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Staff Data and Materials on
**Social Security Financing
Proposals**

Prepared by the Staff for the Use of the
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RUSSELL B. LONG, *Chairman*



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SOCIAL SECURITY FINANCING

I. The Present Situation

The 1977 report of the Trustees of the social security trust funds showed for the fourth consecutive year that the social security cash benefits programs—old age, survivors and disability insurance or OASDI—were inadequately financed in both the near-term and the long-range future. (In addition the hospital insurance program (HI) was described as being adequately financed over the next 5 years but with a tax rate schedule which would not finance the program over the long-run.)

Two deficits.—There are really two cash-benefits deficits, a short-term deficit caused by recent economic conditions and a long-term deficit reflecting changes in economic conditions and the assumptions used for the actuarial estimates. The estimates in the 1977 reports of the Trustees were that the cash-benefits program could be expected to run out of funds in the early 1980's (with the disability program being depleted early in 1979 if some action to provide additional funds is not taken). In the long-run (the 75-year period ending in 2051), the average deficit for the cash-benefits programs was estimated at 8.2 percent of taxable payroll. This is equivalent to annual amounts of \$66 billion if based on the 1977 taxable payroll.

These deficits represent the magnitude of the financing problems facing the social security programs when averaged over the entire valuation period. The deficit at present and in the years immediately ahead is much smaller, but the ultimate deficit is much larger. (See chart 1).

The short-term deficit.—The 1977 report of the Trustees of the social security trust funds indicated that the cash-benefit programs need relatively modest but growing amounts of additional funds in the immediate future and quite large amounts later on. The estimated 1976-1981 income and expenditures of the combined cash-benefit trust funds and of each separate fund are shown in the following table.

(1)

TABLE 1.—ESTIMATED OPERATIONS OF THE SOCIAL SECURITY CASH-BENEFITS TRUST FUNDS DURING CALENDAR YEARS 1976-81 UNDER THE INTERMEDIATE COST ESTIMATES

[Dollar amounts in billions]

Calendar year	Income	Disbursements	Net increase in funds	Funds at end of year	Funds at beginning of year as a percentage of disbursements during year
Combined OASDI funds:					
1976 ¹	\$75.0	\$78.2	-\$3.2	\$41.1	57
1977.....	82.1	87.6	-5.5	35.6	47
1978.....	90.7	97.6	-7.0	28.6	36
1979 ²	99.6	107.4	-7.8	20.8	27
1980 ²	108.9	117.9	-9.1	11.8	18
1981 ²	117.4	128.9	-11.5	.3	9
OASI fund:					
1976 ¹	66.3	67.9	-1.6	35.4	54
1977.....	72.5	75.6	-3.1	32.3	47
1978.....	79.8	84.0	-4.2	28.1	38
1979.....	87.7	92.0	-4.3	23.8	31
1980.....	96.1	100.6	-4.4	19.4	24
1981.....	102.8	109.4	-6.7	12.7	18
DI fund:					
1976 ¹	8.8	10.4	-1.6	5.7	71
1977.....	9.6	12.0	-2.4	3.3	48
1978.....	10.9	13.6	-2.8	.5	24
1979 ³	11.8	15.3	-3.5	-3.0	3
1980 ³	12.8	17.4	-4.6	-7.6	(¹)
1981 ³	14.6	19.5	-4.9	-12.5	(¹)

¹ Figures for 1976 represent actual experience.

² Because the disability insurance trust funds is exhausted in 1979 under each alternative and because none of the estimated income to one trust fund can be allocated to the other trust fund, under present law, the figures for 1979-81 are theoretical, representing an arithmetical addition of the amounts shown below for each of the funds.

³ Figures for 1979-81 are theoretical because it is estimated that the disability insurance trust fund will be exhausted in 1979.

⁴ Fund exhausted in 1979.

Note: Totals do not necessarily equal the sum of rounded components.

The long-term deficit.—The long-term deficit comes about because earlier cost estimates—and as a result the financing—were based on economic and demographic assumptions which are now considered unrealistic. The intermediate cost estimates are now based on the assumption that in the period covered by the estimates there will be

a 5.75 percent annual rise in average earnings and a 4 percent annual rise in the CPI. While an improved mortality is assumed, this is offset by assuming an ultimate fertility rate of 2.1 percent (the approximate rate at which the population will stabilize at some point in the future). The following table summarizes the long-term cost estimates shown in the 1977 report of the Trustees.

TABLE 2.—THE LONG-RANGE DEFICIT

[In percent]

Calendar year	Expenditures as percent of taxable payroll	Tax rate in law	Difference
25-year averages:			
1977 to 2001.....	12.24	9.90	-2.34
2002 to 2026.....	18.85	11.18	-7.67
2027 to 2051.....	26.47	11.90	-14.57
75-year average: 1977 to 2051.....	19.19	10.99	-8.20

II. Alternatives for Short-Range Financing

Short-range financing objectives.—The goal of social security financing is to provide enough income to meet benefit payments. In the short run, the traditional objective has been to maintain a reasonable fund balance as contingency reserve, for example, to carry the program through a recessionary period. In the past, it was believed that a fund equal to about one year's benefit payments was appropriate. In 1972, when the last major financing changes were made, the Social Security Advisory Council recommended that the fund be maintained at a level of 75 percent to 125 percent of one year's benefits. The Administration has indicated that it would be appropriate at this time to aim for a goal of about 50 percent of one year's benefits.

Administration short-range proposals.—The Administration has submitted a legislative package which seeks to reduce the short-term and long-term deficit. The short-range financing provisions in the Administration bill do not meet the 50 percent goal but they do provide sufficient new income to prevent the funds from running completely out of money. Under the Administration bill, a fund level of 37 percent of one-year's benefits would be attained by 1987.

The Administration's short-range financing package includes the following elements:

General revenues.—General revenues would be transferred to the OASDI trust funds to replace social security taxes lost as a result of unemployment in excess of 6 percent during the recent recession. The proposal would apply to the period 1976–1982. (Under the intermediate assumptions in the 1977 trustees report, the unemployment rate drops below 6 percent after 1978.)

Employer Tax Base.—The limit on annual wages subject to the employer part of the social security tax would be eliminated entirely in 1981. (It would be increased to \$23,400 in 1979 and \$37,500 in 1980.)

Employee and Self-Employed Tax Base.—The Administration proposal would increase the annual amount of wages or self-employment income subject to the employee share of social security taxes (or the self-employment tax) by \$2,400 over and above the levels which would apply under existing law. This change would take place in 4 steps with \$600 increases in 1979, 1981, 1983, and 1985.

Eligibility for Dependents' Benefits.—The package includes a proposal under which a wife, widow, husband, or widower would have to meet a test of dependency on the spouse in order to qualify for dependents' or survivors' benefits.

Self-Employment Tax Rate.—The rate of the social security tax for the cash-benefits program for self-employed persons would be increased to a rate equal to $1\frac{1}{2}$ times the rate for employees. This change would be effective in 1979.

Reallocation of III Tax Revenue.—A portion of Hospital Insurance tax rate would be shifted to the cash-benefits program beginning in 1978.

The Administration proposal also would raise the social security cash-benefits tax rate by 0.25 percent (employer and employee each) effective January 1985. This increase in the tax rate, in effect, moves forward a part of the 1 percent (each) tax rate increase which under present law is scheduled to take place in 2011. (The remaining 0.75 percent (each) would be moved forward under the Administration's long-range proposals to 1990.)

Short-term effects of the Administration proposals.—The Administration has indicated that the cash-benefits program will need an additional \$83 billion in the period 1978–1982 in order to have a trust fund balance equivalent to 50 percent of one year's outgo. In order to provide this amount they have suggested a number of changes which could (1) reduce the amount needed by \$27 billion and (2) provide an additional \$56 billion in additional income.

The additional income would be provided by :

	<i>Billions</i>
Additional employer taxes.....	\$30
Additional employee taxes.....	4
Diversion of hospital insurance taxes.....	7
Increase in self-employment tax rate.....	1
Appropriation from general revenues.....	14
Total	56

The reduction would come from :

	<i>Billions</i>
Reducing the ratio of trust fund assets to expenditures from 50 percent to 35 percent.....	\$24
Adding a dependency requirement for spouses benefits.....	3
Total	27

The following tables show the estimated status of the cash-benefits trust funds under present law and under the Administration's package of proposals over the period 1977–1987 :

TABLE 3.—ESTIMATED OPERATIONS OF THE OASI AND DI TRUST FUNDS, COMBINED, DURING CALENDAR YEARS 1977-87 UNDER PRESENT LAW AND UNDER THE PROGRAM AS MODIFIED BY THE ADMINISTRATION'S PROPOSALS

[Dollar amounts in billions]

Calendar year:	Income		Outgo		Net increase in funds		Funds at end of year		Funds at beginning of year as a percentage of outgo during year	
	Present law	Administration proposal	Present law	Administration proposal	Present law	Administration proposal	Present law	Administration proposal	Present law	Administration proposal
	1977.....	\$82.1	\$82.1	\$87.6	\$87.6	-\$5.5	-\$5.5	\$35.6	\$35.6	47	47
1978.....	90.7	98.0	97.6	97.5	-7.0	.5	28.6	36.2	36	37
1979 ¹	99.6	108.5	107.4	107.0	-7.9	1.5	20.8	37.7	27	34
1980 ¹	108.9	121.3	117.9	117.4	-9.0	3.9	11.8	41.6	18	32
1981 ¹	117.4	134.1	128.9	128.1	-11.5	6.1	.3	47.6	9	32
1982 ¹	125.2	144.7	140.1	138.9	-14.9	5.8	-14.6	53.4	(²)	34
1983 ¹	132.9	155.1	152.0	150.3	-19.2	4.8	-33.8	58.2	(³)	36
1984 ¹	140.7	165.7	165.1	162.9	-24.4	2.8	-58.2	61.0	(³)	36
1985 ¹	148.4	184.7	179.2	176.4	-30.8	8.2	-89.0	69.2	(³)	35
1986 ¹	156.2	198.1	194.4	190.8	-38.1	7.3	-127.2	76.6	(³)	36
1987 ¹	164.4	211.3	210.5	206.0	-46.1	5.3	-173.3	81.8	(³)	37

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¹ Because it is estimated that the DI trust fund will be exhausted in 1979 under present law, the figures for 1979-87 under present law are theoretical.

² Less than 0.5 percent.

³ Funds exhausted.

Additional employer taxes.—Under present law employers, employees and the self-employed are taxed on the first \$16,500 of an individual's earnings. (The amount is scheduled to rise each year as average earnings rise.) The Administration proposes to remove this limitation on the employer tax base in three steps. In 1979 the employer tax would be applied to the first \$23,400 of an individual's wages and to the first \$37,500 in 1980. Starting in 1981 the employer's total payroll would be covered. The additional taxes which employers would pay in the years 1979-82 would be:

[In billions of dollars]

Year:	Additional employer taxes		
	Old-age, survivors, and disability insurance	Hospital insurance	Total
1979.....	2.1	0.5	2.6
1980.....	5.0	1.1	6.1
1981.....	8.1	2.2	10.3
1982.....	9.0	2.4	11.4

Additional employee taxes.—As mentioned above, the present law puts a ceiling on the amount of earnings subject to the social security tax, and the ceiling rises as average earnings rise. The Administration proposes four additional increases of \$600 in 1979, 1981, 1983 and 1985. The estimated ceilings under present law and under the administration proposal are shown below:

Year:	Ceiling	
	Present law	Administration proposal
1979.....	\$18,900	\$19,500
1980.....	20,400	21,000
1981.....	21,900	23,100
1982.....	23,400	24,600
1983.....	24,900	26,700
1984.....	26,400	28,200
1985.....	27,900	30,300
1986.....	29,400	32,100
1987.....	31,200	33,900
1988.....	33,000	35,700
1989.....	34,800	37,800
1990.....	36,900	39,900

The additional taxes that would be paid by employees and the self-employed as a result of the tax base increases are shown in the following table:

[In billions of dollars]

	Additional employee taxes		
	Old-age, survivors, and disability insurance	Hospital insurance	Total
Year:			
1979.....	0.4	0.1	0.5
1980.....	.5	.1	.6
1981.....	.9	.2	1.1
1982.....	1.0	.3	1.3

Diversion of hospital insurance taxes.—Under present law the hospital insurance program (Part A of Medicare) is financed through a payroll tax (separate from the taxes which support the cash-benefits program) which is permanently appropriated to the Federal Hospital Insurance Trust Fund. The tax is subject to the same ceiling which applies to the cash-benefits program and is paid by employees, employers and the self-employed. For 1977, the tax rate is 0.9 percent of earnings and is scheduled to rise to 1.1 percent in 1978 and to 1.35 percent in 1981 with additional increases in later years. The Administration proposes that these rates be cut to 1 percent in 1978 and to 1.15 percent in 1981. At the same time the cash-benefits tax rates would be increased by 0.1 percent in 1978, from 4.95 percent to 5.05 percent, and by an additional 0.1 percent (to 5.15 percent) in 1981.

INCREASE IN OASDI TRUST FUND AND DECREASE IN HI TRUST FUND

	Billions
1978.....	\$1.6
1979.....	2.0
1980.....	2.3
1981.....	4.8
1982.....	5.4

Although the 1977 report of the trustees of the hospital insurance trust fund states that, over the 25-year period covered by the cost estimates, the average deficit is 1.16 percent of taxable payroll, the Administration says that the program will need less money than previously anticipated if their cost containment program is enacted. Should that program be enacted, they anticipate a savings of about \$10 billion through 1982. In effect, they propose to allocate \$7 billion of the anticipated savings plus all of the added revenue generated by the proposed tax base increases and general fund contributions to the cash-benefits programs.

The net impact of the Administration's short-range financing proposals on the hospital insurance program would be an increase in the deficit from 1.16 percent of taxable payroll to 1.22 percent of taxable payroll. If the Administration's cost containment proposals are enacted and have the anticipated effects, that deficit would be reduced to 0.79 percent of payroll (at current payroll levels about \$6.3 billion per year over the 25-year valuation period). The hospital insurance trust fund would become exhausted under the Administration's financing proposal in 1985 or, if the cost containment proposals are enacted and effective, in 1990.

TABLE 4.—LONG-RANGE (25-YR) STATUS OF HOSPITAL INSURANCE TRUST FUND UNDER INTERMEDIATE ASSUMPTIONS

[In percent of taxable payroll]

	Under present law	Under administration financing proposal	
		Without cost containment	With cost containment
Average cost.....	3.96	3.66	3.23
Average tax rate.....	2.80	2.44	2.44
Actuarial balance..	-1.16	-1.22	-.79

TABLE 5.—HOSPITAL INSURANCE TRUST FUND BALANCES

Year	Start-of-year balance (billions)			Start-of-year balance as percent of outgo for year		
	Administration proposal			Administration proposal		
	Present law	Without containment	With containment	Present law	Without containment	With containment
1978..	\$11	\$11	\$11	55	55	58
1979..	12	12	13	56	53	60
1980..	14	12	14	53	47	60
1981..	14	11	16	45	39	59
1982..	17	13	20	50	38	65
1983..	19	12	23	50	50	67
1984..	19	9	25	44	20	64
1985..	17	2	24	34	5	56
1986..	11	0	21	20	0	44
1987..	6		21	10		38
1988..	0		18	0		29
1989.....			12			18
1990.....			2			3
1991.....			0			0

Increase in self-employment tax rate.—When earnings from self-employment were made subject to the social security tax in 1950, the rate was set at 1.5 times the employee rate. At that time the employee rate was 1.5 percent and the self-employment rate was 2.25 percent. Over the years as tax rates were increased, the 1.5 ratio was maintained until 1973 when the cash-benefits rate for the self-employed was frozen at 7 percent. (When the hospital insurance program was established the self-employment rate for that program was made equal to the employee rate and has remained equal as the rate has increased.) The Administration proposal would increase the self-employment tax rate for cash benefits according to the original ratio of 1.5 times the employee rate. The self-employment hospital insurance rate, however, would continue to be equal to the employee rate.

The additional taxes that would be paid by the self-employed in the period 1979–1982 are shown in the following table:

ADDITIONAL SELF-EMPLOYMENT TAX		<i>Billions</i>
Year:		
1979	.....	\$0.1
1980	.....	.3
1981	.....	.4
1982	.....	.4

New tax rate schedules.—The parts of the Administration package calling for increased self-employment tax and the diversion of hospital insurance funds into the OASDI funds would necessitate the enactment of revised tax rate schedules as shown below:

TABLE 6.—SOCIAL SECURITY TAX RATES UNDER PRESENT LAW AND UNDER THE ADMINISTRATION'S PROPOSALS

[Percent of taxable earnings]

	OASDI	OASI	DI	HI	Total
EMPLOYEES AND EMPLOYERS, EACH					
Present law:					
1977	4.950	4.375	0.575	0.900	5.850
1978–80	4.950	4.350	.600	1.100	6.050
1981–82	4.950	4.300	.650	1.350	6.300
1983–84	4.950	4.300	.650	1.350	6.300
1985	4.950	4.300	.650	1.350	6.300
1986–89	4.950	4.250	.700	1.500	6.450
1990–2010	4.950	4.250	.700	1.500	6.450
2011 and later	5.950	5.100	.850	1.500	7.450
Proposal:					
1977	4.950	4.375	.575	.900	5.850
1978–80	5.050	4.300	.750	1.000	6.050
1981–82	5.150	4.350	.800	1.150	6.300
1983–84	5.150	4.300	.850	1.150	6.300
1985	5.400	4.550	.850	1.150	6.550
1986–89	5.400	4.475	.925	1.300	6.700
1990–2010	6.150	5.000	1.150	1.300	7.450
2011	6.150	5.000	1.150	1.300	7.450

TABLE 6.—SOCIAL SECURITY TAX RATES UNDER PRESENT LAW AND UNDER THE ADMINISTRATION'S PROPOSALS—Continued

[Percent of taxable earnings]

	OASDI	OASI	DI	HI	Total
SELF-EMPLOYED PERSONS					
Present law:					
1977.....	7.000	6.185	.815	.900	7.900
1978.....	7.000	6.150	.850	1.100	8.100
1979-80.....	7.000	6.150	.850	1.100	8.100
1981-82.....	7.000	6.080	.920	1.350	8.350
1983-84.....	7.000	6.080	.920	1.350	8.350
1985.....	7.000	6.080	.920	1.350	8.350
1986-89.....	7.000	6.010	.990	1.500	8.500
1990-2010.....	7.000	6.010	.990	1.500	8.500
2011 and later.....	7.000	6.000	1.000	1.500	8.500
Proposal:					
1977.....	7.000	6.185	.815	.900	7.900
1978.....	7.100	6.045	1.055	1.000	8.100
1979-80.....	7.600	6.470	1.130	1.000	8.600
1981-82.....	7.700	6.500	1.200	1.150	8.850
1983-84.....	7.700	6.430	1.270	1.150	8.850
1985.....	8.100	6.830	1.270	1.150	9.250
1986-89.....	8.100	6.710	1.390	1.300	9.400
1990-2010.....	9.200	7.480	1.720	1.300	10.500
2011 and later.....	9.200	7.480	1.720	1.300	10.500

Appropriation from general revenues.—The Administration proposal includes what it describes as a counter-cyclical financing mechanism to compensate the cash-benefits and hospital insurance programs for the income that is not forthcoming from taxes because unemployment is in excess of 6 percent. The proposal would transfer funds from general revenues to the OASDI trust funds. The amount of the transfer from general revenues would be calculated as follows: for every tenth of a percent that the unemployment rate exceeded 6 percent, general funding equal to 3/10 percent of social security tax collections would be added to the trust funds. This formula would apply to the years 1975-1978. The amount calculated under this formula is estimated to be \$14.1 billion for the entire period. It would be appropriated to the trust fund in three installments:

Year:	Billions
1978.....	\$6.5
1979.....	4.3
1980.....	3.3
Total.....	14.1

Although the Administration proposals are based on an assumption that the provision would become a permanent part of the social security financing plan, they suggest that it be enacted on a temporary basis. The Advisory Council on Social Security (to be appointed this year and to report at the end of 1978) would be charged with recommending whether such a provision should be part of the permanent financing scheme.

Ratio of trust fund assets.—The Administration short-term financing proposals are premised on a decision to recommend that the balance in the social security trust funds at the end of any year should be about 50 percent of the expenditures anticipated for the following year. This 50 percent ratio, they say, could be further reduced to 35 percent, provided that their recommendations for general revenue financing are adopted. If a 50 percent trust fund level was determined to be desirable, rather than the 35 percent level, an additional \$24.1 billion would be needed for the period 1978–1982.

Dependency requirement for spouses benefits.—The Social Security Act provides benefits for a wife or a widow without regard to her actual dependency on her husband. However, benefits for a husband or a widow are authorized in the law only if the husband received at least one-half of his support from his wife in the year before she became disabled, retired or died. Recently the Supreme Court ruled that the provision of the Act requiring a husband or widower to establish his dependency was discriminatory and unconstitutional. Therefore, the Social Security Administration has begun to pay benefits to husbands and widowers even though they were not dependent on their spouses. Under the Administration proposal, dependency would have to be established to qualify for wife's, widow's, husband's, or widower's benefits. The dependent spouse would be the one who had the smaller income for the three year period prior to application for benefits. The savings resulting from the adoption of this provision are estimated at approximately \$3 billion in 1978–1982.

TABLE 7.—SOURCE OF ADDITIONAL REVENUES PRODUCED BY THE ADMINISTRATION PLAN

[In billions of dollars]

Year	Change in trust funds current law	Removing base for employers	Counter-cyclical general revenues	Increasing base for employees	Increasing self-employment tax rate	Reduced outgo ¹	Reallo-cation of part of HI rate	Added interest income	Total effect	Change in trust funds under plan
Old-age, survivors, and disability insurance										
1978.....	-6.9	.....	+5.5	.....	.....	+0.1	+1.6	+0.3	+7.5	+0.6
1979.....	-7.9	+2.1	+3.6	+0.4	+0.1	+3	+2.0	+8	+9.3	+1.4
1980.....	-9.1	+5.0	+2.8	+5	+3	+6	+2.3	+1.5	+13.0	+3.9
1981.....	-11.5	+8.1	.....	+9	+4	+9	+4.8	+2.5	+17.7	+6.1
1982.....	-14.9	+9.0	.....	+1.0	+4	+1.5	+5.4	+3.7	+20.9	+6.0
Hospital insurance										
1978.....	+1.9	.....	+1.0	.....	.....	+0.8	-1.6	.....	+0.2	+2.0
1979.....	+1.2	+5	+7	+1	.....	+1.3	-2.0	+0.1	+7	+1.9
1980.....	-.1	+1.1	+5	+1	.....	+2.0	-2.3	+1	+1.5	+1.4
1981.....	+3.6	+2.2	.....	+2	.....	+2.7	-4.8	+2	+5	+4.0
1982.....	+2.3	+2.4	.....	+3	.....	+3.4	-5.4	+2	+9	+3.2
Cumulative total, 1977-82										
OASDI.....	-50.3	+24.2	+11.9	+2.8	+1.2	+3.5	+16.1	+8.8	+68.4	+18.1
HI.....	+8.8	+6.2	+2.2	+7	.....	+10.2	-16.1	+6	+3.7	+12.5
Total...	-41.5	+30.4	+14.1	+3.5	+1.2	+13.6	.....	+9.4	+72.1	+30.6

¹ Includes effect of institution of new dependency test, decoupling, and hospital cost containment.

Note: Individual items may not add to total due to rounding.

Alternative short-range financing proposal.—The Administration short-range financing package relies most heavily on two elements: a “counter-cyclical” transfer of funds from general revenues and a substantial increase in the amount of earnings subject to Social Security taxes through a phased-in removal of the limit on the amount of annual wages subject to the employer part of the Social Security tax. If the Committee wishes to provide the necessary short-term financing without reliance on general Treasury funds, it could consider an alternative proposal which essentially adopts most of the other elements of the Administration package but makes them effective somewhat sooner. Such an alternative package could include the following elements:

1. Remove the ceiling on the annual wages subject to the employer social security tax effective January 1978. (This is a modification of the Administration proposal to remove the ceiling in three steps occurring in 1979, 1980 and 1981.)

2. Increase the employer and employee tax rate by 0.25 percent each effective January 1981. (This is a modification of the Administration proposal to make the same rate increase effective January 1985.)

3. Increase the self-employment tax rate to $1\frac{1}{2}$ times the employee rate effective January 1981. (This is a modification—in this case a deferral—of the Administration proposal which would make the change effective January 1979.)

4. Increase the annual wages and self-employment income taxable to employees and the self-employed by \$2,400 over and above the levels which would be taxed under present law. There would be four increases of \$600 each in 1979, 1981, 1983, and 1985. (This is part of the Administration proposal.)

5. Modify the cash-benefit and hospital insurance tax rates so that all the additional income resulting from increasing the tax base would go to the cash-benefit programs. (This is a substitute for the Administration proposal which would divert present income from the hospital insurance program to the cash-benefit program. The alternative proposal would neither reduce nor significantly increase Medicare funding.)

6. Reduce the benefits payable to the dependents and survivors of a worker by the amount of any public retirement or disability benefits payable to the dependent or survivor on the basis of his employment which was not covered under social security. (This is a substitute for the dependency test the Administration proposes be used to determine eligibility for spouse's benefits. The alternative proposal follows a recommendation by the most recent Social Security Advisory Council. The staff believes that the Administration proposal has two significant drawbacks. First, it would be subject to some degree of manipulation. For example, individuals could tailor their retirement decisions in a way to assure eligibility; in this way much of the projected savings from the adoption of the provision might not materialize. Second, the Administration provision would be difficult to administer and would introduce a type of means test into the determination of eligibility for Social Security beneficiaries. The alternative proposal would accomplish much the same objective in a simpler way.)

TABLE 8.—ESTIMATED OPERATIONS OF THE OASI AND DI TRUST FUNDS, COMBINED, UNDER THE ALTERNATIVE PROPOSAL

[Dollar amounts in billions]

	Income	Outgo	Net Increase in fund	Fund at end of year	Fund at beginning of year as a percent- age of dis- bursements during year
Calendar year:					
1977.....	\$82.1	\$87.6	-\$5.5	\$35.6	47
1978.....	97.3	97.6	-.4	35.2	36
1979.....	108.9	107.3	1.6	36.9	33
1980.....	120.0	117.7	2.3	39.2	31
1981.....	138.9	128.5	10.4	49.5	30
1982.....	149.2	139.5	9.8	59.3	36
1983.....	160.2	151.1	9.1	68.4	39
1984.....	171.4	163.8	7.6	76.0	42
1985.....	183.1	177.5	5.7	81.7	43
1986.....	195.4	192.0	3.4	85.1	43
1987.....	208.5	207.4	.7	85.8	41

TABLE 9.—SHORT-TERM ADDITIONAL FUNDING UNDER ALTERNATIVE PROPOSAL, 1978-82

	<i>Billions</i>
Elimination of ceiling for employers.....	\$48
Increase in employee and self-employed tax base.....	3
0.25 percent increase in employee and employer tax rates, 1981.....	12
Increase self-employment tax rate to 1½ times employee rate, 1981.....	1
Additional interest earnings.....	9
Decrease in outgo.....	2
Total, additional funding.....	75

¹ Includes additional income that would go to HI trust funds if HI tax rate were not changed. As a result, proposed changes would have no effect on current actuarial status of HI program.

The overall impact of the alternative short-range financing proposal would be comparable to the impact of the Administration proposal ex-

cept that there would be no reliance on general revenue funds and the trust funds would come somewhat closer to meeting the 50 percent of a year's benefit objective by 1987 (see chart 2).

TABLE 10.—INCREASED SOCIAL SECURITY TAX REVENUES UNDER THE ALTERNATIVE FINANCING PROPOSAL, 1978-87

[In billions of dollars]

Calendar year:	Elimination of base for employers	Increases in base for employees and self-employed persons	Increases in tax rates for employees and employers	Increases in tax rates for self-employed persons	Total
1978.....	6.9				6.9
1979.....	8.9	0.5			9.4
1980.....	9.7	.6			10.4
1981.....	10.8	1.1	5.8	0.1	17.8
1982.....	11.4	1.3	6.5	.7	19.9
1983.....	12.1	1.7	7.0	.8	21.5
1984.....	12.8	1.8	7.5	.8	23.0
1985.....	13.7	2.3	8.0	.9	24.8
1986.....	15.0	2.7	8.5	.9	27.2
1987.....	15.9	2.8	9.1	1.0	28.9

Alternatives proposed by Senator Curtis.—A second alternative financing package has been proposed to the Committee by Senator Curtis. This proposal primarily relies on an increase in the social security tax rate to provide short range financing and incorporates the price-indexing proposal for long-range financing. The following elements are included in Senator Curtis' package:

1. An increase in the social security tax rate of 0.3 percent (employer and employee each) effective January 1, 1978.

2. A further increase in the tax rate of 0.2 percent (employer and employee each) effective January 1, 1979.

3. An increase in the self-employment tax rate to 1½ times the employee rate effective January 1978.

4. Reduce the benefits payable to the dependents and survivors of a worker by the amount of any primary public retirement or disability benefits. (This proposal is comparable to the staff proposal concerning dependents benefits.)

5. Long-range financing through price indexing.

TABLE 11.—ESTIMATED OPERATIONS OF THE OASI AND DI TRUST FUNDS, COMBINED, UNDER THE PROPOSAL OF SENATOR CURTIS

[Dollar amounts in billions]

	Income	Outgo	Net increase in fund	Fund at end of year	Fund at start of year as a percentage of outgo during year
Calendar year:					
1977.....	\$82.1	\$87.6	-\$5.5	\$35.6	47
1978.....	95.8	97.6	-1.8	33.8	36
1979.....	110.1	107.2	2.9	36.7	32
1980.....	121.7	116.4	5.3	42.0	32
1981.....	132.2	126.8	5.4	47.4	33
1982.....	142.1	137.0	5.0	52.5	35
1983.....	152.2	147.8	4.4	56.9	36
1984.....	162.6	159.2	3.4	60.3	36
1985.....	173.3	171.4	1.9	62.2	35
1986.....	184.5	183.7	.7	62.9	34
1987.....	196.5	196.4	.1	63.0	32

Two year plan.—In addition to the complete financing package described above, Senator Curtis offered for committee consideration a “two-year” plan designed primarily to meet the immediate cash flow problems of the program (but also including the price-indexing approach). The two-year plan is the same as the package described above except that the 0.3 percent tax rate increase (employer, employee each) would be effective for only 2 years (1978 and 1979) and the second rate increase of 0.2 percent (each) in 1979 is deleted from the plan. The following tables show the estimated progress of the trust funds under this approach.

TABLE 12.—ESTIMATED OPERATIONS OF THE OASI AND DI TRUST FUNDS, COMBINED, UNDER THE 2-YR PLAN PROPOSAL OF SENATOR CURTIS

[Dollars amounts in billions]

	Income	Outgo	Net increase in fund	Fund at end of year	Fund at start of year as a percentage of outgo during year
Calendar year:					
1977.....	\$82.1	\$87.6	-\$5.5	\$35.6	47
1978.....	95.8	97.6	-1.8	33.8	36
1979.....	106.3	107.2	-.9	32.9	32
1980.....	110.6	116.4	-5.8	27.1	28
1981.....	118.9	126.9	-8.0	19.1	21
1982.....	126.9	137.2	-10.3	8.8	14
1983.....	135.1	147.9	-12.8	-4.0	6
1984.....	143.3	159.3	-16.0	-20.1	(¹)
1985.....	151.7	171.5	-19.8	-39.9	(¹)
1986.....	160.4	183.9	-23.5	-63.4	(¹)
1987.....	169.7	196.6	-26.9	-90.3	(¹)

¹ Funds are exhausted in 1983.

TABLE 13.—SHORT-TERM ADDITIONAL FUNDING UNDER THE PROPOSALS OF SENATOR CURTIS, 1978-82

[In billions of dollars]

	Complete package	2-yr plan
Tax rate increases.....	47.8	10.8
Increase self-employment tax rate to 1½ times employee rate.....	3.3	1.8
Decrease in outgo from dependency test.....	2.0	2.0
Decrease in outgo from new benefit formula.....	5.9	5.9
Total, additional funding.....	59.0	20.5

TABLE 14.—SOCIAL SECURITY TAX RATES UNDER VARIOUS PROPOSALS¹

[In percent; employer and employee, each]

Year	Present law	Administration proposal	Staff alternative	Curtis proposal
A. Total tax rate:				
1977.....	5.85	5.85	5.85	5.85
1978.....	6.05	6.05	6.05	6.35
1979-80.....	6.05	6.05	6.05	6.55
1981-84.....	6.30	6.30	6.55	6.55
1985.....	6.30	6.55	6.55	6.55
1986-89.....	6.45	6.70	6.70	6.70
1990-2010.....	6.45	7.45	7.45	6.70
2011 and after.....	7.45	7.45	7.45	7.45
B. Cash benefits part of total tax:				
1977.....	4.95	4.95	4.95	4.95
1978.....	4.95	5.05	5.00	5.25
1979-80.....	4.95	5.05	5.00	5.45
1981.....	4.95	5.15	5.35	5.45
1982-84.....	4.95	5.15	5.30	5.45
1985-89.....	4.95	5.40	5.30	5.45
1990-2010.....	4.95	6.15	6.05	5.45
2011 and after.....	5.95	6.15	6.05	5.95

¹ Including long-range proposals described in pt. III below.

III. Alternatives for Long-Range Financing

The short-range financing changes proposed by the Administration (or under the alternative proposal) would have a favorable impact on the long-range financial status of the system. However, a very large long-range deficit would still remain after making those changes. This deficit relates to economic and demographic factors and to the operation of the present law system for automatically increasing the benefit formula used to compute benefits for new retirees. While it is not possible to directly change future economic and demographic factors, it is possible to modify the benefit structure of the program to reduce the anticipated deficit. Most proposals which have been advanced for dealing with the long-range social security deficit do provide for a structural change in the way of computing initial benefits in order to reduce the cost of the program and make it less sensitive to economic changes. Table 15 shows how benefit levels and program costs have increased in the past and are projected to increase in the future if the present benefit formula is left unchanged.

TABLE 15.—HISTORICAL BEHAVIOR AND PROJECTIONS OF PRESENT PROGRAM

- Initial Average Benefit Same as in Present Law
- Workers Earnings Records Not Indexed
- Benefit Formula Bend Points Not Indexed
- Benefit Formula Factors CPI Indexed (ad hoc increases prior to 1975)

Year	Worker with average earnings ¹		Replacement rate for worker with—		Aggregate OASDI expenditures	
	Annual benefit in 1977 prices	Replacement rate (percent)	Low earnings ² (percent)	High earnings ³ (percent)	As percent of payroll (percent)	As percent of GNP (percent)
1955.....	\$2,141	31	45	31	3.3	1.3
1960.....	2,493	33	45	30	5.9	2.3
1965.....	2,665	32	43	33	8.0	2.8
1970.....	2,987	34	46	29	8.1	3.4
1975.....	3,619	43	56	30	10.7	4.6
1979.....	4,444	46	58	35	10.9	4.5
1985.....	5,354	48	60	35	11.6	4.8
1990.....	5,871	49	63	36	12.4	5.1
1995.....	6,476	49	66	37	13.1	5.4
2000.....	7,406	52	75	39	13.9	5.7
2010.....	9,489	56	84	42	16.6	6.8
2020.....	11,916	60	91	44	21.6	8.9
2030.....	14,765	63	96	46	26.0	10.7
2040.....	18,122	65	102	47	26.7	11.0
2050.....	22,088	67	106	48	26.9	11.1

	Percent
Average medium-range cost (1977-2001).....	12.2
Average medium-range revenue.....	9.9
Average medium-range deficit.....	-2.3
Average long-range cost (1977-2051).....	19.2
Average long-range revenue.....	11.0
Average long-range deficit.....	-8.2

¹ Assumed to be 4 times the average 1st quarter covered earnings.

² Assumed at \$4,600 in 1976 and following the trends of the average.

³ Assumed at the maximum taxable under the program.

⁴ Based on full employment and assuming taxable payroll equals 41.1 percent of GNP.

Note: The estimates in this table are based on the economic and demographic assumptions used in the intermediate cost estimates (alternative II) in the 1977 OASDI Trustees Report. The replacement rates pertain to workers with steady employment at increasing earnings and compare the annual retirement benefit at age 65 with the earnings in the year immediately prior to retirement.

Decoupling.—The starting point for most proposals for dealing with the long-term deficit of the social security system is a concept called “decoupling.” Decoupling means that the automatic benefit increase mechanism in present law would continue to apply to keep benefits inflation proof after a person retires and begins to draw his benefits but the formula for initially determining benefits at the time of retirement would no longer be automatically increased. If the system were simply decoupled with no other changes, a man or woman retiring in 1987 would get the same initial benefit as a man or woman with the same average earnings retiring in 1977. The level of initial benefits would tend to grow in the future but only as a result of rising wage levels which, using the same benefit formula, would tend to generate higher benefits. However, the rise in actual benefits awarded in the future would not be enough to keep pace with rising wage levels or to offset the rise in the CPI.

Simple decoupling would completely eliminate the long-range deficit and would, in fact, generate a long-range surplus of 3.8 percent of taxable payroll. However, the impact on benefit levels for initial retirees in the future would be a decline in adequacy as compared with the present situation whether measured in terms of purchasing power or in terms of replacement rates. After simple decoupling, it would be necessary to adopt a new automatic mechanism for increasing initial benefit levels in order to assure continued adequacy unless Congress wished to leave this to ad hoc legislation. A number of proposals for automatic increases in initial benefit levels are discussed in the following pages.

TABLE 16.—IMPACT OF SIMPLE DECOUPLING

[Present law provisions except no CPI adjustment of benefit table]

- Initial Average Benefit Same as in Present Law
- Workers Earnings Records Not Indexed
- Benefit Formula Bend Points Not Indexed
- Benefit Formula Factors Not Indexed

Year	Worker with average earnings ¹		Replacement rate for worker with—		Aggregate OASDI expenditures	
	Annual benefit in 1977 prices	Replacement rate (percent)	Low earnings ² (percent)	High earnings ³ (percent)	As per cent of payroll (percent)	As per cent of GNP ⁴ (percent)
1979.....	4,444	46	58	35	10.9	4.5
1985.....	4,133	37	46	26	10.8	4.5
1990.....	3,724	31	40	22	10.3	4.2
1995.....	3,376	26	34	19	9.3	3.8
2000.....	3,177	22	32	16	8.2	3.4
2010.....	2,827	17	24	13	6.7	2.8
2020.....	2,699	14	18	12	6.3	2.6
2030.....	2,753	12	14	10	5.8	2.4
2040.....	2,956	11	12	10	4.9	2.0
2050.....	3,294	10	11	9	4.3	1.8

	<i>Percent</i>
Average medium-range cost (1977-2001).....	10.0
Average medium-range revenue.....	9.9
Average medium-range deficit.....	-1
Average long-range (1977-2051).....	7.2
Average long-range revenue.....	11.0
Average long-range surplus.....	+3.8

¹ Assumed to be 4 times the average 1st quarter covered earnings.

² Assumed at \$4,600 in 1976 and following the trends of the average.

³ Assumed at the maximum taxable under the program.

⁴ Based on full employment and assuming taxable payroll equals 41.1 percent of GNP.

Note: The estimates in this table are based on the economic and demographic assumptions used in the intermediate cost estimates (alternative II) in the 1977 OASDI Trustees Report. The replacement rates pertain to workers with steady employment at increasing earnings and compare the annual retirement benefit at age 65 with the earnings in the year immediately prior to retirement.

Administration Proposal.—The bill submitted by the Administration, like other long-range financing proposals, provides for decoupling—eliminating the present automatic adjustment mechanism as it applies to new retirees. The proposal then substitutes a new benefit formula for new retirees, effective in 1979. In 1979 the Administration's new benefit formula would generate approximately the same benefits as the current law formula. However, it would not be applied to the individual's actual wages, as is the case under current law. Instead, it would be applied to the individual's wages after adjustment for changes in national wage levels during his working years.

The Administration proposal is designed to assure that the benefits for new retirees in the future will represent the same percentage of their earnings in the year before retirement as would be the case under present law in 1979. The purchasing power of benefits would increase (in constant dollars) from about \$4,300 in 1979 for a worker with average wages to about \$14,000 by the year 2050.

The wage indexed benefit formula proposed by the Administration has a cost which significantly exceeds the savings from decoupling and the revenues generated by the short-term financing proposals. The Administration proposes to meet a part of the residual long-range deficit by moving forward to 1990 a tax rate increase of 0.75 percent (employer and employee each). Even with this additional financing, however, the Administration proposal does not attain long-range actuarial soundness. The remaining deficit after all of the Administration proposals are adopted would be 2.1 percent of payroll (at 1977 payroll levels approximately \$17 billion per year) on the average over the next 75 years. (The Administration package would have a favorable balance of +0.4 percent of payroll over the next 25 years, an unfavorable balance of -1.7 percent of taxable payroll from 2002 to 2026, and of -5.0 percent of taxable payroll over the 25 years from 2027 to 2051.)

TABLE 17.—WAGE INDEXING

[Proposal recommended by Carter administration]

- Initial Average Benefit Close to Present Law in 1979
- Workers Earnings Records Wage Indexed
- Benefit Formula Bend Points Wage Indexed
- Benefit Formula Factors Not Indexed

Year	Worker with average earnings ¹		Replacement rate for worker with—		Aggregate OASDI expenditures	
	Annual benefit in 1977 prices	Replacement rate (percent)	Low earnings ² (percent)	High earnings ³ (percent)	As percent of payroll (percent)	As percent of GNP ⁴ (percent)
1979.....	\$4,444	46	58	35	10.9	4.5
1985.....	5,027	45	58	34	11.5	4.7
1990.....	5,460	45	58	34	12.0	4.9
1995.....	5,939	45	58	35	12.4	5.1
2000.....	6,455	45	58	35	12.7	5.2
2010.....	7,626	45	58	36	14.0	5.7
2020.....	9,012	45	58	36	17.0	7.0
2030.....	10,648	45	58	36	19.3	7.9
2040.....	12,583	45	58	36	18.8	7.7
2050.....	14,863	45	58	36	18.1	7.5

	Percent
Average medium-range cost (1977-2001).....	11.8
Average medium-range revenue.....	9.9
Average medium-range deficit.....	-1.9
Average long-range cost (1977-2051).....	15.3
Average long-range revenue.....	11.0
Average long-range deficit.....	-4.3

¹ Assumed to be 4 times the average 1st quarter covered earnings.

² Assumed at \$4,600 in 1976 and following the trends of the average.

³ Assumed at the maximum taxable under the program.

⁴ Based on full employment and assuming taxable payroll equals 41.1 percent of GNP.

Note: The estimates in this table are based on the economic and demographic assumptions used in the intermediate cost estimates (alternative II) in the 1977 OASDI Trustees Report. The replacement rates pertain to workers with steady employment at increasing earnings and compare the annual retirement benefit at age 65 with the earnings in the year immediately prior to retirement. The values in this table refers only to the Administration wage-indexing proposal and exclude the effect of all other benefit and financing modifications in the Administration proposal.

The above table shows the impact on social security program costs of the Administration proposals for revising the benefit formula. The overall impact of the Administration package including short- and long-range financing changes is shown in table 18 below.

TABLE 18.—IMPACT OF TOTAL ADMINISTRATION PACKAGE ON MEDIUM- AND LONG-RANGE STATUS OF SOCIAL SECURITY CASH-BENEFITS PROGRAM

	<i>Percent</i>
Average medium-range cost (1977-2001).....	10.87
Average medium-range revenue.....	11.32
Average medium-range surplus.....	+0.45
Average long-range cost (1977-2051).....	14.07
Average long-range revenue.....	11.97
Average long-range deficit.....	-2.10

Other proposals.—Several alternative long-range financing proposals have been made. One of these, called “price indexing”, would adopt a new benefit formula in which benefits would be computed using the individual’s wages after an adjustment for changes in price levels during his working years (rather than for changes in wage levels as under the Administration proposal). This price indexing proposal would entirely eliminate the long-range deficit and would still permit substantial increases in future purchasing power of initial benefits. However, it would result in an immediate and continuing decline in replacement rates (initial benefit levels as a percentage of income in the year before retirement).

TABLE 19.—PRICE INDEXING

[Proposal recommended by panel of consultants to Congressional Research Service]

- Initial Average Benefit Close to Present Law in 1979
- Workers Earnings Records CPI Indexed
- Benefit Formula Bend Points CPI Indexed
- Benefit Formula Factors Not Indexed

Year	Worker with average earnings ¹		Replacement rate for worker with—		Aggregate OASDI expenditures	
	Annual benefit in 1977 prices	Replacement rate (percent)	Low earnings ² (percent)	High earnings ³ (percent)	As percent of payroll (percent)	As percent of GNP ⁴ (percent)
1979.....	\$4,444	46	58	35	10.9	4.5
1985.....	4,508	41	53	30	11.0	4.5
1990.....	4,597	38	50	28	11.0	4.5
1995.....	4,713	36	47	28	10.8	4.4
2000.....	4,908	34	45	28	10.5	4.3
2010.....	5,360	32	42	27	10.6	4.3
2020.....	5,962	30	40	26	12.0	4.9
2030.....	6,665	28	37	25	12.8	5.3
2040.....	7,496	27	35	24	11.8	4.9
2050.....	8,477	26	32	23	10.9	4.5

	<i>Percent</i>
Average medium-range cost (1977-2001).....	10.8
Average medium-range revenue.....	9.9
Average medium-range deficit.....	-9
Average long-range cost (1977-2051).....	11.3
Average long-range revenue.....	11.0
Average long-range deficit.....	-3

¹ Assumed to be 4 times the average 1st quarter covered earnings.

² Assumed at +4,600 in 1976 and following the trends of the average.

³ Assumed at the maximum taxable under the program.

⁴ Based on full employment and assuming taxable payroll equals 41.1 percent of GNP.

Note: The estimates in this table are based on the economic and demographic assumptions used in the intermediate cost estimates (alternative II) in the 1977 OASDI Trustees Report. The replacement rates pertain to workers with steady employment at increasing earnings and compare the annual retirement benefit at age 65 with the earnings in the year immediately prior to retirement.

The price indexing approach to long-range financing is incorporated into the overall package proposed by Senator Curtis. Taking into account the long-range impact of the short-range financing included in that package, the overall financial status of the trust funds under the Curtis proposal would be:

TABLE 20.—BALANCE OF SOCIAL SECURITY SYSTEM UNDER CURTIS PROPOSAL (AS A PERCENT OF PAYROLL)

	<i>Percent</i>
Average medium-range cost (1977-2001).....	10.8
Average medium-range revenue.....	10.8
Average medium-range surplus.....	+.1
Average long-range cost (1977-2051).....	11.2
Average long-range revenue.....	11.4
Average long-range surplus.....	+.2

Another proposal would follow the wage indexing methodology proposed by the Administration but would start off with a less generous benefit formula. This would result in an immediate reduction in replacement rates which would remain stable thereafter. The purchasing power of benefits would increase substantially in the future, however.

TABLE 21.—WAGE INDEXING AT REDUCED REPLACEMENT RATE LEVEL

- Initial Average Benefit Close to 11 Percent Below Present Law in 1979
- Workers Earnings Records Wage Indexed
- Benefit Formula Bend Points Wage Indexed
- Benefit Formula Factors Not Indexed

Year	Worker with average earnings ¹		Replacement rate for worker with—		Aggregate OASDI expenditures	
	Annual benefit in 1977 prices	Replacement rate (percent)	Low earnings ² (percent)	High earnings ³ (percent)	As percent of payroll (percent)	As percent of GNP ⁴ (percent)
1979.....	\$4,444	46	58	35	10.9	4.5
1985.....	4,481	40	52	28	11.1	4.6
1990.....	4,868	40	52	28	11.2	4.6
1995.....	5,293	40	52	29	11.2	4.6
2000.....	5,752	40	52	29	11.3	4.6
2010.....	6,797	40	52	30	12.3	5.1
2020.....	8,032	40	52	30	14.9	6.1
2030.....	9,492	40	52	30	16.9	7.0
2040.....	11,215	40	52	30	16.4	6.8
2050.....	13,252	40	52	30	15.9	6.5

	Percent
Average medium-range cost (1977-2001).....	11.1
Average medium-range revenue.....	9.9
Average medium-range deficit.....	-1.2
Average long-range cost (1977-2051).....	13.7
Average long-range revenue.....	11.0
Average long-range deficit.....	-2.7

¹ Assumed to be 4 times the average 1st quarter covered earnings.

² Assumed at \$4,600 in 1976 and following the trends of the average.

³ Assumed at the maximum taxable under the program.

⁴ Based on full employment and assuming taxable payroll equals 41.1 percent of GNP.

Note: The estimates in this table are based on the economic and demographic assumptions used in the intermediate cost estimates (alternative II) in the 1977 OASDI Trustees Report. The replacement rates pertain to workers with steady employment at increasing earnings and compare the annual retirement benefit at age 65 with the earnings in the year immediately prior to retirement.

Combination alternative.—If the Committee wishes to provide for long-range actuarial soundness of the social security program without requiring an immediate decline in replacement rates, an alternative proposal (shown as “combination” proposal on Charts 4, 5 and 6) could be developed. Such a proposal would involve:

- (1) advancing the 0.75 percent tax rate increase (employer and employee each) to 1990 as proposed by the Administration;
- (2) adopting a wage indexed benefit formula as proposed by the Administration but making it effective as of 1978 rather than 1979; and
- (3) providing for a reduction in the benefit formula factors by 50 percent of the gains in real earnings starting in 1988 and continuing until 2031.¹

¹ For example, in a year when wages increase by 5.75 percent over the prior year and prices increase by 4 percent, the increase in wages is 1.7 percent higher than the increase in prices ($1.0575 \div 1.0400 = 1.0168$). Under this proposal, half of this real growth in wages of 1.7 percent (that is, 0.8 percent) would be used to reduce the benefit formula factors. Thus the benefit formula factors of 91 percent, 33 percent, and 16 percent applied to various levels of indexed average earnings would be reduced to 90.2 percent; 32.7 percent; and 15.0 percent—a reduction in each case of 0.8 percent.

TABLE 22.—COMBINATION ALTERNATIVE

- Initial Average Benefit Close to Present Law in 1978
- Workers Earnings Records Wage Indexed
- Benefit Formula Bend Points Wage Indexed
- Benefit Formula Factors Not Indexed Before 1988, then reduced by 50 percent of Gains in Real Earnings until 2031, thereafter not indexed

Year	Worker with average earnings ¹		Replacement rate for worker with —		Aggregate OASDI expenditures	
	Annual benefit in 1977 prices	Replacement rate (percent)	Low earnings ² (percent)	High earnings ³ (percent)	As percent of payroll (percent)	As percent of GNP ⁴ (percent)
1979.....	4,444	46	58	35	10.9	4.5
1985.....	4,949	45	56	34	11.5	4.7
1990.....	5,243	44	57	33	11.9	4.9
1995.....	5,466	42	54	32	12.0	4.9
2000.....	5,697	40	52	32	11.9	4.9
2010.....	6,191	37	47	30	12.1	5.0
2020.....	6,727	34	44	28	13.6	5.6
2030.....	7,311	31	40	25	14.3	5.9
2040.....	8,639	31	40	25	13.2	5.4
2050.....	10,208	31	40	25	12.6	5.2

	<i>Percent</i>
Average medium-range cost (1977-2001).....	11.6
Average medium-range revenue.....	9.9
Average medium-range balance.....	-1.7
Average long-range cost (1977-2051).....	12.6
Average long-range revenue.....	11.0
Average long-range balance.....	-1.6

¹ Assumed to be 4 times the average 1st quarter covered earnings.

² Assumed at \$4,600 in 1976 and following the trends of the average.

³ Assumed at the maximum taxable under the program.

⁴ Based on full employment and assuming taxable payroll equals 41.1 percent of GNP.

Note: The estimates in this table are based on the economic and demographic assumptions used in the intermediate cost estimates (alternative II) in the 1977 OASDI Trustees Report. The replacement rates pertain to worker with steady employment at increasing earnings and compare the annual retirement benefit at age 65 with the earnings in the year immediately prior to retirement.

The cost and revenue estimates shown in the above table do not take into account the tax base and tax rate increases included in the staff alternative. The status of the system under the combination alternative when these additional financing elements are added is shown in the table below.

TABLE 23.—MEDIUM- AND LONG-RANGE STATUS OF SOCIAL SECURITY CASH-BENEFIT PROGRAM UNDER ALTERNATIVE FINANCING PACKAGE

	Percent
Average medium-range cost.....	10.7
Average medium-range revenue.....	11.2
Average medium-range surplus.....	+.5
Average long-range cost.....	11.8
Average long-range revenue.....	11.8
Average long-range balance.....	0

While the serious financial situation of the social security program has focused major attention on the need for added funding, many people have also called attention to other aspects of the program which need attention. Some of these areas directly contribute to the financing problems. For example, the disability insurance part of the program has experienced unanticipated changes in allowance and termination rates so that the program has expanded and has become expensive far beyond earlier projections. Questions have been raised concerning the continuing appropriateness of the present provisions for dependents' benefits in view of changing work patterns and changing conceptions of the role women play in the family and in the labor force. Questions have also been raised concerning the desirability of extending coverage to the few remaining segments of the population not now in the program—and even as to such basic matters as the proper role of social security in providing income support to low-income individuals on the one hand, and its relationship to the private pension system on the other hand. In view of the pressing need for restoring the program to a condition in which confidence can be placed in its soundness, it does not seem possible to address these various important questions before resolving the basic financing question. The alternative proposal, however, would place the system back in a sound financial status without causing any near-term reduction in benefits as a percent of earnings in the year preceding retirement. Adoption of this type of change would give the Congress ten years in which to examine these more fundamental questions which may also have a significant impact on the long-range financial status of the program.

IV. Additional Issues for Committee Consideration in Connection With Social Security Financing

The benefit formula.—The Administration proposal, the staff alternative, and the Curtis proposal each assume the adoption of a new formula for computing the initial benefit for a new retiree. The Administration proposal and the staff alternative would use a formula based on the worker's average wage after indexing related to wage

level changes and the Curtis proposal would be based on average wages after indexing related to price level changes. In each instance, however, the benefit formula would be designed to produce a close fit to the results that present law would produce as of the effective date. In other words, the formula in the Administration bill is intended as nearly as possible to produce the same benefit amount when applied to wage-indexed earnings as the benefit table which will be in the law as of 1979 produces when applied to unindexed earnings. A similar match is sought for the staff alternative (effective as of 1978 rather than 1979) and for the Curtis proposal.

The formula in the Administration bill is 94 percent of the first \$180 of wage indexed average earnings, plus 34 percent of the next \$1,075, plus 16 percent of the remainder. The formula under the staff alternative would be 91 percent of the first \$175 of wage indexed average earnings, plus 33 percent of the next \$870, plus 16 percent of the remainder.

The formula under the Curtis proposal would be 80 percent of the first \$250 of price indexed average earnings, plus 35 percent of the next \$500, plus 25 percent of the remainder.

Each of these formulas is based on the economic assumptions contained in the 1977 Trustees' Report. If the economy does not behave in the way assumed by the Trustees, then the benefits produced by the formula will either be higher or lower than those provided under the present law. In view of the way the economy has been changing over the past few years, it may well happen that the formula in the Administration bill would not reflect actual economic circumstances at the time it goes into effect. In order to avoid this uncertainty, consideration might be given to writing into the law specific directions as to how the benefit formula should be constructed and directing the Secretary of HEW to calculate the initial formula at the latest possible time. Subsequent changes in the earnings brackets in the formula would then be made automatically as contemplated in the proposal.

Wage indexing period.—Under the Administration proposal, earnings would be indexed up to the second year before an individual begins receiving social security benefits. As a result, the time when an individual retires could have a significant effect on the benefits paid and an individual planning to retire would have to make a decision as to when the best time to file a claim would be. In order to make the determination he would need to know (in addition to knowing how benefits are computed) how his lifetime earnings pattern related to changes in average earnings over the same period, what changes might occur in average earnings in the next few years, and how future changes in average earnings would be related to his earnings pattern.

The Committee may wish to provide that the period over which wages are indexed would be determined by the year the individual reaches age 62 (or dies or becomes disabled). In this way no individual needs to make a guess as to whether filing a claim at any given time will be more or less advantageous than any other time.

Grandfather clause.—In the past, when significant changes have been made in the way benefits are computed, the law has contained a grandfather clause which in effect guaranteed all further beneficiaries a benefit at least as high as the benefit which would have been computed under prior law. The Administration proposal contains a

grandfather clause which would apply to people who become eligible for retirement benefits in the first five years after the effective date of the change. (No guarantee would be provided for disability or survivor claims.) The Ford Administration bill contained a similar provision which would have been effective for the first 10 years. Others have favored continuing the grandfather clause into the indefinite future as has been past practice.

The type of grandfather clause used can have significant effect on the early-year cost of the proposal. When the Ford Administration proposal was described to the House subcommittee last year, there was considerable criticism of the cost of the 10-year grandfather provision. In partial response to that criticism, this year's bill has reduced the period to 5 years and made it applicable only to retirement benefits. With these changes, the actuaries now estimate the cost of the provision at about \$50 million per year.

The grandfather clause proposed in the Administration bill would guarantee for 5 years a benefit equal to what would be produced by the benefit table in effect for 1979 under present law. Because of the way the wage-indexed benefit formula was designed, people whose earnings have changed at the same rate as average earnings have increased would be paid benefits under the new formula approximately equal to those provided under present law and those whose earnings increased at a rate faster than average would be paid higher amounts under wage indexing than under present law. A grandfather provision would be of little use to the first group and would provide no advantage to the second. The wage-indexed benefit formula, however produces benefits lower than provided under present law for people whose earnings increased at a slower rate than average. For these people a grandfather clause could mean a considerable increase in benefits in the year or so after the change. The advantages of the grandfather clause decreases each year after wage indexing goes into effect because the grandfather benefit formula is static while the wage-indexed formula produces higher benefits each year.

The family maximum.—Under the present law, the family maximum is determined by a column in the benefit table and it fluctuates generally between one and one-half and one and four-fifths of the primary insurance amount. The Administration bill contains a four-step formula for determining family maximum benefits (in which different percentages are applied to different parts of the primary insurance amount) intended to preserve the relationships to primary insurance amounts in present law.

Provisions related to treatment of men and women.—In addition to the provision related to eligibility for dependents benefits which was discussed in connection with the alternative financing proposal, the Administration bill includes a number of other provisions related to the treatment of men and women under social security. In general, the proposals modify provisions of existing law which provide differential treatment for men and women. In some cases the changes simply ratify decisions already made by the courts, while in others the changes seem to anticipate future court decisions. The following changes are made in the bill:

1. *Divorced husbands.*—The bill would make divorced husbands of retired (or deceased) women eligible for dependents' benefits on the

same basis as benefits are now provided for divorced wives. These benefits are not now paid pending a decision on the appeal of a court case.

2. *Remarried widowers.*—Widowers who are otherwise eligible for widowers' benefits become permanently ineligible if they remarry. The Administration proposal would modify this provision to permit widowers to become eligible after the termination of their remarriage as is now permitted for widows.

3. *Illegitimate children.*—The Administration bill makes certain special rules governing eligibility of illegitimate children to benefits on their father's account also applicable to their eligibility for benefits on their mother's account.

4. *Special benefits.*—In 1965 and 1966, provision was made for the payment of certain special benefits for persons without sufficient social security coverage to qualify for a regular minimum social security benefit. These provisions apply only to a small number of very old persons. The Administration bill would modify these provisions to eliminate certain differences in treatment between men and women in connection with these benefits.

5. *Father's insurance benefits.*—The statute now provides for the payment of benefits to young widows with minor children in their care but has no comparable provision for young widowers. Under a Supreme Court decision, these "mothers" benefits are now payable to "fathers" as well. The Administration bill ratifies the existing situation.

6. *Termination of benefits upon marriage.*—Existing law ordinarily provides for the termination of dependents benefits when the recipient marries. Exceptions are provided when the marriage is to a person also entitled to certain categories of benefits. In such cases, however, the eligibility may subsequently terminate if the husband ceases to qualify for those benefits. The Administration bill would terminate benefits in such cases if either the husband or the wife loses eligibility for the other benefits.

7. *Treatment of self-employment income in community property States.*—Existing law generally attributes self-employment income in community property States to the husband unless the wife exercises substantially all the management and control of the business. The proposal would make the spouse with the greater proportion of management and control the self-employed person in such cases.

8. *Credit for certain military service.*—The Administration proposal gives widowers an option concerning the combination of civil service and social security entitlements now available to widows only. (The provision relates to which program credits military service prior to 1957.)

Staff recommendation.—While the provisions related to the treatment of men and women are included in the draft financing bill sent to Congress by the Administration, they are not actually related in any significant way to the financing of the program (with the exception of the provision concerning eligibility for dependents' benefits which has been discussed separately.) These provisions do not appear to require enactment on an urgent basis and they involve a number of questions of policy which the Committee may wish to consider at another time, such as:

If benefits are to be extended to divorced husbands as well as to divorced wives, should the special dependency tests formerly required for such benefits be reenacted?

In cases where continued eligibility for a dependents benefit depend upon a spouse's continued eligibility for another type of benefit, should the treatment of men and women be made comparable by terminating entitlement when a spouse of either sex loses eligibility for other benefits or by continuing eligibility in such cases?

If benefits are to be provided on a statutory basis for young widowed fathers as well as for young widowed mothers, would it be appropriate to consider limiting eligibility (for both sexes) in some other manner; e.g. some required showing of a necessity for the widowed person to remain home to care for the child?

The staff feels that the provisions of the Administration bill dealing with the treatment of men and women involve considerations which the Committee may wish to study more carefully when it considers the social security program structure more generally. The staff recommends that these provisions not be included in the present financing legislation.

V. Social Security Savings Projected in the Congressional Budget Resolution

The President's budget for fiscal year 1978 assumed the enactment of several legislative proposals which were estimated to reduce fiscal year 1978 expenditures under the medicare and social security programs. In making its March report to the Budget Committee, the Committee on Finance allowed for possible legislative action to reduce outlays in the income security function by a net \$0.5 billion. In its report to the Budget Committee, however, the Committee added these words of caution concerning the projected savings in the social security program:

"As with the health function, the Committee notes that the President's budget assumes substantial cost reductions in the Social Security programs. While the Committee believes that those budget assumptions may present an optimistic estimate of the savings that can be achieved, it recommends acceptance of those estimates as a goal at this time."

In the first concurrent resolution on the budget for fiscal year 1978, targets were adopted which included an assumption that legislation would be enacted providing for reduction of \$0.8 billion in the social security program. This assumption is also reflected in the allocation report (S. Rept. 95-299) filed by the Committee on Finance after the completion of action on the first budget resolution. (This report is required to be filed by each committee showing how it would allocate among the programs under its jurisdiction the total outlay and budget authority amounts provided for in the resolution. The Finance Committee allocation report, in this instance, followed the assumptions used by the Budget Committee.)

On July 21, 1977, during the Senate Floor debate on the Black Lung bill, Senator Muskie, the Chairman of the Senate Budget Committee,

referred to the savings proposed in the income security category and made the following statement:

"I understand that the Finance Committee will soon report H.R. 7200, a bill pertaining to various programs under the Social Security Act. If the savings suggested by the Finance Committee are not contained in that measure, I, along with other Senators, shall sponsor an amendment to H.R. 7200 which would achieve those savings."

In its report on the second concurrent resolution on the budget for fiscal year 1978, the Senate Budget Committee indicated that its proposed spending levels for income maintenance assume a net reduction in social security and welfare programs of \$0.3 billion for fiscal year 1978.

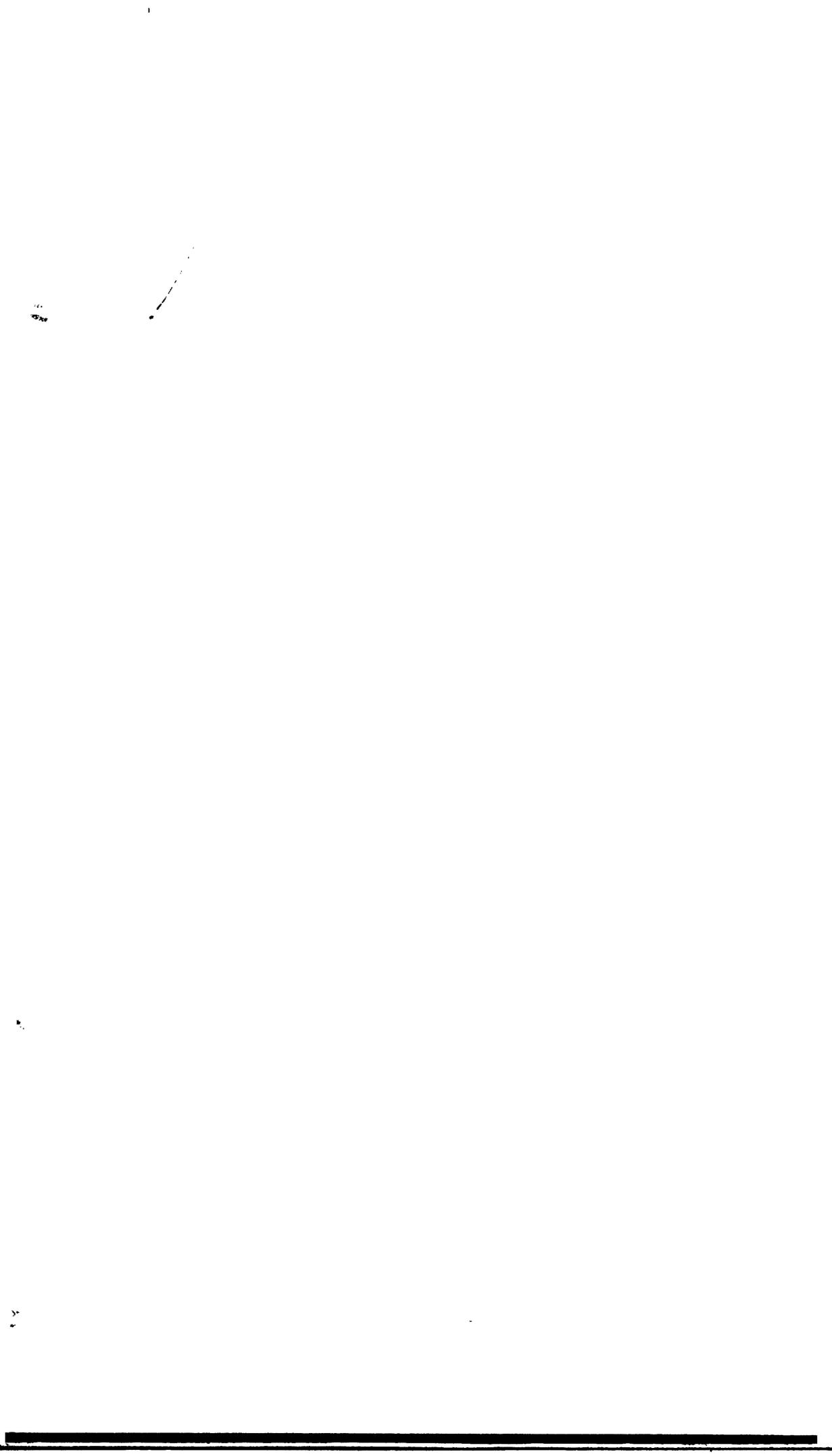
If the committee wishes to consider proposals which would reduce expenditures for fiscal 1978 in the social security program, a number of areas have been identified in which such savings could be achieved. In each case, the provisions are assumed to become effective for benefits payable for January, 1978, and thereafter.

Limitation on retroactive benefits.—The Social Security Act permits applicants to claim benefits for up to 12 months prior to the month they file a claim (provided that they would have been eligible in those prior months). The Administration has proposed barring such retroactive benefits when months of eligibility prior to age 65 are involved (that is, when the award of retroactive benefits would result in a permanent reduction of the permanent benefit rate). This proposal would reduce fiscal year 1978 costs by \$0.2 billion. An alternative proposal would be a 3-month limit (rather than 12 months) on retroactivity in all cases. This would save \$0.2 billion in fiscal year 1978. The two proposals taken together would save \$0.3 billion.

Apply earnings limit on annual basis only.—The social security retirement test provides for a reduction in benefits for persons under age 72 who earn over \$3,000 per year. There is, however, a monthly exception to this test which permits an individual to get his full social security check for any month in which he earns no more than \$250 no matter how high his annual earnings are. Elimination of this monthly exception would save \$0.1 billion in fiscal year 1978. (This proposal was also recommended in the President's budget.)

Reduce student benefits.—Social security benefits for dependent and surviving children terminate when the child reaches age 18 unless he continues as a full-time student, in which case they are continued (at the same rate) until the child reaches age 22. President Carter's budget proposed to place a limitation on the amount of these benefits for children in school. (In fiscal year 1978, the maximum under the Carter proposal would be \$117 per month.) This proposal would lower fiscal year 1978 costs by \$0.1 billion.

End mother's benefits when all children are over 15.—Benefits for children of deceased, disabled, or retired workers under social security are provided until the child reaches age 18 or age 22 if he is in school. Benefits are also provided for the mothers of such children until the youngest child reaches age 18 so that the mother can remain home to care for the child. (Under a Supreme Court ruling, "fathers" are also eligible for such benefits in cases involving a deceased woman worker.) Consideration could be given to amendment of the law to provide that these benefits for the mothers and fathers of young children would be available only until the youngest child reaches age 15. Such a change would reduce outgo by \$0.2 billion in fiscal 1978.



Appendix A: Social Security Financing Charts

Chart 1

Social Security Trust Funds (Balances in billions of dollars)

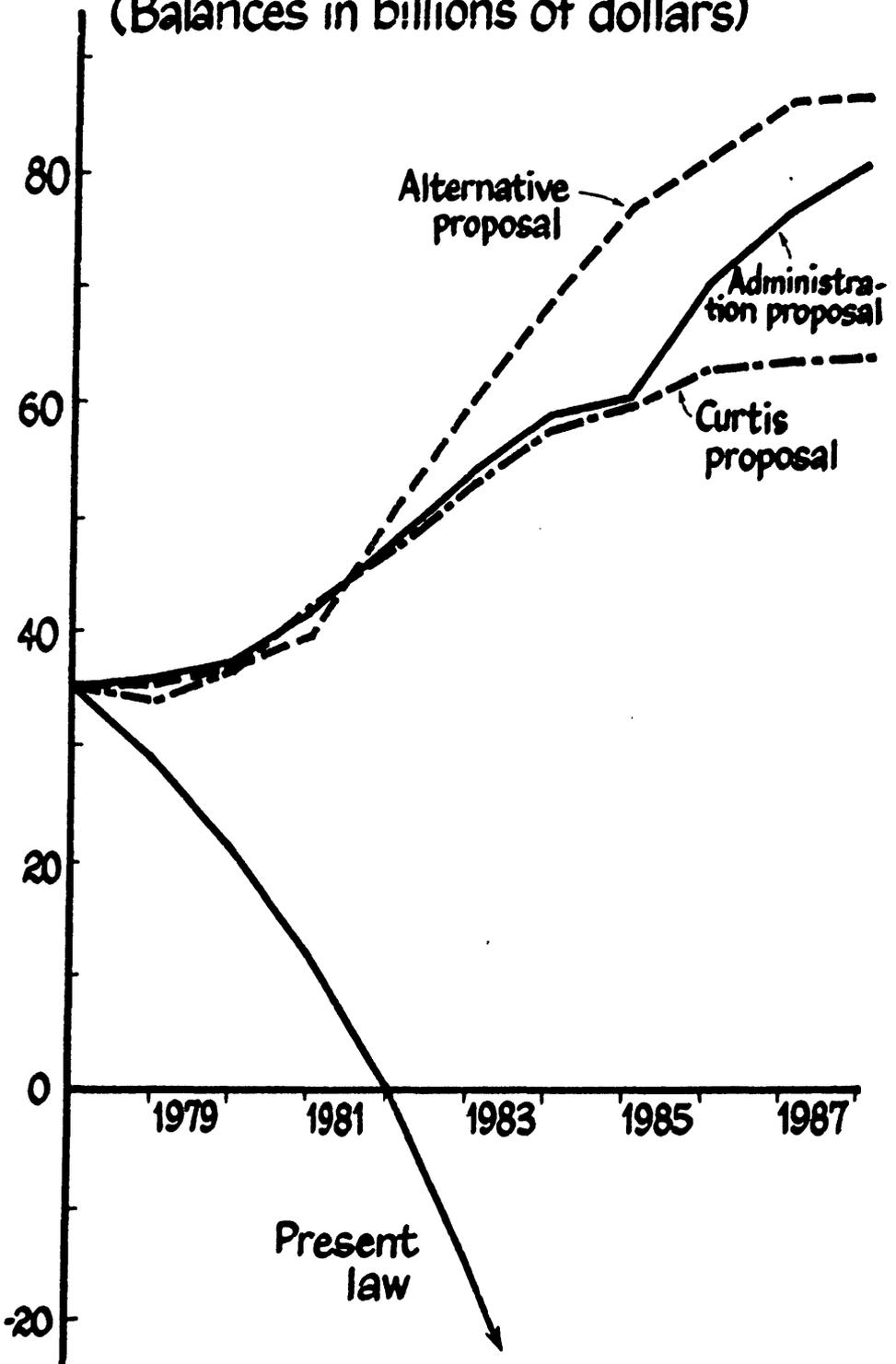


Chart 1.—Social Security Trust Funds

Under present law social security benefit payments are now running ahead of income so that it is necessary to dip into the trust fund in order to meet the annual cost of the program. As of the end of 1976, the cash benefits trust funds had a combined balance of \$41.1 billion. By the end of 1977, this will have been reduced to \$35.6 billion and continuing deficits are projected into the future so that the funds will be completely exhausted shortly after the end of 1981. There are actually two funds, one for retirement and survivors' benefits and a separate, smaller fund for disability insurance benefits. The disability fund is running out of money at an even faster rate and will be exhausted by early 1979 or even late in 1978.

The short range elements of the Administration's financing package would stop the decline in the funds by a combination of measures including general revenue financing in the early years. Under the Administration's proposal the fund would show a slight surplus of \$0.5 billion in calendar year 1978, \$1½ billion in 1979, and nearly \$4 billion in 1980. By 1987, the annual surpluses would have built the fund from its level of \$35.6 billion at the end of 1977 to \$81.8 billion by the end of 1987. (Under the Administration proposal the trust fund outgo would continue to exceed social security tax revenue income through 1980. The trust fund accounts would show a surplus in each year, however, because of the infusion of \$14 billion from general revenue funds).

The staff alternative proposal would increase social security tax revenues starting in 1978 reducing the deficit for that year from \$7.0 billion under existing law to \$0.4 billion. In 1979 and 1980 the fund would show a small surplus and then would build up for several years starting in 1981 when the tax rate increase would become effective under the proposal. Overall the fund balances would rise from \$35.6 billion at the end of 1977 to \$85.8 billion by the end of 1987.

Under the short-range financing proposal made by Senator Curtis the progress of the fund would be quite similar to what would occur under the Administration proposal for the first few years. After 1980, however, the funds would grow somewhat more slowly reaching a level of \$63.0 billion by the end of 1987 as compared with \$81.8 billion under the Administration proposal or \$85.8 billion under the staff alternative. The staff notes that the Curtis proposal would show a 1987 fund balance of \$73.3 billion if the savings under the proposed offset of dependent's benefits against civil service retirement payments were estimated to save as much as the Administration's dependency test based on pre-retirement income. The staff is unable to find any reason why the Administration proposal would not save less, if anything, than the civil service offset. The staff believes that the difference in estimates results from the fact that different and inconsistent data bases had to be used by the actuaries to estimate the costs of the two provisions.

Chart 2

Social Security Trust Funds as a Percent of Next Year's Outgo

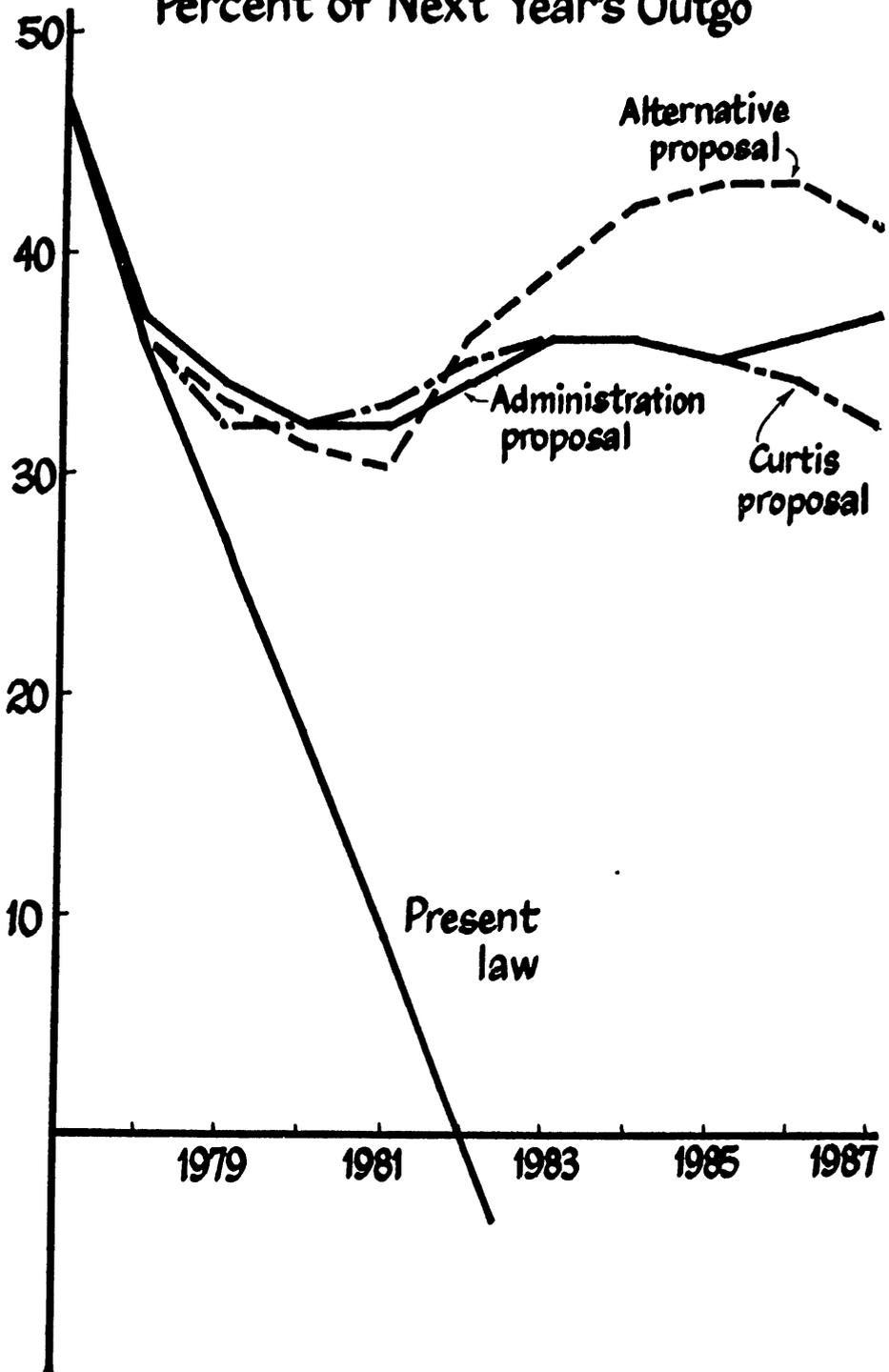


Chart 2.—Social Security Trust Funds as a Percent of Next Year's Outgo

Although the trust fund balances would increase over the next 10 years under the Administration proposal, the staff alternative, and the Curtis alternative, the outgo from the trust fund will also be rising over this period. Consequently, the significance of the trust fund balances appear in somewhat different perspective when viewed as a percent of a year's benefit payments rather than in absolute dollar amounts. The Administration has suggested that an appropriate objective for short-range financing would be the rebuilding of fund balances to a level of 50 percent of a year's outgo. Chart 2 shows how fund balances would relate to this goal under present law and under the various alternative proposals.

By the end of 1977, the fund balances will have fallen to 47 percent of a year's outgo under present law and will continue to decline rapidly until the end of 1981 at which point they will have been exhausted. Each of the three alternative proposals would halt the rapid decline by adding additional funds to the program starting in 1978. Under the Administration proposal, the funds would reach a low of 32 percent of a year's outgo in 1980 and then increase to 37 percent by 1987. The staff alternative would drop somewhat below the Administration proposal to 30 percent as of 1981 and then rise to a level of 41 percent by 1987. Under the Curtis proposal the fund balance would be 32 percent of a year's outgo by 1987. As noted on chart 1, the differential between the results of the Administration proposal and the Curtis proposal appears to result largely from a questionable difference in the estimated costs of proposals for dealing with dependents' benefits which should have about the same cost impact.

Social Security Cash Benefits: Cost as a Percent of Payroll

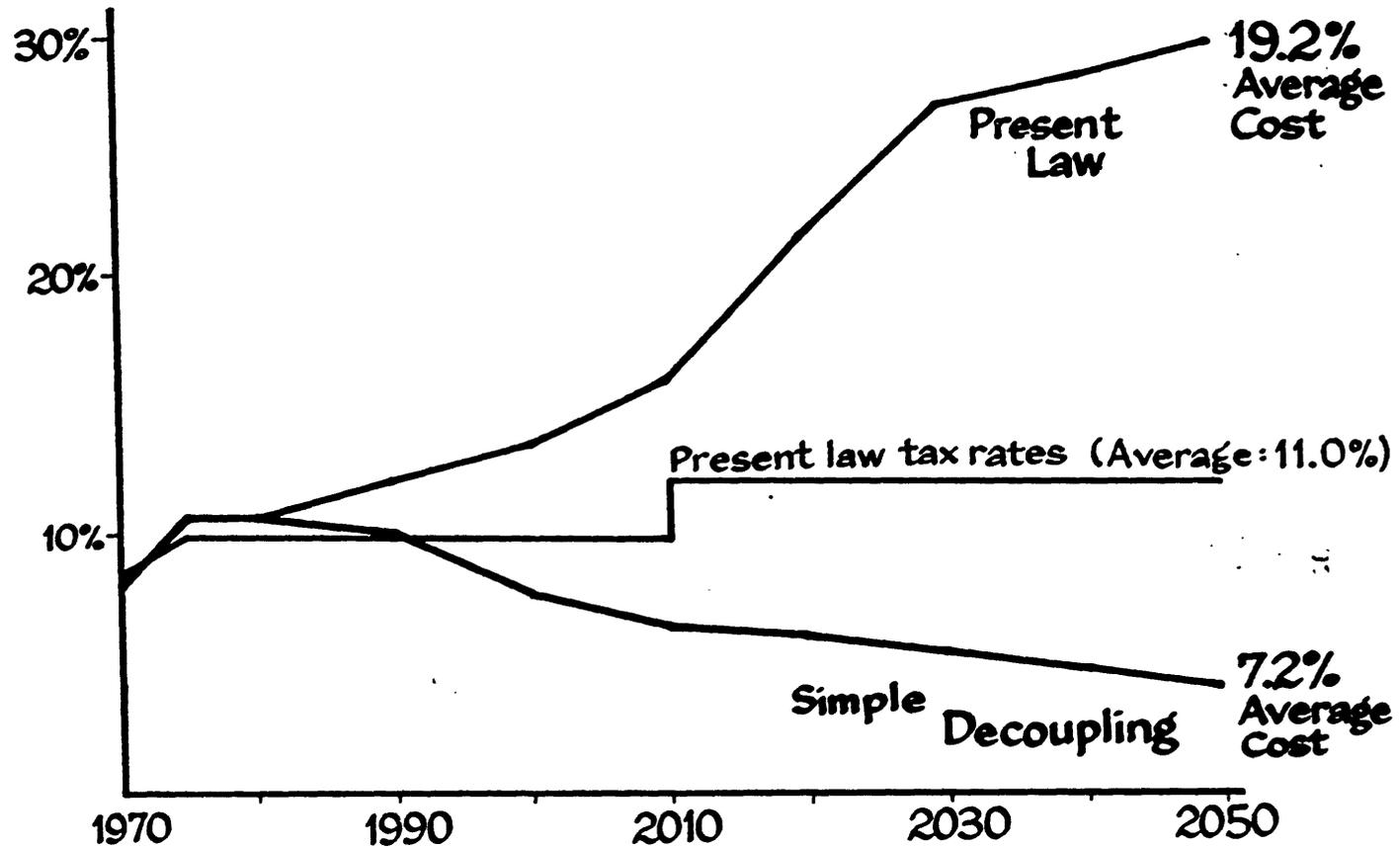


Chart 3.—Social Security Cash Benefits: Cost as a Percent of Payroll: Present Law

The social security payroll tax paid by employers and employees is now set at a rate of 9.9 percent (combined) of taxable wages. The law now also provides for that rate to increase to 11.9 percent in the year 2011. Over the next 75 years, the rate will average 10.99 percent.

The cost of the program, however, is now somewhat more than the current 9.9 percent tax rate and is projected to grow to 27.51 percent by the year 2055. Over the next 75 years, the average cost of the program will be 19.2 percent of taxable payroll or 8.2 percent more than the average tax rate.

The cost of the program grows so rapidly because the law contains an automatic mechanism for raising the level of benefits paid to new retirees as the Consumer Price Index increases. If the law were amended so that benefits would continue to be adjusted for inflation after an individual retires but no further adjustment were made in the formula for determining benefits for new retirees, the cost of the program would be substantially reduced. This approach is called "simple decoupling" in that the inflation adjustment mechanism which now applies both to benefits after retirement and to the initial benefit formula would be made applicable only to benefits after retirement.

Under simple decoupling, the cost of the program as a percent of taxable payroll would begin to decline almost immediately and would reach a level of 4.3 percent of payroll by the year 2050. Over the 75 year period, the annual average cost of the program would be 7.2 percent of payroll or 3.8 percent less than the tax rate now in the law. Although simple decoupling would produce a significant long-range actuarial surplus, there would still be need for added financing in the next few years to maintain the short-range cash flow. In addition, simple decoupling would lead to declining adequacy of benefit levels when measured as a percent of pre-retirement earnings or when measured in terms of purchasing power. In order to restore and maintain the adequacy of the benefits after decoupling, some further changes in the law would have to be made. The next three charts illustrate various aspects of alternative possibilities.

Social Security Cash Benefits: Cost as a Percent of Payroll

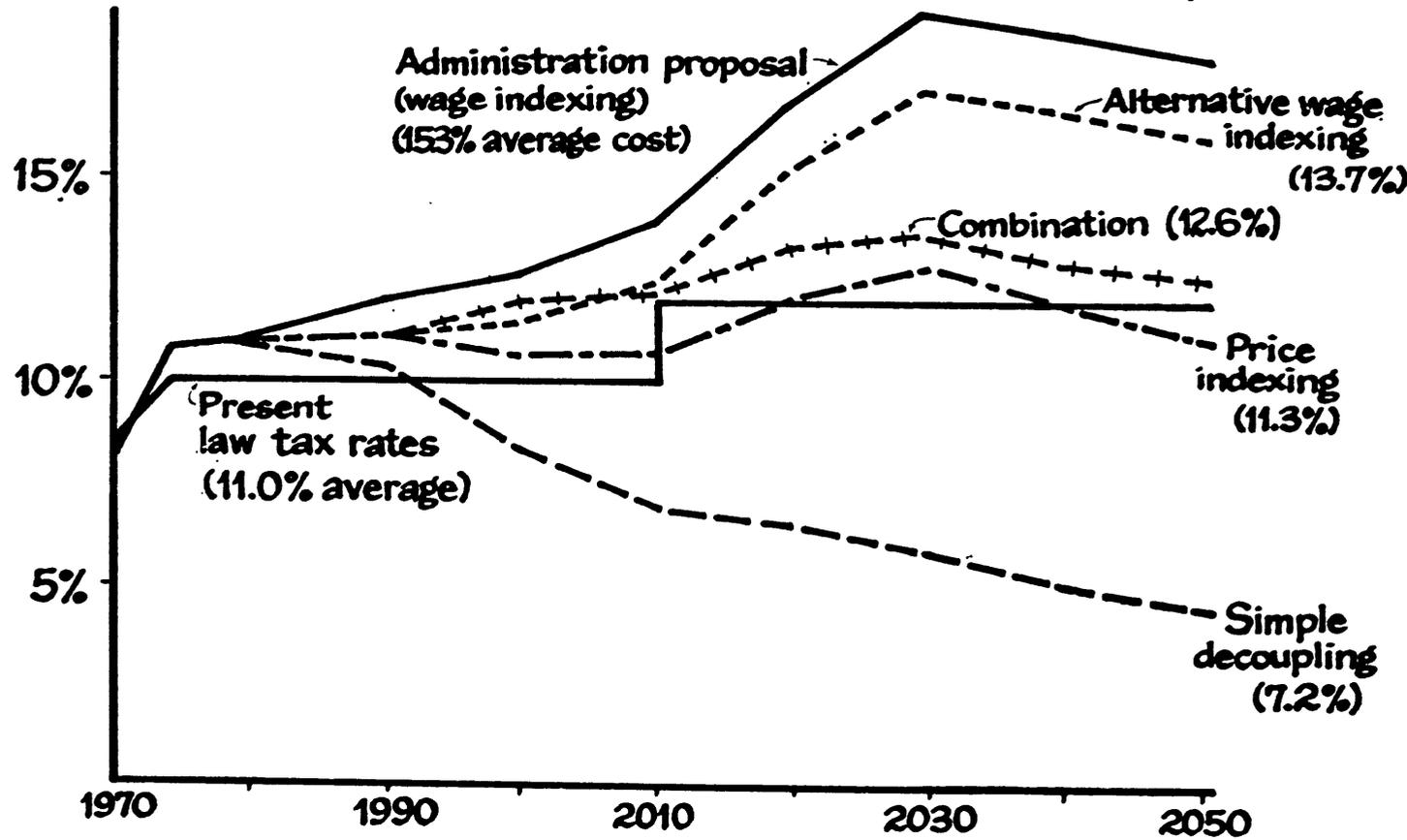


Chart 4.—Social Security Cash Benefits Cost as a Percent of Payroll

Chart 4 shows how the cost of the social security program would be affected by a number of alternative options for revising benefit formula. Costs on this chart are shown as a percent of taxable payroll. In order to show the relative cost of the different proposal on an equivalent basis, this chart uses taxable payroll under existing law as the basis for comparison. Both the Administration proposal and the staff alternative includes changes in the wage base for employers and employees. This has effect of increasing taxable payroll. Consequently, the long-range cost of these two proposals, if enacted, would be smaller as a percent of the new expanded payroll than is shown on this chart. However, their cost in relation to the existing-law payroll would be the same as is shown on this chart.

Simple decoupling as described on Chart 3 would reduce the long-range average cost of the program by 12 percent of payroll to a level of 7.2 percent, but would lead to declining benefit adequacy for future retirees.

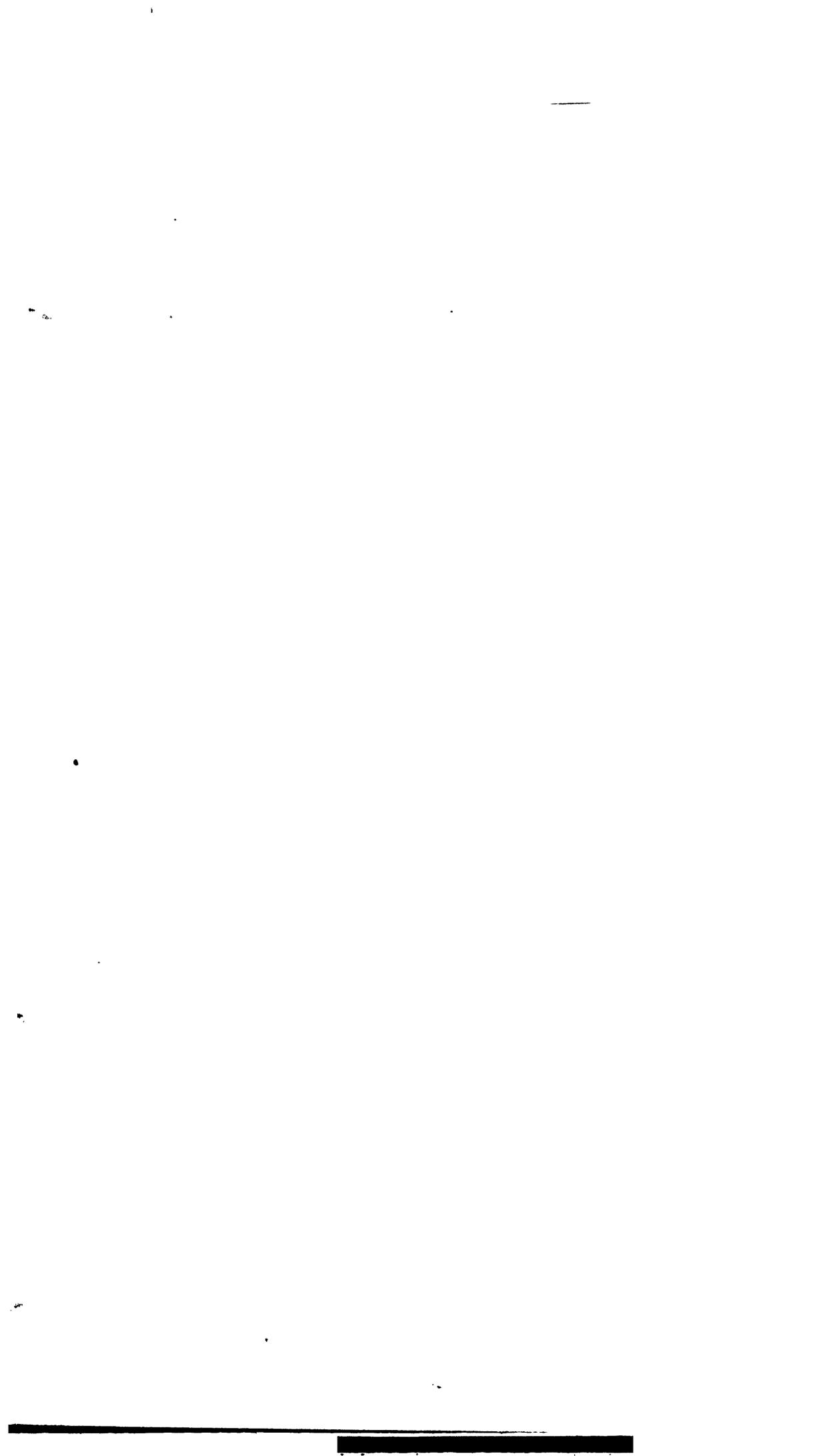
The proposal recommended by the Administration is called wage-indexing. This approach adopts a new benefit formula in which the percentage factors are not changed periodically but in which indexed rather than actual average wages are used in applying the formula. Under the Administration proposal, wages would be indexed according to changes which took place in national wage levels during the individual's working years. This approach would reduce the 8.2 percent deficit to 4.3 percent. Put another way, it would use up the 3.8 percent surplus from decoupling and would create a new deficit equal to 4.3 percent of taxable payroll. (The 15.3 percent of existing law payroll cost of the Administration proposal is equivalent to 14.07 percent of taxable payroll as it would be expanded under the Administration proposal and that change coupled with the added financing included in the Administration package would bring the long-range deficit under that package to 2.1 percent of payroll.)

The "alternative wage indexing" line on chart 4 shows the cost of a proposal to adopt a new benefit formula similar to what is proposed by the Administration but with an immediate reduction in the replacement rate.

Another option would be to decouple but then substitute a new mechanism for automatically adjusting benefit levels for new retirees designed in such a way as to use up the 3.8 surplus from decoupling without requiring any additional new financing. One such approach called price indexing was designed by a consultant panel to the Congressional Research Service (Hsiao panel). Their proposal would adopt a new formula for determining initial benefit amounts based on indexed rather than actual average wages. Wages would be indexed to changes in price levels during the individual's working years. This

price indexing approach is incorporated in the financing package which has been proposed by Senator Curtis.

The combination alternative would follow the wage-indexing approach for 10 years and then introduce elements which would reduce costs by causing benefits to rise at a lesser rate than under the Administrative proposal. Such an approach would be designed to use up the surplus generated by decoupling and would reduce the cost of the program to 12.6 percent of payroll in terms of the existing law payroll. In terms of the expanded payroll resulting from the increase employer and employee wage base proposed in the staff alternative, the cost of the program would be 11.8 percent of payroll. This would be exactly in balance with the long-range revenues under the staff alternative of 11.8 percent of payroll.



Social Security Benefits Upon Retirement as a Percent of Earnings in the Year Before Retirement (Worker with Average Earnings)

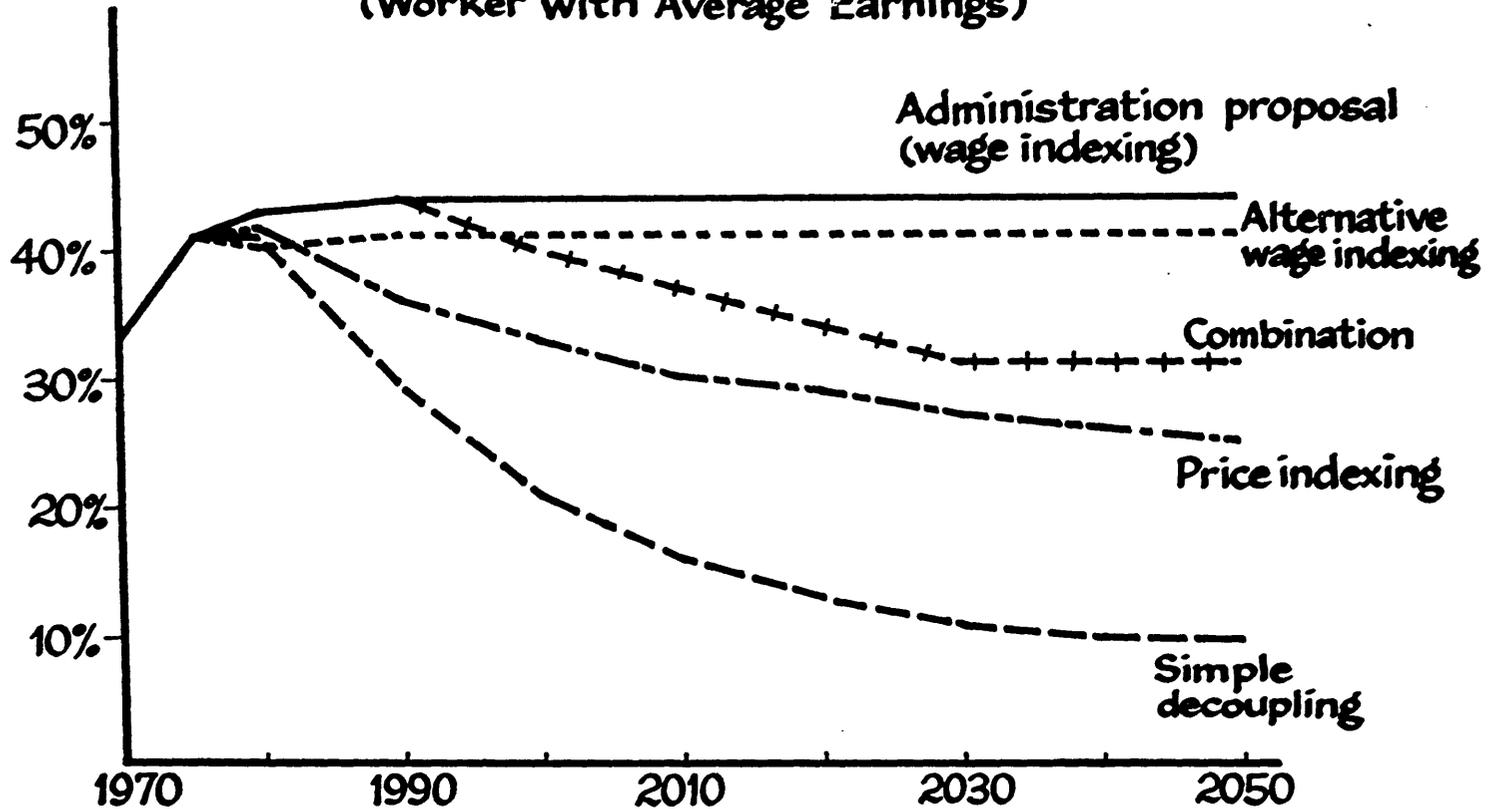


Chart 5.—Social Security Benefits Upon Retirement as a Percent of Earnings in the Year Before Retirement: Proposals

Chart 5 illustrates the effect of several decoupling proposals on the relationship of benefits at time of retirement to wages just before retirement.

In 1955, the benefits paid to a worker with average earnings were about 31 percent of his earnings and by 1970 they had risen 3 percentage points to 34 percent. In the next 5 years, the rise was 9 percentage points to about 43 percent. This trend could be expected to continue on into the future under present law.

One of the purposes of the various proposals is to cut off the trend of benefits to represent an increasing part of preretirement earnings. The wage indexed proposal recommended by the Administration would maintain future benefits at about the present level in relationship to earnings in the year before retirement. The other proposals would allow the replacement rates to decline although the combination approach would result in no decline during the next 10 years. For a worker with average earnings in all years, the ultimate percentage of preretirement earnings represented by benefits would be 45 percent under wage indexing, 40 percent under the alternative wage-indexing approach, 31 percent under the combination plan, 26 percent under price indexing, and 10 percent under simple decoupling. These percentages compare with the 67 percent rate projected under present law.

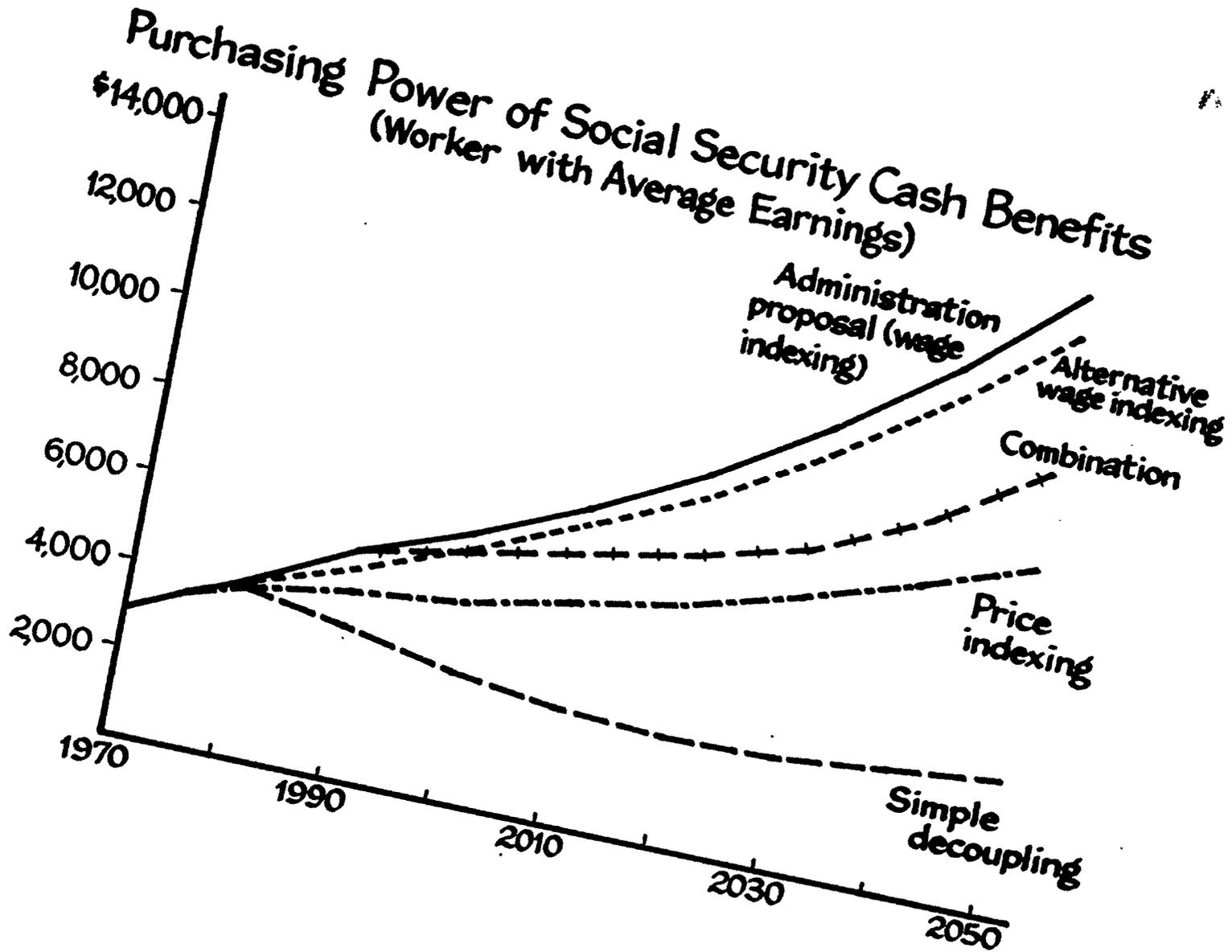
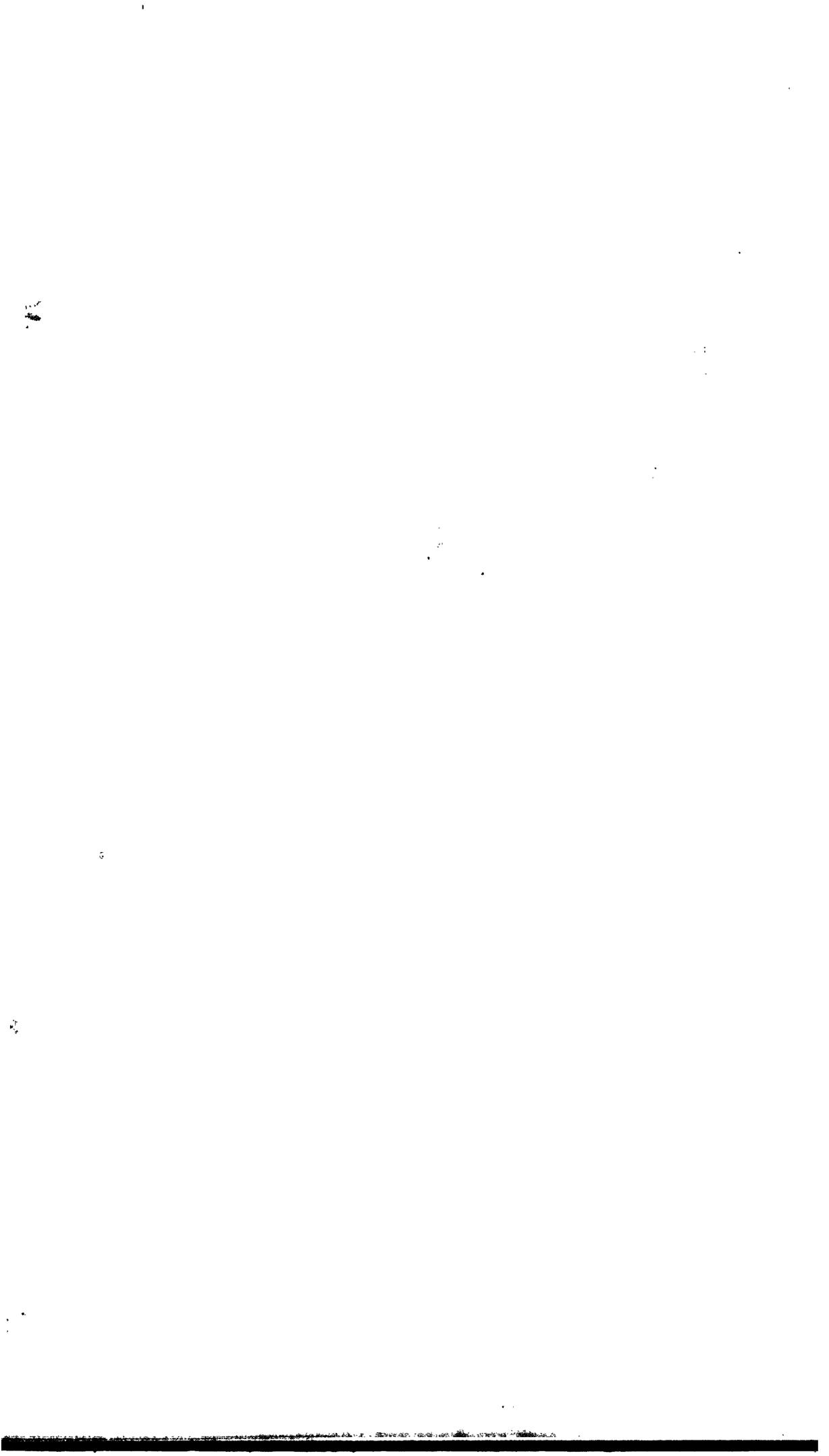


Chart 6.—Purchasing Power of Social Security Cash Benefits

Under the present law the worker who has average earnings in every year can expect to get an annual benefit of \$4,444 in 1979 which in constant dollars will rise to \$22,088 by 2050. This large increase is the result of the automatic benefit increase mechanism in present law, and the various proposals are intended to reduce it to levels which can be financed. Under three of the four proposals shown in the chart, the purchasing power of benefits—measured in 1977 dollars—rises from the \$4,444 estimated for 1979. Under the simple decoupling proposal shown by the bottom line purchasing power falls to \$3,294 by 2050. This contrasts with the rise to \$14,863 under the wage indexing proposal, to \$13,252 under the alternative wage indexing approval, to \$10,208 under the combination proposal, and to \$8,477 under the price indexing proposal.

Thus, all of the indexing proposals do more than make benefits inflation proof and provide future retirees with improved purchasing power but with a lesser increase than would be provided under present law.

**Appendix B: Computing Social Security Benefits: Present Law
and Indexing Proposals**



Computing Social Security Benefits: Present Law and Indexing Proposals

A. PRESENT LAW

Under existing law, the amount of benefits paid to a newly retired social security beneficiary is determined by averaging his wages subject to social security taxes during a number of years prior to retirement and then converting those average wages to a primary benefit amount through the use of a benefit table in the law. This table is constructed so that the primary benefit amount increases as average wages rise, but relatively higher benefit levels are provided for the lower levels of average wages. (The primary benefit determined in this way is the amount which would be paid to a retired worker who begins to draw benefits at age 65 and is the basis for computing benefits for dependents or for individuals who retire before age 65.)

How many years are used.—The basic formula for computing social security benefits is designed to average an individual's wages over a number of years roughly comparable to the number of years over which he could reasonably be expected to have been working under social security (with a "dropout" of 5 years as an allowance for occasional unemployment, work in noncovered employment or periods of low earnings). For a retired worker, average wages for determining benefits will ultimately be averaged over 35 years; i.e. five years less than the number of years between age 21 and age 62. Since social security coverage did not reach its present state of near universality until the 1950's, persons reaching age 62 prior to 1991 have their earnings averaged over less than 35 years. The rule for them is: 5 less than the number of years between 1950 and the year they reach age 62. Thus, a person reaching age 62 in 1977 will have his earnings averaged over 21 years and in 1978 it will be 22 years and so forth.

In the case of disability and survivorship cases special rules are also applied. In such cases, the number of years over which earnings must be averaged ends with the year preceding death or disability; however, a minimum of 2 years is required in all cases.

Determining the benefit.—When an individual applies for social security benefits, the number of years over which his earnings must be averaged is determined as described above. Then, his earnings in the number of years are added and averaged. (The years with highest earnings are used and zero years are included if necessary.) The resultant average is then converted, through the benefit table, to a primary benefit amount (called the "Primary Insurance Amount" or PIA).

The benefit formula which underlies the table in the law is shown in the table below and the benefits that formula produces at various average wage levels is illustrated in chart B.

SOCIAL SECURITY BENEFIT FORMULA, JUNE 1977

*Benefit as
percent of
average
monthly
earnings*

Formula:

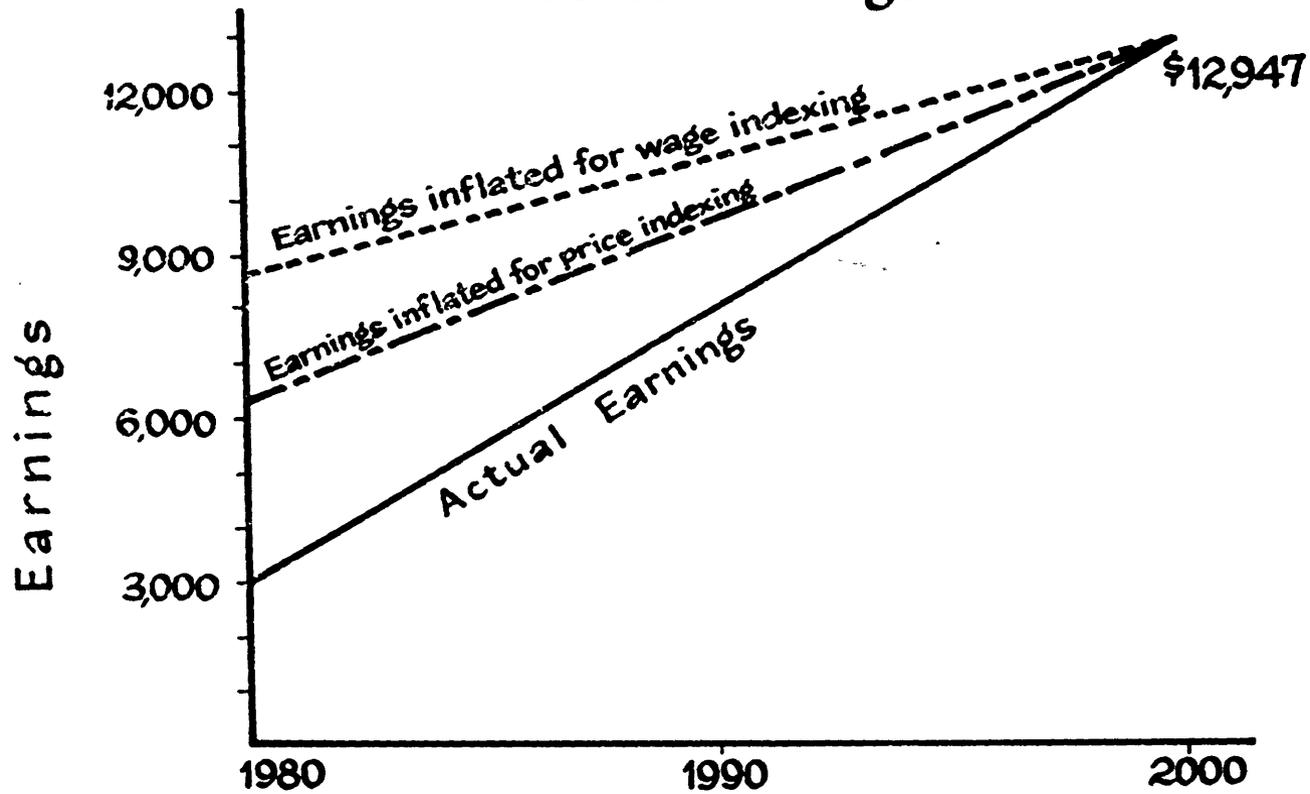
145.9 percent of first \$110 of average monthly earnings, but not less than \$114.30.....	(at least) 146
\$160.49 plus 53.06 percent of average monthly earnings above \$110 and not more than \$400.....	146-79
\$314.36 plus 49.58 percent of average monthly earnings above \$400 and not more than \$550.....	79-71
\$388.73 plus 58.3 percent of average monthly earnings above \$550 and not more than \$650 ¹	71-69
\$447.03 plus 32.42 percent of average monthly earnings above \$650 and not more than \$750.....	69-64
\$479.45 plus 27.02 percent of average monthly earnings above \$750 and not more than \$1,000.....	64-55
\$546.99 plus 24.34 percent of average monthly earnings above \$1,000 and not more than \$1,175.....	55-50
\$589.58 plus 22.54 percent of average monthly earnings above \$1,175 and not more than \$1,275..	50-48
\$612.12 plus 21.18 percent of average monthly earnings above \$1,275 and not more than \$1,375.....	48-46

¹ This is the last step in the formula used for men who retire at age 65 in 1977.

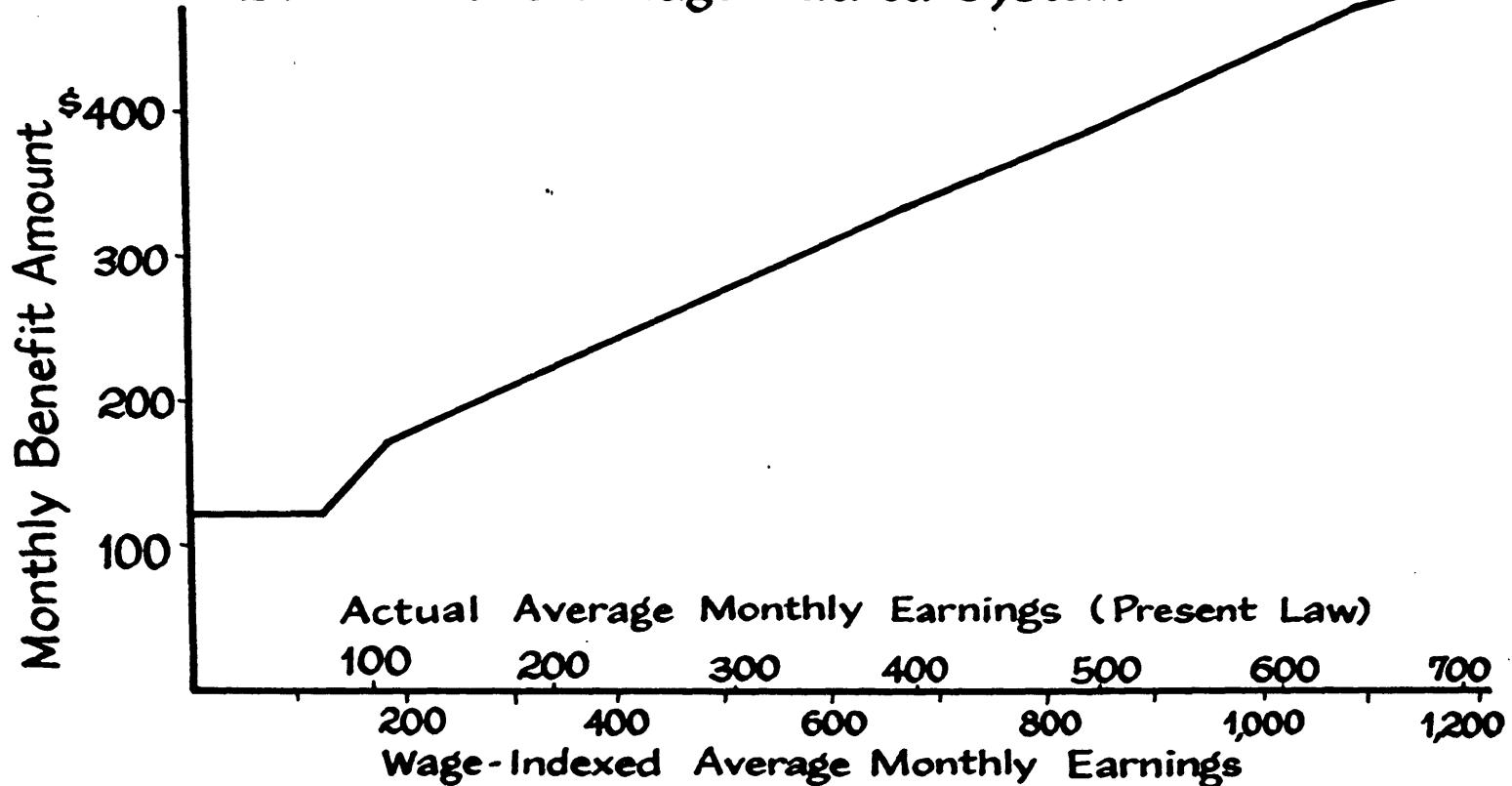
Chart A shows how an individual's wages might rise over a 20-year period assuming he had evenly rising wages (at a rate of 8 percent per year). For such an individual, the present law would produce a benefit based on an average wage of approximately \$8000 (assuming that his computation used 20 years and that the wages shown are the highest he had earned). Another individual whose final wage levels were the same (\$12,947) but who had a different wage pattern in earlier years or who had a lesser number of years used in his computation (in a disability case, for example) would have quite different average wages and therefore a quite different benefit amount.

How the formula changes.—Under present law, wage increases for individual workers and for workers in general tend to produce higher benefits since the amount of benefits is related to average wages and since average wages rise as wage levels rise. In addition, when the cost of living rises, the benefit formula factors are increased annually by the percentage increase in the Consumer Price Index. In effect, the benefit line shown on chart B would be raised each year by that percentage. Thus, benefits would be enriched as workers' increases in average wage move them along the bottom line of that chart and also as the level of benefits for each monthly wage level is increased.

Hypothetical Example of Actual, Wage-Indexed, and Price-Indexed Earnings



Benefit Amounts Related to Average Earnings Under Present Law and Under Wage-Indexed System



B. WAGE INDEXING

The Administration has proposed eliminating the present system for computing initial social security benefit amounts and replacing it with a system known as wage indexing.

The Administration formula resembles existing law in that benefits are based on average wages, but it differs from present law in that the percentages applied to average wages to determine the benefit amount would no longer be increased from year to year as the cost of living rises. Instead, the value of the wages themselves would be inflated to reflect changes in wage levels from year to year. Chart A shows the impact of indexing over a 20-year period on a worker who starts out earning \$3000 and whose wages increase evenly at 8 percent per year while wage levels nationally are rising at 5.75 percent. When he retires (in the year 2000 in this hypothetical example), his earnings for each prior year are inflated to reflect the percentage increase in national wage levels between that year and the year of retirement.

Thus, in this example, the individual would have earned \$12,947 in the year 2000 and that amount would be used in determining his average earnings. The \$3000 he had earned in the year 1980, however, would be inflated to \$8678 since wages in the economy had increased by 189 percent between 1980 and 2000. Similarly, the individual's actual wages in 1981 would be inflated by the percentage rise in national wage levels between 1981 and 2000 and so forth for each year.

Since the adjustments made by wage indexing result in inflating wage levels, average indexed wages will be higher than average unindexed wages. If indexed average wages were applied to the existing benefit table, therefore, a quite different benefit amount would result than the benefit based on actual average wages. The Administration proposal, however, would use a new benefit formula to be applied to average indexed wages. The formula in the Administration bill is:

- 94 percent of the first \$180 of average indexed monthly earnings; plus
- 34 percent of the next \$1.075 of average indexed monthly earnings; plus
- 16 percent of the remainder of average indexed monthly earnings.

When applied to wage-indexed average wages, the Administration formula is intended to yield approximately the same results as of 1979 that the benefit table in present law (as of 1979) would yield when applied to actual average wages in 1979. Thus, in chart B, a worker with \$1,000 of wage-indexed average monthly earnings is shown as having about \$600 in actual average wages. Applying the wage indexing formula shown above to his \$1,000 of indexed wages results in a benefit of approximately \$450 or the same amount as is obtained by applying the present benefit table to his \$600 of actual average wages.

It should be pointed out that chart B is based on the average wages and average indexed wages of workers whose wage levels in the past rose evenly from year to year at the same rate as wages in the overall economy. As will be discussed later, the relationship on the chart between indexed and unindexed wages will not hold true for other

workers with less evenly rising wage levels. Thus, while the new formula proposed in the Administration bill has the same results in terms of 1979 benefits for the type of worker shown in chart B, other workers may have higher or lower benefit levels under the new formula than under present law.

While the intent of the Administration formula is to have a benefit formula in 1979 which matches as closely as possible the expected results in 1979 under present law, the results in future years are intended to be quite different. Under present law, the formula for computing benefits from average wages would increase each year. (In effect, the benefit line shown on chart B would each year move upward throughout its length.) Under the Administration proposal, the benefit formula itself would remain static (except that the wage brackets would be adjusted as described below) but the value of wages would be further inflated each year.

Thus, in chart A, the \$3,000 of actual wages, which is inflated to \$8,678 for a computation in the year 2000, would be further inflated to \$9,178 for a computation the year 2001.

Because wage levels in the economy are assumed to rise continuously into the future, the impact of the benefit formula under the Administration proposal would tend to change dramatically if the wage brackets to which each part of the formula applies were left unchanged. On chart B, by way of illustration, as average indexed wages move farther and farther to the right the most heavily weighted part of the benefit formula (94 percent of the first \$180 of average indexed monthly wages) would have less and less impact on the total benefit amount. To offset this result, the Administration bill would provide for an annual increase in the brackets to which each part of the formula applies. The amount of the increase would be determined by the percentages increase in average wages. Thus, the first part of the formula "94 percent of the first \$180 of average indexed monthly earnings" would become "94 percent of the first \$190 of average indexed monthly earnings" if wage levels in 1980 are 5.75 percent higher than wage levels in 1979. Under similar circumstances, the second part of the formula "34 percent of the next \$1,075" would become "34 percent of the next \$1,137". On Chart B, this would be shown in effect by moving to the right the two points at which the benefits line bends.

C. PRICE INDEXING

The mechanics of a price indexing benefit system would be quite comparable to the mechanics of the wage indexing system described above. However, instead of inflating earnings by changes in wage levels in the economy the price indexing approach would inflate earnings in accord with changes in the Consumer Price Index. In Chart A, for example, the individual who earned \$3,000 in 1980 and had evenly rising earnings at 8 percent per year to a level of \$12,947 in the year 2000 would have his earnings inflated as shown in the middle line. Assuming that during this period price levels increase each year by 4 percent, his \$3,000 of actual earnings in 1980 would be inflated to \$6,321 in the year 2000 under price indexing as compared with \$8,678 under wage indexing. Since prices over the long run rise less rapidly than wages, the use of price indexing would tend to produce less increase

in the indexed wages and consequently a slower rate of increase in initial benefit amounts.

As under the Administration proposal, a new benefit formula would have to be computed in order to put a price indexing program into effect. The formula would be:

80 percent of the first \$250 of average monthly indexed earnings; plus

34 percent of the next \$500 of average monthly indexed earnings; plus

25 percent of the remainder.

Also, as under wage indexing, the wage brackets to which each of the percentage factors in the formula applies would have to be increased. Under a price indexing system, however, these bend points would be increased by the annual rise in price levels rather than by the annual rise in wage levels.

D. DIFFERENT RESULTS OF INDEXING

The effect of an indexed formula on the benefits payable to an individual will depend on the earnings pattern of the individual. The benefit formula in the Administration bill is designed so that an individual whose earnings increase at the same rate as average earnings will get a 1979 benefit approximately equal to the benefit payable under present law. For example, such an individual whose actual earnings averaged \$400 a month would get a \$333 a month benefit under both present law and under the Administration proposal and one whose actual earnings averaged \$500 a month would get a \$389 monthly benefit under wage indexing and \$385 under present law.

However, a somewhat different picture would emerge with different earnings patterns as illustrated in the following examples.

Example 1.—An individual whose earnings are averaged over 20 years, who earned \$3,000 in the first year and whose wages rose over the 20 years to \$8,769. Under present law, he would have average monthly earnings of \$448 which would give him a monthly benefit of \$376 in 1977. Under the wage-indexed formula in present law his average indexed monthly earnings would be \$723 and the monthly benefit would be \$354.

Example 2.—On the other hand, had the earnings pattern been one that began with high earnings (\$8,769 a year) in the first year then fell at an even rate until reaching \$3,000 in the 20th year, different results occur under wage-indexing. Under wage indexing his average earnings would be \$907 and his monthly benefit would be \$416. But, under present law he would still get the \$376 as in example 1.

Example 3.—Still different results occur in the case of a young person who has relatively high earnings and who becomes disabled. A disabled person whose benefits are based on 5 years of earnings which start at \$10,000 and rise at 5.75 percent each year would have actual average monthly earnings of \$935 under present law and \$1,042 of wage-indexed earnings. This results in a monthly benefit of \$587 under present law and \$462 under wage indexing.

The wage-indexed formula is designed to accommodate an earnings pattern in which an individual's earnings start at a low level and rise

at a rate approximating the changes in average covered earnings. The Hsiao panel points out, however, that this may not be the normal pattern and that for a significant part (and perhaps the major part) of the population there is considerable variation with maximum earnings at some point considerably earlier than retirement. Others have wages which go up in one period, fall in another, rise in another, and so on. In addition to cases of disability, for example, there are persons who have varying wage levels as they move from job to job, persons (such as married women) who may be out of the labor force for some extended periods of time, persons who may work in non-covered employment (such as employment abroad or for a Governmental agency) for some part of their career. Depending on the particular circumstances involved, such irregular coverage patterns could result in greatly different benefits under an indexed system than under existing law. For some individuals, the difference could be quite favorable and for others it could be quite unfavorable.

There are two major considerations which arise from the fact that the proposals for an automatically indexed benefit formula are designed from an analysis based on hypothetical workers with evenly rising wages whose wage patterns are not typical of the actual work force:

1. Actual experience could result in significant proportions of the workforce being advantaged or disadvantaged as compared with the hypothetical worker even though the net result would be to bear out the actuarial cost estimates. In such circumstances, however, there would likely be substantial pressure to improve the benefit structure for those who did less well than the hypothetical worker. Such a change would require either further increases in taxes to pay for the increased benefits or a cutback in the benefits of those workers who proved to be advantaged by the new system.

2. Actual experience could result in a different mix of advantaged and disadvantaged workers (as compared with the hypothetical worker with evenly rising earnings) under which program costs might prove to be much higher (or lower) than the actuaries now project.

The adoption of any system for automatically adjusting the initial benefit levels of retirees involves the use of assumptions as to future economic elements which are impossible to predict with any great confidence. Some of these elements are: the amount of wage-increase in the economy, the amount of price-increase in the economy, the relationship between wages and prices, the year-to-year as well as average patterns of wage and price increase, the relationship of wage patterns of individual workers as compared with the workforce as a whole. This is true of the existing system adopted in 1972 which adjusts future initial benefit levels by automatic changes in the benefit formula. The proposals for automatically adjusting future initial benefit amounts through price-indexing or wage-indexing of the individual's wages as applied to a fixed benefit formula appear to be somewhat less sensitive to those particular unpredictable elements which have caused the existing system to go out of control. However, there can be no assurance that any automatic system will in fact produce the results now envisioned for it.