percent or less for the rest of this century. Would such an 8 1/2 percent rate, if needed, be a greater burden than a 6 percent rate now? In all probability it would not.

First, we must recognize that the very assumptions which produce an increasing ratio of older people to those at work also result in a declining ratio of children to those at work. If instead of the ratio of those over 65 to those 20 through 64, we take what has been called a total dependency ratio, the ratio of those over 65 plus those under 20 to the group 20 through 65, we get a much different picture than if we look only at the elderly. It just isn't true that reasonable demographic assumptions show a large increase in the number of dependents for each worker after the early part of the next century. Instead, what they show is a shift in the composition of the dependency group--fewer children, more elderly.

Today we have about 75 people either over 65 or under 20 for every 100 in the age group 20 through 64. Over the next 25 or 30 years this proportion drops steadily until it reaches a low point of 68 per 100 around 2010. In other words, up to that year there are actually fewer dependents per worker than we have now, and it takes until about 2020 to get back to where we are today. Even at the high point in the total dependency ratio in 2035, we get a ratio

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of only 86 per 100, as compared to 90 in 1970, and 95 in 1965. In the future, people may need to shift some of the resources that were once spent to raise children to building the kind of world they want for themselves and others in retirement, but they will have the means to do so.

Second, it can be expected, over the long run, that productivity increases translated into higher levels of living will make any increase in contribution rates that might be necessary easier to bear. Most people do not question some increase in productivity in the future. The argument is mainly over how large these increases will be. Modest increases of 1 3/4 percent a year, on the average

(a much lower percentage increase than the 2 to 2.5 percent which, up until recently, has been the historical average)--translate into a doubling of real wages after social security taxes by about 2025. As a percentage of GNP, social security cash benefits, according to one of the intermediate estimates of the board of trustees, gradually drop from 4.98 next year to 4.38 by 2005, and then rise to a peak of 6.03 in 2030, falling again to 5.50 in 2055. It would be unwise to make reductions in social security protection now based on the notion that in the distant future the cost of the present social security law will somehow become much more difficult to support. This is not likely to be the case.

And, in any event, an 8 1/2 percent rate is not an overwhelming burden, even today. German workers already pay 8 percent for old-age, survivors' and disability insurance protection, and, in addition, the general revenues of the German government pay for 19 percent of the cost of the system.

APPENDIX B

TAKING SOCIAL SECURITY OUT OF THE UNIFIED BUDGET AND ADMINISTERING IT THROUGH A SEPARATE BOARD

We need to make some institutional changes in the way social security is handled in order to assure people that the program will continue to operate as an independent insurance system, protected against the short-term policy swings of elected officials and political appointees. Under social security, workers are creating rights for their retirement which may not occur for 40 or more years down the road. They should feel secure that those rights will be respected. It is not enough to have the system operated as part of a Cabinet department with a President appointing both the Cabinet Secretary and a Commissioner of Social Security Social security should be handled in a way more in keeping with the obligations of the huge pension and group insurance plan that it is. We propose that the policy functions be performed by a Board of Directors with staggered terms, appointed by the President and approved by the Senate, and that the Board, in turn, have the right to hire and fire the chief executive officer without regard to usual civil service rules. The power to set benefits and the financing of the program would, of course, remain with the Congress and the President as it is today. We believe, too, that the financing of the program should be made entirely independent of the unified budget as it was prior to fiscal year 1969. Only in this way can the program be protected against attempts to use social security as a tool of short-term budget policy.

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It would add significantly to public understanding of the trustee character of social security as a retirement and group insurance plan if the program were administered by such a board directly under the President and if its financial transactions were kept entirely separate from other government income and expenditures. Social security has nearly 90,000 employees and some 1300 district offices across the country; it is one of the very largest direct-line operations of the Federal government. It does not make sense administratively to have this huge program, which intimately touches the lives of just about every American family, operated as a subordinate part of another government agency. The management of social security could be made more responsive to the needs of its beneficiaries and contributors if it were free from the frequent changes in the levels of service to the public which grow out of short-term decisions about employment ceilings and the varying management value systems which follow the frequent changes of HEW Secretaries and their immediate staffs. But most importantly, an independent Board would be visible evidence that contributory social insurance was separate from other government programs.

In the interests of protecting social security's long-term commitments, the separateness of social security financing should be made unmistakably clear. The purpose of the annual budget is to make choices among expenditures, giving preference in the budget period to one expenditure over another, and also to determine who pays what and how much for the expenditures. Social security promises--stretching into the distant future, resting on past earnings and contributions, and with separate financing--are not a proper part of this essentially competitive process. The obligations of social security should be "uncontrollable" in the sense that they are the product of an agreement to furnish certain protection in return for certain contributions.

The inclusion of social security transactions in a unified budget is bad for other reasons as well. It leads to a distortion of the decision-making process in other programs. Excess of income over outgo in social security operations for the short run tend to be used as an excuse for financing additional general revenue expenditures since social security income, though legally reserved for social security expenditures, is now treated in the budget the same way as general revenue income and shows up as if it were available money. Contrariwise, short-run social security deficits, financed from the reserves, lead to unwarranted reductions in other government expenditures because everything is included together in the budget ceiling set by the Executive Branch and the Congress.

Just about every American has a major stake in protecting the long-term commitments of the social security program from fluctuations in politics and policy. The administration of social security by a separate Board and the separation of social security financial transactions from other government income and expenditures would strengthen

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public confidence in the security of the long-run commitments of the program and in the freedom of the administrative operations from short-run political influence. It would give emphasis to the fact that in this program the government is acting as trustee for those who have built up rights under the system.

We must make it known beyond the shadow of a doubt that the United States government will fully carry out its compact with contributing workers under social security--that the government, as insurer, will meet its obligations as they fall due. Social security is a government promise that must be honored.

TESTIMONY BEFORE THE
UNITED STATES SENATE

COMMITTEE ON FINANCE
SUBCOMMITTEE ON SOCIAL SECURITY

BY

JACOB CLAYMAN, PRESIDENT
NATIONAL COUNCIL OF SENIOR CITIZENS
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July 9, 1981

Mr. Chairman, Members of the Committee, my name is Jacob Clayman and I am President of the National Council of Senior Citizens. The National Council is a non-profit, non-partisan membership organization with nearly 4,000 affiliated clubs, area councils and state organizations which represent nearly four million older Americans.

The National Council of Senior Citizens is also a participating member of the SOS Coalition, the Coalition to Protect Social Security, chaired by Wilbur J. Cohen, former Secretary, U.S. Department of Health, Education and Welfare. We would like to associate ourselves with the remarks of Robert Ball, former Commissioner of Social Security, testifying on behalf of the Coalition.

The Social Security program grew out of the social revolution of the 1930s. It was--and is--testimony to the best among the achievements that a government and a society may claim. It helped stabilize the nation, and it helped stabilize the family unit. For every person, it lessened the anxiety over possible events that could destroy lives--loss of income due to retirement, death of a family breadwinner or total and permanent disability.

Today, the anxiety returns. The Social Security program, born in 1935 and nurtured to maturity over more than four decades, is threatened by a new social revolution. This revolution recognizes little that is good in government; it would make us relive the deprivation of earlier times--the deprivation that Social Security is supposed to help us overcome.

We are told again and again that Social Security is about to go over the cliff, to go bankrupt--or other phrases that indicate that catastrophe is just around the corner. We are told that the choices we face are to cut benefits, to raise taxes, or to delay paying benefits. We are also told that raising taxes is unthinkable, leaving one with the clear (but erroneous) message that we have no choice but to cut benefits.

But there are many things we are not explicitly told:

We are not clearly told that there are different potential problems at different points in time. The immediate concern is a temporary cash-flow problem; the concern 25 to 45 years from now relates to the potential impact of a shift in population by age. The first we know a good bit about; the impact of the second we know very little about, except that the demographic change will occur.

We are not told that there are different approaches to these different problems. We are permitted--and the media is encouraged to propagate the notion that the problems in Social Security are permanent and intractable and that the only solution is to amputate!

The Administration has proposed permanent cuts in Social Security protection that amount to an overall reduction of 23 percent, reductions of about one-third for the disabled and over 40 percent for those forced to apply for benefits at 62. The reductions will affect 2.3 million people already receiving benefits and just about everyone now contributing.

We are also not clearly told that there are other options. We can infuse additional monies into the system in a number of different ways, some permanent and some temporary.

- As has already been proposed by J. J. Pickle, Chairman of the Social Security Subcommittee of the House Ways and Means Committee, we could shift half of the payroll tax money from the hospital insurance trust fund (Part A of Medicare) and make up the difference to Medicare with general revenues.
- We could add general revenues across the trust funds and have a smaller income tax reduction.
- We could raise the payroll tax enough to cover the shortfall, while at the same time reducing the worker's income tax liability.
- We could authorize borrowing from the general fund with repayment on a limited basis.

According to a recent survey by Peter D. Hart Associates done for The National Commission on Social Security, an overwhelming majority of the American public of all ages would rather pay more to sustain current benefit levels than have benefits cut. The public appears to understand that eliminating or reducing benefits does not eliminate or reduce the problems that Social Security addresses. Social Security is not the problem--it is the answer!

The Administration has proposed large and permanent cuts that go well beyond even their own estimate of the financial needs of the system. Could it be that the Administration is using Social Security, which is now part of the unified budget, to cover up deficits elsewhere? We think that's part of the answer. That's why we think Social Security should be independent and not part of the general purpose budget. Social Security should not be manipulated for short-term budgetary goals that have nothing to do with the program itself..

Moreover, failure to make changes when changes are needed is unacceptable. The Trustee's Report highlights the financial difficulties of Medicare down the road. This is not new information. We were aware that health care costs, particularly hospital costs, were running ahead of other items in the consumer price index. Health care costs were a cause of inflation, not a result of inflation. Yet Congress refused to enact Hospital Cost Containment legislation. Congress refused to consider serious National Health proposals. These are still the correct answers, not benefit reductions!

I would like to take one moment more to share with you a phone call received at the NCSC headquarters on Tuesday of this week. It was a call from a gentleman from Johnstown, Pennsylvania--George D. Miles. Mr. Miles survived as a member of the U.S. Navy during the battles of World War II; he survived a near-lifetime in the steelmills of Pennsylvania, and he and his wife survived after raising eight children. But he called to say that, at age 63 and disabled, he wasn't sure he'd survive the cuts in Social Security. What he wanted to know was why Congress with a very lush pension that was subsidized by him during all his working years--why Congress was so unwilling to help him, the little guy? He didn't even know, as you and I do, that Congressional pensions cost in the neighborhood of 55 percent of payroll.

I don't believe that Congress is overpaid. I don't begrudge Congress the advantage of a superior pension plan. But I also know that Social Security doesn't begin to provide a decent livelihood for millions of America's elderly or disabled. Indeed, millions just don't make ends meet with their present Social Security checks.

I merely suggest in all sincerity that Congress apply the same quality of compassion and generosity to the country's senior citizens who rely wholly or mainly on Social Security for their sustenance that it lavishes on Congressional pensions.

If such a degree of justice, decency toward ones fellow humans and simple fair play exist in the halls of Congress--and I devoutly hope that it does--then it follows that the Administration's feverish call for further deep and wounding cuts in the Social Security system will be denied.

Thank you for the privilege of appearing here today.

Senator ARMSTRONG. At this time, we are going to rearrange slightly the schedule in order to accommodate the other commitments of some of the participants.

May I ask Sister Frances Mlocek, who is assistant to the executive director, Leadership Conference of Women's Religious and also representing Men Superiors of the United States.

Sister, would you join us at the table.

Senator DOLE. Perhaps Sister Evangeline would like to come up and join Sister Frances. We are not going to ask any hard questions, but we would like to have you here.

You made a long trip from Kansas.

I would like to say to the chairman that I appreciate this very much. Senator Baker wanted me in his office at 5 o'clock. It is now about 5:08.

I may have to leave very shortly, but I at least wanted to be here when you started your testimony.

STATEMENT OF SISTER FRANCES MLOCEK, ASSISTANT TO THE EXECUTIVE DIRECTOR, LEADERSHIP CONFERENCE OF WOMEN RELIGIOUS OF THE UNITED STATES

Senator ARMSTRONG. Sister, we are very happy to have you with us. I was just explaining to the distinguished Senator from Kansas that I am familiar with the problem about which I think you are going to testify. I am very sympathetic to it. I hope you will share it with us so that the entire committee will have the benefit of knowing what the problem is.

Sister MLOCEK. Thank you, Senator.

I would like to very briefly summarize the printed statement which you have access to.

I do represent the Leadership Conference of Women Religious and the conference of Major Superiors of Men.

These conferences are associations of a general and provincial superiors of Roman Catholic men's and women's religious communities and institutes.

They exist to promote the spiritual and ministerial welfare of Roman Catholic sisters, brothers, and order priests.

More specifically, the purpose of each conference is to assist its respective members in developing creative responsible leadership.

There are approximately 700 religious orders within the United States having a total membership of just over 153,000.

Given the purposes of the two conferences, it truly is most unusual to appear before this subcommittee on what is basically an in-house congregational matter; that is the participation of the religious institutes in the social security system.

Our presence is reflective of a growing serious concern over the evolution of social security amendments and their impact upon the citizens of the United States and most particularly, of course, upon the members of religious institutes.

Until 1967, members of religious orders, subject to the vow of poverty, were specifically excluded from the social security system.

In 1967, the coverage of religious order members as self-employed individuals was included in a bill which passed the House.

Because the legislation was not truly reflective of the circumstances of the religious life, orders requested that coverage be delayed until a comprehensive proposal could be developed.

The Senate Finance Committee rejected the House language in 1967 and the House receded.

An interim study committee made a number of recommendations which did serve as a basis for the 1972 amendments.

The 1972 legislation had several critical provisions. Religious institutes were permitted to enroll their members on a 5-year retroactive basis.

The institute had to make irrevocable election for both its members and its lay personnel.

The institute would pay the rate of the combined employer and employee, the tax currently being 13.3 percent.

Finally, because the religious member does not earn personal income from the service which is rendered as the result of the vows of obedience and poverty, a statutory wage base was established. Its calculation is the determination of the fair market value of board, lodging, clothing, and other perquisites furnished to members by the order.

This is the wage base upon which FICA tax is levied and future benefits are determined.

Current responses from about one-half of all the religious institutes indicate that some 240 religious institutes with approximately 75,000 members have enrolled in the program.

The response to the 1972 legislation has been so positive that 225 institutes chose to enroll on a retroactive basis. Such an overwhelming response, given the truly limited resources, could only connote a spirit of great faith and reliance upon a social security system and a Congress that enacted appropriate amendments permitting the inclusion of vow of poverty persons.

Due to the limitations of the 1972 legislation, a member of a religious institute today could only have 13 years of coverage since 1952, the computation date for those at or near retirement age.

Coupled with a low statutory wage base, the typical religious is entitled only to minimal benefit.

The recent votes of Congress to eliminate the minimum benefit provision therefore eliminates for members of religious institutes an extremely important provision of the law and severely modifies the effect of the 1972 legislation.

The inherent shortfall in quarters will correct itself as religious are able to build up their period of coverage.

Meanwhile, members of religious orders who are now retired or who reach retirement age during these next few years will receive exceedingly small monthly benefits, far below those actuarially projected given the 1972 legislation.

We recommend that the effective date for eliminating the minimum benefit provision should be delayed until 1992 for those persons who became eligible to enroll in 1972.

In closing may I note that the funding considerations must be consistent with the human commitments of the program and the congressional sensitivity to need.

I trust that the 1972 posture of Congress was sincere and that those institutes who made long-term planning and financial commitments based upon trust in that posture will not be dealt a very severe financial blow.

I thank you.

Senator ARMSTRONG. Thank you, Sister. I trust that that will prove to be the case. I am very grateful for your statement.

Senator Moynihan.

Senator MOYNIHAN. Mr. Chairman, I would simply echo your views. It seems to me that an element of equity suggests we do what you have suggested. We cannot have a large adverse impact such as that. It is very thoughtful of you to provide with us specifics. If we could delay eliminating the minimum until 1992 for those individuals who became eligible under the 1972 act, that would meet your concerns.

Sister MLOCEK. Yes.

Senator MOYNIHAN. I can assure you, speaking for the minority on the Committee, that I cannot imagine that we would not support you completely in this.

The reconciliation process is chaos. No one knows what is happening or what will happen. We shall look after this. I will take it to the chairman as one of our personal concerns.

Senator ARMSTRONG. Thank you, Sister. We are grateful to you for bringing this to our attention.

Sister MLOCEK. Thank you.

Senator ARMSTRONG. In one way or another we will try to work that out.

[Statement follows:]

TESTIMONY OF

SISTER FRANCES MLOCEK, IHM

REPRESENTING

THE LEADERSHIP CONFERENCE OF WOMEN RELIGIOUS
OF THE USA

AND

THE CONFERENCE OF MAJOR SUPERIORS OF MEN

BEFORE THE

SUBCOMMITTEE ON SOCIAL SECURITY

SENATE COMMITTEE ON FINANCE

THURSDAY, JULY 9, 1981

My name is Sister Frances Mlocek, IHM. I represent the Leadership Conference of Women Religious of the United States of America and the Conference of Major Religious Superiors of Men in the U.S.A. These two conferences have their national offices, or secretariats, in Washington, D.C. The conferences are associations of the general and provincial superiors of Roman Catholic men's and women's religious communities and institutes. The conferences exist to promote the spiritual and ministerial welfare of Roman Catholic sisters, brothers and priests. More specifically the purpose of each conference is to assist its respective members personally, collectively and corporately in developing creative responsible leadership and in undertaking those forms of services which are consonant with the evolving gospel mission of men and women religious in the world through the Roman Catholic Church. These are approximately seven hundred religious orders within the United States having a total membership of just a bit over 153,000.

Given the purposes and goals of the two conferences it is most unusual to appear before this subcommittee presenting testimony on what is basically an in-house congregational matter, that is, the participation of religious institutes in the Social Security program. Our presence here is reflective of a growing serious concern over the evolution of Social Security amendments and their impact upon the citizens of the United States and most particularly, of course, upon the members of religious institutes.

May I preface my remarks by expressing an appreciation to the two congressional subcommittees who devote so much of their time and energy to the various areas of the Social Security programs. The legislation with which these committees are concerned is indeed very complex and yet at the same time exceedingly important to many ordinary citizens of the U.S. Your efforts are indeed appreciated.

LEGISLATIVE HISTORY

Until the Social Security Amendments of 1972 there existed a legislative exclusion from Social Security in regard to religious with a vow-of-poverty. Section 1402(3), was enacted in 1954. This law permitted ministers of religion to opt into the Social Security system on a self-employment basis by filing a certificate of election. Members of religious orders subject to the vow-of-poverty were specifically excluded. In 1967, the coverage of religious order members as self-employed individuals was included in a bill which passed the House. Because the legislation was not reflective of the circumstances of religious life, religious orders requested that coverage be delayed until a comprehensive proposal could be developed which would have the support of the religious orders, the Social Security Administration, and the Congress. The Senate Finance Committee rejected the House language of 1967 and the House receded.

Thus, the preliminary inclusion of religious in a House bill in 1967 led to the creation of a study committee consisting of members of LCWR, CMSM and USCC (United States Catholic Conference). In consultation with the Social Security Administration and the Internal Revenue Service, this study committee made a number of recommendations which served as the basis for the 1972 Social Security Amendments.

THE 1972 LEGISLATION

The 1972 Social Security Legislation as it related to the members of religious institutes had several critical provisions. Religious institutes were permitted to enroll their members on a five year retroactive basis. Secondly, the religious institute had to make an irrevocable election for both its members and lay personnel. Thirdly, the religious institute would pay at the rate of the combined employer and employee tax, currently 13.3%. Finally, because the religious member does not earn personal income from the services which he or she renders as a result of the vow-of-poverty, a statutory wage base was established equal to the "fair market value" of the board, lodging, clothing, and other perquisites furnished to members by the order. This is the wage base upon which the F.I.C.A. tax is levied and future benefits determined.

IMPACT OF PENDING SOCIAL SECURITY LEGISLATION

We have been unable to gather complete data in time for this hearing. However, we do have responses from about one half of all the religious institutes. Of these, some 240 religious institutes with approximately 75,000 members have enrolled in the Social Security program. The response of religious institutes to the 1972 legislation has been so positive that 225 of the 240 institutes chose to enroll on a retroactive basis. Needless to say, such an overwhelming response, given the traditionally limited resources of religious institutes, could only connote a spirit of great faith and reliance upon the Social Security system and the Congress that enacted appropriate amendments permitting the inclusion of vow-of-poverty persons.

Due to the limitations of the 1972 legislation few religious are at this time entitled to more than minimal benefits. At most, these individuals can only have 52 quarters of covered employment (20 if they promptly exercised the full by-in provision and 32 at the rate of four per year). In short, a member of a religious institute could only have 13 years of coverage since 1952 which is the computation date for those at or near retirement age. The combination of a low statutory wage base and the short period of coverage entitles the typical religious member to minimal benefits. The recent votes by the Senate and the House to eliminate the minimum benefit provision therefore eliminates for members of religious institutes an extremely important provision of the law and severely modifies the effect of the 1972 legislation.

In choosing to enter the Social Security system, religious institutes, conscious of the irrevocable circumstances of their choice, carefully weighed the benefits of enrollment in the light of their very limited resources.

In summary, because religious religious orders were excluded from Social Security prior to 1972, members of religious orders under the vow-of-poverty have not been able to accumulate sufficient quarters of coverage to qualify for retirement benefits equal to the minimum benefit payment. This situation will correct itself as religious are able to build up their period of coverage. Meanwhile, members of religious orders who are now retired or who reach retirement age during these next several years will receive exceedingly small monthly benefits, far below those anticipated when the religious orders elected to join the system on the basis of the 1972 legislation.

RECOMMENDATION

We recommend that the effective date for eliminating the minimum benefit provision should be delayed for ten years, until 1992, for those individuals who first became eligible for coverage as a result of the amendments in the Social Security Act of 1972. This would allow members of religious orders an opportunity to build up their years of coverage to a level comparable to those individuals who were allowed into the system prior to 1972.

In closing, may I simply note that funding considerations must indeed be consistent with the human commitments of the program and Congressional sensitivity to need. I trust that 1972 posture of Congress was sincere and that those persons who made long-term commitments based upon trust in that posture will not be dealt a severe financial blow. We appreciate the opportunity to present our reflections and wish to extend to you an invitation to continued communication within this very specialized area of participation within the Social Security program. Thank you.

Senator ARMSTRONG. The committee will now hear from a panel. We apologize to the panelists. We are running behind schedule. We are grateful to you for your patience as well as for being willing to come and share your expertise with us.

The panel consists of Mr. Bob Roberts, director of the LSU Assessment Center, LSU Medical Center; Mr. Irvin P. Schloss, director, Government Relations Office, American Foundation for the Blind, Dr. Boggs, member, Governental Affairs Committee, Association for Retarded Citizens, and Mr. E. Winslow Turner, member of the Government Relations Committee of the National Multiple Sclerosis Society.

Again, our thanks to you for coming. Unless the panelists themselves have otherwise arranged, it would be my suggestion we simply proceed in the order in which I have introduced them. We will begin with Dr. Roberts, of LSU.

STATEMENT OF DR. BOB ROBERTS, DIRECTOR OF THE LSU ASSESSMENT CENTER, LSU MEDICAL CENTER

Dr. ROBERTS. Thank you, Mr. Chairman. I appreciate the opportunity to be here today. I apologize. I received notice the day before yesterday of appearing. I dictated the report and failed to proof it. I was out of the office yesterday and picked it up. I will apologize for a couple of errors.

Senator MOYNIHAN. Mr. Roberts, will you bring the microphone a little closer?

Dr. ROBERTS. Yes. And I apologize for a couple of errors in not only typing but possession and a few other things I noted.

Unlike previous members who have been on the panel to testify, I am here to talk about some things rather specific. It does not relate to overall budgeting or the salvation of the entire social security program. It does, however, relate to some specifics as far as individuals who have paid into the system and who should in the course of their work history, become disabled and seek out disability insurance benefits under title 2, of the Social Security Act.

I am relating primarily to some recommendations that were made by the Secretary of Health and Human Services on one of primary concern, the elimination of nonmedical factors such as aid to education and prior work experience and relying solely on medical factors.

I will briefly summarize some of the points in this. There is psychiatry and a number of other medical professions, there is considerable difference of opinions with regard to medical diagnosis and treatment, in many cases.

There are reviews that have been done by the Social Security Administration on differences of opinion between State disability determination offices and consultative medical examiners and medical experts that administrative law judges have access to when it reaches the adjudication level.

There is a great deal of controversy between these individuals as to whether or not based on objective written medical information that a person is or is not disabled under the current law.

It has been my experience in working with over 1,500 individuals, working with them and reviewing cases, working as far as evaluating their ability, consulting with medical professionals on rehabilitation processes, these type things, that ofttimes inadequate information is available on which to make a decision.

Initial decisions are made by medical examiners at State disability determination units and they must rely solely on written medical information in the file.

Ofttimes this information has been copied numerous times, many times it is illegible and incomplete. Therefore, they tend to rely on a nonscientific approach to make objective determinations of disability based on incomplete or unreliable medical information.

What generally happens once a person is denied benefits, they do have a right to appeal. At that point in time they are generally sent for a general medical evaluation by medical consultants who ofttimes contract with local disability determination units to provide such evaluations.

It has been my experience that these applicants for disability insurance benefits who appear before these medical examiners get less than what I would consider adequate medical treatment or diagnosis.

Generally, the comments are that they spend no more than 15 or 20 minutes in consulting physician's office. They are asked very few questions, yet we tend to get long flowing medical reports that indicate that a person does or does not have the ability to perform substantial gainful work activity based on medical findings.

When we look objectively at the medical evaluation the individuals receive, ofttimes it is no more than getting up and down off a medical examining table, but yet from this the physician makes conclusions about a person's ability to work for an 8-hour day, draws conclusions that a person has the ability to stand and walk 6 out of 8 hours and perform a full range of physical motions that allow a person to perform substantial gainful work activities.

I guess essentially what I am saying is from the experience of working with individuals, if we look at using the medical-only factor to determine disability, of course it will in fact save money, because very few people receive the type medical examinations that could objectively provide that information.

Therefore, most would not meet the listings for disability.

I don't want to belabor the point on that, but when we look at the current state of the art in medicine and recently had an opportunity to be on the faculty of an international symposium in Atlanta, Ga., which has medical experts throughout the United States.

I wanted also to address the issue that the Ways and Means Committee points out of eliminating the factor of pain in disability determination. The reason for this is there appears to be great controversy between different physicians as to what pain is.

Generally, the administrative law judge, when he gets to the hearing level, is required to consider pain in making a determination.

Because of these discrepancies the Ways and Means Committee has recommended removing pain as a factor. To do so would, in my opinion, indicate that pain, in and of itself, does not either exist or it does not have debilitating effects.

There is enough controversy over medical practices and procedures, particularly diagnostic techniques, to determine that pain in and of itself is extremely hard to evaluate and will require more extensive research and development in order to do that.

Also, the next point I would like to address and I realize the bell has sounded, but I would like to speak to this issue, if I might, is another recommendation from the Secretary to remove the 12-month disability requirement or continuation of disability for 12 months or expect to last 12 months to a period of 24 months.

In working with individuals what we see is that the majority of people apply for benefits between the 6th and 12th month of disability. In other words, they assume that they are going to get better. So they postpone applying for benefits.

Generally, this does not occur. Some significant things begin to happen and we look at cause-and-effect relationships about that period in time. A person has run out of money. They can no longer afford proper medical treatment. They are at the point where they are losing cars, homes, the church has supported them all they can, as have their relatives.

Generally, if a person did not have a substantial medical condition because of lack of treatment and/or medication, at this time it is significant.

Of course, if any impairment, illness, is diognosed and it is not properly treated, then it will, of course, proceed and get worse.

To look at the idea of extending the 24-month period in lieu of the 12-month period is feeling that this would substantially increase the amount of time a person would in fact draw disability benefits.

If a person has gone through that point in time without the resources to provide adequate treatment, they would in fact take longer to rehabilitate themselves and to recover from such illnesses.

So, if the 12-month period was maintained and a proper coordination of services were allowed, then a person would in fact have a lower recovery rate or a lower recovery time rather and be able to have benefits terminated and resume work activities.

One other point on the elimination from the trust fund of financing vocational rehabilitation services for disabled applicants, at the present time the people, and I am not here speaking on behalf of an organization or agency or anybody who has vested interest in the outcome of the proceeding. I guess I am speaking as an advocate in a role because I have been a service provider to individuals working with the rehabilitation process.

I have never been employed by the State rehabilitation agency, but have always worked closely with them in providing these type services to individuals.

When we look at the average age of workers being 45 when they become disabled. Their average educational level being 9th grade or less, we find most of these people do not have the ability in and of themselves to adjust to different types of work activities. We find there is a need for somebody to provide these services.

Traditionally vocational rehabilitation has done this. Traditionally there have been requirements in the legislation that once an individual receives disability insurance benefits that they should automatically be contacted by vocational rehabilitation and seek out such services.

If they failed to do so, supposedly benefits would be terminated for their nonparticipation.

The idea of eliminating funds from vocational rehabilitation services would completely eliminate any possibility to the individual who became disabled to receive the type services that are necessary to get them back to work and off the disability rolls.

Without the mechanism to do that, the long-term effects of social security would be to not only have a great deal of individuals retiring going into the system and removing funds from it, but also it would maintain greater numbers and disability statues and would also decrease amounts of funds.

In summation, even though I am talking about specifics in the act, and I am not talking about anything in general, I am looking at impacts on people at the level at which they feel the results of what occurs here in Washington.

Looking at their trust and the question was: How do individuals get the idea that disability, that there is insurance benefits. They call it disability insurance benefits and that is the way people feel about it.

But that trust is there, some mechanism is there to assist an individual since they have contributed to get them back on their feet and to make it to that retirement age, and then worry about surviving then.

Unfortunately, a mechanism has been in place. Financing has not been available to make sure it works. Coordination of services between agencies have not occurred, even though it was provided for in the law.

I guess essentially what I am saying is that if there was following the mandate of the law as it currently exists, and funds made available for this process, individuals receiving adequate treatment on a timely basis, and also receiving coordinated services, the problem you are looking at as far as deficits in the social security law, the social security trust fund, would almost be eliminated by the fact that people would return to work on a more timely basis, pay their full contribution to the system and once again, be sound financially themselves so that they could maintain a level of stability that is necessary for them to function on a day-to-day basis.

Thank you very much.

Senator ARMSTRONG. Thank you, Mr. Roberts.

Mr. Schloss.

STATEMENT OF IRVIN P. SCHLOSS, DIRECTOR, GOVERNMENT RELATIONS OFFICE, AMERICAN FOUNDATION FOR THE BLIND

Mr. SCHLOSS. Thank you.

My name is Irvin Schloss. I am representing the American Foundation for the Blind. I have submitted a written statement which I would appreciate having included in the record of the hearings.

Senator ARMSTRONG. Thank you. It will be included in the record, sir.

Mr. SCHLOSS. I have been asked by the American Association of Workers for the Blind to indicate their concurrence in the positions we take in our statement.

I would also like to add that the American Foundation for the Blind is a member of the Save Our Security coalition and concurs in the views expressed in Mr. Ball's testimony.

We oppose any drastic, abrupt cuts in benefits which would radically affect the protection of future beneficiaries under the Nation's basic social insurance system—protection against total loss of income, in the event of retirement, death and severe disability.

I would like to remind the committee that members of the armed services have been covered by social security since 1956 and that any changes made that would cut benefits will also affect them and their families. With the reinstatement of the draft imminent, and with the need, in addition to that, to attract long-term career military personnel, I would caution against anything that would not only detract from the benefit structure for the total population, but also reduce incentive of individuals to serve in our Armed Forces.

Based on the fact that the Administration's own figures accompanying their proposals tend to indicate an oversaving compared to what the administration's own assumptions indicated were needed, we would like to recommend that the social security trust fund be removed from the unified budget and placed under its own board for administration.

I think there is too much temptation to use the savings (which would accumulate rather rapidly if the Administration's proposals were enacted) to reduce deficits in the unified budget.

With regard to disability insurance benefits we would strongly recommend against enactment of any of the proposals made by the administration.

The Congress last year adversely affected disability insurance beneficiaries by reducing the dropout years for those under 47, and by placing a ceiling on family benefits of disability insurance beneficiaries.

The types of changes in eligibility criteria which the administration is recommending are regressive. They would result in the elimination of many individuals from eligibility for disability insurance benefits.

One proposal that would increase the requirement for 20 out of 40 quarters of coverage before the onset of disability to 30 out of 40 quarters. One would reinstate the repealed provision for 6 out of 13 quarters of coverage before the onset of disability.

I might add that the latter provision was repealed in 1958 at the urging of the Eisenhower administration.

We would also oppose elimination of age, education, and vocational factors, leaving the determination process solely to the medical listings criteria.

This, coupled with the other eligibility criteria changes proposed by the administration, would adversely affect individuals with progressive conditions such as multiple sclerosis—which will be discussed in more detail by one of my colleagues—and also adversely affect people with progressive types of eye conditions such as retinitis pigmentosa, glaucoma, macular degeneration, and diabetic retinopaphy.

We would urgently recommend that the 6 out of 13 quarters provision, which is in the Senate version of the omnibus reconciliation bill but not in the House version, be deleted in conference. We hope the Senate will recede.

With regard to the beneficiary rehabilitation program, it is cost effective based on studies made by the Social Security Administration in the late 1970's, with a mean cost-benefit ratio of 2 to 1.

We would also advocate statutory establishment of the substantial gainful activity dollar amount in lieu of the administrative way it is now determined. There is always a lag between increases in cost and the time the Secretary increases the SGA amount.

I would like to indicate the need for universal coverage, specifically phasing in coverage of all employees of the three branches of our Federal Government, without adversely affecting the benefits of long-term employees.

As other witnesses have testified, this would not only assist in cost factors in the program over a long term, but it would also give Federal employees who leave the Federal service a system that is completely portable. Career Federal employees would have basic social security protection which many of us who are not Federal employees enjoy and would also have their own retirement annuity system.

In view of the time factor, Mr. Chairman, I will terminate by urging the committee not to take any action that would drastically curtail benefits.

As other witnesses, principally Mr. Ball, have indicated, the short-range financing problem is easily soluble.

We have made recommendations in our written statement for dealing with the long-range financing problems. We hope that in your deliberations you will take into account the expectations of the American people for a stable, dependable social insurance system that will protect individuals and their families in retirement and in the event of death or disability.

Thank you.

Senator ARMSTRONG. Thank you, Mr. Schloss.

Dr. Boggs.

STATEMENT OF DR. ELIZABETH M. BOGGS, ASSOCIATION FOR RETARDED CITIZENS

Dr. BOGGS. Thank you, Senator.

I represent a group of 12 organizations. You have our written statement. I trust it will be inserted in the record.

Senator ARMSTRONG. Yes, it will be.

Dr. BOGGS. Like the other witnesses in the preceding panel, I am dealing with specific subpopulations who may be disadvantaged disproportionately either deliberately or inadvertently by actions taken by this committee as a result of the macroissues that you are having to address. We sympathize with you in that endeavor.

There are also microissues. The people who are affected by the microissues may be affected severely as far as they themselves are concerned, even though the impact on the whole system is not noticeable.

We are looking for fairness and equity for them also.

I do want, as I proceed, to compliment you, Senator Armstrong, and also Senator Dole for your public appearances recently on TV. I watched both of you and it was quite reassuring, I must say.

We favor the notion that whatever penalties there may be, or necessities to tighten up, should be broadly distributed and shared by many people and not concentrated on a few.

We feel that, as has already been indicated, some of the proposals for tightening up on the disability program would have a particularly deleterious effect on a few people.

I remind you that the disabled have already taken a considerable impact beginning last year. An additional impact has to be carefully considered.

I would like to speak particularly however to an issue that has not heretofore been addressed and that is the proposal of the administration to further restrict the maximum family benefit formula.

The proposal is to impose on the OASI program the same maximum family benefit program that was enacted last year as part of the disability package.

The effect of reducing to 85 percent of AIME or 150 percent of PIA, whichever is less, impacts heavily on families with children, including disabled children.

Now only about 10 percent of the cost of the system goes to benefits to minor children. Less than 1 percent goes to adult disabled children. It is to that group I wish to speak and particularly call your attention.

The proposals that the administration put before you would bring about, I estimate, reductions in benefits of about 15 percent for about half of those beneficiaries projected in the future, of course. Considering what their benefits are already less than the full PIA, that would be a considerable difference.

Furthermore, you aggravate a planning problem for parents of adult disabled children who count heavily on the eventual benefits their children will receive when the parents die or retire.

The present benefit does have the advantage in a family who has had the misfortune of having a child disabled in childhood, who never entered the work force and is now entitled on a working parents' earnings record, that family now has something to build on for their child's future. However, if you reduce those benefits you find yourself in a position where the family really begins to wonder if it is worthwhile for them to try to establish a trust fund and build up the income. Because the alternative to that is to minimize the benefits to the child so he becomes eligible for SSI and other means tested assistance.

Therefore, we feel first that you are inadvertently moving people from one planning area to another and second, that there is detriment not anticipated. We would like to avoid that.

Thank you.

Senator ARMSTRONG. Thank you, Dr. Boggs.

Mr. Turner.

STATEMENT OF E. WINSLOW TURNER, NATIONAL MULTIPLE SCLEROSIS SOCIETY

Mr. TURNER. Mr. Chairman, Senator Moynihan, we also have submitted a full statement to the committee. I have prepared a brief summary of that. The time being what it is I will try to take selected parts of it and move along. My name is E. Winslow Turner. I am a member of the Governmental Relations Committee, of the National Multiple Sclerosis Society.

Several years ago, I was diagnosed as having multiple sclerosis. I found it necessary to retire after 18 years of service in the Senate staff employment.

I am now an attorney in private practice. I am trying to cope with an unpredictable work future. I am here this afternoon, along with my colleagues, to express a serious concern with the Senate position on eligibility criteria for social security disability insurance.

I will concentrate on the specific provisions in the Senate reconciliation bill which would add a new "recency of work test" for disability coverage.

This is a test of such short duration that many people with progressive and chronic types of diseases and disabilities may be barred from eligibility, even though they may have contributed substantially to the system over the years.

To be more specific, the present law determining insured status requires work in 20 out of the last 40 quarters immediately preceding disability (or half of the quarters elapsed since age 21 but at least 6 quarters). The proposed "recency of work test" would add a further requirement that severely disabled persons must have worked in covered employment during 6 out of the last 13 quarters preceding the date when disability is determined to meet the medical and other criteria.

The House does not have such a restrictive eligibility requirement in its reconciliation bill.

Essentially the Senate approved "recency of work test" would remove from insured status, those persons who have paid into social security during at least half of the last 10 years, but who have become so disabled they were unable to work at least half the time during the most recent 3 years.

Such a restriction was a part of the original disability insurance program in 1956. But 2 years later, it was changed when it became clear that many totally disabled individuals who had contributed substantially to social security were permanently barred from disability benefits.

Those affected by the Senate provision are primarily persons who become disabled by conditions or diseases which often create a history of intermittent employment for a considerable period before a final determination of disability can be made, and those persons whose disability has an earlier onset and continued to age 65 to a chronically disabling condition.

While it may not have been understood or intended, this proposal focuses in a discriminatory manner on those citizens who happen to become disabled with multiple sclerosis and other progressive diseases or conditions such as emphysema, lupes, arthritis, epilepsy, mental illness, and some forms of cancer.

Unlike an automobile accident or other form of trauma, and unlike conditions caused by acute illness, many disabilities do not occur at a precise time.

One may experience numbers of exacerbations and remissions of a disease with a medically unpredictable pattern causing periods of unemployment, but not clearly eliminating the possibility of future employment. For example, a person who had worked for 10 years under social security might then develop symptoms of multiple sclerosis and experience a work history which includes 4 periods of unemployment (equally 8 quarters) related to exacerbations within a 13-quarter period. At the end of this 13-quarter period, eligibility for disability benefits would be lost, even though the person has paid into the system for 45 of the last 53 quarters.

The erratic pattern of a disease and its effects on the ability to hold a job, coupled with the difficulties of diagnosis, might mean that the individual was never quite medically eligible to obtain benefits until he or she was no longer work eligible under the new "recency of work" test, a catch 22 situation, gentlemen.

This would be especially true in cases where the impact of disease caused fatigue is a significant element or where the cumulative impact of two or more symptoms occuring in cyclical courses produce severe disability, loss of balance, intention tremors, weakness in coordination and other multiple sclerosis symptoms which often create unemployment for persons, and create a situation in which such persons are finally determined to be medically eligible.

The complications of life activities, for persons with disabilities suggest that a "recency of work" test of such limited duration would not be fair to those who have contributed substantially to previous years.

We favor retaining the present eligibility requirements in the law with respect to fully insured status and we hope that in the reconciliation bill conference the proposed addition of the "recency of work" test by the Senate will be deleted in accord with the House position.

Thank you very much for the opportunity to express our concern on behalf of those citizens who will become severely disabled in the future.

Senator ARMSTRONG. Thank you, Mr. Turner.

Panelists, the committee is indebted to you for your insights and for focusing on specific problems that might otherwise gone unrecognized.

We are also grateful to you for your precision and conciseness and courtesy of your remarks.

Senator Moynihan.

Senator MOYNIHAN. Mr. Chairman, I would want to echo your statement, and thank each of the panelists.

I note in particular the statements by Dr. Roberts, Mr. Turner, and Mr. Schloss, about the effect of disability. Disability doesn't come because of an automobile collision. It is denied, for about 6 months, to most persons who have a disability, to insure there is a problem. But these people can't work. They don't know why. They are tired. When they are not tired they are ill.

It seems to me the "recency-of-work" test is a terrible effort to save money for purposes which I won't characterize, but it can only lead to the disadvantage of disabled persons.

They are not ripping off the system. They are entitled to benefits.

I thank you very much.

Dr. Boggs.

Dr. BOGGS. Since I am the only woman on this panel, could I point out that one of the effects of the Senate approval "recency of work" test is that it discriminates against women who may take some time out for child bearing.

Senator MOYNIHAN. Oh, yes. Your testimony makes that point. Thank you. I thank the panel.

Senator ARMSTRONG. Thank you all.

[Statements follow]:

AMERICAN FOUNDATION FOR THE BLIND, INC.

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STATEMENT OF IRVIN P. SCHLOSS, DIRECTOR, GOVERNMENTAL RELATIONS DEPARTMENT, AMERICAN FOUNDATION FOR THE BLIND, TO THE SUBCOMMITTEE ON SOCIAL SECURITY AND INCOME MAINTENANCE PROGRAMS, COMMITTEE ON FINANCE, UNITED STATES SENATE, ON OPTIONS FOR SOCIAL SECURITY FINANCING

July 9, 1981

Summary

The American Foundation for the Blind recognizes the need to deal effectively with the acute short-term financing problem in the Old Age and Survivors Insurance (OASI) Trust Fund and to assure the financial integrity of the entire Social Security System over the long term. We believe that these objectives can be accomplished without the radical benefit cuts for retirees, survivors, and the disabled contained in the Administration's proposals. We respectfully urge the Committee to reject these proposals and to enact alternative financing measures which will not so adversely affect current and future beneficiaries.

Since the savings realized from the Administration's proposals far exceed what is needed to assure the financial stability of the trust funds, we can only conclude that the purpose of the proposals is to reduce projected deficits in the total budget. Therefore, we urgently recommend that the Social Security trust funds be removed from the unified budget and administered by a nonpartisan board. In this way, the American people will be assured that changes in the financing and benefit structure will be made solely to

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preserve the financial integrity of the nation's basic social insurance program.

With regard to the disability insurance program, the Social Security Disability Amendments of 1980 have already adversely affected disability insurance beneficiaries coming onto the rolls after June 1980 by reducing the dropout years for those under age 47 and by placing a cap on family benefits. We respectfully urge the Committee to reject the Administration's proposals to make the criteria of eligibility for disability insurance benefits stricter than current law provides. We also oppose placing a cap on family benefits of retirees since this proposal would adversely affect those entitled to disabled child's benefits.

We urge the Committee to reject the Administration's proposals which drastically alter the computation of benefits, such as reduction in the "bend points" and computation of earnings records to age 65 instead of age 62. Similarly, we urge rejection of the proposals which would penalize workers for retiring before age 65 by sharply cutting instead of actuarily reducing benefits and by eliminating the benefit for dependent children of early retirees. These proposals would adversely affect disabled child's benefits and make it desirable for handicapped workers to apply for disability insurance benefits instead of early retirement benefits.

If the Committee considers it desirable to change the payment date for cost-of-living adjustments to the Federal fiscal year, this should be done in a way which will not cut benefits in the transition year. Any change in the method of computing the cost-of-living adjustment should be made only after thorough study by the Bureau of Labor Statistics of alternative indices.

Finally, we believe that universal coverage under the Social Security System is desirable. We recommend that all officers and employees of the three branches of the Federal Government be covered by the System.

Introduction

Mr. Chairman and members of the Subcommittee, I appreciate this opportunity to present the views of the American Foundation for the Blind, the national voluntary research and consultant organization in the field of services to blind children and adults, on ways of strengthening the financial stability and integrity of the Social Security System. The Foundation recognizes the need to strengthen the financing of the Social Security System to avoid bankruptcy of the Old Age and Survivors Insurance Trust Fund in the near term and to assure the financial integrity of the system over the long term.

We believe that both objectives can be accomplished without the radical benefit cuts proposed by the Administration. These proposals have shaken the faith of the American people, both current and future beneficiaries, in the nation's basic social insurance program, which is designed to provide protection from total loss of income in the event of retirement, severe disability, or death of a worker. The Administration's proposals have caused the American people to question the integrity of their political leaders whose recommended benefit cuts would contradict campaign promises not to harm current beneficiaries. The extent of the cuts appears to be a transparent effort to use the Social Security System to reduce the deficits in the general budget rather than to assure the fiscal integrity of the System.

We should like to present some statistics to illustrate the importance of Social Security to blind persons. According to the National Society for the Prevention of Blindness, there are close to 500,000 persons of all ages in the United States who are blind as defined in Section 216(i)(1) of the Social Security Act. Of this number, the National Society estimates that 53.4 percent (some 265,000 people) are aged 65 or older. Most of them are OASI beneficiaries. Another 21.7 percent are aged 45 through 64.

In June 1980, according to the Social Security Administration, there were close to 97,000 blind persons under 65 on the disability insurance rolls. There are some 78,000 blind persons on the SSI rolls, 35 percent of whom are also receiving either OASI or disability insurance cash benefits.

Removal of Social Security Trust Funds from the Unified Budget

We recommend removal of the Social Security trust funds from the unified budget and establishment of a nonpolitical, nonpartisan board to administer the Social Security System. We believe that inclusion of the trust funds in the unified budget is a temptation to political leaders to use program changes in Social Security protection for purposes unrelated to the financial stability and integrity of the Social Security System itself. The System should be protected from the vagaries of the annual general budget processes since Social Security is predicated upon assuring current and prospective beneficiaries of a dependable source of income over a long period of time.

The substantial cuts proposed by the Administration this year would appear to be prompted by general budgetary considerations and not by the need to preserve the integrity of the Social Security System.

Disability Insurance Programs

As you know, the Social Security Amendments of 1980 have cut disability insurance benefits for persons coming on the rolls since June 1980 and their families by reducing the number of "dropout" years permitted in the computation of benefits for those under age 47 and by placing a cap on family benefits of 85 percent of average indexed monthly earning or 150 percent of the benefit amount, whichever is lower. These adverse across-the-board cuts were made to deal with a small number of anomalous situations in which family benefits exceeded the worker's pre-disability net earnings.

In view of this action by the Congress, we oppose the changes in the disability insurance program recommended by the Administration. First, we oppose the changes in the eligibility criteria which would raise the current requirement of 20 out of 40 quarters in covered employment before the onset of disability to 30 out of 40 quarters. Second, we oppose the reimposition of the additional requirement of six out of the 13 quarters preceding the onset of disability, a requirement repealed in 1958. Third, we oppose the restriction to disabilities specified in the medical listings and the elimination of age, education, and vocational factors in the disability determination process.

The first and second proposals described above would adversely affect women who leave the work force temporarily for child-bearing and child-rearing responsibilities. These proposals would also adversely affect workers with progressive medical conditions, such as multiple sclerosis, requiring frequent temporary absences from work between remissions, and older workers with progressive conditions which may not meet the medical listings but which, nevertheless, prevent a worker from doing the job he has been employed in for a substantial period of time. Some of the leading ultimate causes of blindness, such as glaucoma, diabetic retinophathy, and macular degeneration are in this category.

Another undesirable Administration proposal would alter the definition of disability to require a prognosis that the disabling condition will last for at least 24 months instead of the 12 months required in present law. Another would extend the five-month waiting period to six months.

The effect of all of these Administration proposals would be to further erode the protection of the Social Security System against loss of the worker's income as a result of disability. Unless that individual has private disability insurance protection, he will have to resort to the means-tested SSI program if eligible, or use up assets until he does become eligible.

It is ironic that this Administration has chosen to observe the International Year of Disabled Persons by recommending drastic cuts and regressive eligibility criteria for the disability insurance program.

We urge the Committee to retain the beneficiary rehabilitation program in the form currently provided under Section 222 of the Social Security Act. Studies in the late 1970s indicate a cost-benefit ratio ranging between 1.39 and 2.72 to one for this program. Although this ratio is not as high as the 11-to-one cost-benefit ratio for vocational rehabilitation of clients under the Rehabilitation Act of 1973 owing to the severity of disabilities among disability insurance beneficiaries, we still believe that the Section 222 program is worth retaining. With the small increases in the regular federal-state vocational rehabilitation program made by the Senate version of the omnibus reconciliation bill and the sharp cuts made by the House version, it is likely that only a few disability insurance beneficiaries will be served in this program unless additional financing is provided by Section 222.

As you know, the dollar amount of substantial gainful activity (SGA) is administratively set by the Secretary of Health and Human Services except for the blind, for whom the Social Security Amendments of 1977 equated SGA with the retirement earnings test basic amount. In view of the historic lag in administrative adjustment of SGA, we recommend that it be statutorily established for other disabilities as well, with appropriate indexing. If current cost considerations prevent equating SGA with the basic amount of the retirement earnings test for all disability insurance beneficiaries, then we recommend that the Committee approve a statutory provision similar to that contained in H.R. 3207, the Social Security bill currently being marked up by the House Subcommittee on Social Security, without changing existing provisions for the substantially smaller number of blind disability insurance beneficiaries. The House provision would statutorily establish SGA for beneficiaries other than the blind at monthly earnings of $340 with indexing.

Reduction in the Bend Points

One of the unwarranted benefit cuts contained in the Administration's May 12 proposals is the allegedly temporary reduction beginning in 1982 to 50 percent of the wage-level index applied to average indexed monthly earnings in the benefit computation method established by the Social Security Amendments of 1977. This would result in a cut of approximately 25 percent in all future retirement, survivor, and disability benefits.

We urge the Committee to reject this proposal and leave the benefit computation method with stable replacement ratios as present law provides.

Early Retirement Penalties

The Administration's proposals to cut benefits for workers retiring before age 65 can best be described as punitive. These proposals would compute benefits to age 65 instead of age 62 as under present law, reduce benefits for a worker retiring at age 62 to 55 percent of the benefit he would receive at age 65 instead of the current actuarial reduction of 20 percent, and eliminate the benefit for minor children of workers retiring before age 65.

It is estimated that only some 22 percent of workers retire voluntarily before age 65. The vast majority retire between ages 62 and 65 because of poor health not severely disabling enough to qualify them for disability insurance benefits, poor health of members of their families, and inability to find jobs after protracted unemployment.

We strongly oppose these proposals and urge the Committee to reject them as unworthy of serious consideration because of their callous disregard of the real needs of American workers.

<u>Elimination of Retirement Earnings Test</u>

We strongly oppose the Administration's proposal to eliminate the retirement earnings test after a worker reaches age 65. This recommendation would result in workers, most of whom are professionals with substantial earnings, receiving a tax-free benefit to supplement high earnings. If the Social Security System is facing serious financing problems, it is inconceivable that the Administration would propose this liberalization for people whose Social Security benefit would be an insignificant part of their retirement income while at the same time recommending substantial benefit cuts for retirees, widows and orphans, and disabled people to whom Social Security benefits are vital for food, clothing, and shelter.

Until the Social Security System can be transformed into a true annuity system, we recommend that this proposal be rejected and that elimination of the retirement earnings test be made effective at age 72 as it was prior to the change to age 70 which becomes effective next year.

Cap on Family Benefits

We opposed unsuccessfully the cap placed on disability insurance family benefits by the Social Security Disability Amendments of 1980, and we must oppose the current Administration proposal to place an identical cap on family benefits for retirees and survivors. The proposal again uses the mechanism of an across-the-board cut, which would result in eliminating benefits for many minor children, to correct a small number of anomalous situations in which benefits exceed pre-retirement net earnings.

This Administration proposal would adversely affect disabled child's benefits, and we urge the Committee to reject it.

Cost-of-Living Adjustment

We urge the Committee to reject the Administration's proposal to change the payment date of the cost-of-living adjustment to the beginning of the Federal fiscal year and to alter the calculation base to 12 months instead of three months. If the Committee believes that it is important to have these payments coincide with the beginning of the Federal fiscal year, then it should be done in two steps to avoid harming current beneficiaries; and the base quarter should be advanced to the second calendar quarter.

If the Committee believes that the use of the Consumer Price Index (CPI) should be modified specifically for Social Security cost-of-living adjustments, then we recommend that this be done only after thorough studies and recommendations by the Bureau of Labor Statistics. These studies should take into account the effect on the elderly of the nationwide trend toward condominium conversions as well as higher health care costs and other factors.

Universal Coverage

We believe that universal coverage of all American workers by the Social Security System is desirable. We recommend that officers and employees in all three branches of the Federal Government be covered by Social Security and that the coverage be phased in so as not to adversely affect retirement pensions of long-term Federal employees.

The final product should be comparable to what is increasingly in effect in private business; i.e., Social Security coverage and retirement annuities financed by employer and employee. I would remind the Committee that members of the armed services are covered by Social Security as well as service retirement programs. It seems anomalous that civilian officers and employees of the Federal Government have been deprived of the benefits of Social Security coverage.

Alternative Financing Proposals

Instead of the drastic benefit cuts proposed by the Administration, we would like to recommend that the Committee adopt financing changes which, we are confident, will be more acceptable to the American people.

To meet the near-term crisis in financing of the OASI Trust Fund, we recommend permanent authority for borrowing between the OASI, Disability Insurance, and Hospital Insurance Trust Funds and temporary authority to borrow from general revenues.

To assist in meeting long-term financing needs, we recommend that half of the portion of Social Security payroll taxes allocated to the Hospital Insurance Trust Fund be allocated to the cash benefit trust funds and supplanted by general revenues. This concept is supported by Rep. J. J. Pickle, chairman of the House Subcommittee on Social Security, and by Rep. Barber Conable, ranking minority member of the House Committee on Ways and Means, as well as by a substantial number of organizations interested in preserving the integrity of the Social Security System.

If necessary, we would also recommend an increase in the Social Security payroll tax. A poll conducted for the National Commission on Social Security demonstrated that the American people overwhelmingly preferred increases in the payroll tax to cuts in benefits. In contrast, the Administration's May 12 proposals promise the possibility of a cut in Social Security taxes if the recommended benefit cuts are enacted into law.

If would be fair to provide for a partial offset in increased Social Security taxes by a reduction in individual income taxes through a tax credit or income tax deduction and a liberalization of the refundable earned income tax credit for low earners.

We believe that these recommendations will be more acceptable to the American people than the Administration's radical proposals.

Conclusion

Mr. Chairman, the American Foundation for the Blind emphatically opposes the Administration's proposals for assuring the financial integrity of the Social Security System. The Administration's proposals are Draconian and unwarranted. They appear to be prompted by the desire to reduce the deficit in the general Federal budget rather than to meet the financial needs of the Social Security System itself.

We urge rejection of the Administration's proposals by the Committee and the Congress and adoption of alternative methods of assuring the financial soundness of the Social Security System without pauperizing substantial numbers of our citizens.

# # #

TESTIMONY

of

PANEL ON DISABILITY

Representing:

American Coalition of Citizens with Disabilities
Association for Retarded Citizens
Epilepsy Foundation of America
National Association of Private Residential Facilities for the Mentally Retarded
National Association of State Mental Health Program Directors
National Association of State Mental Retardation Program Directors
National Easter Seal Society
National Mental Health Association
National Multiple Sclerosis Society
National Society for Autistic Children and Adults
United Cerebral Palsy Associations, Inc.

Regarding

SOCIAL SECURITY

Before

THE SUBCOMMITTEE ON SOCIAL SECURITY
AND INCOME MAINTENANCE PROGRAMS

of

THE COMMITTEE ON FINANCE

U.S. SENATE

Thursday
July 9, 1981

SUMMARY

TESTIMONY ON SOCIAL SECURITY
by the
Panel on Disability

Disability organizations are concerned about the potential impact of the Administration's proposed changes to the Social Security system on the lives of disabled persons. We are also concerned about the rapidity with which some of these proposals were approved by the Senate. A summary of our testimony is as follows:

1. We endorse the more measured approaches to modifying the Social Security system favored by Finance Committee Chairman Dole, e.g. a careful phasing in of changes and an equitable distribution over all beneficiaries of any prospective adjustments determined necessary to rectify the cash flow and fund ratio problems (pages 1, 2 and 16).
2. Our organizations support funding one-half of the hospital insurance program from general revenues (pages 15 and 16).
3. We oppose all current proposals for recalculating the Consumer Price Index and other similar proposals which would have the effect of establishing a continued erosion of benefit levels. However, we recognize that Congress may decide it is necessary to restrict the growth of benefit levels. If such a decision is imminent, our organizations strongly recommend the use of interfund borrowing or borrowing from general revenues in order to allow sufficient time for study and analysis to determine

the most appropriate means by which such a restriction be accomplished. We also recommend that a fair analysis of the real inflationary costs of those items and services especially needed by disabled citizens and the resources available to disabled individuals and their families be conducted (pages 15 and 16).

4. We vehemently oppose extending the limit based on 150% of Primary Insurance Amount (PIA) to the family maximum currently in effect for the Old Age and Survivors Insurance programs. We oppose this extension because it disadvantages the people who now have replacement rates well below a safe margin. It is this taxpayer who is currently most sensitive to the tax burden of social security because he/she is simultaneously experiencing the increase in tax rate and tax base (pages 2 - 9 and Figure 1).

5. Our organizations also vehemently oppose the Administration's proposal to change the "recency-of-work" test which was approved by the Senate. The impact of this change would be primarily on those persons who became disabled by conditions or diseases which often create a history of intermittent employment for a considerable period before a final medical determination of disability can be made (pages 9-14). We recommend that during Conference on the Reconciliation bill the Senate agree to the deletion of this provision.

6. We support the use of trust funds to finance vocational rehabilitation services for disabled social security recipients. The

failure to obtain vocational rehabilitation services will likely result in the disabled individual's inability to obtain work, resulting in continued dependency on various government programs, including the Disability Insurance program, to survive. Given the severity of disability required in order to be eligible for Disability Insurance benefits, we believe states must be provided with incentives to focus attention on the SSDI as well as the Supplemental Security Income disabled population (pages 16-18). We recommend that during Conference on the Reconciliation bill the Senate adopt the House provision which provides reimbursement from the trust funds for "successfully" rehabilitated Disability Insurance beneficiaries.

7. Our organizations strongly oppose the Administration proposals to restrict eligibility for disability benefits by: (1) redefining disability according to medical factors alone, eliminating any vocational criteria; (2) requiring applicants to show they will be disabled for twenty-four months, instead of the current twelve months; and (3) lengthening the waiting period for disability benefits from five to six months. Each of these proposals would place undue hardship on disabled individuals in need of social security benefits within a program that the General Accounting Office has determined to be the toughest disability program in the nation. Under current law, only 30% of those who apply for disability benefits actually have their claim approved.

INTRODUCTION

The organizations represented by this testimony are gravely concerned about the potential impact of the Administration's proposed changes to the Social Security system on the lives of disabled persons. Some of these changes have already been endorsed by the Senate during the Reconciliation process. The very haste with which these actions took place is a cause for apprehension.

As members of the Save Our Security (S.O.S.) Coalition we generally endorse the recommendations expressed in Mr. Robert Ball's testimony and have focussed our own remarks primarily on those issues directly impacting on disabled beneficiaries. Obviously, some of the recommendations made by S.O.S. go beyond the scope of expertise and focus of many of the groups representing the disabled community.

The initial wave of proposals on social security from this Administration revived some recommendations put forward in 1979 by the Carter Administration, some of which have now been adopted by this Committee. The opening strategy appears to have been one of "divide and conquer." Until recently most targets have been relatively small, vulnerable and politically unorganized subgroups such as orphaned college students. We respectfully suggest that these tactics now be replaced by the more measured approaches favored by Chairman Robert Dole, e.g. a careful phasing in of changes and an equitable distribution over all beneficiaries of any prospective adjustments determined necessary to rectify the cash flow and fund ratio problems. If each beneficiary and prospective beneficiary is held harmless as to actual or potential benefits and bears a small share of any future decrement, none need suffer conspicuously, and future changes can be held within a tolerable range of uncertainty. While this is going on it is important not to engage in overkill by compounding additional actions which can discriminate selectively and cumulatively against any one relatively small group of beneficiaries, present or prospective.

Impact of Social Security on Families of Adults Disabled in Childhood

One such group at risk are those adults who have been disabled since childhood. No one knows precisely how many there are, but the order of magnitude may be two or three million, of whom some 425,000 now receive social security benefits as dependents or survivors of a covered parent who has himself retired, become disabled or died.

Because these adults have never had an opportunity to enter the regular work force and to build up a history of covered earnings on their own work record, they were incorporated into the system in this way in 1957 when the Disability Insurance program went into effect. Although they are disabled by the same definition used in the DI program, the majority of them draw benefits under the Old Age and Survivors Insurance program (Table 1).

For the purposes of entitlement they are treated in the same way as minor children of their covered parents, although their demographics are different. A family with a disabled child over 18 is no longer a "young" family. They have paid their way. About 30,000 of these "children" are themselves more than 60 years old; the median age is about 38.

It is popular to speak of the "basic purpose" of the Social Security program and to deplore "over-emphasis" on its "social-adequacy (or welfare-oriented) elements," as Deputy Commissioner Robert J. Myers did on June 16th before the Senate Special Committee on Aging. It is true that the system has a certain "social welfare bias" - it lies in the method by which benefit levels are slanted in favor of the workers with low covered earnings. This bias is illustrated by the Social Security Administration's figures showing that, as of this year, the "long range constant replacement rate" is only 28% for a maximum earner (i.e. one who pays FICA taxes on the full covered wage, now $29,700) as compared to 53% for someone employed at the federal minimum wage. We do not propose to redirect this bias, but we do recommend that it not be aggravated by further eroding the perquisites of the families of middle and "maximum" earners. It is this taxpayer who is currently most sensitive to the tax burden of social security because he/she is simultaneously experiencing the increase in tax rate and in tax base. However, he/she is also likely to be a family man or woman who values protection.

Mr. Myers characterizes survivors and dependents benefits as among the "welfare-oriented elements" of the Social Security system which he deplores. We strongly repudiate this characterization. Inclusion of survivors and dependents protection is common in fringe benefit packages put together in the larger industries; in some instances these expressly include disabled adult dependents' provisions, building on the base accepted twenty-five years ago in social security. It seems clear that it is part of the "basic purpose" of social security to take advantage of its volume and portability to provide similar risk sharing for other workers (and their dependents) such as those who are employed in less massive corporate environments or who are self-employed, as well as continuing the base on which existing corporate pension plans have been built.

The Administration is proposing to limit further the maximum family benefits now payable by placing on them a cap of the lower of 85% of the average indexed monthly earnings (AIME) or 150% of PIA. When this limit was proposed and passed in 1980 applicable only to families of disabled workers, the proponents argued that it was needed to discourage malingering by disabled persons who would not make the effort to return to work, an argument scarcely applicable to retired and deceased workers. We can understand the current pressure to limit replacement rates to 85% of AIME, but we must strongly oppose extending the limit based on PIA at 150% since it disadvantages the people who now have replacement rates well below a safe margin. (See Figure 1.)

This can be illustrated by the following examples. Each dependent or survivor child (whether a minor or a disabled adult child) is entitled under current law to 50% of the parent's PIA while the parent lives (after the parent's retirement on age or disability) or 75% after the parent's death, subject to a specified family maximum. Thus, if an adult disabled child is the sole dependent [redacted] of an "average earner" who retired at age 65 this year with a PIA of $592.50, the child would be entitled to a monthly benefit of $296.25. If his/her other parent is also drawing on the same record as a spouse, with the same 50% entitlement, both will be affected by the limit on family benefits. At this PIA the family maximum is currently 175% of PIA producing a monthly benefit for each dependent (the spouse and the child) of $222.45. Under the Administration proposal to reduce family maxima to 150% or less, regardless of replacement rate, each of the two dependents would receive only 25% of PIA or in this case $148.20.

Individual survivor benefits are somewhat higher but subject to the same family maxima. Under present limits, on the death of the primary insured, the eligible spouse of the "average earner" would receive a full benefit of $592.50 and the entitled child would receive $444.40. Under the proposed limitation these benefits would be reduced pro rata to $507.90 and $380.90 respectively. The adult disabled surviving child of a "maximum" earner - that is a person retiring at age 65 whose wages in covered employment have equaled or exceeded the base ($29,700 in 1981) - would be entitled to a benefit of $564.70 under present law but only $484 under the proposal. The proposal would impact in some degree on all such prospective beneficiaries who depend on a PIA exceeding $270.

Figure 1 illustrates two relevant points (1) workers with higher earnings receive progressively lower replacement rates, and (2) limiting family benefits to 150% of PIA as proposed by the Administration (even if done only prospectively) will substantially and permanently reduce benefits for the dependents and survivors of precisely those middle Americans who contribute most to the system. The cap of 85% of AIME will impact heavily on those with low covered earnings, in some cases wiping out the benefit entirely. Elderly and disabled people in this group who have no other income and few assets will be able to make up all but $20 of the difference through SSI. It is at this end of the scale that the alleged "social welfare-oriented elements" are admittedly concentrated.

For those unfamiliar with the history of the family maxima the shape of the present curve may require some explanation. Robert Ball, in his book Social Security Today and Tomorrow, explains how it was derived:

> "...the theory of the maximum is still to relate the total amount payable to the wage loss and ... to limit the total amount of benefits, generally, to something less than the worker had been earning. Now, since the benefits are so heavily weighted in favor of those with the lowest average earnings, there is not much room at the bottom to add other benefits to the PIA without the total amount becoming excessive in relation to the earnings on which the benefits

are based. From this point of view it makes sense to allow total benefits payable on a single wage record to rise as a percentage of the PIA as the PIA itself becomes a smaller proportion of past earnings." (Page 251.)

As indicated in Table 1, those adult disabled children who are already in current payment status and have average or less than average monthly benefits may well fall within the range of eligibility for federal SSI payments. If they have no significant other income and limited assets they can qualify dually. Their social security benefits will net them only $20 a month more (above the SSI payment level) than if they had never been insured. However, as the foregoing calculations show, the adult disabled children of average and above average earners who are now entering the system will do so at levels above the present federal SSI cut-off level of $284.70 a month. Depending on state supplementation levels, they may or may not be disqualified for Medicaid, a coverage which is much more significant than Medicare for most disabled persons, although all could qualify on entering a nursing home, if without significant additional income. These are children of middle income Americans who have traditionally eschewed "welfare."

The initiation of the adult disabled child component of the Social Security program nearly a quarter century ago gave many such parents a basis for planning constructively for the adult child's future. Such planning must be long-range, predating retirement by 20 or 30 years. Even the smaller benefits available 20 years ago represented the equivalent of an annuity which most parents would find hard to fund from scratch. Numerous instances can be cited in which the combined social security benefits provided to a widowed mother and her adult son or daughter have tipped the balance to keep that family unit going and to postpone, if not prevent, recourse to institutional care.

Under current circumstances, however, the middle income parent is put in a serious dilemma. Depending on the likely benefit level his child may ultimately enjoy, and the severity of the child's handicap, the parent has to make an educated projection and judgement as to whether to try to minimize or maximize the resources directly available to the child when the parent is no longer in a position to offer support and/or guidance. Many middle and upper income parents tell us that they would like to build on expected social security benefits, setting up whatever kind of trust or IRA type account they can to augment the basic social security benefits. To these parents the initial level of benefits and their indexing to inflation are critical components. By building up income or assets for the child, the parent risks disqualifying him or her for the means tested benefits - SSI and Medicaid. If the social security base is eroded, these parents will see themselves like Sysiphus and their private efforts as unavailing. They will be tempted to opt out and to fall back on SSI and federally-aided state support systems.

Some years ago a group at the Wharton School at the University of Pennsylvania examined in some detail the possibilities of generating an adequate voluntary insurance plan in the private sector which could cover the catastrophic costs of long-term care originating early in life; they concluded that the conditions which would make for a sound generally available private voluntary plan did not exist - that only a very large group plan without self-selected risks could produce actuarially sound coverage. As indicated earlier, a few very large corporations have included in their pension plans benefits for adult disabled dependents and survivors of employees, building on the base of social security. In general, however, adequate voluntary coverage is not available to most workers, and the disasterous experiences with "life care contracts" negotiated with parents by some private residential facilities in the past half century have given everyone involved pause. This is an area where it is appropriate for the private sector to give way to resources unique to government, as has already been done in relation to the disabilities associated with aging. In short, our recomendation is to sustain the dependents and survivors benefits components in the various programs of Title II and, when possible, in the future to strengthen them. Family benefits should not be further limited, especially for adult disabled children, aside from possible minor adjustments to simplify the formula.

Recency-of-Work Test

The financial stability of the social security trust funds has been a nagging problem for Congress and the various Administrations since 1975. Actuarial estimates have been given, legislative "remedies" passed, and revised estimates provided ever since passage of the 1977 social security financing amendments. Until now, Social Security Disability Insurance recipients have borne the brunt of efforts both to restore fiscal balance to the system and to slow the growth in demands upon the Social Security program. Several of the changes to the Disability Insurance program which resulted from these efforts were, in our opinion, based on faulty assumptions regarding the disabled beneficiary population. These assumptions emerge from the lack of a clear understanding of the nature of various disabilities and the resulting lifestyle experienced by the disabled individual and his/her family. Now, much to our dismay, we see some of these same assumptions operating as the basis for additional changes to the Disability Insurance program.

The Administration's proposal, recently approved by the Senate, to change the "recency-of-work" test by requiring Disability Insurance beneficiaries to have worked one and one-half out of the last three and one-quarter years (or six out of the last thirteen quarters) preceding disability in order to be eligible for DI benefits, which replace lost wages, is a case in point. This proposal clearly demonstrates a lack of understanding regarding the impact on employment of many disabling conditions.

The present law determining insured status requires work in twenty out of the last forty quarters immediately preceding disability or half of the quarters elapsed since age twenty-one but at least six quarters. The proposed "recency-of-work" test would add the additional requirement for severely disabled persons to have worked in covered employment during six out of the last thirteen quarters preceding the date when disability is determined to meet the medical and other criteria. This new proposal is a part of S. 1377, the "Omnibus Reconciliation Act of 1981" as passed by the United States Senate. The House of Representatives has no such provision in its Reconciliation bill, H.R. 3982.

Essentially, the Senate-approved "recency-of-work" test would remove from insured status for Disability Insurance benefits some of those persons who have paid into social security during at least half of the last ten years, but who became so disabled they have been unable to work at least half the time during the most recent three years. Such a restriction was a part of the original disability insurance program in 1956, but two years later was changed when it became clear that many totally disabled individuals who had contributed substantially to social security were permanently barred from disability benefits.

We have estimated, on the basis of Administration proposal figures, that by fiscal year 1986 approximately 140,000 disabled citizens, who under current law would be eligible for SSDI benefits, will be barred from eligibility if the "recency-of-work" test approved by the Senate becomes law.

Those affected by this provision would <u>not</u> be a representative sample of the current disability beneficiaries. Rather, the impact would be primarily on those persons who became disabled by conditions or diseases which often create a history of intermittent employment for a considerable period before a final determination of disability can be made.

While it may not have been understood or intended, this proposal focuses in a discriminatory manner on those citizens who happen to become disabled with multiple sclerosis and other progressive diseases or conditions such as emphysema, lupus, arthritis, mental illness, and some forms of cancer. Unlike an automobile accident or other form of trauma, and unlike conditions caused by acute illness, many disabilities do not occur at a precise time. Since the definition of disability for social security purposes is very strict, and includes inability to engage in any substantial gainful activity, a worker may be significantly disadvantaged in the labor market for a considerable period of time before he or she meets the definition.

Additionally, one may experience numbers of exacerbations and remissions of a disease with a medically unpredictable pattern causing periods of unemployment, but not clearly eliminating the possibility of future employment. For example, a person who had worked for ten years under social security might then develop symptoms of multiple sclerosis and experience a work history which includes four periods of unemployment (totalling eight quarters) related to exacerbations of multiple sclerosis within a thirteen quarter period. At the end of this thirteen quarter period, eligibility for disability benefits would be lost, even though the person had paid into the system for forty-five of the last fifty-three quarters. The erratic pattern of the disease and its effects on the ability to hold a job, coupled with the difficulties of diagnosis, might result in the person's medical eligibility being undetermined until after he or she was no longer eligible because of the "recency-of-work" test - a "Catch-22." This would be especially true in cases where the impact of disease-caused fatigue is a significant element, and/or where the cumulative impact of two or more symptoms occurring in cyclical courses produce severe disability. Loss of balance, intention tremors, weakness and uncoordination and other multiple sclerosis symptoms often create unemployment for persons with MS before other symptoms create the situation in which such persons are finally determined to be medically eligible.

Though not as dramatic or commonplace as MS, increasing age frequently compounds the impact of disability on functioning with some persons with cerebral palsy. For some aging persons with the substantial physical disability of cerebral palsy, the proposed "recency-of-work" test would be very detrimental. Similarly, many persons with seizure disorders who experience periods of unemployment due to uncontrolled seizures will also be barred from SSDI eligibility.

If the Senate-approved "recency-of-work" test becomes law, many disabled persons, especially those with disabilities which exacerbate and remit in unpredictable patterns, will be faced with new disincentives to returning to work. Many would be caught in the trap of quarters-counting and betting on the odds of whether they will be able to work for the next several quarters.

The complications of life activities for persons with disabilities suggests that a "recency-of-work" test of such short duration would not be fair to those who have contributed substantially in previous years. We intensely favor retaining the present eligibility requirements with respect to fully insured status. Current law requires beneficiaries to have worked five out of the last ten years (or twenty out of the last forty quarters). We believe that, if enacted, the change endorsed by the Senate would be extremely harmful and hope that during the Conference on the Reconciliation bills a compromise on social security proposals will result in the deletion of the proposed change in the "recency-of-work" test.

Other Restrictions on Applicants for Disability Benefits

The Administration has also proposed to restrict eligibility for disability benefits by:

1. redefining disability according to medical factors alone, eliminating any vocational criteria;
2. requiring applicants to show they will be disabled for twenty-four months, instead of the current twelve months; and
3. lengthening the waiting period for disability benefits from five to six months.

Our organizations strongly oppose all of the above proposals which would gut the disability program. These proposals exemplify our contention that the Administration's strategy has been to take targeted pot shots at the more vulnerable, politically less powerful social security recipient populations.

Each of these disability proposals would place undue hardships on disabled individuals in need of social security benefits within a program that the General Accounting Office has determined to be the toughest disability program in the nation. Under current law, only 30% of those who apply for disability benefits actually have their claim approved.

Limiting Benefit Increases

Various proposals which have emerged during discussions of ways to help the financial problems of the system would have the effect of establishing a continual erosion of benefit levels. Less than 100% of CPI increases, the lesser of wage or price increases, and other adjustments which would over a period of years reduce the benefit levels in real dollar terms, assume that benefit levels are overly generous. We do not believe that is true for the vast majority of DI recipients. We are certain that methods to reduce benefit increases which have been proposed so far fail to take account of the real inflationary costs of those items and services especially needed by disabled citizens. Any fair analysis of the resources available to disabled individuals and families receiving DI as compared to other citizens would demonstrate the extreme financial restraints under which most disabled persons and their families live.

While our organizations favor resolving Social-Security financing problems primarily by funding one-half of the hospital insurance program from general revenues, we recognize that Congress and the Administration may decide it is necessary to restrict the growth of benefit levels. If such a decision appears imminent, our organizations strongly recommend the use of interfund borrowing or borrowing from general revenues in order to allow sufficient time for study and analysis to determine the most appropriate means by which such a restriction be accomplished. We wholeheartedly endorse Senator Dole's belief that any such change be phased in over time and structured so that all beneficiary groups share the burden of reduced benefit increases.

Trust Fund Financing for Vocational Rehabilitation Services

One objective of this Administration is to encourage disabled Title II beneficiaries to return to work. For many disabled persons vocational rehabilitation services are the key to a job and independence. We cannot understand how the Administration expects to succeed in meeting its objective by abolishing trust fund financing of vocational rehabilitation services for disabled beneficiaries. We are concerned that the Senate, being aware that the Vocational Rehabilitation program is one of the best cost benefit programs funded by the U.S. Government, has approved the President's proposal.

The elimination of trust fund financing for vocational rehabilitation services and a possible reduction in vocational rehabilitation funding in general will result in intense competition for the same, limited resources by vulnerable disabled persons needing rehabilitation services. States will be forced to tighten eligibility requirements and/or reduce services. The failure to obtain vocational rehabilitation services will likely result in the disabled individual's inability to obtain work, resulting in continued dependency on various government programs, including the Disability Insurance program, to survive.

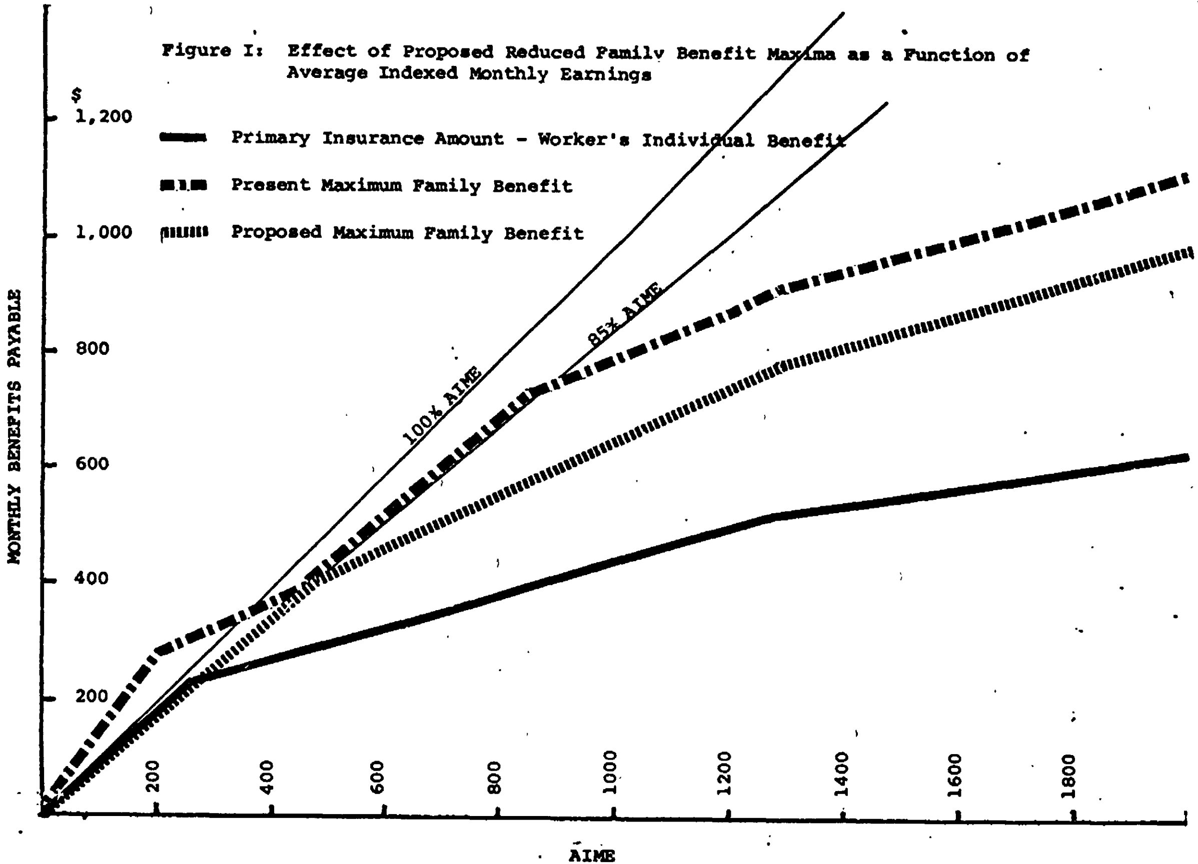
Given our current economic dilemma, allowing disabled people to become tax payers instead of tax burdens clearly should be a very high priority. Yet, the Administration and the Senate have chosen to eliminate funding for the very services needed by many Disabled Insurance recipients in order to return to work. We are frankly puzzled by this short-sighted policy.

The House of Representatives also repealed the program that provides social security trust funds for the rehabilitation of disabled social security recipients. However, the House added a provision to allow states to receive reimbursement for rehabilitation services provided to disabled beneficiaries if they engage for nine continuous months in Substantial Gainful Activity (SGA). Our hope is that during Conference on the Reconciliation bills the Senate will adopt the House provision and approve reimbursement from the trust funds for "successfully" rehabilitated Disability Insurance beneficiaries. Given the severity of disability required in order to be eligible for Disability Insurance benefits and the overall reduction in funding for rehabilitation services, we believe states must be provided with incentives to focus attention on the Social Security Disability Insurance as well as on the Supplemental Security Income disabled population. The "bonuses" provided by the House are one such incentive.

Table 1: Adult Disabled Children of Workers by Program 1979

Program	Beneficiaries Receiving Payments	Average Monthly Payment
OASI		
Children of:		
Retired Workers	138,756	$137.70
Deceased Workers	264,327	195.90
DI		
Children of:		
Disabled Workers	32,263	117.70
TOTAL	435,346	
Federal SSI as of July 1, 1979	Individual alone	$208.70
	Individual in household of another	$138.80

Figure I: Effect of Proposed Reduced Family Benefit Maxima as a Function of Average Indexed Monthly Earnings



JULY 9, 1981

TESTIMONY OF E. WINSLOW TURNER

BEFORE

SOCIAL SECURITY AND INCOME MAINTAINANCE PROGRAMS SUBCOMMITTEE,

OF THE SENATE FINANCE COMMITTEE

AS PART OF A PANEL OF

GROUPS REPRESENTING DISABLED PERSONS

DEALING WITH PROPOSED REVISIONS IN THE

SOCIAL SECURITY LAW

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE,

MY NAME IS E. WINSLOW TURNER, AND I AM A MEMBER OF THE GOVERNMENTAL RELATIONS COMMITTEE OF THE NATIONAL MULTIPLE SCLEROSIS SOCIETY.

SEVERAL YEARS AGO I WAS DIAGNOSED AS HAVING MULTIPLE SCLEROSIS AND FOUND IT NECESSARY TO RETIRE AFTER 18 YEARS OF SENATE STAFF EMPLOYMENT. I AM NOW AN ATTORNEY IN PRIVATE PRACTICE, AND TRYING TO COPE WITH AN UNPREDICTABLE FUTURE.

I AM HERE THIS AFTERNOON, ALONG WITH MY COLLEAGUES, TO EXPRESS A SERIOUS CONCERN WITH THE SENATE'S POSITION ON ELIGIBILITY CRITERIA FOR SOCIAL SECURITY DISABILITY INSURANCE. I WILL CONCENTRATE ON THE SPECIFIC PROVISIONS IN THE SENATE RECONCILIATION BILL WHICH WOULD ADD A NEW RECENCY OF WORK TEST.

IT IS A TEST OF SUCH SHORT DURATION THAT MANY PEOPLE WITH

PROGRESSIVE AND CHRONIC TYPES OF DISEASES AND DISABILITIES MAY BE BARRED FROM ELIGIBILITY EVEN THOUGH THEY MAY HAVE CONTRIBUTED SUBSTANTIALLY TO THE SYSTEM OVER THE YEARS.

TO BE MORE SPECIFIC, THE PRESENT LAW DETERMINING INSURED STATUS REQUIRES WORK IN TWENTY OUT OF THE LAST FORTY QUARTERS IMMEDIATELY PRECEDING DISABILITY (OR HALF OF THE QUARTERS ELAPSED SINCE AGE TWENTY-ONE BUT AT LEAST SIX QUARTERS). THE PROPOSED "RECENCY OF WORK TEST" WOULD ADD A FURTHER REQUIREMENT THAT SEVERELY DISABLED PERSONS MUST HAVE WORKED IN COVERED EMPLOYMENT DURING SIX OUT OF THE LAST THIRTEEN QUARTERS <u>PRECEDING</u> THE DATE WHEN DISABILITY IS DETERMINED TO MEET THE MEDICAL AND OTHER CRITERIA.

THE HOUSE DOES NOT HAVE ANY SUCH RESTRICTIVE ELEGIBILITY IN ITS RECONCILIATION BILL.

ESSENTIALLY, THE SENATE-APPROVED "RECENCY OF WORK TEST" WOULD REMOVE FROM INSURED STATUS THOSE PERSONS WHO HAVE PAID INTO SOCIAL SECURITY DURING AT LEAST HALF OF THE LAST TEN YEARS, BUT WHO HAVE BECOME SO DISABLED THEY WERE UNABLE TO WORK AT LEAST HALF THE TIME DURING THE MOST RECENT THREE YEARS. SUCH A RESTRICTION WAS A PART OF THE ORIGINAL DISABILITY INSURANCE PROGRAM IN 1956, BUT TWO YEARS LATER IT WAS CHANGED WHEN IT BECAME CLEAR THAT MANY TOTALLY DISABLED INDIVIDUALS WHO HAD CONTRIBUTED SUBSTANTIALLY TO SOCIAL SECURITY WERE PERMANENTLY BARRED FROM DISABILITY

BENEFITS.

THOSE AFFECTED BY THIS SENATE PROVISION ARE PRIMARILY PERSONS WHO BECAME DISABLED BY CONDITIONS OR DISEASES WHICH OFTEN CREATE A HISTORY OF INTERMITTENT EMPLOYMENT FOR A CONSIDERABLE PERIOD BEFORE A FINAL DETERMINATION OF DISABILITY CAN BE MADE, AND THOSE PERSONS WHOSE DISABILITY HAS AN EARLIER ONSET AND CONTINUES THROUGH AGE SIXTY-FIVE AS A CHRONICALLY DISABLING CONDITION.

WHILE IT MAY NOT HAVE BEEN UNDERSTOOD OR INTENDED, THIS PROPOSAL FOCUSSES IN A DISCRIMINATORY MANNER ON THOSE CITIZENS WHO HAPPEN TO BECOME DISABLED WITH MULTIPLE SCLEROSIS AND OTHER PROGRESSIVE DISEASES OR CONDITIONS SUCH AS EMPHYSEMA, LUPUS, ARTHRITIS, MENTAL ILLNESS, AND SOME FORMS OF CANCER. UNLIKE AN AUTOMOBILE ACCIDENT OR OTHER FORM OF TRAUMA, AND UNLIKE CONDITIONS CAUSED BY ACUTE ILLNESS, MANY DISABILITIES DO NOT OCCUR AT A PRECISE TIME.

ONE MAY EXPERIENCE NUMBERS OF EXACERBATIONS AND REMISSIONS OF A DISEASE WITH A MEDICALLY UNPREDICTABLE PATTERN CAUSING PERIODS OF UNEMPLOYMENT, BUT NOT CLEARLY ELIMINATING THE POSSIBILITY OF FUTURE EMPLOYMENT. FOR EXAMPLE, A PERSON WHO HAD WORKED FOR TEN YEARS UNDER SOCIAL SECURITY MIGHT THEN DEVELOP SYMPTOMS OF MULTIPLE SCLEROSIS AND EXPERIENCE A WORK HISTORY WHICH INCLUDES FOUR PERIODS OF UNEMPLOYMENT (EQUALLY 8QUARTERS) RELATED TO EXACERBATIONS WITHIN A THIRTEEN

QUARTER PERIOD.. AT THE END OF THIS THIRTEEN QUARTER PERIOD, ELIGIBILITY FOR DISABILITY BENEFITS WOULD BE LOST, EVEN THOUGH THE PERSON HAS PAID INTO THE SYSTEM FOR FORTY- FIVE OF THE LAST FIFTY-THREE QUARTERS.

THE ERRATIC PATTERN OF A DISEASE AND ITS EFFECTS ON THE ABILITY TO HOLD A JOB, COUPLED WITH THE DIFFICULTIES OF DIAGNOSIS, MIGHT MEAN THAT THE INDIVIDUAL WAS NEVER QUITE MEDICALLY ELIGIBLE TO OBTAIN BENEFITS UNTIL HE OR SHE WAS NO LONGER WORK ELIGIBLE UNDER THE NEW "RECENCY OF WORK TEST"- A "CATCH-22." THIS WOULD BE ESPECIALLY TRUE IN CASES WHERE THE IMPACT OF DISEASE-CAUSED FATIGUE IS A SIGNIFICANT ELEMENT, OR WHERE THE CUMULATIVE IMPACT OF TWO OR MORE SYMPTOMS OCCURING IN CYCLICAL COURSES PRODUCE SEVERE DISABILITY. LOSS OF BALANCE, INTENTION TREMORS, WEAKNESS AND UNCOORDINATION AND OTHER MULTIPLE SCLEROSIS SYMPTOMS OFTEN CREATE UN-EMPLOYMENT FOR PERSONS WITH MS BEFORE OTHER SYMPTOMS CREATE THE SITUATION IN WHICH SUCH PERSONS ARE FINALLY DETERMINED TO BE MEDICALLY ELIGIBLE.

THE COMPLICATIONS OF LIFE ACTIVITIES FOR PERSONS WITH DISABILITIES SUGGESTS THAT A RECENCY OF WORK TEST OF SUCH LIMITED DURATION WOULD NOT BE FAIR TO THOSE WHO HAVE CONTRIBUTED SUBSTANTIALLY IN PREVIOUS YEARS. WE FAVOR RETAINING THE PRESENT ELIGIBILITY REQUIREMENTS WITH RESPECT TO FULLY INSURED STATUS AND WE HOPE THAT IN THE RECONCILIATION BILL COMFERENCE THE PROPOSED ADDITION OF THE RECENCY OF WORK

TEST WILL BE DELETED IN ACCORD WITH THE HOUSE POSITION.

THANK YOU FOR THE OPPORTUNITY TO EXPRESS OUR DEEP CONCERN ON BEHALF OF THOSE CITIZENS WHO WILL BECOME SEVERELY DISABLED IN THE FUTURE.

WE ARE PREPARED TO RESPOND FURTHER TO YOUR QUESTIONS.

SCHOOL OF ALLIED HEALTH PROFESSIONS
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New Orleans, LA 70112
Telephone: (504) 568-7107

LSUMC

Assessment Center

July 7, 1981

Subcommittee on Social Security
Senate Finance Committee
United States Senate
2227 Dirkson Senate Office Building
Washington, D.C. 20510

Gentlemen:

I am enclosing information concerning the proposed changes in the Social Security Regulations that deal with the determination of disability and length of time required to establish eligibility for disability insurance benefits. I will also be present on July 9, 1981 at 2:00 p.m. to testify on the proposed changes and to offer alternatives to those proposed by the Committee on Ways and Means and the Secretary of Health and Human Services.

The Secretary of Health and Human Services proposes to require a "Medical Only" determination of disability and disregard non-medical factors, such as age, education and work experience. There are several problems with this recommendation which would result in even greater discrepencies in the application of the Social Security Law in determining disability.

1. State Disability Determination Unit Medical Examiners....

   ---Must rely solely on their subjective evaluation of written medical reports and hospital records because they have not seen, or have they examined, the applicant for benefits.

   ---Must evaluate reports that are often illegible, incomplete, and adequate to provide sufficient objective information on which to make a determination.

   ---Must attempt to interpret effects of multiple impairments based on numerous medical documents that deal with individual impairments.

2. Consultative Medical Examinations provided by Physicians who....

   ---Do not understand and follow the standardized Residual Functional Capacity Evaluation Form that is furnished by the State Agency.

   ---Do not have training in conducting job analysis and who do not understand industrial criteria for performing work activities.

---Do not have experience working in a variety of industrial settings and have not visited a variety of industrial settings. Most physicians have very little knowledge of work activities that exist outside of the medical professions.

---Do not understand the physical requirements necessary to perform work activities in a variety of industrial settings.

---Do not and often can not relate the effects of impairments and medications to specific vocational restrictions.

---Do not conduct objective medical examinations which determine an individual's physical strength; physical stamina; prolonged walking, sitting, standing, bending, stooping, etc., capabilities; repetitive lifting capabilities; and other factors that relate to the ability to perform substantial gainful work activities.

---Draw conclusions about an individual's ability to function for an 8 hour work day, 40 hour work week, from a 15 to 20 minute generalized physical examination.

---Has never seen the applicant prior to the examination and is most likely to never see the applicant again.

3. State Disability Determination Examiners....

---Do not have adequate vocational information regarding an applicant's previous work experience in order to make a decision about ability to perform "previous work" or the ability to perform "related work" as defined in the Dictionary of Occupational Titles.

---Rely solely on the information in a claimant's file to make a determination. This information may or may not be complete, accurate, or up-to-date, depending on the experience of the interviewer who obtained the information.

---Use the third edition, (1965), of the Dictionary of Occupational Titles and subsequent supplements to make decisions about how to classify previous work of claimants and to determine if the claimant's skill levels would be considered transferable to related work activities that are classified as Light and Sedentary by Department of Labor standards. The third edition of the Dictionary of Occupational Titles is outdated and contains hundreds of errors. The new fourth edition, (1977), did not have the supplements necessary to make disability determinations until 1981. Decisions have been made for the last 4 years on incomplete, inaccurate, non-existent, and antiquated information. The tradegy is that disability examiners, by and large, have continued to make subjective decisions regarding disability with inadequate information.

4. Effects of age, education, and prior work experience....

---The Social Security Administration, Office of Research and Statistics have published numerious reports related to age, education, and work experience of individuals eligible for Title II benefits.

These reports show that the average worker has 9 years or less of education, are approximately 45 years of age, and have worked since they were 18 years of age.

---Most individuals have performed work activities of the same or similar nature for the last 15 years.

---Most individuals have difficulty in adjusting to work activities different than those activities for which they have significant work experience.

---Studies show that an individual with a 9th grade education usually functions on the 5th to 6th grade level.

---An increase in age results in an increase in the amount of time that it takes for an individual to recover from an illness or an impairment.

---Theories and research in the area of Vocational Development show that individuals do not have the ability to readily adjust to a change in vocations after the age of 40.

The Secretary of Health and Human Services proposes to require a prognosis of "24-Plus Months of Disability", which would replace the current 12 month requirement. This measure would have a long term negative effect on the Disability Program and would not be practical to implement based on the current "state of the art" in medical technology.

1. Individuals applying for Title-II Disability Benefits do so because they feel they have an impairment that prevents them from working. Research shows that 56.5% of all applicants file for benefits within the first 12 months of disability. Almost all applicants have been without work during this entire process.

   ---Most applicants have been without proper medical treatment because they could not afford to pay for treatment or to pay for medication for their conditions.

   ---Most applicants conditions become worse within this period of time because of a lack of proper treatment.

   ---Because of the duration of their illnesses, treatment is more difficult and recovery time is usually longer.

   ---Work adjustment become considerably more difficult the longer an individual is out of the work force.

   ---Most applicants develop secondary problems, such as severe depression, after being out of work and without income for long periods of time.

2. Physicians are requested to determine the amount of time that an individual is expected to be unable to perform substantial gainful work activities.

   ---Physicians can not usually objectively predict durations of impairments with the exception of terminal or extremely severe cases.

---Usual prognosis for recovery is contingent on a maximum effect of maximum treatment. Very few cases achieve such effects from such treatment. Individuals vary from case to case and each will obtain and receive treatment differently. This fact, in and of itself, makes it impossible to make accurate predictions.

---Physician's skills vary as much as treatment techniques vary. It is often difficult to gain concensus of opinion between treating and consulting physicians.

The Committee on Ways and Means, U.S. House of Representatives has recommended the exclusion of pain as a factor in determining disability. "The polar variances in consideration of pain in decisions at different levels can only be resolved by statutory exclusion of pain as a factor."

1. To recommend the exclusion of pain is to have a recognition that pain does not exist, or if it does exist, that it cannot be of significant consequence.

---An International Symposium on the industrially disabled was held in Atlanta, Georgia in March of 1981. International medical experts concluded that pain was the most significant factor in treating both orthapedic and neurological impairments.

---International medical experts concluded that the diagnosis and treatment of pain is an area in which physicians are least qualified because of inadequate diagnostic techniques or procedures.

---Pain can be one of the most handicapping conditions and vocationally limiting factors in disability cases.

Because of the time frame between notice of appearance and preparation of this document you have limited information in written form. This information is based on 8 years of experience with over 1500 individuals who were either applying for or receiving benefits from Title II of the Social Security Act. This experience is related to providing vocational assessment, rehabilitation services, work adjustment services, and job placement services to these individuals.

There are any number of positive ways to improve the Social Security Disability Program other than the hit and miss recommendations that have been proposed by some who have little or no experience at the "grass roots" level where there is first hand knowledge of the operation and impact of the program. Reductions in the programs and modifications in the programs provided through the Social Security Act will not solve the problems the system faces on a long term basis. The program under Title II that covers Disability Insurance could be organized and administered to achieve the overall results sought by the President. The proposed changes will not achieve the desired results and will serve to place the program in even a worst situation at the cost of those who contribute a portion of their income to receive benefits that are rightfully theirs.

Sincerely yours,

Bob Roberts

Bob Roberts, Director
LSU Assessment Center

BR/rmt

Senator ARMSTRONG. Finally, in conclusion of this afternoon's hearing we are pleased to welcome Ms. Carol Grossman, who is the president of the Women's Equity Action League, and equal opportunity specialist at Wayne State University. Her testimony, I believe, has been endorsed by a number of other groups, in addition to the Women's Equity Action League, for whom she speaks.

STATEMENT OF CAROL GROSSMAN, NATIONAL PRESIDENT OF WOMEN'S EQUITY ACTION LEAGUE, AND EQUAL OPPORTUNITY SPECIALIST, WAYNE STATE UNIVERSITY

Ms. GROSSMAN. Senator Armstrong and Senator Moynihan, I am very pleased to be able to testify on behalf of the Women's Equity Action League.

WEAL is one of the founders and an active participant in the National Coalition on Older Women's Issues, an organization concerned with the economic problems of people as they grow older.

As you can see, I am not an older person. I am a member of the baby boom generation. I am scheduled to turn 68 and it seems in the very precarious year of 2016.

However, I am greatly indebted to the many women and men who are retiring now and whose benefits are in deep jeopardy, especially those who provided student benefits for me when my father died suddenly at my age of 15.

I don't have to tell you that women in this economy and this society are in deep trouble. Older women are the fastest growing segment of our population. They are also the poorest.

Older women are not likely to have earnings and when they do they earn less than men. In 1979, fully employed women between the ages of 55 and 64 earn $10,664 as compared to $19,437, earned by men in the same age group.

The median income for women 65 and over was $3,760 as compared with $6,430 for men.

Seventy percent of women over 65 are or will become widows living alone for an average of 18 years. Thirty percent of elderly women living alone are poor. The poverty rate for elderly minority women living alone is the highest in the Nation, 47 percent for Hispanic women and 62 percent for black women.

Those older women who do not fall within the official measure of poverty hover precariously above it.

As you know, women are not well covered by private pension plans and the reality is that 60 percent of all unmarried women over age 65 depend on social security as their only source of income.

I would like to briefly comment on a few of the administration proposals that are of deep concern to us.

One is the elimination of the minimum benefit, which, as I understand by votes of both the House and Senate, has already been eliminated.

Given the elimination of the minimum benefit, the average recipient will suffer a 40 percent reduction in her monthly benefit.

Women are 76 percent of all beneficiaries receiving the minimum benefit as retired or disabled workers and 85 to 90 percent if widows and dependent spouses are included.

WEAL has analyzed the admittedly conflicting information available from the Congressional Research Service and the Social Security Administration.

WEAL research, however, does show that they at least agree that 99 percent of the minimum beneficiaries receiving benefits as survivors, age 60 and over, are women.

The administration cites the GAO report and the GAO report claims that 74 percent of the minimum beneficiaries do not need the benefit. They have sufficient income and can do without it.

The GAO defines sufficient as having enough annual income to be ineligible for supplementary security income, a form of welfare with a strict income and asset test.

Sufficient therefore means having an income of more than $3,100 a year. This is a ludicrous standard when we consider the Department of Labor announced in March that the Nation's official poverty level for a single person family is $4,310.

The administration also says that the truly needy will be able to apply for SSI. Well, we know that currently eligible persons who can apply for SSI often don't, perhaps because of the hassle of applying for welfare, not to mention the perceived stigma.

We are also concerned about the phaseout of the student benefits which we understand has also been a part of the earlier vote.

This is going to have a tremendous burden on widows between the age of 40 and 60.

The mothers' efforts to augment her income will be thwarted by limited employment possibilities and the proposed cuts in the two main Government student loan and grant programs will make it difficult, if not impossible, for these students to get a college education.

We are concerned about the administration assumptions about early retirement. It would seem that the average early retiree retires voluntarily while enjoying good health and unlimited employment opportunities.

Admittedly research and data on beneficiaries is inadequate, but it is very clear that many persons who are on the minimum benefit also have to retire.

We are also concerned, of course, in the change in computation points for average indexed monthly earnings.

The administration proposes to increase by 3 the number of years in which a worker's age 65 benefit is computed.

Under the proposal, the formula will assume a person works from age 22 until 68, instead of 65.

This will give women who have been homemakers and in and out of the work force another few zeros to average into their social security benefit.

We are concerned with the disability insurance reforms and do know that they will have a substantial impact on women. Other people today have spent some considerable time in that area, so I won't.

It is interesting to note that the one expansion of benefits in one sense is phasing out of the retirement test. And, of course, it would be noted that this will have an impact primarily on men.

Only 8 percent of women over 65 are currently working. We feel that a good proportion of those are not in danger of meeting the earnings test.

I would like to conclude by saying that the Women's Equity Action League recognizes that the social security system is undergoing financial difficulty and that we agree that solutions must be found.

But, we do not accept the solutions proposed thus far. They are punitive and they threaten massive reduction of benefits to almost everyone, but impact most harshly on minorities, low-income individuals, and women.

We urge the committee to examine carefully and thoughtfully alternatives to the proposed plan and make sure that the economic concerns of elderly women, 59 percent of people over 65 and the poorest segment of the population are uppermost in your mind.

We would like to ask, in addition, that if indeed some of these benefit reductions stick and are included in the final bill, that you add to that bill some provision that the Social Security Administration study the impact of these reductions so we will have finally some important conclusive data.

Senator ARMSTRONG. Senator Moynihan.

Senator MOYNIHAN. I would just like to thank Ms. Grossman for a very careful, concise, and comprehensive statement.

Can you help me with one figure? The amount of widows over age 65 live alone for an average of 18 years?

Ms. GROSSMAN. Yes. That is correct. The lifespan of American women is growing longer. There are a tremendous number of women who are living alone and for a very long period of time.

This labor force pattern is not well understood by women even in the past or even today. Young women do not realize what a large proportion of their life they will need to be employed and will be alone.

Senator MOYNIHAN. That is a very impressive and important figure. An average of 18 years alone.

Ms. GROSSMAN. It is a long time. In looking at the average earnings of men one can also note that the majority of men are in two-earner families or two-person families and their average income, which I did not mention, was $11,000 per year.

The majority of women living alone are beneficiaries of social security.

Senator Moynihan. I would also like to note your point that the proposal to eliminate the retirement test creates a disproportionate advantage for male as against female recipients.

It is troubling to find in the middle of a series of proposals to cut benefits for the disabled or sick, we propose to increase benefits to those who are active in the professions, in one form or another active in economic life. I don't want to introduce any partisan note, it would be totally out of character for us to be partisan, but——

Senator ARMSTRONG. It certainly would be oppressive.

Senator MOYNIHAN. It strikes me as class legislation.

Ms. GROSSMAN. That's true. It is interesting to me that we are working to remedy a situation that is the incentive for early retirement and we really have limited information about why people retire at age 62.

Senator MOYNIHAN. We do know more than that—we do know some things. We know that most of those who retire at 62 are sick or ill.

Ms. GROSSMAN. That's right.

Senator MOYNIHAN. A very considerable portion of them haven't been earning anything. When they reach age 62 they become eliglbe for benefits. They are out of the work force because they are sick or lost an election or something like that. [Laughter.]

Thank you very much. We appreciate your testimony.

Senator ARMSTRONG. Ms. Grossman, I appreciated your statement very much. I recognize the concerns you expressed without necessarily agreeing with all of your conclusions. You raised a point well worth consideration of the committee and of the Senate.

In your concluding remarks you state that the Women's Equity Action League recognizes that the Social Security System is undergoing financial difficulties and we agree that solutions must be found.

You have, however, rejected the various proposals for savings that have been suggested and have stated your reasons both in your remarks today and your written statement.

What do you suggest? I do not mean to put you on the spot, obviously that is not necessarily a responsibility that falls to you, but if you have specific suggestions to make as to how we can resolve this problem, we would be glad to have them.

Ms. GROSSMAN. We have not done comprehensive financial analysis. We have, of course, looked at the data that is available.

We tend to agree that the short-term problem and the long-term problem are two very separate issues. We tend to agree with the solutions that have been proposed by Mr. Robertson, I would say, and Senator Chiles, that, indeed, the interfund borrowing gives us some immediate remedy for the short-term problem.

Indeed, we do not between now and September have to have a proposal that would remedy the long-term program in a major way.

We need a little bit more time. We were, of course, disheartened to find that the votes on the minimum benefit and the student benefit have already been taken before benefit of at least this testimony today, and the confusion that now rests in the budget process.

It is not even clear to me and I would like to ask this question, "Is there any opportunity at this point to restore or substantially change the elimination of the minimum benefit or the student benefit or any of the particulars associated with those programs?"

Senator ARMSTRONG. Well, I think the answer to your question is, if you are asking procedurally——

Ms. GROSSMAN. Procedurally.

Senator ARMSTRONG. Well, in the environment in which Senator Moynihan and I work, anything is possible procedurally.

If you are asking is it likely that further changes in that will be made between now and the final action on the reconciliation, I would think not.

My expectation is that there will be another look at some of the issues that have been raised, possibly including those that you have mentioned, and certainly including the questions that were raised by the sisters earlier.

It will be addressed in separate legislation rather than in the reconciliation bill.

Ms. GROSSMAN. I see.

Senator ARMSTRONG. That would be my guess.

Has your group looked at the proposal, which has been endorsed by Senator Chiles and recommended by just about everybody that has looked at the problem, to gradually increase the age of retirement from 65 to 68?

Ms. GROSSMAN. Yes. We are fairly comfortable with gradually increasing the retirement age. But we would tend to agree with Mr. Robertson that that needs to be done with sufficient leadtime so that people can prepare themselves.

Women are totally unprepared for retirement and many of the things that are already happening to them. A sudden turn around with existing beneficiaries that are about to come on the rolls in the very near future is much too abrupt change to give us any time to prepare ourselves for that.

Senator ARMSTRONG. I think there is a general agreement on that. In fact, this is not the moment to try to distill a consensus, but what I personally sense shaping up is a coalescing around the idea that we ought to raise the age very slowly.

One popular proposal has been to increase it 1 month each year for the next 36 years. It would be so gradual as to be imperceptible.

Yet, I am told that that would wipe out something like half or two-thirds of the long-term deficit.

Ms. GROSSMAN. One of the things I would like to point out is that as an organization like WEAL that is dealing with the entire legislative docket, it is very hard to isolate social security.

The entire budget package has very, very severe implications for women. I would refer you to the latest and the upcoming WEAL Washington Report which all members of Congress get.

It is not simply the social security benefit. Women's programs eliminate problems that women face in the work force and education. Yet women's programs have been targeted and are being severely cut.

They are most likely to be cut when money needs to be saved. The employment and training for displaced home makers, some of these things that may indeed provide some substantial relief to women who could possibly plan for an adequate retirement picture.

This is going to be difficult to put these things all together in this type of budget environment.

Senator ARMSTRONG. Thank you very much.

Senator MOYNIHAN. Thank you.

Senator ARMSTRONG. Senator Moynihan and I would like to stay and chat longer, but we have to retire to our offices to prepare additional charts for tomorrow's hearing. [Laughter.]

Thank you.

Senator MOYNIHAN. Thank you very much.

[Statement follows:]

[Whereupon, at 6:07 p.m., the hearing adjourned, subject to the call of the Chair.]

WEAL

TESTIMONY ON SOCIAL SECURITY PROPOSALS AND WOMEN

SENATE FINANCE COMMITTEE

SUBCOMMITTEE ON SOCIAL SECURITY

BY

CAROL BURROUGHS GROSSMAN

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JULY 9, 1981

THE FOLLOWING ORGANIZATIONS ENDORSE THE TESTIMONY OF THE WOMEN'S EQUITY ACTION LEAGUE:

AMERICAN ASSOCIATION OF UNIVERSITY WOMEN
DISPLACED HOMEMAKERS NETWORK
NATIONAL BLACK WOMEN'S POLITICAL LEADERSHIP CAUCUS
NATIONAL COUNCIL OF JEWISH WOMEN
NATIONAL SENIOR CITIZENS LAW CENTER
NATIONAL WOMEN'S POLITICAL CAUCUS
OLDER WOMEN'S LEAGUE
WIDER OPPORTUNITIES FOR WOMEN

WEAL

TESTIMONY OF THE WOMEN'S EQUITY ACTION LEAGUE

PRESENTED BEFORE THE SENATE FINANCE COMMITTEE SUBCOMMITTEE ON SOCIAL SECURITY

SENATOR ARMSTRONG, MEMBERS OF THE COMMITTEE, I APPEAR BEFORE YOU REPRESENTING THE VIEWS OF THE WOMEN'S EQUITY ACTION LEAGUE, KNOWN AS WEAL. FOUNDED IN 1968, WEAL IS A NATIONAL ORGANIZATION DEDICATED TO SECURING AND PROTECTING EQUAL RIGHTS FOR WOMEN. WEAL IS ONE OF THE FOUNDERS AND AN ACTIVE PARTICIPANT IN THE NATIONAL COALITION ON OLDER WOMEN'S ISSUES, AN ORGANIZATION OF GROUPS WHOSE PRIMARY CONCERN IS THE ECONOMIC PROBLEMS OF PEOPLE AS THEY GROW OLDER. I COMMEND THE COMMITTEE FOR MAKING THIS THEIR CONCERN AS WELL.

I WANT TO MAKE THREE POINTS TODAY. FIRST, OLDER WOMEN ARE A DISADVANTAGED POPULATION. SECOND, SOCIETY AND THE SOCIAL SECURITY SYSTEM CONTRIBUTE TO THE ECONOMIC PROBLEMS OF OLDER WOMEN. THIRD, THE ADMINISTRATION'S MARCH AND MAY PROPOSALS TO REDUCE AND ELIMINATE SOCIAL SECURITY BENEFITS WILL FURTHER DISADVANTAGE OLDER WOMEN AS WORKERS, DEPENDENT SPOUSES, AND WIDOWS.

IN 1976, OF A TOTAL OF 24.5 MILLION AGED SOCIAL SECURITY BENEFICIARIES, ABOUT 14.5 MILLION (59%) WERE WOMEN, INCLUDING 8 MILLION DEPENDENT WIVES AND WIDOWS. AT THE END OF 1980, WOMEN RETIRED WORKERS 65 AND OVER COMPRISED 46% OF ALL RETIRED WORKERS. SO WHEN WE TALK ABOUT PUBLIC POLICY AND SOCIAL SECURITY, WE MUST CONSIDER ITS IMPACT ON WOMEN.

OLDER WOMEN ARE THE FASTEST GROWING SEGMENT OF OUR POPULATION. THEY ARE ALSO THE POOREST. OLDER WOMEN ARE NOT LIKELY TO HAVE EARNINGS, AND WHEN THEY DO, THEY EARN LESS THAN MEN. IN 1979 FULLY EMPLOYED WOMEN BETWEEN THE AGES OF 55 AND 64 EARNED $10,664 AS COMPARED TO $19,437 EARNED BY MEN IN THE SAME AGE GROUP. THE MEDIAN INCOME FOR WOMEN 65 AND OVER WAS $3,760 AS COMPARED TO $6,430 FOR MEN OVER 65. THIS MEDIAN INCOME COMPARISON BECOMES EVEN MORE SIGNIFICANT WHEN ONE CONSIDERS THAT MOST OLDER MEN ARE MARRIED AND LIVE ON A FAMILY BUDGET THAT COMBINES THE INCOME OF HUSBAND AND WIFE, AN INCOME WHICH IN 1979 AVERAGED $11,000 ANNUALLY. THIS IS NOT TRUE FOR OLDER WOMEN, MOST OF WHOM LIVE ALONE.

INDEED, SEVENTY PERCENT OF WOMEN OVER 65 ARE OR WILL BECOME WIDOWS LIVING ALONE FOR AN AVERAGE OF 18 YEARS. THIRTY PERCENT OF ELDERLY WOMEN LIVING ALONE ARE POOR. THE POVERTY RATE FOR ELDERLY MINORITY WOMEN LIVING ALONE IS THE HIGHEST IN THE NATION: 47% FOR HISPANIC WOMEN AND 62% FOR BLACK WOMEN. THOSE OLDER WOMEN WHO DO NOT FALL WITHIN THE OFFICIAL MEASURE OF POVERTY, UNDER $4,000 A YEAR, HOVER PRECARIOUSLY ABOVE IT.

ALTHOUGH TODAY, OVER 50% OF ALL WOMEN OVER AGE 16 ARE IN THE WORK FORCE AND ARE REMAINING THERE FOR LONGER PERIODS, WE MUST NOT FOOL OURSELVES AND OTHERS INTO THINKING THAT WOMEN HAVE BECOME, OR WILL BE IN THE NEAR FUTURE, THE ECONOMIC EQUALS OF MEN. A COMBINATION OF LOW WAGE HISTORIES AND LACK OF ADEQUATE PRIVATE PENSION COVERAGE FORCE MOST WOMEN INTO DEPENDENCE ON SOCIAL SECURITY AS THEIR PRIMARY SOURCE OF RETIREMENT INCOME. OF WOMEN WORKERS RETIRING TODAY, ONLY 21% HAVE HAD PRIVATE PENSION COVERAGE ON THEIR LONGEST HELD JOB. AND ONLY 13% EVER ACTUALLY COLLECT BENEFITS.

THE REALITY IS THAT 60% OF ALL UNMARRIED WOMEN OVER 65 DEPEND ON SOCIAL SECURITY AS THEIR ONLY SOURCE OF INCOME. IN DECEMBER 1979 THE AVERAGE MONTHLY SOCIAL SECURITY BENEFIT FOR WOMEN WAS $256, AND FOR THOSE WHO ELECTED TO RECEIVE BENEFITS EARLY, THE AVERAGE WAS $238, OR LESS THAN $3,000 A YEAR. THIS MEAGER BENEFIT REFLECTS WOMEN'S EMPLOYMENT PATTERNS AND LOW WAGES, DUE PARTLY TO DISCRIMINATION IN THE PAID LABOR FORCE; AN AVERAGING FORMULA IN WHICH CHILD-CARE YEARS (OVER 5) COUNT FOR ZERO; ACTUARIALLY REDUCED BENEFITS OF SPOUSES AND WIDOWS WHO TAKE THEIR BENEFITS EARLY; AND A SOCIETY WHICH PLACES LITTLE VALUE ON THE HOMEMAKING ROLE.

I WILL NOW ADDRESS THE WAY IN WHICH SOME OF THE ADMINISTRATION'S PROPOSALS WILL FURTHER DISADVANTAGE OLDER WOMEN.

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ELIMINATION OF THE MINIMUM BENEFIT

IN MARCH, 1981, THE ADMINISTRATION PROPOSED THE FULL ELIMINATION OF THE MINIMUM BENEFIT. THIS BENEFIT IS AWARDED TO WORKERS WHO WOULD OTHERWISE RECEIVE A LESSER AMOUNT BASED ON THEIR EARNINGS RECORD AND SHORT TERM OR SPORADIC WORK HISTORY UNDER COVERED EMPLOYMENT. IN ADDITION, DEPENDENTS AND SURVIVORS OF RETIRED, DECEASED OR DISABLED WORKERS RECEIVE SOCIAL SECURITY BENEFITS BASED ON THE MINIMUM BENEFIT.

IN 1977 CONGRESS DECIDED TO FREEZE THE MINIMUM BENEFIT AT $122 AND, IN EFFECT, PHASE IT OUT. AS EARNINGS RISE, THE MINIMUM BENEFIT WOULD CEASE TO BOOST A RECIPIENT'S RETIREMENT BENEFIT OVER WHAT S(HE) EARNED BASED ON SOCIAL SECURITY TAXES PAID DURING YEARS IN COVERED EMPLOYMENT. INDIVIDUALS WHO BECAME ELIGIBLE FOR BENEFITS IN 1978 OR EARLIER ARE STILL RECEIVING BENEFITS BASED ON THE OLD MINIMUM BENEFIT PROCEDURE AND MAY BE RECEIVING A MONTHLY BENEFIT OF UP TO $153. THE NEW "FROZEN" MINIMUM APPLIES ONLY TO INDIVIDUALS WHO REACHED AGE 62, BECAME DISABLED OR BECAME ELIGIBLE FOR SURVIVOR'S BENEFITS IN 1979. ALL MINIMUM BENEFICIARIES, WHETHER UNDER THE NEW "FROZEN" OR OLD PROCEDURES RECEIVE COST-OF-LIVING ADJUSTMENTS ONCE THEY COME ON THE ROLLS.

PRESIDENT REAGAN DECIDED TO ELIMINATE THE MINIMUM SOCIAL SECURITY BENEFIT FOR OVER THREE MILLION BENEFICIARIES WHO ARE CURRENTLY ELIGIBLE TO RECEIVE IT, AS WELL AS FOR NEW BENEFICIARIES COMING ONTO THE ROLLS. THIS MAJOR POLICY DECISION WAS BASED ON A 1977 REPORT OF THE GENERAL ACCOUNTING OFFICE (GAO).

WEAL IS APPALLED THAT A DECISION OF THIS MAGNITUDE WAS BASED ON SCANTY AND INCONCLUSIVE EVIDENCE FOUND IN THIS REPORT, WHICH FAILS TO MAKE A CASE FOR ELIMINATING THE MINIMUM BENEFIT EVEN PROSPECTIVELY.

GAO FAILS TO PROVIDE COMPREHENSIVE ENOUGH DATA TO SHOW WHO THE RECIPIENTS OF THE MINIMUM BENEFIT ARE AND HOW THEY WILL BE AFFECTED BY ITS LOSS. INDEED, THEY PROVIDE NO FINANCIAL DATA FOR 26% OF THEIR SAMPLE AND INCONCLUSIVE DATA AND QUESTIONABLE CONCLUSIONS ABOUT THE FINANCES OF THE REMAINING 74%.

FURTHER, GAO AND THE MEDIA HAVE DISTORTED AND EXAGGERATED THE ISSUE OF "DOUBLE-DIPPING." THEY REPORT THAT 15% OF MINIMUM BENEFICIARIES HAVE A FEDERAL PENSION AND ITS AVERAGE IS $900 A MONTH. HOWEVER, 20% OF THESE FEDERAL PENSIONERS RECEIVE ONLY $250 - $300 A MONTH IN FEDERAL PENSION BENEFITS. THE SOCIAL SECURITY ADMINISTRATION (SSA) SAYS, HOWEVER, THAT ONLY 12% OF MINIMUM BENEFICIARIES HAVE PUBLIC PENSIONS; AND OF THESE, ONLY 6% HAVE FEDERAL PENSIONS. SSA DATA SHOWS THAT 22% ARE RECEIVING A PENSION OF LESS THAN $300 A MONTH. SO YOU SEE, THERE IS NO AGREEMENT EITHER ON THE NUMBER OF MINIMUM BENEFICIARIES RECEIVING A FEDERAL PENSION OR ON THE DOLLAR AMOUNTS OF THESE PENSIONS.

IF THE ADMINISTRATION ELIMINATES THE MINIMUM BENEFIT, THE AVERAGE RECIPIENT WILL SUFFER A-40% REDUCTION IN HER MONTHLY BENEFIT. WE SAY HER BECAUSE, THIS PROPOSAL DISPROPORTIONATELY AFFECTS WOMEN. SSA DATA REVEALS THAT WOMEN ARE 76% OF ALL BENEFICIARIES RECEIVING THE MINIMUM BENEFIT AS RETIRED OR DISABLED WORKERS. FURTHER, THE CONGRESSIONAL RESEARCH SERVICE

(CRS) ESTIMATES THAT WHEN WIDOWS AND DEPENDENT SPOUSES ARE ADDED, WOMEN WILL COMPRISE 85-90% OF ALL MINIMUM BENEFICIARIES CURRENTLY ON THE ROLLS. INDEED, WEAL'S ANALYSIS OF DECEMBER, 1980 SSA DATA CONFIRMS CRS PROJECTIONS. OUR RESEARCH SHOWS THAT 99% OF THE MINIMUM BENEFICIARIES RECEIVING BENEFITS AS SURVIVORS AGE 60 AND OVER ARE WOMEN.

THE ADMINISTRATION CLAIMS THAT OF THE 3 MILLION ELIGIBLE TO RECEIVE THE MINIMUM BENEFIT, ABOUT 1 MILLION PECIPIENTS WILL SUFFER NO LOSS IN INCOME BECAUSE THEY ARE DUALLY ENTITLED--RECEIVING A BENEFIT BASED ON THEIR SPOUSE'S EMPLOYMENT RECORD. AN ADDITIONAL 500,000 MINIMUM BENEFICIARIES CURRENTLY RECEIVE SUPPLEMENTAL SECURITY INCOME (SSI), A FORM OF WELFARE WHICH WOULD INCREASE, DOLLAR FOR DOLLAR, TO MAKE UP FOR THE LOSS OF THE MINIMUM BENEFIT. THE ADMINISTRATION ESTIMATES THAT ANOTHER 450-500,000 INDIVIDUALS WILL BECOME NEWLY ELIGIBLE FOR SSI WITH THE ELIMINATION OF THE MINIMUM BENEFIT; HOWEVER THE ADMINISTRATION ALSO ESTIMATES THAT <u>ONLY</u> 145,000 WILL APPLY FOR SSI. BUT OF THE REMAINING INDIVIDUALS WHOSE MONTHLY INCOME WILL ACTUALLY DIMINISH WITH THE LOSS OF THE MINIMUM BENEFIT, 900,000 ARE WOMEN, MOST OF WHOM ARE OLD. (CRS DATA SHOWS THAT 78% OF MINIMUM BENEFICARIES ARE 65 OR OLDER, AND MANY ARE CONSIDERABLY OLDER THAN 65. FOR INSTANCE, AMONG THE RETIRED AND DISABLED WORKERS ALONE, THERE ARE ABOUT 1.5 MILLION BENEFICIARIES 70 YEARS OR OLDER: OF THESE, 532,000 ARE 80 OR OLDER, AND 80,000 ARE 90 OR OLDER.)

THE ADMINISTRATION CITES THE GAO REPORT AND CLAIMS THAT 74% OF THE MINIMUM BENEFICIARIES DO NOT NEED THE BENEFIT; THEY HAVE SUFFICIENT INCOME AND CAN DO WITHOUT IT. BUT GAO DEFINES "SUFFICIENT" AS HAVING ENOUGH ANNUAL INCOME TO BE INELIGIBLE FOR SUPPLEMENTARY SECURITY INCOME (SSI), A FORM OF WELFARE WITH A STRICT INCOME AND ASSET TEST. SUFFICIENT THEREFORE MEANS HAVING AN INCOME OF MORE THAN $3,100 A YEAR. $3,200 MISSES THE MARK! THIS IS A LUDICROUS STANDARD WHEN WE CONSIDER THAT THE DEPARTMENT OF LABOR ANNOUNCED IN MARCH THAT THE NATION'S OFFICIAL POVERTY LEVEL FOR A SINGLE-PERSON FAMILY IS $4,310.

NO MATTER HOW POVERTY IS DEFINED, WE KNOW THAT ELIMINATING THE MINIMUM BENEFIT WILL HARSHLY IMPACT WOMEN. WOMEN WHO WILL BE ESPECIALLY HURT ARE:

- RETIRED WORKERS RECEIVING THE MINIMUM BENEFIT AS WELL AS A SMALL FEDERAL, STATE OR LOCAL PENSION;
- NEVER MARRIED RETIRED WORKERS RECEIVING THE MINIMUM BENEFIT BUT WHO WORKED THE MAJORITY OF THEIR WORK-LIFE IN EMPLOYMENT NOT COVERED BY EITHER A PENSION OR OTHER RETIREMENT BENEFITS (DOMESTIC WORKERS, LOW-PAID, PART-TIME WORKERS, AND OTHERS);
- AGED WIDOWS WHO ARE RECEIVING A SURVIVOR'S BENEFIT BASED ON A DECEASED SPOUSE'S MINIMUM BENEFIT, BUT LITTLE OR NO ADDITIONAL INCOME; AND
- MINIMUM BENEFICIARIES WHO ARE EARLY RETIREES (AGE 62-64), WIDOWS (AGE 60-64) AND SPOUSES (AGE 62-64), FOR THEY ARE TOO YOUNG TO QUALIFY FOR SSI.

THE ADMINISTRATION SAYS THAT ONCE THE MINIMUM BENEFIT IS ELIMINATED, THE "TRULY NEEDY" (THOSE WITH LESS THAN $3,100 A YEAR IN INCOME) WILL APPLY FOR SSI. HOWEVER, MANY OF THE INDIVIDUALS IN QUESTION WILL NOT BE QUITE POOR ENOUGH TO QUALIFY FOR SSI, AND THOSE WHO DO QUALIFY MAY WELL CHOOSE INDEPENDENCE AND IMPOVERISHMENT OVER THE STIGMA AND HASSLE OF APPLYING FOR WELFARE. INDEED, CURRENTLY, ½ OF THE MINIMUM BENEFICIARIES ELIGIBLE FOR SSI CHOOSE NOT TO APPLY FOR IT.

PHASE OUT THE STUDENT BENEFIT

IN 1978, 62% OF STUDENT BENEFICIARIES AGED 18-22 WERE CHILDREN OF DECEASED WORKERS. ALMOST 2/3 OF ALL STUDENT BENEFITS WENT TO STUDENTS IN FAMILIES WITH ANNUAL INCOMES UNDER $15,000; THIRTY-TWO PERCENT OF ALL BENEFITS WENT TO STUDENTS OF FAMILIES WITH INCOMES UNDER $5,000. MANY OF THESE WERE MINORITY FAMILIES. FOR A GREAT MAJORITY OF THESE STUDENTS, THE BENEFIT LOSS WILL SHIFT THE COST OF THEIR COLLEGE EDUCATION TO A WIDOWED MOTHER BETWEEN THE AGES OF 40 AND 60 WHO WILL LOSE HER OWN "MOTHER'S" BENEFIT WHEN THE CHILD TURNS 18. THE MOTHER'S EFFORTS TO AUGMENT HER INCOME WILL BE THWARTED BY LIMITED EMPLOYMENT POSSIBILITIES. PROPOSED CUTS IN THE TWO MAIN GOVERNMENT STUDENT LOAN AND GRANT PROGRAMS WILL MAKE IT DIFFICULT, IF NOT IMPOSSIBLE, FOR THESE STUDENTS TO GET A COLLEGE EDUCATION.

DISCOURAGEMENT OF EARLY RETIREMENT

APPROXIMATELY 70% OF ALL WOMEN WHO RECEIVE SOCIAL SECURITY BENEFITS CHOOSE ACTUARIALY REDUCED BENEFITS FOR LIFE. IN 1980, WOMEN ACCOUNTED FOR 51% OF ALL RETIRED WORKERS AGE 62-64 RECEIVING SOCIAL SECURITY BENEFITS EARLY. IN 1977, ABOUT 25% OF WOMEN RECEIVING BENEFITS AS SPOUSES TOOK THEM EARLY. IN 1979 THIS REDUCED BENEFIT AVERAGED LESS THAN $3,000 A YEAR.

THE ADMINISTRATION PROPOSAL RESTS ON THE ASSUMPTION THAT BENEFICIARIES RETIRE VOLUNTARILY AND ENJOY GOOD HEALTH AND UNLIMITED EMPLOYMENT OPPORTUNITIES. A 1979 HARRIS SURVEY REVEALED THAT 51% OF EARLY RETIREES HAD TO RETIRE, AND A SOCIAL SECURITY ADMINISTRATION SURVEY SHOWED THAT ONLY 22% RETIRED VOLUNTARILY, WHILE 75% CITED POOR HEALTH AND EMPLOYMENT PROBLEMS.

UNDER THE ADMINISTRATION'S MAY 1981 PROPOSALS, WOMEN WILL SUFFER BOTH AS WORKERS AND DEPENDENTS. AS WORKERS THEY WILL CONTINUE TO NEED TO RETIRE EARLY, BUT THEY WILL RECEIVE ONLY 55% OF THEIR AGE 65 BENEFIT INSTEAD OF THE 80% THEY ARE CURRENTLY ELIGIBLE TO RECEIVE. TWO EXAMPLES FOLLOW:

- A DISPLACED HOMEMAKER WHO HAS NEVER WORKED OUTSIDE THE HOME, DIVORCED WITH NO SKILLS, TAKES HER SOCIAL SECURITY BENEFIT AT AGE 62 IN ORDER TO SURVIVE. HER RETIRED EX-HUSBAND'S AGE 65 BENEFIT IS $300 A MONTH. UNDER THE ADMINISTRATION'S PROPOSAL, SHE WILL RECEIVE A REDUCED SOCIAL SECURITY BENEFIT OF $82.50 (55% OF HER AGE 65 BENEFIT) INSTEAD OF $112.50 (75% OF HER AGE 65 BENEFIT)--

A LOSS OF $30 A MONTH, ALMOST ONE-THIRD OF WHAT SHE WOULD HAVE RECEIVED UNDER THE CURRENT LAW.

- A TRADITIONAL COUPLE, RETIRING AT AGE 62 (WORKER'S AGE 65 BENEFIT IS $300) WOULD SUFFER A COMBINED LOSS OF $105 A MONTH. UNDER THE NEW PROPOSAL, THE WORKER RECEIVES $165 INSTEAD OF $240, AND THE SPOUSE RECEIVES $82.50 INSTEAD OF $112.50. THEIR MONTHLY CHECKS GO FROM $352.50 TO $247.50 (A 30% REDUCTION IN THEIR ALREADY MARGINAL RETIREMENT INCOME). IF THE WIFE DOES NOT TAKE HER REDUCED SPOUSE'S BENEFIT AT 62, THE LONG TERM FINANCIAL PICTURE IS SOMEWHAT IMPROVED. BUT WHILE SHE IS WAITING FOR HER BENEFIT TO BE WORTH MORE, THE COUPLE WOULD LIVE ON THE WORKER'S REDUCED MONTHLY BENEFIT OF $165 (55% OF $300) WITHOUT THE ADDED $82.50 (55% OF $150) SPOUSE'S BENEFIT.

<u>CHANGE IN COMPUTATION POINTS FOR AVERAGE INDEXED MONTHLY EARNINGS</u>

THE ADMINISTRATION ALSO PROPOSES TO INCREASE BY THREE THE NUMBER OF YEARS ON WHICH A WORKER'S AGE 65 BENEFIT IS COMPUTED BEGINNING IN 1991. CURRENTLY, THE BENEFIT FORMULA ASSUMES A PERSON'S WORKING YEARS TO BE FROM AGE 22 UNTIL 62. OF THOSE 40 YEARS OF EARNINGS, THE FORMULA AVERAGES IN THE 35 YEARS OF HIGHEST EARNINGS AND ALLOWS A WORKER TO DROP THE 5 LOWEST YEARS. UNDER THE REAGAN PROPOSALS, THE FORMULA WILL ASSUME A PERSON WORKS FROM AGE 22 UNTIL 65. OF THOSE 43 YEARS, THE FORMULA WILL USE THE HIGHEST 38 YEARS, AND STILL ALLOW THE WORKER TO DROP 5 YEARS. HOWEVER, THE EARLY RETIREE--ASSUMING HE OR SHE WORKED FROM 22 - 62 -- WOULD THEN BE ABLE TO DROP ONLY 2 YEARS OF LOW OR NO EARNINGS.

OBVIOUSLY, THE ADMINISTRATION EXPECTS EARLY RETIREES TO HAVE CONTINUOUS, NEAR-PERFECT WORK RECORDS AND ONLY MINIMALLY ACKNOWLEDGES THE NEED PEOPLE HAVE TO DROP OUT OF THE PAID LABOR FORCE FOR SCHOOLING OR CHILD-CARE RESPONSIBILITIES. QUITE CLEARLY, THE PROPOSAL DISPROPORTIONATELY PENALIZES EARLY RETIREES AND PARTICULARLY WOMEN, WHO WILL BE MORE LIKELY TO ALREADY HAVE SEVERAL ZEROS AVERAGED INTO THEIR EARNINGS RECORDS WHILE THEY'RE CARING FOR THEIR CHILDREN.

WHAT IS LESS OBVIOUS, BUT EQUALLY IMPORTANT, IS THAT UNDER THE 38 YEAR AVERAGING FORMULA ALL RETIRED WORKERS WOULD RECEIVE LOWER BENEFITS AS A RESULT OF HAVING 3 ADDITIONAL YEARS OF LOWER OR NO EARNINGS AVERAGED INTO THEIR BENEFIT COMPUTATION. INDEED, LOWER BENEFITS FOR ALL WORKERS WILL ALSO MEAN LOWER BENEFITS FOR THEIR DEPENDENT SPOUSES AND SURVIVORS, INLCUDING ELDERLY WIDOWS, BECAUSE THE BENEFITS OF SUCH INDIVIDUALS ARE CALCULATED AS A PERCENTAGE OF THE WORKER'S AGE 65 BENEFIT.

DISABILITY INSURANCE REFORMS

THE ADMINISTRATION'S PROPOSAL REQUIRES THAT TO BE INSURED FOR DISABILITY AN INDIVIDUAL MUST HAVE WORKED IN COVERED EMPLOYMENT FOR 7½ OUT OF THE LAST 10 YEARS, INSTEAD OF 5 OUT OF THE LAST 10 YEARS. WOMEN, LOW WAGE EARNERS, AND MINORITIES WILL SUFFER UNDER THIS PROPOSAL BECAUSE AS GROUPS, THEY HAVE A HIGHER INCIDENCE OF DISABILITY AND SIGNIFICANTLY LOWER LABOR-FORCE PARTICIPATION RATES. WOMEN WHO LEAVE COVERED EMPLOYMENT FOR FAMILY RESPONSIBILITIES FOR EVEN A BRIEF TIME WILL, OF COURSE, BE NEGATIVELY AFFECTED.

DISREGARDING NON-MEDICAL FACTORS WHEN DETERMINING DISABILITY QUALIFICATIONS WILL NEGATIVELY AFFECT OLDER WOMEN WORKERS, ESPECIALLY THOSE WHO ARE FACTORY AND SERVICE WORKERS AND HAVE LESS THAN A HIGH SCHOOL EDUCATION AND FEW TRANSFERABLE SKILLS. UNDER PRESENT LAW, THE COMBINED EFFECT OF A 60 YEAR OLD WOMAN'S AGE, HEALTH, EDUCATION AND EMPLOYMENT HISTORY MIGHT RENDER HER UNABLE TO WORK. UNDER THE NEW PROPOSAL ONLY MEDICAL FACTORS WOULD BE CONSIDERED, AND DESPITE THE REALITY THAT SHE COULD NEVER SECURE ANOTHER JOB, THIS 60 YEAR OLD COULD BE DEEMED INELIGIBLE FOR DISABILITY PAYMENTS.

RAISING AND PHASING OUT THE RETIREMENT TEST

WHILE ELIMINATING THE "EARNINGS LIMIT" MAY NOT AFFECT ALL WOMEN, IT WILL HELP SOME. PRIMARILY, IT WILL HELP WORKERS OVER 65 WHO HAVE GOOD SKILLS AND WORK EXPERIENCE, GOOD HEALTH AND A SATISFYING JOB; THE GREAT MAJORITY OF THESE ARE MEN. ONLY 8% OF WOMEN AGE 65 AND OVER ARE CURRENTLY EMPLOYED AND ONE-HALF ARE WORKING PART-TIME. WIVES OF WORKERS WHO CONTINUE TO EARN WILL BENEFIT AS WILL DIVORCED SPOUSES WHO HAVE NOT BEEN ABLE TO RECEIVE SOCIAL SECURITY BENEFITS BECAUSE THEIR EX-HUSBANDS, DISCOURAGED BY THE EARNINGS TEST, HAVE NOT YET RETIRED.

CONCLUSION

THE WOMEN'S EQUITY ACTION LEAGUE (WEAL) RECOGNIZES THAT THE SOCIAL SECURITY SYSTEM IS UNDERGOING FINANCIAL DIFFICULTY, AND WE AGREE THAT SOLUTIONS MUST BE FOUND. WE DO NOT ACCEPT,

HOWEVER, THE SOLUTIONS PROPOSED THUS FAR. THE MARCH PROPOSALS TAKE BENEFITS AWAY FROM VULNERABLE INDIVIDUALS ALREADY RECEIVING THEM AND DEPENDING ON THEM. THESE ARE MOSTLY OLDER WOMEN AND STUDENTS. THE MAY PROPOSALS ARE MORE THAN DISCOURAGING OF EARLY RETIREMENT. THEY ARE PUNITIVE, AND THEY THREATEN A MASSIVE REDUCTION OF BENEFITS TO ALMOST EVERYONE, BUT IMPACT MOST HARSHLY MINORITIES, LOW INCOME INDIVIDUALS, AND WOMEN. WE URGE THE COMMITTEE TO EXAMINE CAREFULLY AND THOUGHTFULLY ALTERNATIVES TO THE ADMINISTRATION'S PLAN AND MAKE SURE THAT THE ECONOMIC CONCERNS OF ELDERLY WOMEN -- 59% OF PEOPLE OVER 65 AND THE POOREST SEGMENT OF THE POPULATION -- ARE UPPERMOST IN YOUR MIND.

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[By direction of the chairman the following communications were made a part of the hearing record:]

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July 15, 1981

STATEMENT OF

THE AMERICAN SOCIETY FOR PERSONNEL ADMINISTRATION

CONCERNING

SOCIAL SECURITY FUNDING

SUBMITTED TO

SUBCOMMITTEE ON SOCIAL SECURITY AND INCOME MAINTENANCE PROGRAMS

OF THE

UNITED STATES SENATE COMMITTEE ON FINANCE

Preface

We believe that the system for providing human dignity in retirement through adequate retirement income must be viewed as a unified whole, with Social Security, public retirement plans, private retirement plans, and the financial resources of individuals, each serving an important role in meeting the needs of our retirees.

The 30,000 members of ASPA are extremely concerned about the financial integrity of the Social Security System. Representatives have testified on several occasions to Congressional committees and submitted written position papers explaining ASPA's concern with our national retirement system and specifically the role played by the Social Security System.

The 1977 amendments to the Social Security Act did much to strengthen the Social Security System. We agreed in concept with several of the changes made at that time and were encouraged by the effort to correct both the long and short term problems. We are also supportive of the several Congressional review commissions that have been studying the Social Security System over the last few years. The results of these studies combined with input from other interested groups should identify the solutions to the present and future Social Security financial problems.

National Headquarters 30 Park Drive Berea, Ohio 44017 Telephone (216) 826-4790

Recommendations

The following recommendations should be viewed as a series of changes that can be implemented over varying periods of time. The first changes are those that we feel should be acted upon immediately and the last recommendations are those that we feel can be phased in over a longer period of time. Our primary concern is to assure the continuation of the basic Social Security System and to guarantee its fiscal soundness for future generations.

1. Interfund borrowing should be immediately allowed with an appropriate interest rate paid for borrowed funds.

2. The annual inflationary adjustment should be indexed to the lower of the CPI change or wage increase. Efforts should also be made to develop an accurate measure of inflationary impact upon retirees as an alternative means of indexing benefits.

3. The contribution rate for 1985 should be advanced to 1983.

4. The cost of the Social Security System should continue to be borne equally by employers and employees. General revenues (deficits) should not be utilized.

5. Publicize the general policy that it is the intent of the Social Security System to only supply a portion of the income necessary for a comfortable post-retirement standard of living. Make the public aware of this policy and stress the importance of their making their own provisions for the accumulation of the additional funds necessary to provide for the desired standard of living during retirement.

6. Transfer the non-retirement benefits out of the Social Security System. This would include disability, survivor, Medicare, Medicaid and supplemental income benefits which would more properly fall into a welfare classification.

7. Universal coverage should be required. This could be on a prospective basis and would eliminate the potential windfall benefits which certain non-covered groups of employees can presently achieve.

8. Establish a replacement of earnings ratio that would limit the replacement of earnings ratio for low income levels to no more than twice the replacement ratio for high income levels. This assures some relationship between contributions and benefits.

9. Allow employees to deduct Social Security contributions from taxable earnings, abolish the present Social Security earnings test and subject all retirement income to income tax. This would impact only on those recipients of Social Security who had additional retirement income of a substantial nature and would be consistent with the treatment of all other retirement income.

10. Raise the normal retirement age to 67 or 68.

11. Do not extend or make improvements in the existing Social Security System. There are enough inherent serious problems with the present Social Security System that it would be inappropriate to view further expansion of the system until we have firm recommendations concerning existing problems. The general direction for Social Security should be centered on post-retirement income and other types of wage replacement protection should be handled by the appropriate welfare programs.

The proposals that we have submitted include several recommendations for either reduction in benefits and/or increases in the present Social Security tax system. Specifically, recommendation Nos. 2, 3, and 10 should have significant cost reduction implications. Proposals No. 8 and 9 have the potential for either cost reduction and/or increased revenues through the general revenue system and proposal No. 7 would reduce the cost of the federal employees pension plan. The combination of these six recommendations would increase general revenues, reduce the outflow from general revenues, reduce the cost of the Social Security system and increase the revenues to the Social Security system. That combination would basically generate enough additional tax revenues to more than pay for the combination of the Social Security base system and the related welfare programs.

Government actuaries could confirm the actual/cost savings impact and the method of allocating funds from Social Security to general revenues could be accomplished through either a direct transfer of funds or a reduction in the Social Security tax rate and the application of some type of surtax based on Social Security contributions.

The key to our proposal is that the combination of all recommendations will be a net cost savings and not a cost transfer or cost increase.

School of Law

Merton C. Bernstein
Walter D. Coles Professor of Law

July 20, 1981

WASHINGTON UNIVERSITY IN ST. LOUIS

Honorable Bill Armstrong, Chairman
Subcommittee on Social Security and Income
Maintenance Programs
Committee on Finance
2227 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

In response to Press Release No. 81-148, announcing Subcommittee hearings, I submit the attached statement on COLA for inclusion in the hearing records.

With all good wishes,

Sincerely,

Merton C. Bernstein

MCB/jm
enclosure (1)

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ST. LOUIS POST-DISPATCH June 23, 1981

Compensating For Inflation

Is Cost-Of-Living Adjustment For Retired Really Too Generous?

A Statement By Merton C. Bernstein
Washington University Law School

Proposals to reduce Social Security cost-of-living adjustments derive from quite questionable reasoning. Such a change would impose burdens that are both unfair and, for many, unbearable.

Average benefits paid retirees now come to $334 a month ($4,008 per year, or not quite $10.90 per day). With the full July 1981 cost-of-living adjustment that will go to a lordly total of $13.12 per day. Now, does that really sound like too great an amount? Does it even sound adequate?

mirror of public opinion

In today's circumstances, does even $13,500 — the theoretical maximum for a couple which few will get — sound like too much for those who have consistently earned the maximum creditable wage or salary?

Two major arguments seek to justify abandoning the Consumer Price Index as the yardstick for Social Security benefits changes. One is that over the past two years wages have increased more slowly than the CPI and so the present arrangement benefits retirees disproportionately.

However, Social Security actually replaces only little more than half the former cash wages for the poorest paid and much less for the best paid.

In contrast, many still at work have their total wages or salaries adjusted, often at rates above the CPI. So, the disparity between retirees (and disabled) and the working population is less than the crude comparison suggests.

For example, a person at work for $10,000 who receives a 6 percent wage increase ($600) is decidedly better off than the average Social Security beneficiary who receives an 11.2 percent increase on $4,008 a year ($449). ...

Moreover, many of the still-employed have more opportunities to increase their income by work; in periods of high unemployment, many employers prefer to work current employees overtime rather than undertake the costs of new hires. In addition, those currently at work have decidedly higher incomes than Social Security beneficiaries; thus a smaller percentage of their income must be devoted to necessities. For both reasons, the currently employed can adjust better to inflation, although of course, it's no picnic.

The CPI overstates mortgage interest rates and so, arguably, overcompensates the retirees who generally are not purchasing new homes. However, the CPI also understates health care and home heating costs of the elderly. The "average" market basket includes only 40 percent of the health care costs of the elderly — and those costs have been escalating more rapidly than almost all other CPI components.

Possibly most importantly, the CPI adjustment mechanism compensates for past increases. In a period of chronically rising prices, it does not enable retirees to keep up with prices they pay currently. This lag cancels some of the "overpayment" imputed to the mortgage interest factor.

Reputable economists attribute much, if not most, of our inflation (1) to the fact that we fought the Vietnam War on credit and (2) to energy cost increases. Retirees bear no special responsibilities for these developments; they should not bear a disproportionate burden for them. The pressure for budget cutting comes mainly from the enormous projected increases in defense expenditures. To the extent that we really do need them, all of us should bear the cost.

STATEMENT TO THE SUBCOMMITTEE ON SOCIAL SECURITY
U.S. SENATE FINANCE COMMITTEE BY
ROBERT A. BECK ON BEHALF OF THE BUSINESS ROUNDTABLE

July 9, 1981

This statement is submitted on behalf of The Business Roundtable by Robert A. Beck, Chairman and Chief Executive Officer of The Prudential Insurance Company of America, and Chairman of The Roundtable's Social Security and Pension Task Force.

The Business Roundtable supports the Social Security program in its critical role to provide a floor of protection to meet the basic need for replacement of employment income following retirement, disability and death. The program must be properly deisgned and financed so that it will continue to serve this essential function ont only for this generation but for future generations as well. Therefore, the Roundtable welcomes this opportunity to offer recommendations to help assure the financial viability of the program.

The program is confronted with four major problems. It is critical that each of these problems be addressed at this time.

First, there is a lack of public understanding as to the purpose, nature and financing of the program. The program is essentially an intergenerational transfer program designed to meet desirable social objectives. Efforts must be made to improve the public's understanding about the program so that they recognize the necessity of reform measures and the importance of enacting these measures now.

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Second, largely because of this lack of public understanding, there is a severe lack of public confidence in the program. One recent public opinion survey indicated that 75% of all workers between the ages of 25 and 44 have little or no confidence that funds will be available to pay promised benefits when they need them in future years.

At the same time, retirees are terrified that benefits they now receive may be reduced, or cut off completely. As the pressure has grown in Washington to cut government spending, they have become fearful of cutbacks in Social Security benefits far in excess of anything that responsible individuals or groups have recommended.

Third, the program is confronted with well-documented short term cash flow problems. These problems are critical but manageable. Legislation to solve those problems must be enacted now to protect current beneficiaries who rely on Social Security benefits.

Fourth, there are even more difficult long range financial problems confronting the program. The short range problems are the result of unexpected adverse economic conditions and can be solved without major changes in the basic program. The long range problems are the result of demographics and their solution requires more significant reform legislation.

The Business Roundtable recommends that legislation be enacted now to place the program on a financially sound basis for both the short and long term future. This combination of actions is needed to restore public confidence vital to the continued support of the program.

We strongly recommend that general revenues not be used to bail out the system for either the short or long term. Social Security benefits should continue to be financed by equally shared payroll taxes. General revenues should not be introduced, either directly or indirectly, as they would weaken the relationship between benefits and their financing. Also, their use would undermine the basic principle that benefits are paid as a matter of earned right rather than need, as typically required under programs financed by general revenues.

It is apparent that there are no general revenues currently available to finance Social Security benefits. Any further increase in our already substantial deficits would be inflationary and would weaken the economy. A strong economy is essential for continued support of the program.

General revenue financing would not result in an overall reduction in taxes, since benefit commitments must be met. Ultimately, new taxes or increases in already excessive income tax rates would be required. The net result would be to shift financing to means that are much less appropriate than payroll taxes.

As indicated earlier, the short term problems are critical but manageable. Legislation that either reallocates payroll tax rates among the three Trust Funds or that permits inter-fund borrowing would provide a reasonable solution to substantially alleviate the short term cash flow problems. If economic conditions are favorable, this alone would solve the short term problems. However, the current problems are the result of adverse economic conditions, and further actions are recommended to alleviate problems caused by such economic conditions.

Therefore, benefit increases should be limited to wage increases when wages do not increase as rapidly as prices. This would help protect the program from the effects of adverse economic conditions. For example, if such legislation had been enacted in 1977, short term cash flow problems would not have developed.

This legislation would also distribute the burden of inflation more equitably between Social Security taxpayers and beneficiaries. For example, when inflation is caused by external sources, such as large OPEC price increases, workers whose incomes are not price indexed are being inequitably required to bear most of the resulting financial burden. Other major industrialized countries have placed limits on benefits without dire consequences. We are not recommending a decrease in benefits, but a basis for benefit increases that is more intergenerationally equitable and that protects the solvency of the program under adverse economic conditions.

There are other actions that can be taken to improve the financial condition of the program. We know that these reform measures require actions that are not politically popular, but changes of this nature are required to assure the solvency of the basic program. It should also be recognized that some benefits have been added to the program that are more effectively met through alternative means.

In this context, the Business Roundtable supports the following Administration proposals:

- Phase out the post-secondary student benefits. These benefits are best met through alternative programs.

- Phase out the minimum benefit. This benefit represents a "windfall" for many of its recipients.
- Modify the disability program to relate it more closely to work history and medical condition and improve its coordination with other programs. We favor the entire package of disability reform proposals.
- Change the benefit computation point from age 62 to age 65. This change would provide a modest incentive for persons to remain in the work force.
- Increase the bend points by 50% rather than 100% of the increase in average wages during the period 1982 through 1987. This is a desirable technical correction that will compensate for the inadvertent increase in replacement ratios resulting from the faulty 1972 Amendments that over-indexed benefits to inflation.
- Eliminate benefits for children of retired workers age 62 to age 64. This would eliminate an incentive to retire early.
- Extend the disability program family maximum provisions to the survivor and retirement programs. These benefits can now exceed the worker's net take home pay.
- Eliminate the "windfall" portion of benefits for persons with pensions from non-covered employment. This should be accomplished in addition to mandating Social Security coverage as will be discussed later.
- Modify the date for automatic benefit increases to coincide with the fiscal year and use a 12 month CPI average. This is a reasonable change that should be enacted in addition to limiting benefit increases to wage increases when "real wage" losses occur.

Many of the recommendations we have endorsed would help to solve both the short and long term financial problems. However, even with these changes, the demographics of the U.S. will require substantial increases in payroll tax rates once the baby boom generation retires. It seems neither fair nor wise to promise benefits that will require our children and grandchildren to pay a level of taxes that they may be unable to pay and that we ourselves are unwilling to pay.

Old-Age benefits are provided by a transfer of funds from the working portion of the population. The tax levels required to support the transfer must be kept at a reasonable level. As the number of workers relative to the number of persons receiving benefits declines, the burden could become intolerable.

The number of workers relative to benefit recipients, currently 3.2 to 1, is projected to decline substantially and eventually reach 2 to 1. This is the combined effect of improved longevity, the post World War II baby boom and the subsequent decline in birth rates. For example, by the turn of the century, the life expectancy of individuals in their early 70's is expected to be the same as those age 65 when that age was originally selected for the program.

The demographics of the country will likely result in future labor shortages. Our country will then need to encourage productive older members of our society to continue to work to produce needed goods and services. All policies of business and government, including those involving Social Security, should begin to be designed to encourage continued labor force participation.

Therefore, the Business Roundtable recommends that the age at which full Old-Age benefits are available be gradually increased from age 65 to age 68 beginning sometime between 1990 and the turn of the century. The changes should be enacted now so that those affected will have adequate time to adjust their personal and financial planning.

Early retirement at age 62 could continue to be permitted on an actuarially reduced basis. We believe this approach to be far preferable to the Administration's proposal to abruptly reduce the early retirement benefits as that proposal provided virtually no advance notice to those affected. Fortunately, the Administration has expressed a willingness to modify this proposal.

Mandatory universal Social Security coverage should also be enacted to the extent permitted by law. This should be done in a fair and equitable manner to avoid creating benefit anomalies for the employees involved. All workers, including those in Federal, State and local government, should be covered by Social Security. It is recognized that achieving this is not a simple matter, and it should be accomplished in a manner which protects the benefits accrued under existing benefit programs. Further, those existing programs should be modified to coordinate with Social Security.

Mandatory universal Social Security coverage would eliminate undesirable gaps in benefit coverage and floor of protection which is transferable if employment changes take place. In addition, all workers would share in the responsibility inherent in the Social Security program of meeting some of the basic employment income replacement needs of the nation.

We realize the complexities involved and recommend, as minimum first steps, elimination of "windfall" benefits and coverage of all new Federal employees. These minimum steps should be taken now.

The reform measures we have recommended would do much to improve the financial viability of the program for both the short and long term. There is another change being considered that is inconsistent with the purpose of the program and that would add significant costs to the program. That change would eliminate the retirement test. While we recognize the importance of encouraging continued labor force participation of capable elderly citizens, we do not believe that Old-Age benefits should be paid to persons who continue to receive significant employment earnings.

The primary purpose of the Old-Age benefits is to replace employment income. Consistent with this purpose, those benefits should not be paid if significant employment income is present. It is difficult to justify transferring tax free money from younger workers to older workers, particularly since unemployment rates are currently very high and short term cash flow problems are predicted. It should also be noted that a 1980 retiree who paid maximum Social Security taxes as a worker will receive benefits equal to those taxes in less than one and one half years.

A retirement earnings test is now in the law. The 1977 Social Security Amendments scheduled a future liberalization in the age at which the retirement test would no longer apply, reducing the age from 72 to 70 beginning in 1982. The liberalization should be repealed and the age 72 limit on the earnings test should be retained. This recommendation has also been made by the National Commission on Social Security.

Finally, the voluntary expansion of private pension plans and individual savings for retirement should be actively encouraged through properly designed incentives, legislation and regulation. This would alleviate pressures on the overburdened Social Security program. Private pension plans and individual savings provide a valuable source of capital needed to create jobs and to improve the productivity of the economy whereas the pay-as-you-go funded Social Security program probably inhibits capital formation.

Therefore, the Business Roundtable supports legislation that would permit tax-deferred employee contributions to either an IRA or to a qualified pension plan sponsored by an employer who elects to accept tax-deferred contributions. Everyone should be able to elect to participate in an IRA even if covered by a qualified pension plan. Besides alleviating pressures on Social Security, this type of legislation would be an inflation fighting form of an individual tax cut that encourages capital formation, improves economic productivity, and merely defers the collection of taxes.

In conclusion, the Business Roundtable supports a sound, adequately financed Social Security program. Thank you for this opportunity to present our views of these urgently needed reform measures.

June 30, 1981

HOW TO PRQTECT, DEFEND AND IMPROVE THE SOCIAL SECURITY PROGRAM

BY WILBUR J. COHEN

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Should social security benefits be cut back along the lines the Reagan Administration has recommended? None? More or less? Where? When? Is social security going bankrupt? How can social security be made financially sound? Should benefits be reduced below 80% for persons who retire at age 62? Should the age for full retirement benefits under social security be increased from 65 to 68? Should disability benefits be reduced? Should social security taxes be increased or should part of all of social security costs be financed from Federal income taxes. Can you believe all you read or hear about social security?

Despite what individuals have heard or read, the social security system is not bankrupt today and in my judgment it will not go bankrupt tomorrow, next year, or twenty-five years from now. Don't believe these scare tactics. There are over 36 million persons currently collecting benefits each month and some 115 million persons contributing each year to the system. It has not gone bankrupt in the past and based upon past experience and my forty-seven years work with the Congress, I do not believe Congress and and President will or can afford to let social security go bankrupt.

Like the private fire insurance company which insures your house, Social Security is an insurance system, but with several unique and valuable characteristics--while premium payments are mandatory, employers and employees who pay premiums to it aren't allowed to cancel the policy. And the insurance system's Board of Directors--the Congress--is elected by the voters, and there is not medical examination for coverage under the program, and the earnings and benefits are indexed in relation to wages and prices, respectively. It has been carefully developed and warrants loving care.

However, even the system's ardent supporters--and I count myself in that group--recognize that at the present moment it does have some financial problems. But they can be handled. I believe, therefore, that we should stop being diverted by periodic fears of possible or probable bankruptcy and move directly to the more basic and complex question of how will the system be put on a sound basis? It can, should, and will be.

Some $40 billion has been built up on the existing reserve funds. But this is not a lot for the needs of the system. It is there in four separate earmarked funds right now and an additional $160 billion per year is coming in as income and more will come in in the future. However, it is true that due to the current high inflation rate, benefit disbursements under the system have been rising faster than was originally estimated; and because unemployment for the last few years has been higher than normal, the premiums to social security from employers and employees has caused revenue to fall below earlier estimates. There is therefore a serious cash flow problem at least for the short run. But I hope this is a temporary situation. If we believe the American economy will improve in the future, as I do--and as Mr. Reagan does--then Social Security's short run problem can be satisfactorily handled by proposals already pending in Congress. One proposal would allow for what is called "inter-fund borrowing." Social Security premiums or taxes are actually the sum of four premiums which go into four separate reserve accounts or "trust funds." Congress earmarked one fund to pay for old age retirement insurance and survivors' benefits, one for disability insurance, and one for Medicare Part A, and one for Medicare Part B. Many people think of retirement insurance as Social Security, but actually, there are five types of insurance protection and Congress created four separate trust funds to handle these different benefits. The interfund borrowing legislation would simply permit one trust fund to lend money to one of the other three when necessary. Other legislation would permit temporary loans from the Federal treasury to Social Security until the inflation-unemployment crisis subsides. These two changes would handle the short-run cash flow problem. I also recommend reenactment of the Vandenberg amendment which was in the law during 1944-50, which assures beneficiaries that general revenues can be utilized if they are ever needed to pay benefits if any unexpected developments occur before Congress can handle the situation, or if Congress is not in session.

In addition, there is also a possible long-run financing problem when the post-World War II baby boom reaches age 65 around the years 2010-2030. Do you know what the economic conditions will be 30 to 50 years from now? I do not believe that we are compelled in 1981 or 1982 to rush in now and try to solve this possible problem. We should take a little more time to study the alternatives and to concentrate on the issues related to the next 20 years.

President Reagan has stated (during the election campaign) and Secretary Schweiker has reconfirmed this policy, that we do not need to change the normal retirement age in social security from 65 to 68 now or in the immediate future. This is the one area I wholeheartedly agree with him on. The proposal to raise the age to 68 is premature and may be unnecessary. I believe increasing the retirement age is undesirable and certainly controversial. It penalizes persons who become sick and disabled between 62 and 68. We should wait and see what employment, unemployment and fertility developments occur during the next five to ten years. More people are continuing to work at older ages and we should encourage them to do so if they can and wish to do so. Not only should we provide them with useful work and more income, but it increases the income to Social Security and reduced disbursements. The fears expressed about the financing problems in the years 2010-30 may never occur! I, for one, doubt it.

There may or may not also be an intermediate financial issue between 1984-2000. But, under existing law, social security tax rates are scheduled to increase in order to pay for the benefits which Congress has previously promised. The present Federal Budget Director, David Stockman, has proposed substantially cutting these benefits, cutting the taxes, and increasing the surplus of income over benefits. I strongly disagree with the first two of these proposals. I hope, however, that we can build up the social security reserves, to meet unexpected future contingencies. I would like to see us have reserves equal to one years' benefit payments but at least 25% of that goal, and preferably 50%. But we don't have to cut benefits to do so.

The major reason for the Reagan/Stockman proposal to cut Social Security is to meet the two goals of increasing expenditures for defense while at the same time promising to balance the budget. Because the Federal unified Budget includes general revenue expenditures from the U.S. Treasury as well as social security payments from earmarked trust funds, every penny cut from any apsect of social security permits Mr. Stockman to recommend higher military spending while still claiming he's balancing the Budget. I do not think that employees, employers, and the self-employed realize--or support the principle--that what they contribute for social security and Medicare (and the expenditures from those programs) should be used to either balance or unbalance the Budget or increase or decrease the general deficit! But that is the fact! It does do so, unfortunately!

Social security (and State unemployment insurance for that matter) should be completely removed from the Federal Unified Budget. I strongly urge such an amendment, effective as soon as possible. If this were done, one of the major reasons for Mr. Stockman trying to cut social security benefits would be eliminated. Social security income and expenditures should be determined on their substantive merits and not by what effect they have on the general revenue budget financed by other than payroll taxes.

President Reagan and Mr. Stockman has proposed over a dozen cutbacks in social security benefits. While the one to reduce the benefits to persons between ages 62-65 is well known, they have proposed eleven other far-reaching cuts in benefits.

The total reduction in benefits they have proposed would total $81.9 billion during 1981-86 and much more in later years beginning at about $30 billion a year in 1986. I do not think it necessary or desirable to cut any of these benefits. But several of these cuts have already been agreed upon to take place within the coming months. Irrespective of the merits or demerits of an individual benefit, I believe cutting the benefits will result in future contributors losing confidence in the statutory promised made by Congress. If you change one person's benefits today or tomorrow you have adopted a fundamental principle that sets a precedent that you can change some other person's benefit next week or next year. If your neighbor's benefit can be cut a year from now, they have established a precedent to cut your benefit ten years from now. The principle of cutting back on promises in the law then can be extended to interest on the nation debt, Veterans' disability benefits, and even government "promises" to private business and universities for services rendered.

Some persons who are sympathetic to a particular cutback or cutbacks say that the social security system is overextended and has developed far beyond its original purpose. But this view is not supported by historical facts. It is a statement widely circulated and widely believed, but it is not true.

Every benefit in the program is directly related to some siginificant aspect of retirement. All the older age provisions are clearly related to retirement. The disability insurance provisions are a form of premature retirement due to physical or mental inability to work. The survivor benefits are based on the death (permanent retirement!) of the breadwinner. And all the Medicare benefits are

are based upon paying hospital or doctors' bills of retired people.

There is no sound basis whatsoever for the contention that the program involves payments to or on behalf of persons who do not have a valid retirement condition.

Some people erroneously believe that the social security system pays for welfare, aid to families with dependent children, foreign refugees, prisoners, or persons receiving Supplemental Security Income. This is not true. Some people believe that the contributions to social security have been misspent on purposes not related to social security. This is not true. Social Security requires payments into the system before it can pay benefits out. Those welfare families and refugees who never paid in do not receive Social Security benefits. Much of what is said about current social security financing, benefits, or administrative costs is not true or only half-true. There are official reports such as that of the National Commission on Social Security (1981), which should be consulted before rushing in to make unnecessary, undesirable, or controversial changes.

My view on the basic financing issue is that part--but only part--of the cost of future social security benefits should come out of Federal general revenues. This will constrain the future increase on Social Security taxes and distribute the cost more equitably. Part of the cost of the Medicare aspects of social security is already borne out of Federal general revenues--the portion dealing with the payment of fees to physicians. Currently, about 30 percent of the cost of Medicare Part B is borne by the aged and disabled Medicare contributors. I pay $11.00 monthly to Social Security for Part B. The other 70 percent is directly paid by Federal general revenues. None of the income to Medicare Part B trust fund comes from Social Security taxes. This general policy of contributions from the Federal Treasury has been in existence since 1965 and there have been no untoward effects on the benefits or the system.

Some general revenue contributions to the system are justifiable since social security reduces the need for general revenue expenditures for welfare, Medicaid, and Supplemental Security Income.

I propose we pay up to one-half of the cost of the other portion of Medicare--hospital benefits (Part A) out of Federal general revenues. Congress should then transfer that portion of Social Security taxes (1.3 percent of taxable payrolls). Instead of going into the Medicare Part A trust fund, this 1.3% could start flowing into the retirement benefits trust fund. This would keep the system in financially sound shape into the next century without reducing benefits one single cent. The cost of 1.3 percent of taxable payrolls in 1982 is estimated at about $15 billion for the year.

I am opposed to paying <u>all</u> of the cost of any benefit such as Medicare or disability out of general revenues because of the fear that such a benefit would then become a "welfare" benefit. I am opposed to any amendment which would make social security into a welfare system.

A number of radical proposals have been made to completely revise the structure of social security. Suggestions have been made (a) to repeal the entire social security program and leave the whole matter to the private sector and individual, employer, and/or union responsibility, (b) to make the entire program voluntary, (c) to exempt individuals under the age of 40, (d) to transfer the disability and Medicare programs to 100% general revenue financing, (e) to restructure the program as a straight pension-annunity program, and (f) to repeal all benefits not related to the aged. The National Commission on Social Security of which I was one of the nine members carefully studied all these proposals. This bi-partisan panel (which was appointed by the President, the Speaker of the House of Representatives, and the President of the Senate) unanimously opposed all of these radical changes as unwise, and unnecessary. One of the other members of that Commission who joined us in that view is Robert J. Myers, an actuary and a Republican, who is currently the Deputy Commissioner of Social Security in the Reagan Administration. Our full report is available for all to read. We also recommended extending Social Security coverage to all newly hired Federal employees, all members of Congress, the Cabinet and the Commissioner of Social Security. If these groups were covered, they would not only help the financial stability of the system by virtue of their contributions, their participation in the program, in my opinion, would assure the future financial soundness of the program for all time to come.

I am one of many who opposes <u>any</u> reduction in social security benefits and strongly support additional financial contributions to maintain the present benefit structure because I believe that social security benefits are not a free lunch and are a "good buy" for most, if not all, people who contribute to the program. Of course, it is possible to assume that a particular individual would not die or become disabled during the next 40 years, and would live only a brief time after retirement and could have invested his contributions at 15% interest for the entire 40 years and do better, by leaving a big inheritance to his heirs. Or, will not live the average life expenctancy. But, these kinds of assumptions are not realistic for most people. This ivory tower theory assumes no one will ever make a mistake or become sick or disabled before retirement. It assumes that no senior citizen will have a 25 or 50 thousand dollar cancer operation. It assumes that no wage earner will die leaving a 45 year old widow with two children to collect social security. It assumes no 35 year old worker will ever become disabled through cancer, heart disease, or accident in an auto crash who will then collect disability insurance for the next 30 to 40 years.

Moreover, since social security benefits are "indexed" in two different ways the result is that beneficiaries will receive back over an average life expectancy much more than he or she contributed. The earnings on which benefits are calculated are indexed--increased--as wages increase and benefits are increased as the cost-of-living increases. <u>No other private insurance system offers such comprehensive indexed protection!</u> Of course it's true that a person who never married and who paid in all his life and dies at age 60 gets no dollar return. But, if he was married and had children, he had 40 years of survivors and disability insurance protection. Even if he or she never married and had no children, they had valuable disability insurance protection! Lucky for them that he never needed to collect. In the same way, how many home owners are unhappy when they pay fire insurance premiums and collect nothing because their house never burns? Or, do not draw on their automobile insurance because they never have had an accident? Or, never draw on their homeowners insurance policy because their home has never been broken into by burglars? But, they did have protection with the premiums they paid.

Social security offers a well-rounded series of five different but related insurance protections based on real lifetime risks. They are disability insurance, survivors insurance, hospital insurance, doctors insurance, and old age retirement insurance. Social security is not only a good bargain, but a very exceptionally good investment for individuals and the nation. And, social security will continue to pay you your benefits if you live to 100 years old or 120 year old and increase your benefits every year by the increase in the cost-of-living. Where can you buy a better policy?

If a person becomes permanently and totally disabled before retirement, he or she can be eligible for disability insurance benefits and receive approximately the same amount he/she would have received if instead of becoming disabled he/she had stopped working at age 62. And, if the person dies at an early age, the widow and children will receive monthly life insurance benefits, in some cases equally to $250,000 in face value of life insurance. Moreover, many people do not realize that about 10 to 20 percent of their total social security contribution is allocated to Medicare for valuable hospitalization coverage when they are 65 or over, become disabled for a long time such as twenty to thirty years or have expensive kidney dialysis or transplants. I wish to unequivocally state, there is no equal protection for the same contribution cost, anywhere. This, in part, is because social security is a gigantic efficient simple group insurance policy. It is administered at only 1.5 percent administrative costs with no salesmen or commissions or high price executives. It has small reserves, no appreciable adverse selection of risks, and no medical examinations or rejections for coverage. No other private insurance system has such a low administrative cost and still operates at such a high level of efficiency of service. It's a real bargain!

Finally, public opinion polls show that an overwhelming proportion of the population supports social security and would be willing to contribute more if the alternative were reducing benefits. However, while senior citizens vehemently oppose benefit reductions, it must be recognized that many younger workers do not like contributing to the Social Security. Due to inadequate and incomplete information received through the media, they now have little faith in receiving their benefits in the future. While there is no factual basis for their conclusion, that probably has always been a characteristic of younger people--to believe that there is only a "present", but no future. They would rather spend their incomes currently than allocate funds for the future. A significant change in attitude occurs, however, when an individual reaches age 35, 45 or 55. Then it is usually too late to adequately prepare for retirement or disability. Unfortunately, prior to Social Security persons who did not plan for the future often ended up on welfare with the next generation paying for their welfare benefits. Now we have a system to reduce the number of aged persons who have to go on welfare by asking persons to contribute during their working years to provide an insurance benefit for those years when they don't work. If we didn't have social security, there probably would be 15 million additional persons in the poverty group.

Congress made the social security contributions compulsory because worldwide experience has showed that when younger persons are permitted the option of contributing or not, many will not elect to contribute and then eventually have to depend upon welfare, their children, charity or eke out their existence in poverty. The nation decided in the years after the 1929 experience that never again can it accept this alternative as a basis for national policy. I continue to support that policy.

Some people object to social security because contributions are compulsory. Others object because these premiums are too high. Some object that benefits are too high; others that they are too low. Social Security is not perfect, but, in my judgment, Congress has done a responsible and intelligent job of reconciling and balancing these factors in the basic law. I believe there will be constructive changes made in the program in the future just as they have been made over the past 45 years. Seven Presidents and every one of the more than 20 different Congresses have made promises to the contributors and the American people in creating and amending the Social Security Act of 1935. I do not think these solemn promises should be broken. I agree with President Reagan that social security is a safety net which should be preserved. I also believe social security is an intergenerational compact between youthful workers and retired seniors which should be solemnly observed. It is not a free lunch. I believe it should be improved but not at the expense of persons who rely on it, plan to retire or who unfortunately die or become disabled in mid-life.

Sudden changes in benefits can't help but disrupt the entire process of long-term planning for retirement. In addition, sudden changes will disrupt the supplementary coverage of insurance plans purchased from private companies. People must plan a long time ahead for retirement. This kind of longer range planning should be encouraged, not discouraged. Repeal of promised benefits will destroy confidence in the entire planning process. Such a fundamental erosion of an important individual responsibility is neither conservative nor responsible. It is a tragedy!

President Reagan needs to do more than merely compromise on the unwise changes proposed by Mr. Stockman and Secretary Schweiker. They need to back off from their irresponsible proposals, start over from scratch and work with Congress to develop a completely sound alternative solution and to consult with the groups involved who have been paying for and receiving the benefits of the program.

Wisdom, Mt.
June 25, 1981

Re: Social Security Modification
Senator Robert Dole 1981 JUN 25 AM 9 02
Senate Finance Committee
Washington D.C. 20510

Dear Senator Dole;

Enclosed is an outline for modification of the Social Security system, first presented to Senator Baucus. He has asked that it be forwarded to your committee for consideration. These ideas represent a fairly radical, long range program that would not necessarily help with the immediate needs of the Social Security program, but I hope have enough desirable features to merit consideration. In trying to be reasonable brief, I haven't addressed the problem of transition from the present to the new plan. I have given the transition period considerable thought though, and if you find the enclosed ideas worthwhile, either Senator Baucus can provide from his file a copy of a follow-up letter, which addresses the transition problem, or I can be contacted directly and will outline them for you.

This new plan would require a worker, upon entering the work force, to make a declaration to:

A. participate in the present system with benefits payable at retirement on a need basis only

B. join the alternate program which would place 3½% of his earnings, matched equally by his employer, in a local bank of his choice in an irrevocable trust, transferable if the worker moves. Thus, an amount representing 7% of his wage would be deposited at interest, with principle and interest redeemable in 40 years. The only condition under which his account could be prematurely released would be in case of his death or total disability, in which case he or his family would receive his trust fund outright.

Projecting these figures forward forty years, an average income of $20,000 invested in his bank at 7% compounded interest would give a worker a retirement lump sum payment of approximately $135,000. One distinct advantage of this program, especially when compared to the present system, would be that it creates a sizeable estate for the average wage earner regardless of the financial burdens or misfortunes that might have consumed his savings during his working years. I also see these side benefits to the general economy and society as a whole:

1) Assuming a 50% participation of workers, local bank deposits would double, on a fixed dollar basis, over a period of 25 years, at which time the

bank trust balances would likely level out.

2) Using 7% as the adopted withholding figure, a worker would realize about a 3% increase in take-home pay or real income (the difference between his present day contribution of approximately $6\frac{1}{2}$% to the present Social Security system and his $3\frac{1}{2}$% contribution in this case)

3) Greatly benefit local communities by having invested locally both the trust proceeds at maturity and some of the trust fund deposits.

4) Help re-establish self dependence as the corner stone of retirement financial security, and return a major portion of retirement funds to the private sector where they would provide a huge reserve of new investment capital.

5) Increase the volume of disability insurance policies written by private insurance companies as workers turn to them for disability protection.

6) Decrease the cost of the employers Social Security participation, thus reducing his operating or production costs.

7) Possibly giving local banks the opporutnity to lower loan interest charges by virtue of the increased volume of deposits.

8) Vastly strengthen our currency and banking system.

9) And again, provide the individual who works for wages the opportunity to build a sizeable estate.

Below I have projected the benefits to a small comminity of 30,000 to 40,000 population with a work force of 10,000 people.

community population	40,000	
workers	10,000	
at 50% participation	5,000	
at $20,000 per person annual salary		$100,000,000
at 7% deposited first year	$7,000,000	
deposited in twenty five years	$175,000,000	

What funds would be available to the local community would, of course, depend on what reserves would be required of the local banks. Nevertheless, the amounts would be considerable. The reserves could be invested in U.S. Treasury Bonds, or a special bond issue and used to help fund payments to Social Security recipients during the traditional program.

I hope these thoughts will be useful to your committee.

Sincerely,

John Eliel

John Eliel
Box 148
Wisdom, Mt. 59761

★ FARM BUREAU ★

★★ the nation's largest general farm organization ★★

STATEMENT OF THE AMERICAN FARM BUREAU FEDERATION
TO THE SUBCOMMITTEE ON SOCIAL SECURITY
AND INCOME MAINTENANCE PROGRAMS
OF THE SENATE FINANCE COMMITTEE
REGARDING SOCIAL SECURITY FINANCING

July 23, 1981

American Farm Bureau Federation
Washington Office — 425 - 13th Street, NW, Washington, DC 20004. Phone: 202-637-0500

STATEMENT OF THE AMERICAN FARM BUREAU FEDERATION
TO THE SUBCOMMITTEE ON SOCIAL SECURITY
AND INCOME MAINTENANCE PROGRAMS
OF THE SENATE FINANCE COMMITTEE
REGARDING SOCIAL SECURITY FINANCING

July 23, 1981

The American Farm Bureau Federation is the nation's largest general farm organization. Organized in 1919, Farm Bureau has grown to a membership of over three million member families in forty-eight states and Puerto Rico.

Farmers are among the approximately 110 million wage and salary earners and self-employed persons covered by Social Security. Farm Bureau members are concerned about the financial stability of the Social Security system. Recent studies and reports continue to emphasize that the Social Security system is on unstable financial ground. This situation exists despite the fact that the 1977 Social Security amendments contained steep payroll tax increases on a sharply increased wage base. That measure was taken to provide solvency of the program into the next century.

The policy adopted by the voting delegates of the member State Farm Bureaus at the 62nd annual meeting of the American Farm Bureau Federation reflects our concern. While the policy is included in its entirety in the appendix, the following excerpts relate directly to the issue of Social Security financing.

I. "The Social Security system is actuarially unsound. The declining birthrate and high unemployment have resulted in fewer workers contributing to the system and inflation has forced benefit increases beyond what was anticipated. To achieve an actuarially sound system, we prefer action to stabilize benefits rather than to increase Social Security taxes."

Additional increases in payroll taxes to finance Social Security would result only in additional financial burdens to both employers and employees. In addition, increases in payroll taxes would reduce incentives to save and invest, and would intensify the criticism of the system by the shrinking pool of younger workers presently financing the retirement benefits of a growing number of retirees who are receiving increasing benefits each year.

Farm Bureau suggests that the indexing procedure for Social Security benefits be modified. In a letter to President Reagan concerning the indexing of major entitlement programs, Robert B. Delano, President of the American Farm Bureau Federation, urged President Reagan to reduce the indexing of entitlement program annual benefit increases from 100 to 75 percent of the Consumer Price Index. A recent study conducted by the Congressional Budget Office indicates that an indexing cap of 67 percent of the CPI, beginning in 1981, could save $96 billion for OASI and Disability Insurance (DI) together during the period of 1981-86. An 85-percent cap could save more than $44 billion, and the 75-percent cap recommended by Farm Bureau could save approximately $70 billion over the five-year period.

We believe that modification of Social Security benefit increases is crucial to the continuation of the system, just as we believe that the success of President Reagan's Economic Recovery Plan depends upon whether "uncontrollable" entitlement programs are brought under control.

II. "We oppose any proposal to finance Social Security benefits out of general revenues or to exempt low income taxpayers from paying Social Security taxes because of the level of their incomes."

The use of general revenues to finance part of Social Security has been suggested by some. However, general revenue financing would have the effect of providing benefits that are not actually financed by the working life contributions of recipients. While the use of general funds might provide an easy answer to some of the system's funding problems, it would also distort its original intent. All workers who benefit from Social Security should be required to contribute to it.

III. "We urge that all government employees, U.S. Representatives and U.S. Senators be included in the Social Security program and that the existing pension plans for goverment employees be phased out."

Ten percent of the nation's labor force is not covered by Social Security. The majority of federal civilian employees and about 30 percent of state and local government employees constitute most of the excluded group. Farm Bureau believes that all government employees--federal, state, and local--should be brought into the Social Security system. The present arrangement of dual retirement programs works to the advantage of Civil Service retirees who work for a minimum period of time in covered employment to qualify for Social Security benefits in addition to their government pension. Universal coverage could eliminate this inequity as well as expand the pool of workers contributing to the Social Security system.

Finally, we offer our support to changes in the Social Security program recommended by President Reagan in his Economic Recovery Plan. This plan, which was endorsed by the American Farm Bureau Federation's Board of Directors on March 3, 1981, eliminates the $122-per-month minimum benefit, eliminates Social Security benefits to adult students, and tightens eligibility requirements for disability insurance. In particular, benefits have often gone to students who do not need them, just as the minimum benefit may be paid to government retirees who have worked just long enough to be covered by Social Security.

We realize that the high unemployment rate and high inflation rate that reflect the depressed national economy have exacerbated the financial problems of Social Security. However, proposals that suggest changes in accounting procedures or allow interfund borrowing do not solve the basic problem. There must be structural changes in the system to reduce the growth rate of benefits by modifying the indexing process and to require Social Security covering for all employees, both private and public.

As previously mentioned, Farm Bureau policy addresses other Social Security issues. These include opposition to taxing benefits, repeal of the retirement earnings test, equitable treatment of spouses who work outside the home as well as those who work within it, the "double bind" that material participation requirements place upon farmers who want to receive Social Security benefits and qualify for special use valuation of farm property for estate tax purposes, and increasing the accumulated wage level and minimum work days requirement for payroll deductions.

Farm Bureau commends the Committee for examining Social Security financing. We appreciate the opportunity to present our comments and ask that they be included in the hearing record.

American Farm Bureau Federation
425-13 Street, N.W.
Washington, D.C. 20004
Phone: (202) 637-0500

February 13, 1981

A FARM BUREAU SPEEDLINE MESSAGE FOR:

The Honorable Ronald Reagan
The White House
Washington, D.C. 20500

Dear President Reagan:

We are deeply concerned with recent newspaper reports that the indexing of major entitlement programs will not be reduced as part of your plan to reduce government spending.

It is the annual indexing of over 20 federal entitlement programs that is the fundamental force behind the explosive growth in federal transfer payments to individuals. Reducing the annual inflation adjustment in these programs from 100 percent of the annual CPI to 75 percent would generate the type of reductions needed to signal the financial markets that the private sector is not going to continue to be crowded out in favor of financing burgeoning federal welfare expenditures which accounted for over $285 billion and almost 50 percent of total federal expenditures in FY 80.

Further, these reductions from scheduled annual entitlement benefit increases would not cut any of the recipients out of their regular benefits, thus, minimizing the political opposition from those who now depend on these programs. On the other hand, entitlement program beneficiaries certainly can be asked to make some sacrifices like everybody else in the short term for the longer-term benefit of controlling inflation in order to maintain the purchasing power of their incomes.

Reducing the indexing of entitlement program annual benefit increases from 100 to 75 percent of the CPI would be the signal that individuals and the markets urgently need to indicate that you and your administration are serious about stopping the growth in the welfare state and pointing this nation in a clear, new direction away from diverting our resources into welfare and toward economic growth and opportunity.

We recognize the importance of cutting federal programs in all areas. However, this approach is more symbolic than substantive in terms of getting to the heart of runaway growth in federal spending. For example, you may cut $18 million in energy credits for the elderly but indexing social security at the full CPI of 14.3 percent in July 1980 will add $17 billion to FY 81 federal outlays. In short, let them keep the energy credits and some of the other basic welfare program benefits; but reduce the annual benefit increases tied to the CPI.

Sincerely,

Robert B. Delano
President

cc: The Honorable George Bush, Vice-President
The Honorable Murray Weidenbaum, Chairman, Council of Economic Advisors
The Honorable David Stockman, Director, Office of Management and Budget
The Honorable Donald Regan, Secretary of the Treasury
The Honorable Beryl Sprinkel, Under Secretary of the Treasury for Monetary Affairs
The Honorable John Block, Secretary of Agriculture
The Honorable James G. Watt, Secretary of the Interior
The Honorable Richard Schweiker, Secretary of Health and Human Services

1981 Farm Bureau Policy
On Social Security

The Social Security is actuarially unsound. The declining birthrate and high unemployment have resulted in fewer workers contributing to the system and inflation has forced benefit increases beyond what was anticipated. To achieve an actuarially sound system, we prefer action to stabilize benefits rather than to increase Social Security taxes.

We oppose any proposal to finance Social Security benefits out of general revenues or to exempt low income taxpayers from paying Social Security taxes because of the level of their incomes.

We oppose the taxing of Social Security benefits.

We recommend that employers and employees continue to share equally in the payment of Social Security taxes. We support the continuation of the separate deduction of FICA (Social Security) taxes to make them clearly identifiable.

We urge that all government employees, U.S. Representatives and U.S. Senators be included in the Social Security program and that the existing pension plans for government employees be phased out.

We urge Congress to separate the income supplement benefits in the Social Security program from the medical benefits. Medical program benefits should be funded with welfare monies.

We recommend that the law be changed to permit Social Security trust funds to be invested in all types of securities.

We favor a revision of the present rules which would provide agricultural employers the option of making employer contribution payments annually. We also support legislation to eliminate excess employer contributions in multiple employment agreements with individuals.

We recommend that the accumulated wage level for Social Security deductions be increased from $150 to $1,000, and that the minimum days worked requirement be increased to 40 days. The accumulated wage level should be indexed to all future increases in the federal minimum wage. We recommend that full-time students 17 years old and younger be exempted from Social Security withholding.

We urge correction of the inequities in the Social Security system with regard to working wives, widowers and others. We oppose elimination or reduction of the benefits now received by a spouse.

We urge early action to bring about a basic change in the Social Security system to permit individuals the option of purchasing approved private retirement plans in lieu of remaining in the system.

We oppose the earned income restriction for those on Social Security.

We support a more flexible interpretation of "material participation" so that retired farmers may reside on their farms and have their crops produced and sold under a crop-share lease without jeopardizing their Social Security benefits or their participation in the benefits of the family farm provision of the federal estate tax law.

We oppose the payment of Social Security benefits to all convicted criminals who are serving sentences in federal and state institutions.

We oppose placing an imputed value on the work/services of the housewife and requiring the husband to pay Social Security taxes on that imputed value.

83-823 O—81——29

TESTIMONY BY MAGGIE KUHN AND JACK ZUCKER

ON BEHALF OF GRAY PANTHERS

BEFORE SENATE FINANCE COMMITTEE ON

FINANCING OF SOCIAL SECURITY: OPTIONS FOR THE FUTURE

Friday, July 10, 1981

Mr. Chairman,

No one in this country is more concerned with the welfare and security of our people than the older Americans. We are the "elders" of the tribe, we are concerned about the problems of all in our nation.

Born in the turn of the century, we built this country. Our labor and dedication made our nation the richest and most powerful in the world. We fought for this country in two World Wars and suffered thru the great depression of the 1930's. We believe that our experience, our expertise, the fact that in these years we learned to interact with each other for the common wealth is of great value to our nation, to our people. We intend to help turn this country around, to lead it to a rational policy for peace and security for all.

The Reagan Administration is not engaged in budget cutting. It is engaged in budget transferring. The Reagan plan to raise the military budget to about 345 billion dollars by 1986 is a program for economic and social disaster.

The increase in military spending has already weakened the country's high technology civilian industries as equipment and skilled personnel are moved from the civilian sector to the military.

American munition makers are perfecting the production of 20 million dollar military planes, plus cost overruns that cost the taxpayer billions of dollars. On the other hand, our military allies, Germany, Japan, France, Holland, the whole European Community are continuing to perfect the basic industries that produce quality consumer goods at lower prices and lower costs. Our steel, auto and other consumer industries operate with outdated machines in inefficient buildings and are daily losing their competitive position, leading to a continuous loss of jobs and greater unemployment.

Further, the transfer of personnel, engineers, high skilled mechanics, the transfer of materials from the civilian sector to the military create material and personnel bottlenecks in the civilian sector and make more difficult the position of American industry.

These pressures on prices and costs, plus the reality that defense products do not add commodities to the market— although providing income for their employees-produce additional demand pressure on consumer goods with consequent increase in prices.

It is no coincidence that inflation increased from one to three percent during the Korean War and jumped to two digit inflation from the Vietnam War on, as our leaders continued their precepitous increase in the production of armaments.

Inflation was further stimulated by the power of the multi-national corporations, like the oil cartel, to enforce non-competitive pricing. Finally the greater demand for military hardware increased pressures for increasing the price of production in the military sector. Thus we see a direct relation between the increase in war production and inflation.

The Reagan-Stockman argument that defense production will decrease unemployment falls flat. The majority of the unemployed are not in the geographic areas of the armaments industry. Most of the unemployed do not have the skills necessary for present military production. Furthermore, the armaments industry is highly capital intensive and requires relatively few high skilled workers. In addition, what happens to the Reagan-Stockman Theses that we need greater unemployment to curb inflation?

Thus in balance, exhorbitant appropriations for armaments increases the inflationary spiral and does not mitigate the scourge of unemployment.

Since the end of World War II, when the U.S. had a monopoly on the Atom bomb, to this very day we have and are spending billions of dollars on nuclear arms--and we are less secure than ever.

We are told that we have the capacity to kill every living Russian one hundred times over, while the Soviet Union has the capacity to kill every American fifty times over. Will we be more secure if we develop the capacity to kill every Russian two hundred times over, while they only have the capacity to kill every American one hundred times over?

This is sheer madness.

Our allies, Germany, Japan, France, Holland, Italy are much closer to the Soviet Union than we are. They border each other. These countries have increased their budget for social services up to thirteen percent, while increasing their military budget by less than two percent. In the Socialist sector, Rumania, Hungary and Poland are adding to their social services while cutting back on defense budgets.

Only the two giants, the U.S. and the Soviet Union are engaged in this crazy armament race. Even China our latest communist ally refuses to commit its wealth and resources to this policy.

Americans are paying a high price for this adverturism. It has and will continue to lead to the impoverishment of the poor, the workers, and those with low and middle incomes. On the other hand, the munitions makers, the multi-nationals continue to reap unconsciable profits. Cost overruns, the productions of material that does not work or is obsolete before it goes off the production line has become a permanent feature of this corruptive process.

The Reagan Administration while cutting the budget in services that are the rights of all Americans continues to subsidize the multi-nationals, the tobacco industry, the sugar industry and others.

The Reagan Administration is not cutting the budget. It has transferred funds that are needed by the poor, the old, the sick into the pockets of the rich and the powerful.

Mr. Chairman, our generation has seen two committees, one headed by a Republican Senator Nye, the other chaired by a Democrat Senator Truman denounce the munition makers. They warned that the munition makers use their swollen profits to influence domestic and foreign policy. In recent years, President Eisenhower, one of the great military leaders, warned the country to beware of the power of the military industrial complex.

We hope the committee will heed these warnings and help turn the country around.

We need an American initiative for a meaningful freeze of the production of nuclear weapons. We need to stop this armament race and begin negotiations for mutual reductions of weapons.

The security of our nation depends upon the health and vitality of our people. We are entitled as a matter of right to life, liberty and pursuit of happiness. We are entitled as a matter of right to freedom from want, freedom from fear, freedom from hunger, freedom from war, rights enounciated by Franklin D. Roosevelt to Congress. We are entitled as a matter of right to a job at decent union wages and working conditions, a right put forth by the Humphrey Hawkins Act, which states that if industry cannot provide jobs, the government must. We are a proud people. We are a strong people. We do not ask for benefits from a benevolent government. We demand our rights. Our generation fought for and won the Social Security program. Its purpose was to stabilize the family unit, to lessen anxiety over loss of income due to retirement, death of family breadwinner, or total and permanent disability.

We believe that any effort by the Administration and Congress to weaken the integrity of the Social Security System at the expense of the recipients is contrary to sound public policy. We ask for a positive program to extend and liberalize the Social Security Program.

We ask that minimum benefits to the elderly on social security and Supplemental Social Security income be raised significantly.

We believe that there should be a semi-annual rather than annual cost of living increase in Social Security and S.S.I. allotments. We are strongly opposed to a separate cost of living index for the elderly. The argument that inflation is less oppressive for the elderly simply is not true. In fact the elderly have many expenses-- especially medical care-- that are in excess of expenses for other population groups.

We need an affirmative policy to eliminate discrimination against women, particularly homemakers in the payment of social security allotments.

We believe that the wages of older workers should be exempted, when calculating social security payments. This is only fair in view of the exemption of those who are fortunate enough to have unearned income.

We call for affirmative program involving government, private industry, organized labor, religious and social organizations to abolish mandatory retirement as a social policy.

We do not believe that there is a crisis in the Social Security System. From its inception, commissions appointed by the President to review the Social Security System recommended that funds be allocated to the Social Security System from the general funds. Another option would be to finance medicare from the general fund.

Mr. Chairman, the American people have a contract with their government. We are not asking for benefits from a benevolent government. We are asking for rights, that we fought and won. The right of every American to a job with decent wages, to decent, housing, security, education is as important as the right to freedom of speech, religion and assembly. They may not be abridged.

A government that fails to protect these rights, a government that fails its responsibilities will face the wrath of the organized people. The people in our nation do not relish an adversarial relationship with those in power. But our history demonstrates that we have the ability to deal with those who betray the interest of the majority of our nation.

We therefore ask that this committee recommends that this Administration reverse the direction of its present policies; policies which in our opinion will create greater suffering, greater poverty for older Americans, indeed for millions of others.

STATEMENT OF

THE HEALTH INSURANCE ASSOCIATION OF AMERICA

ON

SOCIAL SECURITY FINANCING PROPOSALS

Submitted to

SUBCOMMITTEE ON SOCIAL SECURITY

SENATE FINANCE COMMITTEE

July 20, 1981

The Health Insurance Association of America is an organization of over 300 insurance companies that underwrite more than 80% of the private disability insurance in the United States. Our statement confines itself to issues concerning the Social Security disability insurance program.

It was our privilege to testify before this Subcommittee in support of the Social Security disability amendments of 1980. In that testimony, we highlighted the importance of financial motivation in encouraging people to return to productive work and the debilitating effects of benefits that allow a claimant a higher standard of living than he enjoyed before his disability without having to work. These concepts, which have been an absolutely essential ingredient to providing private disability insurance for a hundred years, are now well established in the public sector as well. But by way of reference and as a reminder, Table A, submitted with this statement, is a repetition of Exhibit II to our testimony before the Senate Finance Committee, October 9, 1979.

We have been much impressed by the proposals made by the Administration and the seriousness with which it is addressing the financial crisis facing the Social Security system. Improving administration to reduce benefit payments to ineligibles has great promise for reducing costs and motivating the recovery of those able to return to productive employment. No legislation is needed to accomplish this objective, but enormous energy and dedication will be required of the Social Security Administration.

The elimination of the minimum benefit will impact disability benefits very little, but it deserves support.

We agree with the Administration's proposals to institute tests to establish recent attachment to the labor force under which a claimant would have to have worked in 30 of the last 40 and 6 of the last 13 quarters at the time a disability begins in order to link disability to real lost earnings.

Appeals to the effect that vulnerable people would be excluded by this test are inappropriate since such people were not earning income prior to being disabled. They must have had some other means of support. Hence, why should they receive disability benefits rather than some other means of support when actual earnings have not been lowered.

We believe that most of the latest disability recommendations proposed by the Administration merit serious consideration and are responsive to the financial problems facing the Social Security program. Those that we believe may hold the most promise of reducing the financial strain on the system, with minimum adverse impact on the most needy beneficiaries, are the following:

1. Increasing the bend points in the primary formulas by 50 percent (instead of 100 percent) of wage increases, 1982-1987. This proposal will gradually reduce replacement ratios, which are out of line with historical ratios, to levels prevailing in past years. This proposal should help limit the necessity for further tax increases and would restore the system to its original purpose.
2. Increasing the disability waiting period from five to six months. Since most private insurance temporary disability group plans provide benefits for up to six months, we believe this recommendation would have little adverse effect on beneficiaries. We also believe this recommendation is consistent with the original concept of the program.
3. Requiring disability prognosis of 24-month duration (instead of 12 months). We believe this proposal is consistent with the intent of the program to provide benefits for permanent and total disability. The prognosis of 24-month duration of disability will help to assure that benefits are not awarded to those with temporary disabilities, who should make provision for private protection.
4. Move the date for automatic benefit increases from June to September (and using 12-month) average. We believe this recommendation will have little impact on current beneficiaries and has merit as a short-term cost saving measure.

We also support the Megacap proposal that has been approved by your Committee as part of the budget reconciliation process as a valid way to prevent overinsurance and motivate recovery. However, this proposal leads us to bring up two questions that have previously been asked, but have not been addressed. The first of these is whether it is desirable to use the same formula for disability benefits as is used for retirement benefits, and the second is whether or not disability should be treated in the same way as death or retirement in dealing with family benefits.

A disabled worker, prior to his disability, can have been in one of three situations. First, he may have been an unmarried person supporting no dependents. Second, he may have had a dependent spouse and children not in the labor market. Third, he may have had a working spouse, with or without dependent children. None of these situations had any influence on how much he has earned in his job. His rate of earnings had depended entirely upon his own education and ability in the industry in which he is engaged. Why, then, should his Social Security disability benefits vary according to the family's situation.

As it is, in the first of the situations described, the primary insurance amount would be paid. In the second, the primary insurance amount plus family benefits (up to the maximum family benefits) would be paid. In the third situation, the primary insurance amount would be paid if there are no dependent children, and family benefits would be paid on behalf of the dependent children, if any. We see no logical reason for such a formula.

The benefit formula for the primary insurance amount and the maximum family benefit now produce widely differing replacement ratios in all these situations. One may ask whether providing this diversity of results in a social insurance program may be carrying the idea of social insurance too far. We suggest that Congress might consider removing the dependents from the Social Security disability benefit formula and providing for them on a needs basis where public and private sector disability benefits combined do not attain minimum standards. We believe that the Social Security disability benefit ought to provide a floor of protection based upon a relatively recent earnings test and ought to produce, for any worker who has become disabled with a given earnings record, the same benefit as it does for any other worker with the same earnings record. We further believe that we should consider a fundamental change in the Social Security disability benefit formula to a simpler one that relates to years of covered employment and a more recent period of earnings such as the last five years or the last three years. Such a formula could be graded to produce more reasonable after-tax replacement ratios. While we have not at this point prepared to recommend a specific formula, and 1981 will clearly not allow time for one to be developed and thoughtfully considered by Congress, we think the following approach should be researched for later consideration.

The kind of benefit formula we propose would produce an initial disability benefit that would be a percentage of the average of the net earnings of the beneficiary over a group of recent years. This could be, for example, a percentage of the average earnings of the highest three of the most recent five years, or of the AIME for the most recent five years, whichever is greater. The point is to choose a formula that will reflect the most recent years of earnings but will allow the selection of some earlier years in the case of an individual whose earning power may have been gradually eroded by a debilitating disease such as multiple sclerosis that ultimately results in total disability. Post-qualification indexing could then proceed substantially as at present, although we are not convinced that the CPI is the most equitable index when applied to tax-free income.

The actual percentage ought to be graded according to the level of earnings of the disabled worker in order to preserve the progressive nature of the benefit and the social purposes of the program along the lines suggested below.

After-tax net earnings would have to be developed by a relatively simple formula that would ignore state and local taxation (which differs from state to state) and non-earned income such as interest, dividends, rents, and royalties. One possible approach would be to use reported W-2 or FICA type wages, commissions and fees only, and to use a hypothetical income tax based on the standard deduction in order to avoid unfair results arising from individual situations and possible difficulty of retrieving actual data. We are preparing some models to test this approach, and we hope to present them to Congress later this year for possible consideration in 1982.

We appreciate the opportunity to present these concepts to you. We look forward to the opportunity of discussing these ideas with you and your staff in the near future.

TABLE A

GROUP LONG-TERM DISABILITY INSURANCE
(Six-Month Elimination Period; Calendar Year of Issue Excluded; All Ages, Males, Females, and Sex Unknown Combined)
Calendar Years of Experience 1969-73

	LIFE YEARS EXPOSED	RATIO OF ACTUAL TO EXPECTED CLAIMS
Ratio of gross benefit (before reduction for integration) to salary:		
Always less than 50%	16,326	52%
Generally less than 50%	45,655	118%
Subtotal (less than 50%)	61,981	99%
50% (exactly or approximately)	628,303	87%
Always more than 50%, exact % unknown	38,648	148%
Generally more than 50%, exact % unknown	32,377	153%
More than 50%, but less than or equal to 60%	513,924	93%
More than 60%, but less than or equal to 70%	56,687	106%
More than 70%	23,824	219%
Subtotal (greater than 50%)	713,976	109%
Other, including not determinable	64,162	71%
Total salaried, nonexecutive	1,468,922	97%
Other income sources included in plan integration provisions:		
Nonintegrated (benefits paid in addition to Social Security)	440,194	110%
Social Security primary benefit only deducted	248,824	97%
Social Security primary and family benefit deducted	761,021	91%
Other integration bases	18,383	77%
Total Salaried, nonexecutive	1,468,922	97%

SOURCE: Transactions of the Society of Actuaries, 1975 Reports Number, P. 266 & 267

A STATEMENT

ON BEHALF OF

THE JOINT PUBLIC AFFAIRS COMMITTEE

TO

THE UNITED STATES SENATE COMMITTEE ON FINANCE,

SUB-COMMITTEE ON SOCIAL SECURITY
AND INCOME MAINTENANCE PROGRAMS

ON

SOCIAL SECURITY FINANCING AND OPTIONS FOR THE FUTURE

TUESDAY, JULY 7TH, 1981

A STATEMENT

ON BEHALF OF

THE JOINT PUBLIC AFFAIRS COMMITTEE

BEFORE

THE U.S. HOUSE SELECT COMMITTEE ON AGING

SUB-COMMITTEE ON HUMAN SERVICES

ON

PROTECTING THE SOCIAL SECURITY SYSTEM

MONDAY, JUNE 1, 1981

AT

One Police Plaza

NEW YORK CITY

83-828 O-81——30

JPAC for Older Adults

JOINT PUBLIC AFFAIRS COMMITTEE / 40 West 68 Street / N.Y., N.Y. 10023 / 724-3200

Sponsored by Jewish Association for Services for the Aged (JASA), YM-YWHA and other senior centers throughout metropolitan New York

My name is Esther Frieder, and I am here to speak on behalf of the Joint Public Affairs Committee (JPAC), whose central headquarters are located on 40 West 68th Street in Manhattan.

JPAC is a citizenship action coalition of older adult representatives of 80 senior centers sponsored by The Jewish Association for Services for The Aged (JASA), Associated YM-YWHA's, Independent Y's, and other groups located throughout Metropolitan New York. I have actively worked as a JPAC representative over the past few years and presently serve on its advisory committee.

The subject of Social Security is the most critical topic of concern among older people today. The majority of us depend on our Social Security Benefits as the backbone of our very survival.

Throughout our lives, we worked hard to shape and build this country for ourselves and for our children. We did so with the understanding that based on our long years of hard earned contributions, we would be able to retire with dignity and a semblance of economic security. This was a contract entered into in good faith. Yet now, many of our elected officials are proposing to breach this contract by slashing benefits once considered sacrosanct.

Even as it stands now, Social Security Benefits average only about 42% of pre-retirement income. Inflation hits older people on fixed incomes the hardest, especially in New York where the costs of health care, housing, and energy are skyrocketing. Vast numbers of older people are already struggling just to meet the costs of these basic necessities. Many older people faced with high fuel bills this winter were forced to pay for heat at the expense of hot meals. These are choices that no one should be forced to make.

It is for these reasons that I am here today to impress upon you the urgency of protecting and preserving Social Security Benefits for the older population of today and of the future. Clearly, the Social Security System must be strengthened to provide a secure retirement for our nation's people. Attacking this very security with plans to reduce Social Security Benefits for early retirees (who are, for the most part, forced to retire due to ill health, unemployment, obsolete skills, etc.) is both cruel and in direct contradiction with the goals of the Social Security System.

Proposals to reduce the cost of living increase formula, and/or to delay cost of living benefits,would inflict serious hardship on our older citizens. The cost of living calculation already underestimates the high cost of medical care and heating, two of the most inflation ridden items in our country, which older people must use more heavily than the general population.

Cost of living benefits, granted in July, reflect inflation of the year just completed. Thus as inflation mounts from month to month, older people are forced to continue living on benefit levels designed to meet the lower cost of living of the previous year. A further delay would even more dramatically reduce the buying power of these dollars. It is unconscionable to consider reducing taxes for the wealthy while asking the most vulnerable members of society to tighten belts already on their last notch.

The people of this nation know that we can afford to supplement the Social Security System through the use of General Revenues as needed to get us through times of crisis. Surveys have shown that the majority of the public supports <u>increases</u> in Social Security Benefits, not decreases. The mandate of the people is not to sacrifice the lives and well being of its elderly to finance massive increases in military spending. I call on you to oppose the cruel attacks on the Social Security System - now creating panic and outrage among citizens close to or at retirement.

What does President Reagan expect the older generation and the children of our nation to do? Social services are being slashed drastically. The elderly now live with the terrible fear that they will be left helpless and hopeless.

We are supposed to be a humanitarian country, not only providing for our own citizens, but for those of other nations.

I call on you to go back to the other members of Congress and the President and fight to protect and preserve the benefits of the Social Security System to which we are rightfully due.

Thank you for this opportunity to express our viewpoint.

COMMUNITY COUNCIL OF GREATER NEW YORK

225 Park Avenue South • New York, N.Y. 10003 • (212) 777-5000

WRITTEN TESTIMONY

submitted to the

SUBCOMMITTEE ON SOCIAL SECURITY
SENATE FINANCE COMMITTEE

RE: REAGAN ADMINISTRATION's
RECENT SOCIAL SECURITY
PROPOSALS.

Presented by

SUSAN K. KINOY

ASSOCIATE EXECUTIVE DIRECTOR

COMMUNITY COUNCIL OF GREATER NEW YORK

July 6, 1981
2227 Dirksen Senate Office Building
Washington, D.C. 20510

84-079 379

RESEARCH AND EDUCATION FOR ACTION IN THE PUBLIC INTEREST
FUNDED BY THE GREATER NEW YORK FUND

My name is Susan K. Kinoy. I am the Associate Executive Director of the Community Council of Greater New York and staff to its Citizens' Committee on Aging.

The Council is the information, research, convening and advocacy center for the welfare and health organizations in New York City. Its Citizens' Committee on Aging is composed of the major voluntary and City agencies as well as representation of the aging themselves. It is concerned with the problems of older people in New York.

In 1977, we sponsored a major forum entitled, "The Future and Function of Social Security". In 1979 we held a second forum on Social Security entitled, "The Urban Aged Today and Tomorrow". As recently as December 16, 1980, the Citizens' Committee on Aging in cooperation with the New York City Department for the Aging, held an all day Technical Meeting on income adequacy at which Social Security was emphasized as a major concern.

I will be pleased to offer to your Committee written reports of three Conferences on Social Security. They speak in detail about some factors which I will stress in today's testimony.

In general, it was recommended at the latest meeting that the Administration "hold the line" in relation to Social Security benefits.

"
- The present benefits, now provided to all beneficiaries, must be protected.
- The criteria for measuring the cost of living for older people should more adequately reflect their major expenses, i.e., food, housing, health, utilities, transportation, etc.
- The Social Security Trust Fund should be removed from the unified budget and reinstated as an Autonomous Trust Fund.
- Universal and mandatory Social Security coverage is necessary.
- Social Security should be safeguarded by the use of General Tax Revenue Funds in addition to employer and employee contributions.
- Full benefits should continue to be provided at age 65.
- Recognizing that minority elderly have a lower life expectancy and often lower incomes than white elderly; special provisions for this group should be made.
- It is further suggested that certain improvements be made in the system. Among them were:
- The recommendation of the 1971 White House Conference on Aging that the standard of income adequacy should be based on the intermediate budget for couples needs to be reaffirmed.
- Budgets of individuals should be not less than 75% of couples' budgets.
- Cost of living adjustments in Social Security and SSI should take place twice a year.

- Liberalization of Medicare should take place with provision made for National Health Insurance.

The recommendations just read were not made frivolously. In the opinion of the Citizens' Committee on Aging and many experts, the Social Security system is not in imminent financial danger nor would the continuance of present benefit levels seriously undermine the financial stability of the entire Social Security system or of the Federal Government itself.

A major question which your Committee might wish to address is whether or not the cutting of benefits to Social Security recipients will have any effect on the solvency of the Social Security system. We repeat: Many experts state that the proposed cuts will not serve as a major deterrent to this nation's inflationary problems, nor will they make much of a dent in terms of balancing the Federal budget.

Sylvia Porter, who writes a widely syndicated financial column, noted on Thursday, March 26, 1981: "There is absolutely no basis for anyone to panic over the short-term financing problem our Social Security system will face between now and 1985. Uninformed talk about the program 'going bankrupt' is vicious rubbish." Ms. Porter went on to state that Social Security is one of the most visible and most vital victims of double-digit inflation and a sluggish economy. She noted that in the fiscal year ending September 30, 1981 the combined disbursements for retirement, survivors and disability benefits, plus hospital insurance payments under Medicare will come to $172 billion. Income from Social Security taxes in the same period is estimated at $170 billion. A $2 billion shortfall would be no problem, because there is $39 billion in reserves in the three Social Security Trust Funds. Ms. Porter, along with many other experts calls for borrowing funds in order to assist in balancing the temporary cash shortage. Solvency is not the problem. If economic conditions do pick up, Ms. Porter estimates that the shifting of some of the Disability Insurance Trust Fund reserves to the Old Age and Survivors Insurance Trust Funds might be sufficient to cover all benefit payments for the next fifty years. Borrowing between Trust Funds could be supplemented by some limited transfer of general revenues in 1984-85. It should be remembered that authority to draw on general revenues was in fact included in the Social Security law for a time - from 1944 to 1950.

The changes discussed above are predicated on the Social Security tax hike that is scheduled for 1985. It must be noted that, in general, people do not object to increasing Social Security taxes so long as they can be guaranteed a sound retirement system. A recent poll conducted by Harris Associates for the National Commission on Social Security showed that a majority of working people preferred the higher tax rates as an alternative to later retirement or to reduced retirement benefits.

Another recommendation made by many experts to improve the financial stability of the Social Security system is that all persons, including Federal employees, be covered by Social Security. Bringing all Government employees into the system would provide it with increased solvency.

The basic stability of the Social Security system is related to the economy of this country. Long-range planning for Social Security should not be based solely on this year's employment indicators. If more persons are employed at adequate salaries, and more funds are deposited by employees and employers in the Social Security Trust Funds, there will be more than adequate dollars to pay for increased Social Security benefits.

LIVING TODAY ON SOCIAL SECURITY RETIREMENT BENEFITS

It should be noted that Social Security is the backbone of income for most of this nation's aging population. Today's older beneficiaries in New York City, prior to any of the projected cuts, do not even have sufficient income to maintain themselves at the Bureau of Labor Statistics Lower Budget Level.

Costs of Living and Adequacy of Social Security Benefits

The BLS Autumn 1979 Budgets updated to April 1981 by the Consumer Price Index for all Urban Consumers, indicates that a retired couple would need $627 per month to live at a BLS Lower Budget Level in the New York-Northeastern New Jersey area. At the BLS Intermediate Level, it is estimated to cost a retired couple $937 per month. Food at home and housing absorbs over two-thirds of the entire budget of both standards.

The average U.S. couple receiving Social Security benefits would need additional income to live even at the BLS Lower Living Level in the New York City area. Only a retired couple receiving benefits near the maximum of $1,016 would have income sufficient to maintain the Intermediate Level Budget.

Although not directly comparable, because the average benefit and award may be higher in the New York City area than in the U.S. as a whole, the average monthly benefit of $506 for a retired couple in May 1981, fell $121 short of the cost of the BLS Lower Budget. The average monthly award to a newly retired worker and spouse, retiring in that month would be $539. This left a gap of about $88 for the newly retired workers and their spouse between their OASDI benefit income and the cost of the Lower Level Budget.

Given the above stated facts, it is apparent that any reduction in benefits would impose severe hardship on Social Security beneficiaries.

It follows that we oppose the proposed delays and alterations in Social Security cost-of-living adjustments.

The average employed person with a much higher income than a retired person,obtains dollar increases roughly three times that of cost-of-living grants provided to Social Security beneficiaries. Older persons have a greater need for expensive heating and expensive medical costs than working persons.(1) Cost-of-living adjustments, whether delayed or reduced, would prove a cruel hardship to the vast majority of Social Security beneficiaries, as the aging attempt to cope with inflation.

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(1) Dr. Merton C. Bernstein, Coles Professor of Law, Washington University, New York Times, May 17, 1981.

EARLY RETIREMENT

One of the most serious and frightening aspects of President Reagan's Social Security proposal relates to early retirement. He proposes to cut approximately one-third of promised benefits to persons at age 62 starting next year. Furthermore, reductions are called for in benefits to persons aged 62 to 65 based on the addition of three countable years in the income averaging formula.

It seems incongruous that only a few years ago, the New York City administration, the automobile industry, and other businesses undergoing financial problems were urging persons to take early retirement. They argued that this would reduce private pension costs and would open jobs for younger workers. The recent proposal tells workers that they are expected to remain in the work force, even though we have not seen a significant increase in the numbers of jobs available. This will create hardships on early retirees.

The proposed cuts in early retirement benefits will fall most heavily on women and minorities. In this society, in the year 1981, members of minority groups frequently have lower paying jobs than non-minority members. Therefore, if persons who are Black or Hispanic are forced to take early retirement, their benefits will be proportionately lower than members of other groups. Secondly, because salaries for women are lower than salaries for men, it follows that if a woman is forced to take early retirement, her benefits will be proportionately lower than those of a man in the same position. Since women have a longer life span than men (both in the minority and non-minority categories), the imposition of lower early retirement benefits will fall most heavily on minority women.

Robert Ball has noted that about 70% of those persons who choose early retirement, do so involuntarily. On the one-hand, these persons may be worn out, burned out, ill, but unable to obtain SSI or Disability Benefits. On the other hand, they may have lost their jobs, been displaced from the job market and unable to be retrained or rehired after age 50 or 55. Many of these persons may have run through their Unemployment Insurance Benefits.

The first examples of hardships relating to early retirement I will describe are health related.

Mr. A is 56 years of age. He has worked in a hospital as a dietary worker for the past ten years. His responsibilities include hard work, i.e. the lifting and washing of pots, mopping floors, moving tables and chairs. This year he applied for Disability Benefits because he is a diabetic and has developed serious cataracts in both eyes. The doctors have not permitted him to continue to work. He is not eligible for Disability because after his eye operations,he will not meet the stringent Disability eligibility requirements. Mr. A made application for SSI, but that application was denied because he was slightly over the financial eligibility level. Mr. A will have to go through his Unemployment insurance and most of his savings until he reaches age 62. Under the Reagan proposal, at age 62, in 1987, he would obtain monthly benefits of between $225 and $348 per month. Under the present law he would receive between $384 and $581.

Martha Green is 62 this year. She has worked as a Nurses Aide in a hospital for sixteen years. She has chronic high blood pressure and a slight heart condition. Her doctors have advised her to discontinue her heavy work of lifting patients, trays and equipment and being subjected to the tensions of a hospital ward. She does not qualify as seriously ill enough to obtain Disability Benefits, nor is her income low enough to obtain Home Relief or SSI. This person's retirement income under the Reagan proposals would be approximately $246.80 or less per month.

It is fortunate for Ms. Green that she worked for ten years. A person with the same medical problems as Ms. Green and receiving the same income, who was forced to retire after seven years of work, would receive no Social Security at all. This would be caused by the proposed elimination of minimum benefits. Under the present law, she would, at least, obtain a minimum benefit. This hard-working person would be forced to go through most of her savings until she could qualify for SSI or Welfare.

The second category of persons for whom early retirement is a serious burden are those forced out of employment.

Mr. Garcia, aged 62, is typical of this group. For thirteen years she has been a skilled sewing machine operator in women's sportswear in New York City. Her shop closed. The business was relocated in a Southern state. Mrs. Garcia has a language barrier. She has had no opportunity to learn another trade. She is not disabled. For her and her family the cut in early retirement benefits may force her on to Public Assistance.

CUMULATIVE EFFECTS OF BUDGET CUTS

After examining the most recent Reagan proposals which seek to slash or eliminate Social Security benefits to retirees, to the disabled, and to children, the conclusion is reached that these will bring severe hardship to all categories of beneficiaries.

The cuts become catastrophic for beneficiaries when they are combined with projected slashes in other vital services. It is well known that medical care is a major budget item for the aged. However, increased costs for co-insurance and deductibles in Medicare are being proposed. How will these be paid if Social Security benefits are decreased? In addition, cuts are being called for in Federal payments for Medicaid. Furthermore, the administration has proposed reducing food stamps and lowering both housing and fuel subsidies.

We urge the administration to analyze the total budgets of recipients of Social Security before any cuts are projected.

EFFECTS ON CHILDREN

It is of deep concern to us that as hearings on the adequacy of the Reagan proposals on Social Security benefits for retirees are being promulgated, that the proposed cuts in benefits to their children are not over-looked. Retirees are deeply concerned about their grandchildren and the children of young persons with whom they come in contact.

A senior retiree told me the other day about his daughter who is a widow. Her children now are aged 8, 10, and 15. Although this young widow works, it is the Social Security benefits to her children that permit this family to survive and to look forward to adequate college or technical educations. My senior friend said: "I do not want to be a burden on my daughter, and right now I can't possibly help her financially. What will happen to me, my daughter and my grandchildren, if these cuts go through?".

CONCLUSION

Planning for retirement is a long-term affair. It is unfair to impose changes in Retirement Benefits on workers now forty or fifty years of age, who have been in the work force for many years. They have calculated their retirement benefits with care and have established long-range plans. I heard a young worker talking with a retiree the day after the Reagan cuts were proposed. The worker said, "You are lucky. I hope that you will be 'grandfathered in', but my retirement benefits due in fifteen years will be slashed." The retiree replied: "Yes, it will be terrible for you and young people. However, if our cost-of-living adjustments are cut back and inflation continues to soar, we will be in the same sinking boat very soon."

During the past few weeks, thousands of aging persons have written and called the President and their legislators objecting to the proposed cuts. In response, the Administration now states that a "compromise plan" will be promulgated. The Citizens' Committee on Aging will oppose any compromises

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that mean radical or gradual reduction of benefits for present or future Social Security beneficiaries.

I conclude with a quotation from a retired member of the Amalgamated Clothing and Textile Workers Union:

> "Let the leaders of our nation work for the welfare of all retired people who are living on Social Security. We have suffered long years of hard work to be entitled to these benefits in later years, . . . We should have justice, peace of mind, and be able to live in dignity."

TESTIMONY BEFORE THE

SENATE FINANCE COMMITTEE

SUBCOMMITTEE ON SOCIAL SECURITY

FRIDAY, JULY 10, 1981

BY

ARTHUR W. MICHAEL

My name is Arthur W. Michael and I am president of two corporations located in southcentral Pennsylvania.

1. Tam Agri Corporation, located near Harrisburg, PA, is a corporation formed in 1974 and installs grain handling, feed processing equipment and steel buildings for the agricultural market.
2. Tam Services Corporation is located near Gettysburg, PA. The corporation was formed early 1981 and purchases an existing John Deere implement business. This business is directing totally to the agricultural market.

The following chart applies to the Tam Agri Corporation and is submitted to clarify points that will be made in my presentation.

As the chart indicates, this corporation is dependent on a high percentage of labor for installation of its equipment. In 1980, 21.5% of the total sales involved labor. Because of this, we are contributing an excessive amount of social security tax (2.6% of total sales.)

Tam Agri Corporation employs 27 persons on a full time basis. Our oldest full time employee is 54 years of age. Upon retirement at age 65 she will be our first person to draw Social Security. Based upon the contributions of the past five years and projecting on the 1980 level of contribution, the employees and Tam Agri will have paid approximately $728,000.00 into the Social Security System. <u>We have no assurance that funds</u> will be available for her at the time of her retirement eleven years from now!

Imagine that, twenty seven people and Tam Agri will have made nearly three quarters of a million dollars in contributions over eighteen years and no one can guarantee my employee that she will receive one nickel in benefits! If we were to handle a private pension plan that way, we'd probably be thrown in jail.

The average age of our employees is 33 years. With the constant reference to the social security system going broke, our employees are asking why they are forced to contribute to this fund. These same people are pressuring us to provide them a safe, sure retirement plan they can count on. With the high rate we are currently paying to FICA we can't possibly afford to fund a private retirement plan.

As an employer, I feel responsible for the financial needs of those who are part of our corporation. Current levels of contributions to FICA are making it impossible to increase salaries and provide the long range benefits that we should be funding.

Current obligations to FICA are forcing us to change our marketing strategy. We are promoting products that require less labor to install. This will push more people into unemployment in the long run. Small businesses generate most of the new jobs in our country, but at current levels of taxation we won't be able to continue to do this much longer.

The accompanying chart shows some interesting facts. Tam Agri pays more in social security taxes than Federal income taxes. We actually paid less in income taxes than shown on the chart because of the use of investment tax credits. We have shown the amount of income taxes before credits to illustrate the point in an undistorted fashion.

Social security taxes are one of our largest expenses. As an example, we paid more social security taxes in 1980 ($25,000) than we spent on utilities, advertising, rent <u>or</u> <u>interest</u>! At least with interest there is some hope for slight relief in the future. I can't pretend that I have any answers to the problem, but I can say that the solution cannot lie in higher FICA taxes. Further increases will just force us into personnel changes that we would rather not consider. As I see it, the problem is not one of insufficient funds. How can it be? We'll pay in nearly $750,000 <u>before</u> any of our employees is of retirement age. That seems like enough money to us. You can't urge job creation on one hand and tax it heavily on the other. As a businessman, I have to look at all my expenses and attempt to control or reduce them. If the FICA tax continues to grow as a significant expense I must try to control it. The only way to do that is hire fewer people. I don't want that and I don't think anyone else does either.

		SALES	PAYROLL	TOTAL FICA	EMPLOYER FICA	FEDERAL INCOME TAX (1)
1980		1,925,000	414,000	50,000	25,000	9,000
	% Sales		21.5	2.6	1.3	.5
1979		2,560,000	352,000	42,000	21,000	15,000
	% Sales		13.7	1.6	.8	.6
1978		1,604,131	301,000	34,000	17,000	12,000
	% Sales		18.8	2.1	1.0	.8
1977		1,607,000	265,000	30,000	15,000	15,000
	% Sales		16.5	1.9	.9	.9
1976		1,031,000	185,000	22,000	11,000	4,000
	% Sales		17.9	2.1	1.0	.4

(1) Before tax credits

Statement
of the
National Conference of Catholic Charities
to the
Finance Subcommittee on Social Security and Income Maintenance Programs
United States Senate
on
SOCIAL SECURITY FINANCING AND OPTIONS FOR THE FUTURE

Hearings: July 7-9, 1981 Submitted: July 16, 1981

The National Conference of Catholic Charities appreciates this opportunity to present its concerns about proposals to reduce benefits under Social Security Old Age, Survivors, Disability and Hospital Insurance. These cuts have been described as a necessary measure to assure the fiscal integrity of the Social Security system.

We are concerned that there has not been adequate consideration to addressing the Old Age, Survivors trust fund shortage by increasing the income to the trust fund. In fact, the Reconciliation Bill deals solely with cuts in benefits as the means to balance the trust fund. We urge reconsideration of this approach. Under a system of current-cost financing, fluctuations in reserves are to be anticipated because of changing demographics and economic shifts. In fact the 1981 Social Security Trustees Report indicates that the forecasted shortfall to the Old Age Survivors trust fund for 1982-1985 will be followed by a surplus until after the turn of the century. It is important therefore that in addressing the shortages clear distinctions be made between the remedies proposed to address the immediate shortage of 1982-1985 and those to address the long range shortage after the turn of the century.

The Social Security system stands as the major bulwark against the loss of wages because of retirement, death or disability of a wage-earner. The immediate crisis of a shortage in the fund should not be dealt with so as to create unnecessary and irreparable damage to the benefit system. The most appropriate way to remedy the immediate shortage is to adopt a procedure which has the capacity to advance supplemental funds to the extent necessary to assure continued payment of benefits until contributions to the fund restore the fiscal stability lost through the last several recessions. We strongly urge the committee to consider the several alternate proposals that have been suggested to bolster the trust fund income. Benefit cuts do not confront the reality that, with current-cost financing, the trust fund will reflect the social and economic fluctuations of our society and that the true stability of social security grows out of the commitment made between the young and old of this country many years ago. The Social Security system will fail if it loses the confidence of current contributors in the viability of the intergenerational compact. The elimination of benefits to current beneficiaries is as threatening as forecasts of financial shortages.

The retroactive elimination of the minimum benefit is perhaps the most dramatic example of a breach in the commitment to assure minimum income benefits to retired workers. Under this proposal, 3.1 million current beneficiaries would have their benefits recalculated to reflect actual earnings histories. Two million of them will receive reduced benefits. Although many will be entitled to receive supplemental security income, this is not a satisfactory alternative for these seniors.

The Social Security system is not a private insurance program—not in its financing and not in its benefit structure. In viewing the stability of Social Security, it should be remembered that from its inception Social Security has maintained a balance between the two concepts of social adequacy and individual equity. The social adequacy principle is evident in the provision of the minimum benefit, a benefit formula that is weighted in favor of low-paid workers and the provision of benefits for dependents. The concept of individual equity is evident in the method of determining benefit levels which are wage-related and, in general, are designed to provide a higher benefit to the individual who earns more and contributes more. In 1972, Congress established a mechanism to index future benefit levels so they would automatically adjust to increases in inflation and the cost of living as measured by the Consumer Price Index.

This balance between social adequacy and individual equity uniquely characterizes the social insurance nature of the Social Security system. As national income is distributed pursuant to these principles, imbalances among people are reduced. Attempts to deal with fiscal soundness of the trust fund through reductions in the social adequacy benefits is a significant and unwarranted departure from the basic nature of Social Security as a social insurance program.

We are particularly concerned about proposals to reduce benefits to those who elect early retirement. In fact, this election is most often not voluntary. As has been recognized through several administrations, persons claiming benefits before age 65 often do so because their health has deteriorated to the point they are no longer able to work, but not to the point they are able to qualify for disability benefits. Others have lost their jobs and are unable to find suitable work. Supplemental Security Income (SSI), being a means tested program and requiring periodic recertification, is not a viable alternative. The intergenerational compact promises replacement of wages lost through age, death and disability while preserving the financial security built during one's working years.

It is reasonable that retirement age policy be adapted to labor market conditions. The original Social Security program was enacted when the national unemployment rate was about 20%. Again, early retirement benefits were extended to men 62-64 in 1961 when the post World War II baby boom swelled the labor force and the number of women workers began to increase.

At a time when reduced labor forces are antipated, we support policies which encourage continued employment after retirement age. We must oppose, however, a change in policy which would reduce benefits to those eligible to elect early retirement, particularly when there is no concomitant proposal to assure benefits for those whose retirement choice is not truly voluntary.

In fact, many administration proposals would limit coverage and benefits for those who are disabled by requiring a stricter employment test and a medical-only eligibility criteria. Such proposals are not in keeping with the social insurance character of Social Security. They unduly impact on women, minorities and the aged 60 to 65 who have no alternative resources and who therefore face destitution. "Medical need only" as a criteria for eligibility ignores the reality facing those aged 60 to 65 whose inability to work includes non-medical factors such as age, skills and employment opportunity. Such an eligibility requirement would deny them financial security after many years of contributing to social security. Current eligibility criteria should be preserved as more adequately protecting workers. Since the fiscal integrity of the disability trust fund is not in jeopardy, cuts in this area appear solely intended to reconstruct the benefit element. It is unjustifiable to reduce benefits without a full discussion of its impact on beneficiaries and sufficient time within which public policies may be adopted to protect those likely to suffer hardship.

Motivated by the teachings of our Church, we clearly affirm:

> "A human being has the right to security in cases of sickness, inability to work, widowhood, old age, unemployment, or in any other case in which he is deprived of the means of subsistence through no fault of his own. . . It is necessary that governments make efforts to see that insurance systems are made available to citizens, so that, in case of misfortune or increased family responsibilities, no person will be without the necessary means to maintain a decent standard of living."

John XXIII, Pacem in Terris, Ch. 11, 329

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STATEMENT

OF

THE NATIONAL EDUCATION ASSOCIATION

ON

CURRENT SOCIAL SECURITY FINANCING PROPOSALS

BEFORE

THE

SUBCOMMITTEE ON SOCIAL SECURITY

OF THE

COMMITTEE ON FINANCE

OF THE

UNITED STATES SENATE

July 8, 1981

The National Education Association appreciates this opportunity to present its views on the current proposals to restore the solvency of the Social Security system. In this statement, we comment on the Administration's proposals of May 12, 1981 and on the financing bill, HR 3207, introduced by Chairman J. J. Pickle.

Under the guise of averting the "greatest bankruptcy in American history," the Reagan Administration is asking Congress to cut up to $111 billion in Social Security benefits over the next five years. That sum amounts to over one-half of a full year's current payments to retirees, disabled workers, their spouses, and dependents.

Painting a "worst-case scenario" in Congressional testimony, the Administration projected Social Security benefits as a monster that will eventually devour resources that now go for other domestic programs, such as education, food stamps, child nutrition, and veterans' benefits.

The Reagan scenario goes far beyond the pessimistic assumptions of the Social Security trustee reports and projections by the Congressional Budget Office. It mixes and matches the gloomiest forecasts of short- and long-term economic performance, and assumes virtually no growth in trust fund revenues attributable to even a modest upturn in productivity.

The Administration proposals and those under consideration by the House Social Security Subcommittee confuse rather than clarify the actual extent of the financing problem. The short-term and long-term condition of the trust fund reserves need to be stated separately and decisions must be target appropriately. Short term needs have been identified as follows.

For the years 1982 through 1986, there is general agreement that the Social Security trust fund reserves will drop to a dangerously small percentage of annual benefit payments. Under the most pessimistic assumptions, these reserves will go as low as 14 percent of anticipated annual outgo. The

Administration proposals are based on an arbitrary goal of boosting reserves to 60 percent--a goal that would, indeed, require draconcian cuts in benefits or a massive infusion of funds--from an increase in payroll taxes, transfer of money from general tax revenues, or both. Rejecting tax increases and general revenue funding out of hand, the Administration has opted for benefit cuts that set off a firestorm of protest around the nation.

On the other hand, the House Social Security Subcommittee bill, HR 3207, establishes no specific goal in terms of reserves, but combines a set of financing changes and administrative reforms that would restore trust fund reserves to sufficient levels (about 25 percent) until the tax rate increases already scheduled to begin in 1985 start reversing the current downward trend.

NEA supports the short-term remedies in HR 3207 as preferable to the Administration proposals. Specifically, we endorse-

Sec. 101, which revises the tax rate schedule reflecting a reallocation of the HI and DI tax rate to the OASI program and providing for restoring the revenues which the HI program would lose from general revenues;

Sec. 102, which provides for interfund borrowing, allowing the OASI, DI, and HI trust funds to borrow from each other;

Sec. 108, which moves the cost of living increase to a fiscal year basis;

Sec. 301, which eliminates unintended windfall benefits received by persons who also have staff pensions from employment not covered by the Social Security system; and

Sec. 304, which would apply the same requirements to state and local governments regarding payment of Social Security taxes as apply to private employers.

These provisions of HR 3207 would effect significant short-run savings, correct certain inequities in current law, and provide a sound basis for future preservation of adequate trust fund balances.

We must oppose, however, the following sections of HR 3207 which make unwarranted cuts in benefits.

Sec. 103, which terminates student benefits, does so without regard for the fact that many workers have paid into Social Security with the expectation that help would be available to their children as they pursue an education. While we agree with some critics of the program that it should be funded from general revenues rather than from a trust fund, no legislative machinery is in place to compensate adequately for the sudden loss of student benefits. Changes in the program should be coordinated, and the termination of this benefit should be contingent upon the availability of Pell grants to those who stand to lose benefits.

Sec. 104, terminating benefits for the surviving parent when the child beneficiary reaches age 16, appears to assume that the parent or the child (perhaps both) can or should be self-supporting by the time the child is 16 years old. If so, we believe the case should be documented prior to serious consideration of so great a change in law.

Sec. 112 raises the age of entitlement to full benefits to age 68. While this proposal, with its long phase-in, is more humane than the Administration plan, we believe it is unsound because many persons in poor health, or in high stress jobs, benefit by being able to retire early, but the proposed schedule would make it impossible for many to retire comfortably.

Of equal importance is the fact that it is neither necessary nor wise to enact such a change at this time. We simply do not know whether current economic conditions are an aberration or a long-term trend. It is important to make such changes with as much precision as is humanly possible, to minimize the fiscal impact on beneficiaries. At some future time it may well be necessary to change this central benefit factor, but we believe that is is premature to act now.

Sec. 303 extends the grace period for the government pension offset for another five years. NEA believes the offset is so discriminatory against public workers that it should be repealed. No such offset is applied to workers in private or non-profit employment.

General Revenue Financing

In previous testimony NEA stated its support of general revenue financing of Social Security. This proposal, advanced early in the history of the program, simply aknowledges the fact that over the long haul payroll taxes will be unable to bear the whole burden. Nation after nation has found that as its social security system matures, benefit growth outstrips the potential of so regressive a tax mechanism. Despite the best efforts to effect savings and to weed out "malingerers," longevity increases, population trends change, poor economic performance strains the revenue source, and the system needs additional funding.

The Administration correctly points out that when shortfalls occur, only three remedies present themselves: benefit cuts, increased payroll taxes, or additional funding from general revenues. The choice is unavoidable, but the principles upon which the choice is made send a powerful signal to the electorate.

If the overriding principle is to restrain the growth of government spending, the choice will be to cut benefits. The public outcry against the Administration's proposals to trim benefits is not the protest of an uninformed mob; the people understand the plan as a primary bread-and-butter issue. They view the Administration proposal as a breach of faith, the breaking of a fundamental social contract. They will not be persuaded otherwise.

The alternatives to benefit cuts are less unattractive. Recent polls show that people would rather pay higher taxes than forego benefits. This does not mean, however, that they would welcome an increase in the payroll tax--particularly when substantial increases are built into current law.

In our opinion, general revenue financing is an alternative that can be adopted without a serious disruption in the funding of other domestic programs. General revenue financing, as proposed in HR 3207, is a carefully limited application. Congress may wish to limit it further by restricting its use to a specified period of time, and subject to periodic review.

The priorities of government are bound to change from time to time. But the development of the Social Security system has been a top priority in this nation for more than 40 years. Its future maintenance may require great ingenuity, and it will certainly require some sacrifice. In our view, it is worth far greater sacrifices than we have been called upon to make thus far. We urge the Committee to take the most humane, the most generous course in addressing the funding problems we face today.

# # # #

National
Farmers Union

STATEMENT BY

RUTH E. KOBELL
LEGISLATIVE ASSISTANT
NATIONAL FARMERS UNION

SUBMITTED TO

SUBCOMMITTEE ON SOCIAL SECURITY AND
INCOME MAINTENANCE PROGRAMS
SENATE COMMITTEE ON FINANCE
UNITED STATES SENATE

REGARDING

SOCIAL SECURITY FINANCING AND OPTIONS
FOR THE FUTURE

JULY 7, 1981

Mr. Chairman

At the outset, we wish to commend you for holding these hearings promptly on this vital subject for millions of Americans.

National Farmers Union appreciates the opportunity to submit testimony on the Administration's proposals to cut Social Security benefits substantially in the years ahead. The Administration's fiscal 1982 budget proposals and the recommendations announced in May would reduce Social Security benefits by about $82 billion over the next five years.

Social Security has become an increasingly important part of retirement and estate planning for farm families since coverage was extended to farmers and other self-employed individuals some twenty-five years ago. They have recognizes it as an entitlement program to which they have contributed and should be assured that the retirement, survivor, and disability eligibility for them and their families is not threatened.

Funding problems forecast for the Social Security program have been discussed in detail for individuals and groups for several years and careful recommendations have been made for addressing problems resulting from several developments. More of our citizens are living

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longer, growing older but locked into an economic pattern that mandates retirement in the sixties, in most cases. Age discrimination in employment discourages employment of older men and women in even part-time work where they would continue to contribute to support of Social Security. Conversely, there are a comparatively smaller number of workers paying into support of the program. The recent high and continuing levels of unemployment also cut the support that would be available to Social Security under a full employment economy.

We believe that the unbirdled charges of public officials that "The Social Security program is verging on bankruptcy" borders on irresponsible demagoguery. The short-term cash flow problems facing the system can be solved with fair measures which should include the authority to borrow between seperate trust funds, and use of general revenue funds to support specialized parts of the program.

Henry Aaron, a senior fellow in economic studies at the Brookings Institution, who served as Chairman of the 1979 Advisory Council on Social Security, outlined in some detail in the Washington Star on June 28, 1981, the problems which have developed for Social Security and listed a number of solutions which have been recommended by citizens who have studied the problem both in and out of Congress. I am attaching the article to my statement to be included in the record of hearings.

Harold F. Breimyer, Extension Economist with the Department of Agricultural Economics at the University of Missouri has also done a careful review of the social security program which I believe will make a useful contribution to your hearing record and which I have attached to my statement.

National Farmers Union delegates meeting in convention in March, 1981, adopted a detailed statement of recommendations on Social Security which I am also attaching to this statement for your review and guidance.

Social Security touches the lives of practically every single family in the United States in one form or another. Almost one out of every six Americans receives a monthly Social Security check. About nine out of ten workers are earning protection under Social Security. Approximately four out of five people 21 to 64 years old have disability coverage. About nineteen out of twenty young children and their mothers have survivor protection.

Social Security is the primary source of support for the vast majority of older Americans. It provides at least one-half of the total support for almost three out of four aged individuals who receive Social Security and more than one out of two similarly situated elderly couples.

Social Security is also one of our most efficient programs. It provides more than 98 cents in benefits for every dollar collected. In addition, it keeps an estimated 12-13 million Americans out of poverty.

These facts underscore the importance of Social Security for practically every person living in the United States. Quite clearly, a system as large and as important as Social Security must be built upon sound and secure financial and substantive bases. And, it must have the full confidence of the public.

A sound and equitable Social Security system is crucial for all Americans, whether they live on farms, rural communities, sprawling suburbs, or central cities. I cannot think of a more important domestic issue confronting our Nation now than to assure the financial integrity of Social Security.

Administration's Proposals

The Administration's proposed cutbacks in Social Security represent an unprecedented frontal attack on the system which will undermine the support and confidence of today's workers and retirees. These measures would reduce benefits substantially for persons nearing retirement and defeat their justifiable expectations. In addition, they would force many older Americans into poverty.

About 400,000 persons were added to the poverty rolls in 1979, raising the total from 3.2 million in 1978 to 3.6 million in 1979. This represents the sharpest increase since poverty statistics were first tabulated nearly 20 years ago. Figures are not yet available for 1980. But most knowledgeable persons expect another sharp increase -- perhaps of the same record-breaking magnitude that occurred in 1979.

These proposals -- along with other recommended Social Security cutbacks in the fiscal 1982 budget -- are clearly overkill. Even if a "cutbacks" strategy could be justified -- and I want to stress that the National Farmers Union strongly opposes these measures -- they greatly exceed reasonable revenue estimates to meet the projected deficits in the years ahead. These recommendations are nothing more than an attempt to balance the budget on the backs of older and disabled persons.

I want to reaffirm that our policy statement has for several years recommended the well-timed and well-conceived use of general revenues for Social Security. This would not only help to strengthen Social Security's financing, but would also make it possible to ease the payroll tax burden for today's and tomorrow's workers. We believe that this is a preferable form of tax relief than the proposed three-year across-the-board income tax reduction which will provide the greatest benefit to the most affluent in our society.

Before commenting on the recommendations announced in May, I would like to focus on an earlier budget proposal -- the repeal of the minimum monthly benefit. We recognize that some people receive this benefit because they have minimum covered employment under Social Security since they have worked most of their lives in non-covered employment. However, many persons receive the minimum benefit because certain employers may have underreported or never reported their wages. This would be particularly true for domestics. Many farmers also receive the minimum benefit because they have had many years of low farm income which resulted in low or no net family income on which to earn Social Security coverage.

Reduced Replacement Rates

The Administration has proposed major cutbacks in benefit protection for future retirees. But the largest cut over the long run is the proposal to reduce the Social Security replacement rate. At present, Social Security replaces about 41 percent of a worker's covered earnings. The Administration would reduce this rate to 38 percent.

This measure would reduce benefits by $4.2 billion over the next five years. However, the future reduction would be substantially greater.

Reduced Benefits for Early Retirees

The most visible immediate cut is the recommendation to reduce Social Security benefits from 80 percent to 55 percent of the maximum payments for those retiring at age 62. This change would slash benefits by $17.6 billion from 1982 to 1986. About 70 percent of all workers take actuarially reduced benefits -- quite often involuntarily -- before age 65.

This heavy penalty for early retirement is designed to encourage workers to remain in the labor force until age 65. However, it would hurt those who are forced to retire early because they (1) are unable to meet the strict tests to qualify for disability, even if they may be in poor health; or (2) cannot find work after exhausting their unemployment benefits; or (3) they have lost their jobs either through the fact that their employer has moved or gone out of business and their age makes it impossible for them to find another job; or (4) in the case of older women, they are left along and cannot find an opportunity to work.

Disability Cutbacks

The Administration is also calling for $22 billion in cuts for the disability program during the next five years by:

-- Basing disability awards solely on medical determinations, instead of considering vocational factors (e.g. age, work experience, and education) as well;

-- Requiring persons 31 or older to have worked 30 out of 40 quarters before becoming disabled to receive benefits, instead of 20 out of 40 quarters;

-- Increasing from five to six months the waiting period to receive disability benefits; and

-- Requiring workers to show that their disability will last at least 24 months -- instead of 12 months as under present law -- or result in death.

These changes will have an especially harsh impact upon older Americans because more than one-half of all disabled workers are 55 to 64 years. In fact, more than one-third of disability awards for individuals 60 to 64 years involve vocational factors.

Farmers will also be hard hit because farming is still the third most dangerous occupation after forestry and mining. Beginning farm families especially need the disability coverage. The heavy debt load required to establish themselves in farming, the limited cash reserves of most beginning farm families and the need for some cash flow to meet the minimum demands of daily living make disability payments especially important to such farm families.

Finally, the more stringent substantially recent work test would hurt persons with degenerative disability conditions.

Reduction in Family Maximum

The Administration's Social Security package also includes anti-family measures. Family benefits, for example, would be limited to 150 percent of the retired or deceased worker's benefit or 85 percent of the average indexed monthly earnings, whichever is lower. Under present law, the family maximum ranges from 150 to 188 percent of the retired or deceased worker's benefits.

The 150 percent cap would have the effect of eliminating children's benefits if a spouse's benefit is payable about the average level. The 85 percent of the AIME maximum would reduce family benefits primarily for those with below average earnings histories.

Cost-Of-Living Adjustments

Present beneficiaries would be affected by the proposal to move back the Social Security cost-of-living adjustment from July to October, starting in 1982. In addition, the adjustment would be based upon a 12-month (July to June) inflation average, instead of the rise in prices for the first quarter (January, February, and March) in the computation year to the corresponding quarter in the preceding year. These two changes are expected to reduce Social Security benefits by $6.3 billion over the next five years.

Conclusion

The Administration's Social Security package is anti-aged, anti-disabled, and anti-family. We urge the Committee to reject these cutbacks. We further urge the Committee to reject sharp benefit cutbacks as a means to strengthen Social Security's financing.

Careful use of general revenues to cover shortages in the trust funds or to stabilize or increase benefits or revenues in the years ahead would make it possible to stabilize the Social Security cash benefits tax rate well into the next century. In addition, it would provide welcome tax relief for today's workers. Moreover, it would make the financing more progressive. The present payroll tax is regressive in that all workers are taxed at the same rate regardless of their earnings. Finally, the payroll tax has just about reached its limits of political acceptability.

Social Security is one of our Nation's most important institutions. Without Social Security, the vast majority of retired persons could not hope to achieve a moderate standard of living. Without Social Security, many older persons would be forced on to the welfare rolls or to depend upon relatives who may be financially hard pressed to provide assistance.

No other program does as much for as many people -- and does it as well -- as Social Security. Its financial integrity must be maintained. Congress must continue its review of Social Security to assure that it is equitable, soundly conceived, and an efficient system.

For these reasons, the National Farmers Union reaffirms its opposition to the proposed Social Security cutbacks.

The Washington Star SUNDAY JUNE 28, 1981

Salvaging Social Security

HENRY AARON

Henry Aaron is a senior fellow in economic studies at the Brookings Institution who served as chairman of the 1979 Advisory Council on Social Security.

The most casual newspaper reader cannot have failed to notice that the Social Security is in some kind of financial trouble. But the more carefully a reader studies the statements of supposed experts, the more likely he is to be confused about the character and size of the immediate financing problem that Social Security faces. Administration spokesmen croon jeremiads about the imminence of the biggest bankruptcy in U.S. history, a $100 billion deficit, and the need drastically and immediately to curtail benefits by as much as 40 per cent for some early retirees. Other experts claim that there is no problem whatsoever and that benefits need not be cut at all.

What is the ordinary citizen to make of such contradictory analyses and prescriptions?

The beginning of wisdom is the recognition that Social Security faces two problems that have almost no relation to each other. A long-run financing problem, that will affect the system in the next century, is traceable to demographic events — the decline in birth and death rates — that will boost costs of presently legislated benefits beginning around the year 2005.

These difficulties are almost completely independent from the short-run financing problems caused by the recent failure of wages to rise faster than prices as has been customary in the United States. The slow growth of wages relative to prices is attributable largely to the virtual disappearance of productivity growth, to the second round of OPEC price increases, and to drought-induced inflation in food prices. The short-run problem must be solved to assure that people now on the benefit rolls or soon to enter them will receive promised benefits.

Once this problem is solved, the Social Security system will face a period of 30 years during which the cost of the system, measured as a per cent of the wage base used to finance it, will be less than it is today. Thus, a 30-year financial interlude, as well as the nature of the issues raised, separates the long-run and the short-run problems facing Social Security.

This fact leads to the conclusion that it is intellectually dishonest, although it may be politically convenient, to use the short-run problems that the Social Security system faces as the basis for making changes in the system that are relevant more to the long-run problem. Attention should be paid to both of these problems. The short-run problem critically demands our attention. The long-run problem, potentially much larger, can be handled best if it is addressed now. It is important to recognize, however, that these problems are separate and require quite different solutions.

A large part of the confusion about the size of the short-run problem stems from the use of different economic assumptions.

For instance, the administration assumes that there will be a $29.2 billion shortfall in the Social Security trust fund reserves for old age and survivors insurance (OASI) by 1986, whereas the Congressional Budget Office calculates the deficit at $63.5 billion, and the most pessimistic assumptions put the shortage at $125.9 billion. For disability insurance, (DI), the administration anticipates $56.9 billion will be in that fund, the budget office is a shade lower with expectations of $47.7 billion, and pessimists put the total at $44.2 billion. Health insurance (HI) funds are anticipated by the administration at $46.2 billion in 1986; $40.1 billion by the budget office, and $41.5 billion at the pessimistic extreme. Thus, predictions of the total available in all three Social Security funds by 1986 varies from the administration's $67.9 billion, to the budget office's $24.3 billion, to a deficit of $40.3 billion by pessimistic standards.

These projections have three striking characteristics. First, the OASI trust fund has a large deficit under all assumptions. Second, the DI and HI trust funds have large surpluses. Third, economic assumptions clearly have an enormous effect on the size of the surplus or deficit in each of the funds. Fourth, whether the system as a whole has sufficient reserves through the end of 1986 to cover month to month imbalances between income and outgo (estimated to be about 9 per cent of next year's outlays) depends on one's economic assumptions. Under the administration's assumptions, reserves are sufficient; under CBO's they just fall short; under the pessimistic assumptions (projected by Data Resources Inc. in February) there is an overall deficit.

What is one to make of all of this? The first thing is that it makes no sense whatsoever to look at the individual trust funds separately if one wants to get some sense of the overall size of the short-run financing problem. The allocation of tax revenues to each of the funds and the accumulated reserves reflect past congressional decisions based on actuarial projections of the cost of each program. The Social Security actuaries have been scrupulous to warn users that their projections were not forecasts, but merely the extrapolations of the implications of the assumptions they employed. When the projections of reserves in one fund turn out unduly optimistic and those in another unduly pessimistic, we should take steps to even things out, by reallocating revenues or by interfund borrowing or both. To the extent that offsetting errors are resposible for the present problem, it would make no more sense to declare bankruptcy for Social Security than it would to declare oneself personally bankrupt, despite having a nice savings account because one had overdrawn one's checking account.

Borrowing Plan

Based on the administration's economic forecast, authorizing the OASI fund to borrow from the DI and HI funds or reallocating revenues from the latter to the former is sufficient to keep the system moving along nicely for many years. Even if one thinks that the president's program should be supported as the one most likely to succeed, however, one can acknowledge that it would be imprudent not to plan for the possibility that things will turn out less well than it supporters hope.

For symmetric, but opposite reasons, one should disregard the projections based on the DRI pessimistic assumptions. These assumptions imply something approaching economic calamity. DRI is no longer using these assumptions in its pessimistic forecast variant because events have been more favorable than those in its February projection. While economic events as pessimistic as these are not inconceivable, they are most unlikely. The operative question today is whether Congress should slash benefits or raise taxes enough to keep the Social Security financially sound even in the face of econom-

-- MORE --

Social Security's Woes Can Be Overcome

ic events that are possible, but improbable, or whether it should take other steps that would make the system more robust in the face of economic adversity.

If Social Security reserves are sufficiently large to assure continued payment of benefits through an extended period of economic adversity, the correct set of economic assumptions to use would be ones that reflect our best forecast of the likely future course of the economy. If events were less favorable, the contingency reserve would be put to its intended use, covering a temporary deficit. Reserves would obviate the need to cut benefits or to raise tax rates in order to sustain benefits during periods when economic events were less favorable than those underlying our projections. That was the arrangement under which Social Security operated until a few years ago. Recent economic events, however, have depleted reserves so much that they now are inadequate unless the economy performs better than it is reasonable to expect.

Reserves Battered

The underlying problem is that, without an adequate contingency reserve, the Social Security system is jerked about by two kinds of economic bad news, prevalent in recent years, that should have little effect on Social Security policy. In the short run, revenues are indexed to wage rates and benefits are indexed to prices; when an OPEC price increase or a drought-induced jump in food prices causes prices to rise faster than wages, the effect on the reserves is immediate and pronounced. The system is also sensitive to fluctuations in employment because employment levels are a major determinant of the wage base and have some effect on the number of benefit claims.

Thus, Congress now faces an important choice. If it acts to reduce the sensitivity of the Social Security system to these economic events, relatively small reductions in benefits or small increases in legislated tax rates will be sufficient to place the system on sound financial footing for the next several decades. The problems of the next century will remain and should be addressed soon; but next century's problems are distinct from today's and call for different solutions. On the other hand, if no steps are taken to reduce the sensitivity of Social Security to short-run economic adversity, there is a risk that economic events less favorable than our best forecasts will place the system in jeopardy again in the near future; only large tax increases or large benefit cuts for those now receiving or soon to receive them would absolutely preclude this unhappy possibility. These are really the only two choices Congress has.

Alternatives Assessed

Adding flexibility, small benefit and tax changes – There exist a variety of ways to protect Social Security from unanticipated economic fluctuations.

First, the proposal to index benefits to the lesser of the rate of growth of prices or of wages has been widely discussed. It would reduce greatly the sensitivity of Social Security to the kind of economic events recently encountered.

Second, Congress has contemplated granting the Social Security trust funds authority to borrow from each other and from the Treasury if reserves sink to unacceptably low levels. This authority should be granted provided that explicit arrangements are made for repayment of such borrowings when economic conditions warrant tax increases and certainly within a stipulated number of years.

Third, it would be desirable to inject some general revenues into the Social Security system in a carefully limited manner, either to offset the effects of protracted high unemployment along lines proposed in 1977 by President Carter or to pay for part or all of medicare hospital benefits as proposed by the last two Advisory Councils on Social Security and by the National Commission on Social Security.

Had any one of these three changes been enacted in 1977 there would be no short-run financial crisis today. Enactment of all three or any two of them would enable the continuation of Social Security benefits and payroll tax rates at approximately their current levels and they would preserve the financial balance of the system even in the face of very unfavorable economic developments.

Weeding Out Needed

The enactment of such provisions should not deter the Congress from weeding out low priority benefits Such reductions combined with already legislated payroll tax rates and the buffers described above, would create a stable financial basis for the Social Security system for several decades.

These provisions should not stand in the way of a plan to build up contingency reserves gradually in the years ahead. Already legislated tax rates will lead to the accumulation of such reserves beginning in 1986. But it will take time for adequate reserves to accumulate. Until they do, it will be important to make sure that economic events, such as an OPEC price increase or a major crop failure, do not automatically produce a crisis in Social Security.

No added flexibility – If Congress does not adopt any of the three buffers described above, large cuts in Social Security benefits or increases in payroll taxes will be necessary to protect social security against unfavorable economic events. It is hard to see why we should raise payroll taxes now when we rightly are contemplating reductions in income taxes.

To return to the issue posed earlier – how big is the short-run Social Security financing problem – the answer is that its size is up to Congress. If Congress enacts the buffers described above, what exists is not a crisis in an sense, but a job of legislative reform and of weeding out benefits that are of relatively low social value. In the face of the widespread fear and handwringing about the imminent bankruptcy of Social Security, such a statement may smack of Panglossian refusal to recognize the gravity of the situation. It is, in fact, recognition of the fact that a problem that needs a solution has one

Excerpt Taken From:

1981 Policy Statement of
National Farmers Union
Adopted by Delegates to the 79th Annual Convention
Orlando, Florida
March 1-4, 1981

C. Social Security

Social Security has become an increasingly important part of retirement and estate planning for farm families since coverage was extended to farmers and other self-employed individuals some twenty-five years ago. They have recognized it as an entitlement program to which they have contributed and should be assured that the retirement, survivor, and disability eligibility for them and their families is not threatened.

Farmers must continue to be assured the right to retire on their farmstead, lease their farms under conventional arrangements to realize retirement income on a lifetime of investment and labor and management, and continue the right to work and earn supplemental income under the regulations of Social Security legislation.

Congress and the Administration should be very careful to preserve the Social Security system so that the American people will have confidence that it will continue to provide the benefits and protection which they expected when they paid their taxes into the system. Benefit cuts should be carefully considered and rarely made, especially those which would affect those most in need of protection.

1. Women and Social Security

Recognition should be given to the contribution which women partners make to the operation and management of a family farm. Under present law, women who are partners in the operation of a family farm are not covered for disability insurance or survivor benefits unless husband and wife have paid Social Security taxes for both as partners. Women on farms are often engaged in the operation of dangerous equipment and are as apt to be disabled as are men.

We urge that the Social Security Administration determine how many women on farms are not covered under Social Security. We also urge the Social Security Administration and the National Farmers Union to disseminate information to farm operators about the way in which women farmers may be covered under Social Security.

Social Security should be revised to provide fair and equal treatment for women workers, and to protect widows who are not eligible for benefits and who do not have marketable skills, to assure that women who wish to remain at home with a young family are not penalized for doing so and to assure that divorced women are eligible for benefits.

2. Retired and Disabled

Minimum Social Security benefits for retired and disabled persons are now exceedingly low in relation to the high cost of living. We urge that minimum benefits be increased.

3. Social Security Financing

We oppose the use of a Value-Added Tax (VAT) to finance any part of the Social Security system and we support the use of general revenue funds to cover shortages in the trust funds or to increase benefits or revenues in the years ahead.

The Social Security trust fund should be compensated out of general revenues for benefits paid out over the years to recipients who have been "blanketed in" for full coverage without having contributed throughout their working lifetimes.

We oppose the proposal to tax Social Security benefits as income.

4. Universal Social Security Coverage

We urge that members of Congress, all government employees, and military personnel be brought into the Social Security system.

5. Medicare

We urge that a Comprehensive National Health Insurance Program be established and that Medicare be brought under such a program.

COOPERATIVE EXTENSION SERVICE UNIVERSITY OF MISSOURI LINCOLN UNIVERSITY

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for Missouri Agriculture

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SOCIAL SECURITY -- SERIOUS PROBLEM BUT NOT A CRISIS

Harold F. Breimyer

". . . are [Social Security and similar programs] consistent with general principles of insurance, or . . . really general income transfer programs?"

-- Martin S. Feldstein in *Challenge*, Nov.-Dec. 1976

Few changes in U. S. society the last half-century have been so dramatic as pensioning the support of older citizens.

Social Security is anchor to programs but private plans are significant too. All face problems. Social Security's is the mounting cost, which arises as more beneficiaries receive payments that are regularly scaled upward for rising cost of living. Private plans, by contrast, are flawed in that few protect retirees at all against higher living cost. Also, many private plans are vulnerable to cutbacks in the Social Security program because their payments make up the difference between Social Security and a targeted income.

Social Security and private plans together amount to collective provision for old-age security. They replace the family as primary support unit. There is little evidence of a wish to revert to the family base.

This review will primarily address problems in Social Security. It will not treat them as a crisis, nor the program as bankrupt. Neither term is accurate. Misunderstandings have made it harder to address policy issues responsibly.

Costs of the Social Security program have increased sharply, because benefits have been liberalized, payments have been indexed for inflation, medical service rates in Medicare have risen fast, and Americans' life span has lengthened. Also, a slowdown in the economy has made it more difficult to pay rising costs, in spite of increased payroll taxes. Even so, Social Security is like any other government program in that it offers benefits and incurs costs, involving Treasury outgo and income. Benefits and cost must always be weighed, as in any government program.

It is likely that Social Security benefits will be trimmed moderately. How to do so will be debated at length. Chances are fairly high that one change will be to adjust for rising cost of living more conservatively than in the past.

The retirement and disability-benefit portion of Social Security could be handled more easily if medical benefits (Medicare) were removed to a separate program. Such a change is not likely soon.

Origin in Depression

The Social Security system came out of the Great Depression of the 1930s. Many older persons found themselves destitute. Even those who had tried to provide for their old age by the customary savings accounts and holdings of corporate stock were often stranded by bank failures and drying up of dividend payments. In that setting a social insurance program took on appeal.

The actuarial principle added to attractiveness. An older person can live better in a group program than by building up and then drawing on his own savings. In the latter case the person must plan for maximum longevity, but an annuity is calculated as an average for all participating individuals. Social Security is in effect a nationwide annuity.

Other developments during the Depression, such as unionization of factory workers, spurred interest not only in a national Social Security program but in private pension plans too. Many union contracts called for retirement benefits. How much to rely on private versus public programs was a

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burning issue that continues to this day.

Even among public programs, in spite of Executive pressure to unify them Civil Service, Railroad Retirement, and military retirement programs remained separate from Social Security.

The Trust Fund Issue

The original Social Security program was announced and promoted, and to some extent designed, as that of a trust fund. Workers and their employers would contribute a specified percentage of wages to such a fund. Upon retirement workers would draw a retirement income bearing a degree of relationship to the amount paid in.

In reality the program did not conform closely to a trust fund. The first difference is that payments received were not really reinvested, but were revenues to the federal government. Likewise, Social Security payments to beneficiaries were expenditures of the government. The so-called trust fund was an accounting device that had a bearing on both payroll taxes and benefits, and was aimed at an approximate long-run balance between the two, but otherwise was not equivalent to a private fund.

As a second departure from the trust fund principle, from the beginning disbursements in the program exceeded amounts previously planned for.

Adding of Benefits

Other benefits were added to the program from time to time. Most of them departed from the original trust-fund design and all increased the cost. Generally they were based on need rather than the work experience of the individual annuitant. An early instance was extending of benefits to disabled persons. Medicare was a more radical and costly addition. Medicare benefits are based entirely on need.

Indexing for Inflation

During the rapid inflation of recent years Social Security payments to beneficiaries have been increased proportional to increases in the Consumer Price Index as published by the Bureau of Labor Statistics. This is a standard index for the purpose. In 1972 Congress chose scheduled increases in lieu of separate Congressional action year by year.

CPI indexing amounts to another denial of the original trust fund idea. It essentially clinches the argument that Social Security is more nearly a welfare program than a socially-managed annuity. If it were an annuity, the increase in payments would be geared to interest rates on invested funds. Instead, CPI indexing reflects an objective of sustaining annuitants' established buying power and level of living.

The Complication of Longevity

As Americans are living to an older age than before, the earlier calculations of how much the program would cost have proved too low. The calculations were made, to be sure, on the best data available at the time.

Pressure to Reduce Program Costs

It has been government policy, couched to some extent in the trust fund idea, to strike a close balance between current income to Social Security and anticipated future outgo. To speed up income, payroll taxes have been increased. Reductions in Social Security benefits have been called for by several advisory committees and more recently by officials of the Executive Branch of the government.

In reality the issue of comparative income and cost need not be viewed in those terms. Program design and budgetary issues are relevant just as normal decision-making.

Among proposals to reduce entitlements are delaying the age of eligibility for early or regular retirement, or reducing the payment rate when retirement begins early; scaling down the ratio-to-income-history at which retirement benefits are calculated; and using a more conservative formula to adjust payments for increases in cost of living.

Various questions arise about proper age for retirement. One relates to legislating uniform rules when individuals differ so much in their aging rates. Perhaps more perplexing, though, is the relation to the state of employment in the economy. When workers are in demand longer employment may generally be sought. During a slack economy, many businesses look on retirement of older employees as appropriate. In that case a side effect is to reduce the demands on unemployment insurance as Social Security benefits begin -- a trade-off between programs.

On the other hand, it is incorrect to suggest that provisions for early retirement necessarily add to cost of the Social Security program. If annuity payments under early retirement are calculated correctly -- that is, if they are reduced fully as much as life-expectancy tables call for -- the ultimate cost is the same irrespective of when workers choose to retire. There can, of course, be a one-time saving of obligations if the minimum age is increased or early-retirement benefits reduced suddenly. Prospective retirees would regard either action as a breach of faith.

With regard to the ratios of retirement benefits to previous income, all are partly arbitrary. They involve the question of how well an earlier living standard is to be sustained.

The issue of indexing Social Security payments for rising cost of living is more complicated. The CPI index is not itself designed for retirees. The housing component particularly has come under fire. Retirees are not home-buyers, and their housing cost may be reflected best by rental rates. Studies indicate that the CPI overstates what retirees need to maintain their level of living. The difference is small in a given year, but compounding over several years can add a substantial sum to cost of the program.

Other Difficult Issues

Treatment of Female Beneficiaries. Equity of payment rates to women is an issue. Rates differ according to whether or not a woman has been employed, and whether she is, or has been, married. It is alleged that the system discriminates against the working wife. In a sense this is a matter of social customs and mores; a system that protects the widow whose lifelong activity has been in the home will implicitly appear to be less favorable to employed women.

Work Rules for Annuitants. A clear illustration of mixed objectives in Social Security is the work rules that limit how much income a retiree can earn from employment. If the program were strictly group annuity there would be no occasion for work rules. But to the extent it is designed for need, the employment-income rule is appropriate. Nonetheless, a major inconsistency shows up: receipt of other kinds of income does not disqualify an annuitant from collecting the full Social Security payment.

Federal Income Tax. This last point about outside income bears some relation to income tax treatment of Social Security payments. Those payments are not subject to federal income tax. This means nothing to the low-income recipient but is a windfall to the retiree whose investment income puts him in a relatively high tax bracket. An advisory committee of a couple of years ago recommended that half of Social Security payments be subject to tax. The idea has resurfaced recently.

Double Coverage of Civil Service and Military Annuitants. Reportedly, almost half of Civil Service retirees have managed to qualify for Social Security retirement benefits in addition to those from Civil Service. Since 1956 all military personnel have been eligible for Social Security. Because a substantial part of costs of Civil Service retirement and all military retirement payments come from Treasury appropriation and payment formulas are attractive, retirees' double qualifying increases cost to government.

Medicare. Benefits payable via Medicare bear no relation to what a retiree and his employer(s) have contributed to the program, and medical costs have risen fast. Medical expenses are a public issue independent of retirement benefits as such, and it has been proposed that Medicare become a separate program.

Private and Public Retirement Programs

As so much attention focuses on the governmental Social Security program, sight is lost of the many private plans and the problems surrounding them. Four major issues arise. First, private plans reduce mobility for the individuals covered. The reason is that once a person has accumulated a substantial entitlement within a given plan he is reluctant to move to different employment where he must begin to build up benefits. The situation is made worse during inflation, for even if benefits from the first employment are retained, their purchasing power when received later may be very small.

The second aspect of private plans lies in their variable integrity. Defaults and scandals led to passage of the 1974 Employee Retirement Income Security Act. That Act was directed first at single-employer retirement but gave secondary attention to multi-employer coverage. A Pension Benefit Guaranty Corporation essentially became the governmental arm to stabilize and reduce risks to employees in private retirement coverage. Issues in public underwriting of private retirement plans remain difficult.

Thirdly, private plans can be hurt seriously by any changes (reductions) in payments made under Social Security, for many of them are supplementary to Social Security. If a retiree receives less from Social Security the private fund is obligated to pay more.

A fourth feature was noted earlier, that most retirees under private funds are not protected against a rising cost of living. Many retirees under state and local government programs are likewise unprotected. During inflation a sharp disparity arises between Social Security and private-fund retirees.

* * * * * *

Editorial Comment

What is Social Security? Business Week of January 9, 1978 rejected the "popular myth" that "one's own taxes are financing one's own future benefits." Martin Feldstein calls Social Security neither true social insurance nor "general income redistribution," but "event-conditioned transfers." Payments follow illness, disability, retirement, or death.

Social Security is neither sacred and untouchable, nor ripe for drastic reform. It is no more aloof from review than other welfare programs, some of which have come under a sharp budget knife. It has broader political support than many programs. Support comes not only from the retiree-beneficiaries but from their sons and daughters too.

It would be wrong to undercut the basic structure of Social Security. The Advisory Council on Social Security concurred unanimously that "the system is basically sound."[1]

Current criticisms of Social Security treat indexing lightly, perhaps because Civil Service, military, and many other retirees have a collateral interest. If Social Security payments should be scaled upward a bit more slowly, so, probably, would other government retirement payments too.

A case can be made for edging all index formulas a little below the CPI, by formula or by computing a separate cost-of-living index for retirees.

The indexing issue is especially sensitive when the economy lags. An employed worker who finds that his income goes up less than his cost of living can resent indexing retired persons' income fully.

[1] Challenge, March-April 1980.

Medicare costs are a separate problem. Medicare itself may contribute to rising cost. Feldstein once more: "There is general agreement among students of the economics of health care that Medicare and Medicaid ignited an explosion of health care costs."

As Social Security becomes based more on need, program changes are likely. E.g., double-public-coverage of Civil Service or military retirement with Social Security will likely be changed or ended. Worst feature is that civil servants and military personnel reporting low earning to Social Security now get their benefits scaled upward, for hardship!

Some critics say all pension plans should be junked in favor of a positive-negative income tax system -- with no deductions. It's a far-out idea, but it may be sensible too.

On the issue of working versus non-working wives, there is no satisfactory answer. To the extent the non-working widow is provided for adequately, there is some inequity relative to the career female.

Although not publicized much, the plight of many private pension plans and their tenuous relationship to Social Security deserves thoughtful attention.

There's nothing truly exceptional, nor anything mysterious, about Social Security problems. It's a case of how well we want to provide for our older citizens and for disabled persons, and how to arrange public and private financing.

-- Harold F. Breimyer

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Extension Economist

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STATEMENT OF

DONALD H. SKADDEN and
JAMES E. WHEELER

ON BEHALF OF THE

AMERICAN INSTITUTE OF CERTIFIED
PUBLIC ACCOUNTANTS

SUBMITTED TO THE

SENATE FINANCE SOCIAL SECURITY AND INCOME
MAINTENANCE SUBCOMMITTEE

UNITED STATES SENATE

HOLDING HEARINGS ON

SOCIAL SECURITY FINANCING ISSUES

Statement of University of Michigan Professors Donald H. Skadden and James E. Wheeler who are members of and representing the American Institute of Certified Public Accountants (AICPA), Federal Tax Division, before the Finance Committee of the United States Senate, July, 1981

Mr. Chairman and Members of the Senate Finance Committee, we appreciate the opportunity to submit this written statement to you as you consider the problems facing the Social Security System.

What you do in regard to Social Security may well affect every living American and future generations as well. The one fundamental change in the OASI system which will be needed to make it both equitable and economically sound is the creation of a proper interrelationship between contributions and benefits. This interrelationship has been ignored too long. The present system has no direct, unavoidable link between contributions and benefits, and this makes it possible to modify one without the other. The resulting lack of coordination is the underlying cause of nearly all problems facing the OASI system today. The fact that the 1977 amendment to the Social Security System failed to make the system financially sound is a clear reflection of the lack of coordination between contributions and benefits.

The AICPA Statement of Tax Policy No. 8, "Suggested Improvements for the Social Security Retirement System," describes a comprehensive integrated approach which can accomplish the essential objectives of raising the necessary revenue and distributing retirement benefits equitably. We are submitting a copy of Statement No. 8 for the record. Both the AICPA study and these comments address only the retirement benefits and not the disability or medical features of Social Security. However, some of the concepts may well apply to those features of the program.

Recommendation No. 1

One of our principal recommendations is that retirement benefits should be actuarially tied to amounts that have been paid by and for each individual, adjusted for inflation plus a modest real rate of return. Thus, each beneficiary would receive only what the combined employee-employer contributions to the retirement system would justify. In an earned retirement system, if an individual's contributions were based on very low earnings or if the occupation were exempt, the resulting pension would be quite low because the tax paid would be low. If this pension plus any other income the individual has after retirement is not sufficient to provide a minimum standard of living, that individual would be eligible for Supplemental Security Income (SSI) or other assistance plans. SSI is a needs-tested, general revenue program and is not financed through the payroll tax.

This is a significant change from the present system. By increasing the equity of the system, it would greatly increase the acceptance of OASI by current taxpayers. It would completely solve or substantially mitigate an extensive array of current problems such as:

1. The extent to which general revenue should be used to supplement OASI funds:

   The financial strain on the current system is due almost entirely to two factors: first, benefits for most retirees are well in excess of what their contributions would justify, and second, the automatic increases necessary to maintain purchasing power of this retirement income have grown rapidly with inflation. The AICPA proposal would address both of these factors. The first--the unpaid-for-benefits--would disappear. General funds might well be needed (and justified) for providing the adjustments for inflation and a real rate of return. However, there would be an actuarial discipline introduced into the system that would prevent arbitrary increases in benefits out of general funds.

   Congress faces a serious dilemma. If we continue to finance from the payroll tax benefits in excess of those justified by contributions and inflation adjustments for those benefits, the tax rates will soon reach unconscionable levels. Yet, Congress is justifiably reluctant to resort to the use of general funds because this would open the door for unbelievable political pressures for even more benefits in excess of those justified by contributions. On the other hand Congress should be equally reluctant to finance welfare with a payroll tax.

2. The inequity in the treatment of retired single persons, one wage-earner families, two wage-earner spouses with equal incomes and two wage-earner spouses with unequal incomes:

   This particular inequity is often cited by single persons and married women in part- or even full-time employment positions. Under the current system, persons in these categories will receive different benefits if contributions are identical. Under the AICPA proposal, similar contributions would produce similar benefits.

3. The effect of death shortly before retirement without a surviving spouse:

   Under the AICPA recommendations, the family or estate of the decedent without a surviving spouse would receive a lump sum distribution. After all, for years the family had foregone current consumption by the amount of the FICA contributions. The federal government should not levy the equivalent of a 100 percent tax on those contributions simply because of death prior to retirement.[1] Realize that an income tax had already been paid on those contributions when earned. This is a tremendous inequity in the present system which provides only a $255 death benefit. Recommendations have been made to eliminate even this small benefit to the estate.

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[1] It has been estimated by Professor Wheeler that for 1981 this 100% tax, on just the employees half of OASI tax when the decedent dies without a surviving beneficiary, will take $8.260 billion dollars from these estates.

4. Work after age 65 and before age 70;

   Under the present system, fairly low earnings after age 65 can mean loss of social security retirement benefits. Under the AICPA recommendations, earnings after retirement would not reduce current benefits, would not be subject to FICA contributions, and would not increase future benefits.

5. Proper age to retire under OASI:

   There has been considerable discussion about raising the retirement age to at least 68. This is seen by some as a way to reduce the strain on the system. In fact, continued earnings between ages 65 and 68 under our present computation scheme will often result in larger monthly benefits in the future (due to a higher taxable wage base), which in many cases will outstrip the additional tax paid and the three-year postponement of benefits. Under an earned retirement system, the monthly pension would be based upon the inflation-adjusted contributions accumulated at the date of retirement. Subsequently, the pension will be affected only by future inflation adjustments and the modest rate of return but not by future earnings. Thus, each individual could choose any point of commencing OASI benefits after age 65. In fact, an individual might elect not to take any benefits and to continue contributing, knowing that the family or estate will get a lump sum settlement. Thus the storm of protest that the current administration has received over increasing the retirement age can be avoided by increasing the equity of the system.

6. The minimum benefit:

The concept of a "minimum benefit" necessarily means that a retiree is receiving, without a needs test, benefits in excess of those justified by the contributions. An earned pension plan would provide all retirees only with those benefits actuarially justified by the contributions. If such pensions were quite low, the retirees would be eligible for SSI unless they had sufficient earnings or retirement income from other sources.

7. Double dipping:

"Double dipping" is the situation where an individual is eligible for two or more penions, including Social Security. The Social Security benefit is often the so-called "minimum benefit." This problem is usually associated with retired federal and some state employees. Double dipping is inequitable, and, therefore, a problem, only if the individual is drawing benefits in excess of those justified by his or her contributions. Under our proposal, there would be no such windfall benefits, and it would no longer be inequitable or inappropriate to receive OASI concurrently with other pensions. Thus federal and all other employees would draw from Social Security only the pension they had paid for.

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8. Universal coverage:

Similarly, the arguments for and against universal coverage lose their significance if Social Security is truly an earned pension. Today, the high FICA taxes paid by middle income wage earners are necessary to pay the unearned benefits to current retirees regardless of what other retirement income or wealth these retirees have. Workers outside the system are not contributing toward these excess benefits, and, therefore, universal coverage has become an equity issue. Under our recommendations, with benefits based squarely on contributions, with inflation adjustments, and a modest real rate of return, we would expect most noncovered groups to elect to be covered.

Recommendation No. 2

The second of our principal recommendations relates to the interplay between the FICA tax and the income tax. Throughout our recent history there has been much discussion of the double taxation of corporate earnings and almost no discussion of the double taxation of wages which are subject to both the FICA and income taxes. This double taxation is especially onerous when the tax treatment of Social Security is compared to that of qualified pension plans. The AICPA proposal provides for current deductibility of all FICA contributions and the subsequent taxation of OASI benefits. Thus, Social Security pensions would be treated in similar fashion to qualified pension plans.

Whenever taxation of Social Security benefits is mentioned, people seem to assume immediately that millions of current retirees will have to pay tax on their pensions. This would be highly inequitable inasmuch as today's retirees did not receive a tax deduction when they paid into the system. Our proposal is to allow today's workers a tax deduction for their FICA contributions just as a deduction is allowed for contributions to IRA's, Keogh plans and qualified corporate plans. Individuals who retire after some specified date, such as 1990, would include their Social Security pensions in their taxable income calculation. It should be emphasized that the taxation of the OASI benefits would not cause hardship to the low income retirees due to the extra exemptions and the zero bracket amount.

Stratification in the benefit calculations

In an earned pension, such as we recommend, every dollar of contribution will yield the same benefits as all other dollars. This result contrasts with the present calculation where the first $2,000-3,000 in annual wages currently yields a 90% Social Security benefit, while earnings above that can yield as little as a 15% benefit. In many cases, the added income from stratification of benefits may be essential for the recipient but it should come from a needs-tested program such as SSI. In other cases, such as with double dippers, different stratification rates are producing unjustified benefits.

Indexation

Study #8 suggests that the Consumer Price Index be used for the inflation adjustment of both accumulated contributions and pension benefits. We did not conduct a thorough study of all available indexes, and we recognize that many economists believe there are defects in the CPI. It is quite probable that a better index might be developed. Today, previously taxed wages are adjusted to reflect changes in average covered wages prior to retirement. After retirement each individual's retirement benefit is adjusted annually for the change in the CPI. We recommend that adjustments of contributions prior to retirement and the resulting pension both be adjusted by the same general purchasing power measurement. The covered wage index can be influenced dramatically by Congressional changes in the amount of wages subject to FICA taxes. This change can be quite independent of movements in the cost of living or in the FICA tax rates.

Inasmuch as the CPI is influenced significantly by factors which affect few retirees, perhaps consideration should be given to developing a new index for retirees.

CPI - May, 1981

Newspaper headlines all emphasized the big jump in cost of living in May.

When the components of the CPI are examined relative to Social Security retirees, one finds:

Four items which affect very few retirees:

Mortgage interest rates	up 2.1%
House prices	up .9%
Rent	up .8%
New car prices	up 2.4%
Net Total	up 6.2%

Five items which affect nearly all retirees:

Food	down	.5%
Medical care	up	.9%
Clothing	down	.2%
Entertainment	up	.5%
Gasoline	down	1.5%
Net Total	down	.8%*

*It should be noted that these are just totals and are not weighted by degree of significance.

Revenue Impact

There will be several countervailing impacts from these proposals. The removal of the "welfare" element from the OASI benefits will allow for a significant reduction in the FICA contributions. The increase in general fund revenues to finance the additional SSI benefits would be smaller than the the decrease in FICA due to the fact that the SSI benefits are subject to a needs test.

There would be an increase in general fund expenditures in order to finance the inflation and real rate of return adjustments to both the FICA contributions and the retirement benefits. There would be a decrease in the general fund revenues because of the deductibility of the FICA contributions. Counter to this would be an increase in general fund revenues due to the taxation of OASI benefits. On this point it should be emphasized that the total benefits attributable to both the employee and employer contributions will be taxed. Thus, the general fund would finally be gaining a return from the employer deduction. Also, if inflation requires adjustments in the benefits, there presumably would be greater revenues from the income taxes on these higher benefits.

Impact on Not-for-Profit Entities

One very important but little discussed aspect of continued reliance on payroll taxes instead of income taxes or other general revenue sources to fund what can properly be termed welfare is that an increasing burden of welfare costs is being shifted to not-for-profit entities such as charities, hospitals, schools, and most state and local governmental units which do not benefit from the income tax deductibility of FICA taxes. These entities are often labor intensive, adding greatly to this inequity.

In addition, use of payroll taxes in place of income taxes unnecessarily increases the direct cost of United States-produced goods and services.

Time Is Running Out

We should make one last observation and that is that this may well be one of the few real chances left to get the Social Security System on a sound financial basis. Thus, your efforts should not even consider short-run solutions or longer run partial solutions. Only with benefits tied to contributions will there be equitable treatment of the payroll taxpayers. This will restore faith in the system. But, if you do not do it now, the political pressure of the baby boom generation as they near retirement in about thirty more years, might well force uncontrolled use of general revenues to continue retirement benefits in excess of those justified by contributions.

The following table reflects the excess or deficit of OASI benefits over an earned annuity as recommended in Study No. 8. These results are among those obtained by Professor Edmund Outslay in his doctoral thesis:[1]

Excess (Deficit) of OASI Benefits Over Annunity Benefits at Low, Medium, and Maximum Wage Levels for Workers Entering the Workforce in 1951 and 1981

	1951			1981		
	Low	Med.	Max.	Low	Med.	Max.
Unmarried;						
Male	12%	(6%)	(9%)	13%	(10%)	(28%)
Female	36%	15%	10%	37%	9%	(13%)
Married (1 earner)	99%	68%	61%	101%	60%	28%
Married (2 earners 75-25)	68%	45%	44%	75%	37%	13%
Married (2 earners 50-50)	55%	33%	32%	63%	27%	12%

The figures in this table are based on the following assumptions:

(1) The employers half of the OASI portion of the FICA tax is attributable to the employee,

(2) Both halves of the OASI tax have been price level adjusted <u>and</u>

(3) The price level adjustments reflect the actual and projected increases in the CPI based on the intermediate assumptions contained in the 1980 Trustees Report.

The percentages reflect the excess of the OASI benefit over the price level adjusted annuity benefit based on the future value of OASI taxes paid (price level adjusted and a 1% real return) as of age 65 for individuals entering the workforce in 1951 and in 1981. The OASI benefits were computed using the Social Security Administration model.

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[1] Professor Outslay is now an assistant professor of accounting at Michigan State University.

We thank you for this opportunity to present the results of our study of the Social Security System and at the same time express our willingness to assist any Senator or Committee to better understand our proposals and to develop a law of which every person in our great country can be proud.

Thank you.

Professors Wheeler and Skadden are two of the three members of the AICPA Tax Division Task Force that prepared AICPA Statement No. 8. The other Task Force member was B. Kenneth Sanden, a retired Price Waterhouse partner. Professor Wheeler was Chairman of this Task Force. He is currently a member of the Tax Division and Chairman of the Accounting Department of the Graduate School of Business Administration of the University of Michigan. He served on the staff of the Joint Committee on Taxation in 1971-72.

Professor Skadden is a member of the Executive Committee of the Tax Division. He is currently Senior Associate Dean of the Graduate School of Business Administration of the University of Michigan. He is also a past president of the American Accounting Association and the American Taxation Association.

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FUNDING THE SOCIAL SECURITY SYSTEM
A Proposed Plan of Action

All Americans are now squarely confronted with the serious inadequacy of the Social Security system's current funding mechanisms. As this is being written, President Reagan and his administration have proposed changes in Social Security benefits that would have a profound effect on millions of people. Such changes, and the underlying problems which prompted them, are of serious concern to the insurance industry, and it is therefore proper for Unionmutual to develop a position on methods of funding the Social Security system and its benefits which would be equitable and effective.*

I. Summary of Recommendations: We have divided our recommendations into two areas: Short-term and long-term solutions.

A. Short-term solutions:

1. Inter-fund borrowing - - permitting the various trust funds** to borrow from each other, depending on the state of solvency in each fund.

2. Reallocation of Social Security taxes - - changing the amount of tax which goes into each fund.

3. Indexing benefits by a special cost-of-living index for the elderly - - using an index that will include a

*In addition to funding, the Social Security system is plagued with numerous administrative problem, such as those associated with the disability claims process. In this regard, we concur heartily with the recommendations of the International Claims Association. However, because of the overriding importance of proper funding, we have chosen to focus exclusively in this paper on that aspect of the system's problems.

**Section II further identifies the trust funds.

housing component calculated for the elderly rather than for the general population.

4. Phasing out minimum benefits and student benefits - - abolishing benefits to children of workers on the basis of their retired parent's wage record.

B. Long-term solutions:

1. Requiring coverage of all wage earners whether in public or private employment.

2. Changing the calculation of the Social Security Disability benefit - - arranging the benefit formula so that benefits are always under 100% of indexed pre-disability net income.

3. Capping benefits, particularly disability benefits, so that benefits from all sources are not excessive.

4. Changing the normal retirement age so as to more accurately reflect present-day mortality and life expectancy.

II. Background: The Social Security tax rate and wage base have increased again in 1981, cutting further into both paychecks and employers' profits. There are now 35 million recipients of Social Security checks who receive a total of more than $10 billion per month. Without reforms, the financially-squeezed system will not have enough cash to keep up with its payments. For those not yet receiving Social Security benefits, but who are paying Social Security payroll taxes, the question is twofold: first, will there be enough money for the future benefits promised, and second, will the taxes mount so high that they will be unaffordable? In 1980, Congress resorted to stopgap measures to stave off a then-imminent crisis in Social Security. It diverted a bigger share of the payroll tax into the trust fund that pays retirement and survivor benefits (Old Age and Survivors Insurance: OASI) and reduced the share going into the financially healthier fund for disability benefits (Disability Insurance: DI).* These measures evidently have not solved the problem. The pressures come primarily from an aging population making ever-increasing demands on Social Security. The number of persons over age 65 will grow from about 26 million now to about 65 million in the year 2030 before leveling off - - a 150% increase. At the same time, a declining birth rate will bring fewer new workers into the system and a greater life expectancy will have retirees collecting benefits longer. Today there are more than three workers paying Social Security taxes to support each beneficiary. By the year 2030, the ratio is expected to be less than two workers for each beneficiary. In addition, in times of high unemployment, many fewer workers are paying into the system and many more workers are retiring early rather than being labeled unemployed. All these factors bring enormous stress to the system, stress which must be addressed now since many of the problems are likely to become more severe in the very near future and many of the solutions are necessarily long-term in nature. For instance, Deputy Social Security Commissioner Robert J. Myers has calculated that the OASI will be bankrupt by 1983, and some experts, including Representative J. J. Pickle, Chairman of the House Social Security Subcommittee maintain that

*The other two Social Security trust funds are Hospital Insurance (HI), which funds the medicare program, and Supplemental Security Income, (SSI), which funds benefits for those below the poverty level.

all three funds (including the Medicare fund, HI), will be bankrupt by 1985. Because the nature of Congress is such that it will not readily address long-term issues, but prefers to deal with short-run cash shortages, we have considered short-term measures as well as the more fundamental long-term solutions.

III. <u>Analysis</u>: There are only three choices or combinations of choices for saving the Social Security system:

1. Reduce future Social Security benefits to levels which can be paid under the tax increases already on the books; Social Security tax rates are scheduled to rise again in 1982, 1985, 1986 and 1990.
2. Raise Social Security taxes to pay for all the future benefits already promised; this means adding more tax increases to those already scheduled.
3. Use income tax revenues to help pay for certain elements of Social Security; the entire Social Security tax could then be used to fund the remaining elements, but significant burdens would be added to the general Federal budget funded through the income tax.

Of these three possibilities, the third has some support right now in the Congress. Several bills presently before Congress would take all or part of Medicare (HI) out of the Social Security system and have it funded instead from general revenues. The cost of Medicare this year will be around $46 billion. If some of that money came from general revenues, Congress would have to cut an equal amount from other programs, simply to keep the deficit unchanged. This is a politically untenable solution, and passage of any such measure is extremely unlikely. Similarly, the second choice (raising Social Security taxes) is politically unacceptable. The perception of the American people is that they are already paying more than enough Social Security taxes. The only sound and feasible solution to the Social Security funding problem therefore, is to lower benefits. The real question is how these benefit cuts are to be made and who will be most affected by them.

A. Current Administration Proposals. The President's program takes a very direct approach to cutting benefits immediately; the most notable elements of his program are as follows:

1. Early Retirement Reductions. Under the proposals, the 1.6 million Americans per year who reach early retirement age and elect to retire on Social Security pensions would receive smaller benefits than under current law. Those retiring at age 62, the earliest age at which Social Security retirement benefits are presently paid, would receive 55% of the benefit payable at age 65, rather than the 80% under current law. Savings under this proposal, in the next five years, would be in the neighborhood of $17 to $20 billions. Since the President intends for this recommendation to be effective as of January 1, 1982, it would severely impact millions of individuals now approaching retirement age, who had done estate planning and retirement planning based on current benefit levels. In many cases, it would make it impossible for them to retire with an adequate income. This would encourage people to work after age 62 and continue contributing to Social Security but it is questionable whether it is morally correct or politically viable to disrupt the lives of several million people by reneging on promises made to them.

2. Disability Insurance Reforms. Currently, the disability program takes into account such factors as age and work experience as well as medical factors in determining eligibility for benefits. The President's proposal would consider medical factors alone. In addition, the waiting period for payments, reduced in recent years to 5 months and scheduled to become even shorter, would be changed back to its traditional period of 6 months. Eligibility for disability benefits now extends to those who have been in jobs covered by Social Security for only 20 of the past 40 quarters; the proposal would change the requirement to 30 or the past 40 quarters. By 1986, the combined effect of the disability changes would reduce benefits (and therefore costs) by nearly $24 billion a year.

3. Cost of Living Adjustments. The Administration proposed that the automatic cost-of-living increase scheduled for July of 1982 be delayed for three months. It was claimed that this change would end the anomaly of Social Security still operating on the pre-1976 federal fiscal year calendar. The saving in the next fiscal year would be $3.3 billion, based on a projected inflation rate of somewhat more than 8%.

4. Integration With Other Plans. The Administration would take into account pensions received from other government plans when calculating Social Security benefits, thus lowering the amount payable from Social Security.

5. Earnings Test Eliminated. The "earnings test" would be phased out and would be removed entirely in 1984. Currently, those who continue to work after the age of 65 have their benefits reduced by $1 for each $2 they earn in excess of $5500 per year until they are 72 years old. The proposal to phase out the "earnings test" would increase costs an estimated $6.5 billion over the next 5 fiscal years.

It would seem that several of the proposals by the Administration are inequitable because they affect the people least able to afford them, and are ineffective insofar as they do not address the long-term nature of the problems facing the Social Security administration.

B. Unionmutual Proposals. In developing a series of proposals to address the Social Security funding problem, Unionmutual has applied the following criteria:

-The solution must be equitably applied so that the impact is borne fairly by all groups.

-The solution must be sufficiently long-term in nature to allow people to adequately plan their retirement.

-The solution must preserve the primary nature of the Social Security system as a basic retirement security mechanism.

On the basis of our analysis and application of the criteria stated above, Unionmutual proposes the following measures to reform the current Social Security funding mechanism.

1. Short-term solutions:

(a) We support authorizing the various trust funds to borrow from each other if such action should be necessary to prevent any of these funds from declining to inadequate levels. In addition, should these actions not be sufficient to meet temporary financial emergencies, we would support authorizing the trust funds to borrow from the general fund of the Treasury whenever their reserves fall below two months' outlay, provided there is adequate provision for automatic repaying of such borrowing. By this mechanism, we would hope that aberrations in collection which are not long-term in nature could be smoothed over and the integrity of the various trust funds still maintained. It should be noted that this does not require reduction in benefits for anybody but is merely a modification of accounting methods.

(b) We support the reallocation of the Social Security tax contribution between OASI and DI. At present, the OASI and DI rate is 5.35% of payroll, with the HI tax (Medicare) making up the difference of 1.3% of the 6.65% present tax rate. The OASI tax allocation is about 60% of the 5.35% with the disability trust fund receiving the balance.*
In addition, we support the allocation being governed by regulation rather than statute so that immediate re-allocations may be made in the event of short-falls in one or the other of the funds. Again, this does not require any immediate reduction of benefits for those presently covered under Social Security. However, it must be noted that this is a very short-term solution. If, as mentioned above, all the funds are in danger of bankruptcy in the next few years, it is clear that this solution and the one above can be useful only in the very short-term until more fundamental changes can be made.

(c) We support the indexing of benefits using a special cost-of-living index for the elderly. At present, benefits are

*Of each dollar of tax paid, therefore, OASI receives $.48, DI receives $.32, and HI receives $.26. SSI is funded through general revenues.

indexed using the Consumer Price Index (CPI). The CPI does not provide an appropriate measure of costs for older persons because the real estate component is too heavily weighted for mortgage payments and interest rates. Many elderly individuals have either completed their mortgage payments, have older mortgages at much lower rates, or have disposed of their homes and are living in rental facilities. Because of the prominence of the real estate component in the CPI, it gives a skewed measure of cost-of-living for those in retirement. Therefore, we propose that a new index specifically tailored for the elderly be devised to eliminate this distortion. In this regard, the President's proposal to move the cost-of-living increases to October should also be adopted. Neither of these measures actually would decrease present monthly benefits paid to recipients, but would simply slow or defer the increase of those benefits.

(d) We support the President's recommendations to remove minimum benefits and student benefits. Minimum benefits were intended for those who worked throughout their lifetime at an extremely low wage rate, or for those who worked intermittently and thus did not acquire sufficient credits to produce an adequate benefit. However, it has become a method for "double-dipping". Many individuals with adequate pensions from public retirement systems or from the military have worked for a few years under Social Security to qualify for the minimum benefit which, together with their other coverage, produces benefits far in excess of those their credits would dictate. This double-dipping would be eliminated by ending the minimum benefit feature. The truly needy who would have gotten a minimum benefit can and should be aided through general revenues by the Supplemental Security Income program.

Similarly, the student benefit has, by and large, gone to many without true need and is one of the factors that has helped to transform the Social Security System from a system of basic social insurance to a welfare plan. At present, children aged 18 to 21 who go to school full time may receive Social Security benefits if one parent who was covered by Social Security is retired, disabled, or dead. Cutting student benefits would eliminate payments to upper-income families who do not need them. Middle-income students would qualify for other types of educational government-funded programs, such as loans, ROTC scholarships, etc. Low-income students would be eligible for Basic Education Assistance Grants. Providing educational assistance through Social Security appears to be a costly and inefficient method. President Reagan has proposed that no students would be added to the rolls starting this August, and that students already in the program would have their benefits cut by 25% a year until the program was phased out in 1986. We believe that this proposal should be enacted; however, we believe the effective date should be postponed one year to permit students to make alternate arrangements for funding their college costs.

2. Long-term solutions:

(a) We support mandatory coverage under Social Security of government employees and employees of nonprofit organizations in a way which assures that the overall benefit protection of employees who have spent their entire careers in such employment is not reduced.* Coverage should be extended to new federal civilian employees, new state and local government employees, all present employees of state and

governments who are not under an existing retirement system, and all employees of nonprofit institutions. This Social Security coverage should be integrated with any pension plan covering the employees involved.

This measure would eliminate the present gaps in the protection of such employees, permit the Social Security tax burden to be shared more equitably, permit the more equitable division of retirement income among the nation's elderly, and would have the added benefit of bringing millions of new taxpayers into the Social Security system to support existing recipients. This measure could also ease the pressure for near-term tax increases.

(b) We support the President's recommendation for changes in the calculation of Social Security Disability benefits to provide that in no event will the Social Security Disability benefit provide a replacement of greater than 100% of predisability net income, indexed annually to reflect inflation, and to

*This solution would render moot the short-term solution mentioned in 1.(d) above (regarding minimum benefits).

provide for a tightening of eligibility requirements for disability. An essential part of our proposal is that the disability benefit formula be adjusted so as to base the benefit on net after-tax income rather than on gross income. This would eliminate the need for family benefits because dependents are accounted for in after-tax income, and it would help to control the cost of future payments of disability benefits if properly reviewed by the Social Security Administration as dependents matured.

(c) We also support the President's recommendation of a "megacap" on disability benefits to assure that benefits from all public plans, including Social Security, Workers Compensation, Railroad Retirement, etc. would not exceed 100% of predisability net income. This measure, and that described above in 2 (b), would eliminate windfall benefits, increase incentive to return to work, and slow the rate of increase in benefit costs, while not reducing benefits for any current recipient.

(d) We approve changing the normal and early retirement ages gradually to reflect present-day mortality and life expectancy. A gradual adjustment in normal retirement age and early retirement age would give individuals sufficient advance notice to adjust their plans. Americans are now living significantly longer and are generally able to work longer than they did in 1935 when the retirement age for the receipt of benefits was set at 65. Unless the retirement age is increased, the future will see a substantial increase in the relative size of the retired population, and relatively few active workers to carry on the nation's productive processes and pay for the benefits of the retired. This change will be especially marked in the early part of the next century when the members of the World War II baby boom population begin to reach age 65. A gradual increase in the minimum retirement age would help to stabilize the financial position of the Social Security system and would avoid

placing undue financing burdens on the working population. Such an increase, being phased in after a long notification period, would greatly reduce the ratio of retirees to active workers in the next century, and in itself would eliminate about 2/3 of the long-term average deficit projected by the Social Security system.*

We do not support the President's proposal for cutting pre-age 65 retirement benefits. It does not appear to us to address the problem of longer life expectancy, nor is it a long-term solution to keeping individuals on the employment rolls to a higher age. Gradually increasing the minimum age for early retirement to 65 in combination with a normal

*Alternately, ages 62 and 65 could be maintained, with a cut-back in benefits from the present level. Also, only the normal retirement age could be moved up (to 68), with a cut-back in early retirement benefits, such as 55% at age 62, 80% at age 65, and 100% at age 68. On balance, however, we believe that a gradually phased-in increase in both normal and early retirement ages more effectively addresses the problem, and more accurately reflects demographic changes since 1935.

retirement age of 68, would have an even greater effect than the President's recommendation without the social and economic disruption the President's proposal would produce.

IV. Conclusion: Although it is clear that the recommended changes in the funding of the Social Security system would place certain burdens upon the insurance industry, it is even more clear that these burdens would be trivial compared to those which will result if dramatic action to save the Social Security system is not taken soon.

Unionmutual applauds the extensive studies of this issue which have been conducted by such groups as the National Commission on Social Security, the President's Commission on Pension Policy and the House Social Security Subcommittee. Our analysis of the issue has drawn heavily upon these resources. In formulating our recommendations, however, we have tested the suggestions of others against our three key criteria, namely:

- the solution must be equitably applied so that the impact is borne fairly by all groups;
- the solution must be sufficiently long-term in nature to allow people to adequately plan their retirement; and
- the solution must preserve the primary nature of the Social Security system as a basic retirement security mechanism.

In addition, we sought to focus upon those recommendations which have the potential to provide meaningful stability to the system, and which have a reasonable chance of being adopted.

Unionmutual urges the American people and the Congress to accept the urgent need for action to preserve the fundamental integrity of the Social Security system, and to recognize that a meaningful solution to the problem cannot be accomplished by sleight-of-hand juggling of accounts or political rhetoric. We must enact substantive modifications to the basic funding and benefits structure of our Social Security system soon. We can avoid the issue no longer.

In full recognition of the enormous complexity of the Social Security funding problem, Unionmutual offers for consideration and enactment the recommendations contained in this paper . . . recommendations which would be both equitable and effective.

A STATEMENT BY

BERNARD WARACH

EXECUTIVE DIRECTOR OF

THE JEWISH ASSOCIATION FOR SERVICES FOR THE AGED

A MEMBER OF

FEDERATION OF JEWISH PHILANTHROPIES OF NEW YORK

TO

THE U.S. SENATE COMMITTEE ON FINANCE

SUB-COMMITTEE ON SOCIAL SECURITY AND
INCOME MAINTENANCE PROGRAMS

ON

SOCIAL SECURITY FINANCING AND OPTIONS FOR THE FUTURE

TUESDAY, JULY 7TH, 1981

My name is Bernard Warach, Executive Director of the Jewish Association for Services for The Aged (JASA), a social agency affiliated with the Federation of Jewish Philanthropies of New York, with its central office at 40 West 68 Street, New York City, 10023.

JASA, organized in 1968, has been engaged in planning, development, and provision of community services and housing for older adults in New York City, Nassau and Suffolk Counties. JASA served more than 42,000 people in 1976, the elderly and their families, through information, referral, outreach, counseling, and case management services. More than 8,000 elderly people are participants in JASA's senior centers.

I appreciate this opportunity to express my views on the impact of President Reagan's proposed reductions in Social Security. The magnitude of these proposals demands an immediate and outspoken reaction by the public and by those officials representing them, to prevent potentially devastating consequences for our aging population.

The Reagan Administration proposals to slash Social Security benefits for current retirees, future retirees and the disabled, is in actuality a direct attack on the philosophy of the Social Security Act. The proposals undermine the very purpose of the Social Security retirement system which is to provide a sense of economic security for retired citizens based on trust in our government's policies and years of earned contributions.

Social Security is viewed by the public as a contract between workers, employers and the Federal government. Young people pay into the Social Security System with the understanding that they are protecting not only the well-being of their parents and grandparents, but are insuring their own futures. Social Security must be left intact not only to fulfill the promises made to the elderly of today, but also to the aged of tomorrow. Breach of this contract will undermine the faith of our young people in the purpose and priorities of our country. Recent surveys showing <u>wide</u> public support for increases in Social Security benefits must not be ignored.

Clearly, means must be found to supplement the Social Security Trust Fund to keep it solvent even in times of crisis. Because of this, many rational proposals have been raised to address problems of financing - proposals which <u>do not attack</u> the very heart of the Social Security Program.

Proposals worthy of support include:

- A temporary loan of 50% of Medicare funds to the Social Security Fund, with infusion of general revenues to cover the Medicare costs.
- Direct infusion of general revenue funds into the Social Security Trust Fund.
- Incentive for later retirement by raising from 3% (in 1982)

to 9% the increase in Social Security benefit levels for those able and willing to work past age 65.

These proposals address current economic realities without inflicting hardship on the 70% of workers forced to retire at age 62 due to illness, unemployment, or obsolete skills and disability.

While there is ever mounting discussion of "The Graying of America", as census takers predict large increases in the proportion of elderly in our society, I urge you to remember that a concurrent decline in the number of children and young adults is anticipated. This may reduce the fiscal costs for other services now funded by general revenues. These trends must be monitored carefully to insure a sensible allocation of resources.

Even as President Reagan addresses the concept of incentives for later retirement, he addresses the right question with the wrong answer. People should be encouraged to work if they are willing and able. However, eliminating the maximum amount which workers can earn and still receive full Social Security benefits ("The Earnings Test") would benefit only the highest income workers, those most likely to continue working anyway. People earning under $6,000/year, those most in need of financial assistance, would see no benefit at all. This increase in income for those least in need would be financed by the precious tax dollars of low income workers. How can one seriously consider eliminating a means test for the wealthy while creating harsher ones for the poor?

For this reason I support increasing Social Security benefit levels for those who are able and willing to continue working past age 65 as stated earlier. In this way, the incentive to continue working will assist low income people, without penalizing those unable to continue as employed workers.

The broad nature of Mr. Reagan's attack on the Social Security System makes it difficult to address every aspect of his proposal in a brief manner. I would like to go on record, however, as opposing all his proposals to reduce benefits, including:

- The delay and/or reduction of cost of living increases desperately needed by older people to offset inflation;
- The reduction of the initial formula for determining Social Security benefits from 42% of pre-retirement income to 32% (particularly in view of the already increasing number of elderly poor);
- The elimination of the minimum benefit, which again is geared to harm our poorest elderly;
- Elimination of student benefits and reduction in disability benefits for workers and their families.

I urge you to address your opposition not only to the specific cuts proposed by the Administration but to the underlying philosophy of the Reagan proposals. This philosophy implies that the only way to continue the Social Security Program is by attacking the benefit system and the elderly themselves - highlighting the belief stated by David Stockman that no one is entitled to anything.

In fact, the people of this country are entitled to receive compensation with dignity for the years of hard work poured into the United States.

There can be no compromise on any of these proposals without truly jeopardizing the future of our nation and its people.

Thank you.

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