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**EBRI Retirement Income and the Economy: Policy Directions**

**RETIREMENT INCOME  
AND THE ECONOMY:  
POLICY DIRECTIONS  
FOR THE 80s**

An EBRI-ERF Policy Forum

1865

EMPLOYEE BENEFIT RESEARCH INSTITUTE

# Employee Benefit Research Institute

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# Retirement Income and the Economy:

## Policy Directions for the 80s

An EBRI-ERF Policy Forum  
May 6, 1981

Edited by:

Dallas L. Salisbury

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Education and Research Fund  
1920 N Street, N.W. Suite 520  
Washington, D.C. 20036  
(202) 659-0670

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## Foreword

As the U.S. retired population continues to grow, the retirement income policy debate over who gets how much, who pays, and through what means it is delivered will become increasingly intense.

As a result of a changing economy, advocates who in prior years simply called for more, have come to realize that there may "temporarily" be limits to economic capacity. They now state that in order to have a decent standard of living in retirement, there may well be a need for reducing preretirement living standards.

Gerontologists and other scholars foresee growing intergenerational pressures as a retired population that "appears" to be living well asks for more of the economic pie. They predict that it will be increasingly difficult to focus attention on the shrinking, yet significant, segment of the retired who remain in or near poverty.

Recognizing the complexity and growing importance of retirement income issues, the Employee Benefit Research Institute (EBRI) began a wide-ranging program of research and educational programs in the area in 1978. The series of programs and reports have been designed to provide interested parties with the information base needed for comprehensive retirement income policy research and decision making.

During 1981 EBRI will publish major studies on retirement program coverage and benefit receipt, funding and capital markets, and retirement income levels. This EBRI Education and Research Fund Policy Forum, entitled *Retirement Income and the Economy: Policy Directions for the 80s* was designed to complement those studies and aid decision makers in the difficult re-evaluation of the Social Security program now taking place.

The Policy Forum papers highlight current issues, concerns and critical information needs. They articulately present alternative approaches to meeting the nation's retirement income policy challenges, particularly as they affect the economy.

The forum would not have been possible without the support of EBRI members, the excellent job done by moderator Robert D. Paul, or the tremendous amount of time contributed by the authors and other participants. To each, special thanks is extended.

DALLAS L. SALISBURY  
Executive Director

## About the Authors

### Robert A. Beck

Robert Beck is Chairman and Chief Executive Officer of The Prudential Insurance Company of America. He is also a member of the Business Roundtable Policy Committee. Mr. Beck is a trustee of Syracuse University and the Committee for Economic Development, as well as a member of the Conference Board and the Business Council. He is also a board member of the American Council of Life Insurance and a member of the Business Council.

### Colin D. Campbell

Colin D. Campbell is Professor of Economics at Dartmouth College. Dr. Campbell is also the Director of the Dartmouth National Bank of Hanover (New Hampshire); the Director of the Thomas Jefferson Center Foundation, the University of Virginia; and an adjunct scholar, the American Enterprise Institute, Washington, D.C. He was formerly the Director of the Student Loan Marketing Association. Dr. Campbell is the author of numerous publications, one of which is *Financing Social Security*.

### Slade Gorton

Slade Gorton is U.S. Senator from the State of Washington. He is a member of the Commerce, Science and Transportation Committee; Environment and Public Works Committee; Budget Committee; Select Committee on Indian Affairs; and the Select Committee on Small Business of which he is Chairman of the Productivity and Competition Subcommittee. Senator Gorton is the former Attorney General for the State of Washington and a former member of the Washington House of Representatives. He practiced law in Seattle, Washington for twelve years prior to his public service.

### William C. Greenough

William C. Greenough is Trustee, TIAA/CREF and Chairman, CREF Finance Committee. He was formerly a member of President Carter's Commission on Pension Policy and a past Chairman of TIAA/CREF. Mr. Greenough is also a Trustee, Aspen Institute of Humanistic



Studies and the Committee for Economic Development. He is a Phi Beta Kappa Visiting Scholar and the recipient of the Elizur Wright Award for “outstanding and original contributions to insurance literature,” awarded to “A New Approach to Retirement Income.” Mr. Greenough is also the co-author of *Pension Plans and Public Policy*.

### **Robert D. Paul**

Robert D. Paul is Vice Chairman of the Martin E. Segal Company. He is a member of the Academy of Management, American Compensation Association, American Pension Conference and other professional organizations. He has authored numerous articles that have appeared in the *Harvard Business Review* and *Risk Management*. He serves on the Board of Trustees of EBRI.

### **Simon Rottenberg**

Simon Rottenberg is Professor of Economics, University of Massachusetts. He was formerly Professor of Economics at Duke University, State University of New York at Buffalo and the Roosevelt University. Dr. Rottenberg is a member, National Labor Panel, American Arbitration Association; an adjunct scholar, American Enterprise Institute for Public Policy Research; and a consultant, Federal Trade Commission. He is the author of several publications and the editor of *The Economics of Medical Malpractice*, *Occupational Licensure and Regulation*, and *Papers on the Economics of Legal Minimum Wages*.

### **Dallas L. Salisbury**

Dallas L. Salisbury is Executive Director of the Employee Benefit Research Institute, Washington, D.C. Prior to joining EBRI, Mr. Salisbury served as Assistant Executive Director for Policy and Planning of the Pension Benefit Guaranty Corporation (PBGC); Assistant Administrator for Policy and Research of the Pension and Welfare Benefit Programs, U.S. Department of Labor; and as Assistant Director of the Office of Policy and Planning, U.S. Department of Justice, in addition to other public and private sector positions. Mr. Salisbury holds degrees from the University of Washington, Seattle, and the Maxwell Graduate School, Syracuse University.

## **Bruno Stein**

Bruno Stein is Professor of Economics and Director of the Institute of Labor Relations at the New York University. He has been Visiting Fellow at the Policy Studies Institute, London; Academic Visitor at the London School of Economics and Visiting Lecturer at Cornell University. Dr. Stein is a panel member of the Federal Mediation and Conciliation Service. He is the author of *Social Security and Pensions in Transition: Understanding American Retirement*.

# Introduction

Each day we are confronted with new survey reports, studies, panel recommendations and policy proposals intended to inform us about, or to alter and improve public and private retirement income programs. Before any decisions can be made based on this material and the data already available, decision makers must assure themselves that the real problems have been identified, that related issues have not been ignored, and that the treatment of an issue has been adequate and thorough.

The Reagan Administration and the Congress are now going through these steps with regard to the Social Security program, other income transfer programs, and incentives for individual initiative.

Effective evaluation of retirement income issues requires precision in three areas: First, the meanings of the terms used to describe a policy issue or proposal must be clear. Second, specific retirement policy issues must be identified precisely so that they are evaluated in light of related issues and alternatives. A final area requiring precision is that of determining whether the material presented or available is complete or whether further data or studies are needed.<sup>1</sup>

The papers developed for this Policy Forum should help concerned persons and decision makers identify and resolve potential definitional problems, integrate individual proposals into a broad and meaningful framework, and determine where further research or analysis is needed.

## The Implications of Error

Over the last fifty years, retirement income programs have increased in importance as sources of income during retirement. For example, while the total population over age 65 increased at an annual rate of approximately 2 percent between 1960 and 1979, the number of Old Age Survivors Insurance (OASI) recipients increased at an average annual rate of approximately 5 percent—from 14 million to approximately 34 million beneficiaries during this period. Beneficiaries of privately administered plans increased even more rapidly—

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<sup>1</sup>Employee Benefit Research Institute, *Retirement Income Policy: Considerations for Effective Decision Making* (Washington, D.C., 1980).

from approximately 2 million in 1960 to approximately 9 million in 1979—representing an average annual growth rate of over 8 percent.

The combined impact of a growing retired population and increasing benefit levels has produced a large increase in total retirement program benefit payments. Table 1 shows that the increase in retirement income plan payments over the 1950-75 period outstripped the increase in Gross National Product (GNP). Retirement program disbursements increased from approximately 1.3 percent of GNP in 1950 to 6.3 percent of GNP by 1975.

Because of the increasing significance of retirement income programs, public attention has turned to the broader economic effects of these programs. For example, the question of whether contributions to retirement income programs represent a real increase in total savings or merely a substitution of institutional for personal savings, is the subject of intensive study by economists in the field. Another economic issue concerns the broader effects of retirement income programs on the labor force participation decisions of potential workers.

These issues underscore the importance of evaluating the adequacy of current public policies in the retirement income area, and of estimating the impact of alternative policies on a broad set of economic factors.

### *A Framework for Policy Evaluation*

The trends in retirement income programs have raised a number of complex public policy issues. Specific issues have become the focus of studies by congressional staff and by individual agencies, advisory councils and commissions in the Executive Branch. We can expect the results of these efforts to improve public awareness of the problems and to provide a range of potential solutions to these problems. The results of many of these efforts have been included in Appendix I.

While evaluating these proposals, policymakers must ensure that specific solutions address all of the policy issues in an integrated fashion. The authors' and discussants' presentations might be viewed as assessments of three fundamental questions:

- *Goals: What retirement income levels should be established for individuals during retirement?* This broad question encompasses the two major policy issues of how to determine the adequacy

**TABLE 1**  
**Benefit Payments Under Public and Private**  
**Retirement Income Programs, Selected Years 1950-1975**  
(millions of dollars)

	1950	1955	1960	1965	1970	1975
<b>Publicly Administered</b>						
OASI	\$ 961	\$ 4,968	\$ 10,677	\$ 16,737	\$ 28,796	\$ 58,509
SSI <sup>a</sup>	1,454	1,488	1,626	1,594	1,866	2,516
Federal Civil Service	266	428	893	1,438	2,752	7,207
Military	331 <sup>b</sup>	442	693	1,386	2,853	6,232
State and Local	320	722	1,265	2,008	3,638	7,490
Subtotal Public	\$ 3,332	\$ 8,048	\$ 15,154	\$ 23,163	\$ 39,905	\$ 81,961
<b>Privately Administered</b>						
Pension and Profit Sharing Plans	370	850	1,720	3,520	7,360	14,810
Total All Programs	\$ 3,702	\$ 8,898	\$ 16,874	\$ 26,683	\$ 47,265	\$ 96,771
GNP	\$286,200	\$399,300	\$506,000	\$688,100	\$982,400	\$1,528,800
Program Outlays As Percent of GNP	1.3%	2.2%	3.3%	3.9%	4.8%	6.3%

<sup>a</sup> Estimates for 1950 through 1970 reflect payments under the Old Age Assistance program (OAA) which was replaced by Supplemental Security Income (SSI) in 1974; 1975 estimates reflect payments only for aged recipients.

<sup>b</sup> Military data are actually for 1952 because 1950 data are not available.

Sources: OASDI and SSI estimates from Social Security Administration, *Social Security Bulletin Annual Statistical Supplement, 1975*; Federal Civil Service estimates from U.S. Civil Service Commission, Bureau of Retirement Insurance and Occupational Health, *Annual Report of Financial and Statistical Data, 1975*; Federal Military estimates from U.S. Department of Defense, Office of the Actuary; State and Local estimates from Bureau of the Census, *Finances of Employee Retirement Systems of State and Local Governments*; Private plan data from *Social Security Bulletin*, November 1977; Gross National Product estimates from *Economic Report of the President*, January 1979.

of retirement income benefits and how to define retirement for purposes of establishing eligibility for retirement benefits.

- *Strategy: What mix of private and public programs should be used to achieve these income levels?* This question requires an assessment of the adequacy of existing opportunities for individuals to receive a retirement benefit. Where gaps exist, policymakers will have to address the policy issues of whether new alternatives should emphasize mandatory or voluntary participation and whether participants should earn benefits or receive them as a societal right. Where unintended overlaps in programs occur, policymakers will have to determine how to coordinate them.
- *Financing: Who should pay for these retirement income programs?* This broad question raises the related policy questions of whether each generation should pay for its own retirement benefits, how different age and income groups should share the costs of these programs and who should bear the risk of funding inadequacies. Addressing these issues will establish whether existing and proposed retirement income policies are affordable and identify how these policies affect the economy.

## **The Papers**

U.S. Senator Slade Gorton discusses the relationship of retirement income, the budget and small business. “The role of small business as a provider of retirement is growing steadily,” writes Gorton. “The small plan sector accounts for nearly 97 percent of the total universe of private pension plans on a numerical basis. In recent years, the growth of private pension plans among small employers covering ten or fewer participants has risen dramatically.”

“Although small business represents the main opportunity for increasing the number of career workers who can participate in pension plans,” Gorton writes, “major impediments exist that stifle its growth. The Employee Retirement Income Security Act (ERISA) increased administrative costs of small plans and contains impediments which have given rise to growing concern in the small business community. Another impediment: inadequate tax incentives tailored to fit the needs and expectations of small business.”

“The policies for the 1980s must encourage the development and maintenance of small business pension plans. Serious consideration must be given to providing additional tax incentives attractive to the small employer, possibly making mandatory employee contributions

to pension plans tax deductible and increasing IRA and KEOGH limits. ERISA needs to be revised to fit the requirements of small business. The Social Security system and other income transfer programs must be stabilized. We must provide an environment in which small business can prosper, add new jobs, improve productivity, enhance competition, and continue the creation of additional private retirement programs," concludes Gorton.

Robert Beck, Chairman of The Prudential Insurance Company of America and a member of the Business Roundtable Policy Committee, outlines the retirement income policy positions of the Business Roundtable. "The proper role of Social Security is to provide a floor of protection for all workers to replace a reasonable portion of income lost because of retirement," writes Beck. "Further expansion of current Social Security benefit levels is neither necessary nor desirable. To assure that the Social Security program continues to serve its essential function, not only for this generation but for future generations as well, benefits must be maintained at levels that the working generation is willing and able to support. The demographics of the U.S. will require that an ever expanding portion of the incomes of wage earners be allocated to maintain existing benefit levels. In recognition of this, Social Security benefits should not be further expanded."

Mr. Beck notes that additional retirement income is best provided by advance-funded, private pension plans and individual savings. "Private plans and individual savings should not be mandated but should be encouraged through properly designed incentives, legislation and regulations. The Business Roundtable opposes the introduction of another layer of mandatory pensions, as recommended by President Carter's Commission on Pension Policy. Instead, legislation should be enacted that would permit tax-deferred employee contributions to either a qualified pension plan or to an IRA, which would act as incentives to encourage individual savings. The adverse impact of inflation upon retirement income should be alleviated by effective control of inflation rather than by general indexation of all retirement benefits."

Simon Rottenberg, Professor of Economics, University of Massachusetts, discusses the allocational consequences of pension policies, with special reference to their labor market effects and to their wealth distribution effects. "Labor force withdrawals and the consumption of leisure are encouraged by the fact that although Social Security benefits are, *per se*, tax free, if earnings from work exceed a specified amount, benefits are taxed at a high rate," writes Rotten-

berg. He notes that the expansion of Social Security coverage and benefit payments will have an inhibiting effect on total private savings, either because payroll taxes reduce disposable income or because Social Security increases the real wealth of households and therefore increases current consumption from disposable income.

“Higher rates of retirement may result if the recommendation of full replacement rates of retirement income by President Carter’s Commission on Pension Policy is implemented,” writes Rottenberg. “The higher the fraction that pension benefits are of earnings from work, if retirement is delayed, an approximate measure of which is the replacement rate ratio of benefits to earnings immediately prior to retirement, the larger is the incentive to withdraw from the labor force. A large increase in disability claims will result if full replacement rates are combined with delayed retirement. This policy is clearly excessive.”

William Greenough, Trustee, TIAA/CREF and Chairman, CREF Finance Committee, presents his views of the recommendations of the President’s Commission on Pension Policy. Greenough, himself a member of this Commission, discusses the objectives of tax policy in connection with retirement security for all people. “This tax policy includes raising enough revenue to meet the full expenditures of Social Security, encourage employers to establish private and public employee retirement systems as strong supplements to basic Social Security benefits, and encourage capital formation and productivity. Current tax laws and regulations do not meet these tests. The President’s Commission on Pension Policy continues to approve of the present tax treatment of employer contributions and all investment earnings of retirement plans. The Commission also recommends treating contributions and benefit limitations for all individuals more consistently for all types of retirement savings, and treating savings specifically for retirement the same as the tax treatment of private pension plans.”

There is one recommendation of the PCPP with which Greenough especially disagrees, and that is the Minimum Universal Pension System or MUPS. “My dissent was on MUPS, which is, I believe, ‘A Real Clunker,’” writes Greenough. “The design of the recommended private plan, if mandated, is excellent. But here my support for MUPS ends. Through Social Security, the Federal government has already made major decisions for almost all American workers as to how much of their earnings they can use currently for themselves and their families, and how much will be transferred from them through Social Security taxes to people already retired. MUPS



would mandate additional shifting forward of life income from a person's working years to the retirement years. The time has come to let tens of millions of families and their employers decide that question."

"Instead of the Commission's recommendation of a federally mandated MUPS, I would favor continued voluntary effort to develop coverage through funded, private pension plans. I would seek ERISA simplification especially for smaller employers, a more precise targeting of the groups that need additional protection beyond Social Security, earlier vesting in present retirement systems, a slower phased-in vesting for new plans, and continued diversity among savings, thrift, and profit sharing plans, defined contributions, and defined benefit retirement systems."

Colin Campbell, Professor of Economics, Dartmouth College, presents an analysis of the long-term prospects for Social Security. "The basic problem facing the Social Security system and all types of long-range plans is adjusting to unexpected developments," Campbell notes. "The decline in the birthrate, the effects of accelerated inflation on adjusting benefits for inflation and the decline in the real wage differential—the difference between the rate of increase in the consumer price index—have contributed to the cost of the system rising sharply."

"The decline in the birthrate since 1956 would not have increased estimated future costs if the Social Security system were advance funded rather than pay-as-you-go," said Campbell. "In a pay-as-you-go system, changes in the birthrate affect the future cost of the system by altering the ratio of the number of beneficiaries to the number of workers paying taxes."

Campbell cites as an important cause of the OASI fund's short-range financial difficulties, the relatively low growth of wages compared to the increase in consumer prices. "Consumer prices rose more rapidly than expected, while wages in covered employment did not rise more rapidly than the 1978 forecast," he said. "Result: expenditures increased faster than tax receipts."

Campbell is critical of the National Commission on Social Security proposals to restore the Social Security system's financial solvency by an increase in personal income tax and for a later retirement age. "The increase in the tax rate, a 2.5 percent surcharge added to the federal personal income tax, runs counter to the Reagan economic program for cutting tax rates and avoiding further increases in the percentage of income paid in taxes. In the 1970s, the rise in the cost of Social Security was a major factor contributing to increases in

federal taxes as a percentage of the gross national product. Raising the taxes could worsen rather than solve the financing problems of the Social Security system.”

“Raising the eligibility age from 65 to 68 would reduce the cost of the system and make it possible to bring the income and outgo of the system into closer balance. But the Commission’s proposal does not reduce costs sufficiently to avoid increasing tax rates, and it does not start until the year 2001. Costs will rise sooner than the year 2001 if the decline in the real wage differential continues, or if the decline in the mortality rate or the trend toward early retirement turns out to be more significant than anticipated.”

Bruno Stein, Professor of Economics, and Director, Institute of Labor, New York University, analyzes the changing American retirement system. He compares and comments extensively on the similarities and differences between the recommendations issued by the President’s Commission on Pension Policy and the National Commission on Social Security. He also critiques the PCPP’s proposal to invoke a Minimum Universal Pension System (MUPS). “One of the intriguing aspects of MUPS is that it is, in the long run, a substitute for Supplemental Security Income,” said Stein. “SSI for the aged is funded on a current basis and thus largely represents an intergenerational transfer. It is an income transfer from the well off to the poor. MUPS presents a different image. Since it requires a tax subsidy, it partially retains a component of income transfer, but primarily on an intragenerational basis.”

Stein noted major problems with MUPS. “Americans are extremely sensitive to the role of government in private capital markets. The PCPP does not give any detail on the management of such a fund, except that it would be administered by independent trustees. How independent will these trustees be?” Stein continues, “MUPS compels people to save and to invest such savings in a manner predetermined by their employers.”

## **The Remainder**

Extensive discussion surrounded the presentations. The discussion has been organized around a number of key policy questions which are noted in the Table of Contents. In addition, as mentioned above, summaries of recommendations of numerous study groups dating back to 1965 are included in Appendix I. And the Executive Summary of a recent major EBRI study, **Retirement Income Oppor-**

**tunities in an Aging America: Coverage and Benefit Entitlement, is included as Appendix II.**

### **Conclusion**

The nation faces major challenges in the near future and in the decades ahead if it is to meet the needs of a growing aged population. Simultaneously, national harmony among generations must be maintained. The task will not be easy. Delay will only make the task more difficult.

# Changing the American Retirement System

Bruno Stein

## Introduction

The last decade has seen considerable change in our retirement system and its component elements. Back in 1972, Congress had put what it thought were the finishing touches on the Social Security system, yet two years later warning signals were heard, loud and clear, that things were not working out. A drastic tax increase and a somewhat disguised benefit cut were enacted in 1977 to rescue Social Security, but severe problems have persisted.

In 1974, after years of debate, the Employee Retirement Income Security Act (ERISA) emerged to regulate and ensure the safety of private pensions and the rights of covered employees. Within six years, further legislation was needed to prop up the multiemployer plans. In the meantime, some state and local public pension systems contain time bombs with fuses of various lengths, and some public equivalent of ERISA may yet be needed.

After a bad start, Supplemental Security Income (SSI), enacted in 1972 and effective in 1974, seems to be functioning well. It is not without problems, especially in the area of state supplementation. The success of the program in ameliorating poverty depends on food stamps and medical transfers-in-kind. Without these, effective benefit levels would be abysmal for this sector of the aged population. Indeed, Medicaid has assumed a role not envisioned by its legislators: a terminal form of income support.

Did something go wrong? In part, what we observe here, as elsewhere, are the consequences of slow economic growth. As Arthur Okun used to say, "When the economy goes wrong, nothing goes right." But we also observe some failings in the mechanics of our retirement support systems. This paper, and the others presented at the EBRI Policy Forum, addresses itself to proposals to remedy at least some of these failings.

The specific proposals to be discussed in this paper are those made by the President's Commission on Pension Policy<sup>1</sup> and the National

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<sup>1</sup>President's Commission on Pension Policy, *Coming of Age: Toward A National Retirement Income Policy* (Washington, D.C., February 26, 1981).

Commission on Social Security.<sup>2</sup> My plan is to begin with an overview of some fundamental issues and a digression on advance funding. The latter is necessary because the report of the President's Commission centers on a proposal for Minimum Universal Pensions (MUPS) and stresses the advantages of advance funding over pay-as-you-go. Advance funding is in danger of becoming a slogan rather than a mechanism, and it needs to be examined for what it can and cannot do.

In the next part of the paper, I compare the two reports for points of convergence on the issues surrounding Social Security. Not surprisingly, I find considerable overall similarity in their ideas, although important differences in detail are apparent. I then examine the proposal for MUPS. The paper ends with a brief discussion in which I list what I believe to be the order of priority for reform of our retirement system.

Before proceeding to the heart of the matter, let me state some *caveats* and some of my prejudices. First the *caveats*: I had very little time between my receipt of the reports and the deadline for my manuscript. Indeed, I had to use a draft report of the National Commission sent to me in advance of publication by what is known as a "reliable source." Accordingly I could not give them the full study to which they are entitled, and confined myself to highlights. If I missed something important, or misinterpreted something, I stand ready to be corrected.

A second *caveat* is that even if I had more time, I would not have been able to come up with some third and more optimal reform proposal. This would require enormous resources, and it is inherently difficult to take two package proposals and rearrange the individual items in each package. There are, however, two studies now under way that, if funding continues, can yield a large variety of policy options together with their micro- and macroeconomic consequences. These are being carried out separately by The Brookings Institution and by a consortium at University of Michigan and New York University.

As for my prejudices, I always attempt to make my analyses as value-free as possible, in the tradition of positive economics. However, no human is free of value judgments, and I had better make some of mine explicit. These include a belief that a social insurance

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<sup>2</sup>*Social Security in America's Future: Final Report of the National Commission on Social Security* (Washington, D.C., March 12, 1981).

system is an important part of the structure of any modern industrial nation. Such a system need not, and possibly should not, be the sole basis for the income security of individuals or households. Adults, in my view, have an obligation to try to provide for themselves, whether through individual saving effort or collective efforts such as pensions. Pensions, notwithstanding some of their problems, have undoubtedly facilitated the ability of many workers to spend the later years of their lives in some tranquility, security and dignity. However, I also share the usual Judeo-Christian value that people who have not been able to provide for their old age should receive assistance from the more fortunate members of the community. In short, public old-age provisions should be somewhat redistributive. These prejudices are not especially startling and are held, in varying degrees, by most Americans.

Finally, I like things that work. The ultimate test of a policy is its ability to achieve its goals without undesirable side effects. No policy, however brilliantly conceived, can do this for all time, because times and needs change. The time for some change in our retirement system is drawing nigh. The two reports reviewed below are major contributions to our search for a workable policy.

## **Overview and Digression**

The National Commission on Social Security was created by Congress to conduct a full-dress study of Social Security and related programs and to develop a policy blueprint for the future. At about the same time, the President's Commission on Pension Policy was asked to examine the nation's retirement, survivor and disability systems and to develop recommendations for changes. These were but two of a host of public groups who looked into all or parts of America's retirement system.<sup>3</sup> Presumably, it was assumed that competition would, as in the private sector market, produce the best possible product, albeit not necessarily at the lowest cost.

In the nature of things, the two groups were compelled to face similar issues, even though their mandates did not completely overlap. This is because it is impossible to examine any one aspect of retirement policy without considering the others. The student of

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<sup>3</sup>Among others were the Advisory Council on Social Security to the then Department of Health, Education and Welfare, the Universal Social Security Coverage Group of HEW, and a number of Congressional special committees and task forces.

pension policy cannot ignore Social Security, and the student of Social Security cannot ignore pensions and other retirement provisions. Nonetheless, the Commissions approach their tasks from considerably differing perspectives.

The National Commission assumed—or concluded—that the existing Social Security system is the proper vehicle for providing the basic retirement income maintenance for the aged, and its recommendations focus on ways to make the system viable through short- and long-term crises. Voluntary pensions and other forms of saving were regarded as supplements—the icing on the cake—to the one system that could not only insure against a broad range of contingencies but also, and more to the point, maintain that protection through indexing.

Accordingly, it considered briefly and rejected the usual set of alternatives to Social Security.<sup>4</sup> Some of these were straw men, easily knocked down. For example, it would be difficult to get the general public to understand the niceties of retirement bonds and probably impossible to persuade it to return to the good old days of personal saving and public charity. Other alternatives were, at the very least, worthy of greater exploration, if only because they function in other industrial nations or are extensions of systems in a process of natural development. Mandatory pensions would fall into the latter category.

The President's Commission did not really quarrel with the primacy of Social Security, at least as the provider of the base level of retirement income which other systems *complement*, nor did it trouble to go through the motions of examining and rejecting a list of alternative retirement systems. Instead, it placed its emphasis on the *complement*—specifically pensions. It was evident, from the early stages of its deliberations, that it was especially concerned with the problems inherent in pay-as-you-go systems and saw advantages in advance funding.

If you believe that: 1) pay-as-you-go contains inherent problems,<sup>5</sup> especially for the future; 2) pension coverage will not grow to include

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<sup>4</sup>The list includes reliance on individual savings, reliance on public assistance, universal flat benefits, double-decker benefit plans, choice of private or public coverage, retirement bonds, and mandatory private pensions. See National Commission on Social Security, *Final Report*, chapter 3, pp. 35-51.

<sup>5</sup>It doesn't, provided that certain conditions are met. This was proved in Paul Samuelson's classic "An Exact Consumption-Loan Model of Interest with or without the Social Contrivance of Money," *Journal of Political Economy*, vol. 66 (December 1958), pp. 467-82. Alas, the conditions are not met, and we *do* have problems.

the lower-paid half of the private sector labor force, which will somehow need to be supported as it ages; 3) compelling people to save is not more wicked in private than in public retirement systems; and 4) advance funding of pensions has intrinsic advantages over pay-as-you-go (including its contribution to the pool of saving for capital formation); then: Q.E.D., you are inexorably led to a proposal for mandatory pensions. Since the President's Commission, like the National Commission, consisted of demonstrably logical and rational people, that is precisely the conclusion at which they arrived.

#### *A Digression on Advance Funding*

Since advance funding is an important aspect of the recommendations of the President's Commission, some comments on it may be useful at this juncture. To begin with, much or most of what is consumed by the retired population consists of a bundle of goods and services that are currently produced. An advance-funded pension, like any prior saving, transfers a right to money claims through time, not to a claim to any specific bundle of goods. So does a pay-as-you-go social insurance system. At any point in time, the economically active population uses *its* money claims to purchase real goods and services. The two groups thus appear in the marketplace to compete for the available supply of consumable goods and services, and divide this pool (really a flow) between them. More for one means less for the other, unless the method of financing the claims of the retired somehow increases the supply of consumable goods so that its division satisfies both groups in some economically efficient or politically acceptable fashion.<sup>6</sup>

It will be noticed at once that soundness, in an actuarial sense, is not the issue. Any one employer pension scheme will be sounder if it is funded on a proper actuarial basis than if it were to be funded haphazardly, or not at all. However, to generalize from one plan to all plans is to fall prey to the fallacy of composition, if claims to real goods and services are to be considered. At best, all plans can keep

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<sup>6</sup>This point was raised in Bruno Stein, *Social Security and Pensions in Transition* (New York: Free Press/Macmillan Co., 1980), pp. 199-200. A thorough exploration of the advance funding versus pay-as-you-go issue is found in Nicholas A. Barr, "Myths My Grandpa Taught Me," *The Three Banks Review* (December 1979), pp. 27-55. For a somewhat parallel view, see Irwin Tepper, "Consequences of Providing for Retirement Income Through Advance-Funded Versus Pay-As-You-Go Programs," in *Retirement Income and the Economy: Increasing Income For The Aged*, ed. Dallas L. Salisbury (Washington: Employee Benefit Research Institute, 1981), pp. 40-55.



their money promises. What these promises are worth at the point of receipt will depend on price level behaviors that prevail at that time, which, in turn, will partly depend on the supplies of consumable goods available at that time.

In a society where a property right takes precedence over a statutory entitlement, the security of an advance-funded money claim is obviously greater. However, a property right can be created without advance funding, both by employers and by government. The former can create it by making the pension a contractual obligation, and the latter can legislate it, for example, by issuing bonds equivalent to the present value of the future payment. Again, it is useful to remember that the Fifth and Fourteenth Amendments to the Constitution protect property rights in nominal but not in real terms. Of course, claims can be indexed to the prices of some bundle of securities or commodities, but this merely shifts some risks around; it does not provide security for a class of claimants.

By now it is evident that indexation, at the point of retirement, can only be undertaken in any significant measure by government through its taxing powers. It can be applied to private pensions, as in the new British scheme,<sup>7</sup> where government undertakes the inflation adjustment, or by offering government index-linked bonds for pension portfolios or retirement savings (what the British call Granny Bonds). It can, as we do it, simply be applied to Social Security. There is no especial magic to indexation. It protects the pensioners' real claims to output by restoring an element of pay-as-you-go, and thus reduces the relative claims of the working population.

We are brought back to the point raised earlier: that an evaluation of the relative merits of advance funding over pay-as-you-go rests on whether the former method, unlike the latter, increases the size of the pie to be divided by the economically active and inactive. I shall not dig into this can of worms at this point, instead I shall content myself with a few comments.

The principal argument for the superiority of advance funding is that it 1) increases the flow of savings, which 2) increases investment in capital, which 3) increases the quantity and quality of our future capital stock, which 4) increases the productivity of the working population, which 5) increases consumable output. Leaving aside the possibility that there are alternative means of increasing saving, and assuming that all the linkages work as they are supposed to, would the proposal for mandatory pensions increase saving?

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<sup>7</sup>Described in *Pensions: Britain's Great Step Forward*, HMSO, n.d. (1977).

The answer is not as obvious as it might appear to be. Economic theory teaches us that guaranteed retirement incomes reduce individual private saving by displacing it, and increase it to the extent that retirement is possible at earlier ages, a factor that necessitates more rather than less saving. This is the celebrated Feldstein-Munnell effect, and its net effect is admittedly theoretically indeterminate.

Historically, the rise of private pensions appears to have led to an increase in total private saving in the U.S.<sup>8</sup> Since growth in coverage of private and public pensions is close to saturation, this effect will become attenuated as a growing cohort of pensioners begin the dis-saving segment of their life cycles. Mandatory pensions for the uncovered part of the working population can have a similar effect. Since the uncovered part of the working population tends to be in the low-wage sector—and if pension costs are shifted backward in the form of relatively lower wages—then there is less scope for displacement of voluntary personal saving by mandatory saving. Hence, the start-up effect of the new program may well be to achieve the desired increase in total saving.

The above is subject to a number of qualifications, including but not limited to: 1) the impact of the lower relative wage on labor supply; 2) the possibility that the proposed tax subsidies for the program will be shifted through to wage earners and used for current consumption, thus offsetting the pension saving; 3) the higher retirement ages of the proposal may diminish what little saving the newly covered group would create.

My purpose in this digression has been to demythologize the advance funding issue. I shall refer to the available empirical evidence in my discussion of MUPS. The proposals of the President's Commission, or those of the National Commission, do not necessarily stand or fall on this issue. It is now time to return to the two Commissions' reports, in terms of both their similarities and their differences.

### Comparing the Two Reports

Both Commissions assumed the perpetuation of Social Security as a vehicle for retirement income maintenance. Both saw problems that required change. It may be instructive, therefore, to compare

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<sup>8</sup>Alicia H. Munnell, "Private Pensions and Saving: New Evidence," *Journal of Political Economy*, vol. 84 (October 1976), pp. 1013-1032.

them on issues where, notwithstanding their differing approaches, they came close to convergence. In this section of the paper I shall look at these points of convergence, organized, perhaps arbitrarily, into the following topics: 1) Financing; 2) Benefits; 3) Indexation; 4) Retirement Age and Earnings Test; 5) Individual Efforts and Older Workers; and 6) Public Assistance. Keeping in mind that the long-term actuarial imbalance is a major problem, I shall then: 7) compare the estimated impacts of their proposals on the long-term actuarial balance of OASDI, using their own data.

### *Financing Social Security*

Both reports favor interfund borrowing, and the National Commission goes a step further by seeking to reallocate part of the Health Insurance (HI) fund to the Old Age Survivors and Disability Program (OASDI). The existing structure of the Funds has long been a puzzle to me. Arguably, OAI and SI are separate programs, deserving separate funds, just as DI is separate. HI is an entirely different piece of business, but health is health, and a still separate Supplemental Medical Insurance (SMI) may be thought of as yet another anomaly. Neither of the health programs is wage-related in terms of benefits.

Arguably, OASI and DI have annuity and life insurance elements, based on previous "contributions"<sup>9</sup> so that they may be grouped under one fund. Shifting funds from one Fund to another suggests that the Social Security fisc has several pockets, and that gains can be made from shifting funds from one pocket to the other. Like the household that keeps money for food, rent, and other expenses in separate envelopes, the Social Security fisc finds it necessary, from time to time, to cover shortfalls in one budget with surpluses in another. The same things can be accomplished by the use of one budget with different items and a common income stream.

There is a political need, both within the household and the fisc, to maintain separation of funds in envelopes or Trust Funds, rather than in an account book. Interfund borrowing, in that case, is a mild deception to assuage this need. Otherwise, it is a perfectly good idea so long as the householder, or the fisc, understand that juggling the books is only a short-term solution. Both Commissions clearly understand this.

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<sup>9</sup>I prefer the word "taxes," but the word "contributions" implies that benefits bear some relationship to prior labor market earnings.

As noted above, the National Commission goes a step further, by proposing to fund 50 percent of HI from a 2½ percent surtax on income taxes. This compromise between shifting all of HI to a progressive income tax or leaving all of it in a payroll tax, enables it to hold the payroll tax rates at the scheduled increase it proposes until 2020, and to promise a maximum joint payroll tax of 18 percent with infusions from general revenue thereafter. It also enables it to slow the rise in the wage base by holding it constant from 1984 to 1986. This means that high earners are gainers on one account and losers on another account.

Both Commissions recognize a need to accelerate the tax rate increases legislated in 1977. The National Commission's proposal is to start the combined OASDHI increases in 1982, leaving all of HI inside the package and avoiding any shift to general revenue. It does not propose to protect high earners by slowing the increase in the wage base.

Underlying these technical details is the distribution of the tax burden. On net balance, the National Commission's financing proposals shift in the direction of greater progressivity.

#### *Benefits and Equity for Women*

On the whole, both Commissions accept the general benefit structure of Social Security, including its generally progressive nature. Given the tenor of these times, it is surprising that both propose the retention of the special minimum benefit and its liberalization. However, there are important differences in the two proposals.

The President's Commission considers its proposal to retain the special minimum benefit as part of its program to help low earners with MUPS. Employee pensions should be taken into account when calculating this benefit (which appears to be an exception to its plan to prevent the integration of MUPS with Social Security). As MUPS matures through time, regular Social Security benefits, combined with MUPS, would meet retirement income goals. Presumably, the special minimum benefit would then phase itself out or become more residual than it now is.

The National Commission, on the other hand, sees a need to improve the social adequacy goal, especially with regard to women, whose time in the labor market was interrupted by years devoted to child rearing, and who, for reasons of divorce or early widowhood, face very low or no retirement benefits. Its proposal is grounded on two important propositions: 1) it opposes MUPS; and 2) it opposes earnings sharing and inheritance of the deceased spouse's earnings

record. Additionally, it finds reliance on SSI distasteful for persons who have, after all, spent a long time in the labor market, albeit as low earners.

Accordingly, it proposes to extend the creditable years from the present thirty to thirty-five and permit ten years of child care for children under age six to be counted. Furthermore, it wants to improve the OASI benefit for widowed spouses. It would do this by indexing the deceased spouse's earnings record by wages rather than price changes in the period between the death of the spouse and either the point of entitlement or the year in which the decedent would have reached age sixty.

The President's Commission, on the other hand, takes a different tack with respect to divorce and widowhood. On the notion that marriage is an economic partnership, it recommends the sharing of earnings credits upon divorce. This, of course, transfers income from the high earning spouse to the low (or non) earning spouse. It is precisely on this point that the National Commission finds a sticking point; it does not want to redress the inequity by *lowering* anyone's benefit, but prefers to achieve equity by *raising* another benefit.

For the OASI benefit of the spouse who was widowed, the President's Commission would allow the survivor to inherit the decedent's earnings record. This is consistent with the philosophy that marriage is a partnership. It would enable the survivor of a two-earner couple to achieve benefit levels equivalent to those available to a full-career homemaker. Furthermore, it would improve old age benefits for survivors of spouses who died young.

As can be seen, both groups address essentially the same set of problems. The diverse perspectives are interesting. The National Commission can be said to be looking backward to the older tradition where the social adequacy goal was needed to relieve distress arising from the breakup of the traditional one-earner family. This is not necessarily a sentimental reaction. The traditional role of the wife as homemaker may be receding, but it is not dead, by any means. The President's Commission looks forward to a society in which marriage is a partnership, regardless of how households may choose to divide functions within themselves, and where equity matters.

### *Indexation*

Indexation is one of the hotter issues surrounding Social Security. Beginning, rather innocuously, as a result of the 1972 amendments, it developed into a controversial matter on two grounds: 1) indexation of the benefit computation formula and 2) indexation of benefits upon

retirement. The first of these, which took only a few years to become totally unworkable, became the notorious decoupling problem. Considering its importance, it is noteworthy that it escaped public attention entirely. The issue was resolved—at least for the time being—by the choice of wage indexing over price indexing, which kept future replacement ratios stable (after the cuts that the 1977 amendments introduced). Both Commissions favor the retention of this formula.

Double digit inflation rates have now succeeded in raising issues regarding benefit indexation during the retirement period. It is costly, it may be excessive, and it presents problems of equity by favoring pensioners over workers during times when real wages are falling.

The Consumer Price Index may overprotect Social Security benefits if the market basket of the target group differs from that of the reference group in such a way as to introduce an unwarranted upward bias for the former.<sup>10</sup>

The President's Commission suggests the development of a separate price index for the elderly, since it is concerned with providing some measure of inflation protection for retirement incomes. Such an index would be applicable to Social Security benefits and to federal pensions, once it has been developed.<sup>11</sup> It could serve as a guideline for adjusting other pension benefits. However, the President's Commission is careful to state that its goal of increasing pension coverage takes precedence over the goal of inflation-proofing all retirement systems. Accordingly, it suggests voluntary adjustments of nonfederal pensions through tax incentives and individual tradeoffs of lower benefits for future adjustments.

In contrast to the President's Commission, the National Commission comes to grips with the inequity of maintaining the real benefits of Social Security payments in periods when real wages are falling. To be sure, it dips its toes rather gingerly into these chilly waters. Its recommendation is to use average wage increases in lieu of CPI increases if, over a two-year period, the average rise in the CPI has exceeded the average rise in nominal wages. However, it wants the lost benefits restored on a cumulative catch-up basis once the economy returns to "normal times." It points to the usefulness of its proposal as a preventer—or at least ameliorator—of short-term liq-

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<sup>10</sup>That is the least of its problems, since it may not accurately reflect price change effects on the welfare of the reference groups, both urban and clerical workers, and all urban workers. The problems are both conceptual and technical, and cannot be dealt with in this essay.

<sup>11</sup>In addition, the President's Commission wants federal benefits to be adjusted annually rather than semi-annually, and by the lesser of price increases or federal wage increases.

uidity crises in the system. Had its proposal been in place, it would have prevented the financing problems that will face the cash benefit program during 1982-1985.<sup>12</sup>

On the question of a special index for the elderly, the National Commission displays considerable reluctance. It commissioned some experimental indices, and found no significant divergence between them and the CPI. Moreover, it objects to a special index for the elderly alone: if there is to be a special index, it should include all beneficiaries. Notwithstanding this objection, the Commission recommends—but not very forcefully—that the Bureau of Labor Statistics do a more elaborate job than the Commission was able to do, on a retrospective basis, using existing survey data. If the results were to indicate significant differences, then Congress should provide funds to the BLS for the market surveys needed to do a really good job. If, after all of this has been done, and presumably if significant differences are found, then—and only then—should the Secretary of Labor *recommend* to Congress the use of such an index. That is caution, indeed.<sup>13</sup>

#### *Retirement Age, Taxation of Benefits, and the Earnings Test*

Advancing the normal retirement age from sixty-five to sixty-eight is an idea whose time is creeping forward at an accelerating pace. It is the largest single item in the usual menu of proposals for a reduction of the actuarial imbalance that faces the OASDI system. It is also guaranteed to turn ordinary and intelligent politicians into trembling neurotics. And for good reason. Since God gave us life for a finite span of years, longer work lives mean shorter periods of retirement during which benefits are distributed. In short, extension of the age of benefit eligibility constitutes a major reduction in lifetime benefits.

Both Commissions took the plunge. The National Commission proposal is to begin phasing in the higher age in 2001, over a twelve-year period. The President's Commission has the same twelve-year phase-in, but would start it in 1990. Clearly, the earlier the evil day can be faced, the better will be the condition of the OASDI system when the tidal wave of war babies reaches retirement—especially if it turns out that the usual actuarial assumptions err on the optimistic side.

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<sup>12</sup>National Commission on Social Security, *Final Report*, table 7-4, p. 167.

<sup>13</sup>The National Commission also recommends the use of the CPI-U instead of the CPI-W for indexation of benefits, since the CPI-W excludes retired persons from its sample and is, in general, more narrowly based. Up to now, the two indices have not diverged, to all intents and purposes.

Another way to reduce benefits is to tax them. The National Commission's report does not touch upon this topic. In contrast, the President's Commission does so, but in the context of rationalizing the tax status of all retirement contributions and benefits, and linking it with the earnings test. Briefly, it favors a tax deduction or tax credit for the employee's share of the payroll tax. As this is phased in, taxation of benefits is phased in, and the earnings test is phased out. The net effect, when the phase-in is complete, is to eliminate the 50 percent marginal tax rate on the labor earnings of older people.

The proposal has the interesting property of converting OASI from insurance against the contingency of loss of earnings into an annuity payable at age sixty-eight (or at actuarially reduced rates at age sixty-five). This is the way most people think of OASI; hence, the continuing political irritant of the earnings test would ultimately be removed.

Removal of the earnings test has relatively little impact on the long-term actuarial balance of OASDHI, raising it by a range of 0.9 percent to 0.16 percent. Since nothing is free, the cost of making employee contributions deductible is estimated at \$25.6 billion in 1982 dollars, or 85.3 percent of the Commission's total package of proposals in 1982.<sup>14</sup>

The National Commission, faithful to the visions of the founders of Social Security, wants the earnings test to be retained. Indeed, it opposes the scheduled drop to age seventy at which the test will no longer apply, preferring to stay at age seventy-two, and to raise the exempt age in tandem with the increases in the retirement age. In recognition of the labor market effects of the retirement test, it proposes a refundable tax credit as a way of reducing the 50 percent implicit marginal tax rate of the retirement test.

The astute reader will note, at this point, that both proposals introduce general revenues into Social Security through a back door, or, if you prefer, shift funds from one pocket of the fisc to the other. The need for this kind of sleight of hand is a continuing tribute to the mythic content of the term "social insurance"; it is, indeed, a powerful need if it has survived since 1935.<sup>15</sup> The National Commission is, at least, more honest on this, since it calls for direct infusions of general revenues in 2020—which is a long time off.

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<sup>14</sup>President's Commission on Pension Policy, *Coming of Age*, tables 21 and 24, pp. 55, 58.

<sup>15</sup>I have elsewhere commented on this peculiarity which, as an economist, I have trouble understanding. See Bruno Stein, *Social Security and Pensions in Transition*, p. 172.



### *Individual Efforts and Older Workers*

This topic is, of course, closely linked to the one above. Both Commissions want to reduce the penalty of work past retirement age in their separate ways. In addition, the National Commission proposes an improvement in the delayed retirement credit, which now stands at an actuarially unfair 3 percent. The President's Commission sees a need to provide labor market assistance for older workers in the form of information and retraining, and short-term Unemployment Insurance to encourage them to stay in the labor market. It also sees a need to consider the abolition of all mandatory retirement once the experience from the increase to age seventy becomes available.

As for efforts to encourage voluntary personal saving before retirement, the President's Commission wants favorable tax treatment (within limits) for employee contributions to pension plans, including refundable tax credits for lower earners. It stresses the importance of treating all retirement saving in a consistent manner. Although this appears to be sensible, it requires people to earmark saving for retirement and nonretirement purposes. Since money is fungible, and since saving and investment motives are complex (e.g., an owner-occupied home is a multipurpose investment), the proposal does not really remove the distortion that taxes introduce.

The National Commission proposes an increase in the present \$1,500 limit on Individual Retirement Accounts. This is consistent with its opposition to MUPS and its belief that lower earners should be able to rely on Social Security. IRAs favor those higher earners who, happenstance, are not covered by pension plans.

### *Public Assistance: The Supplemental Security Income Program*

No set of proposals to reform our retirement system is complete without some provision for those of the aged who are, or become, poor. Accordingly, both Commissions considered changes in the bottom tier of our three-tier system, the SSI program.

They agree on the elimination of the asset test for SSI. It is demeaning and intrusive, it excludes potential recipients who are trivially above the asset test,<sup>16</sup> and it is expensive to administer. The underlying presumption is that people with substantial asset holdings are unlikely to have low enough incomes to qualify for SSI.

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<sup>16</sup>The National Commission cites SSA's estimate that average total "Countable" resources of disallowed SSI applicants is \$4,686. "Countable" excludes homes with an average value of \$19,349. National Commission on Social Security, *Final Report*, table 12-1, p. 252.

From there on, the two Commissions proceed on different tacks. The National Commission sees a long-term need to preserve and liberalize SSI. Its proposals include updating and indexing the income disregards, increasing SSI (presumably the federal portion) by 25 percent to bring it approximately up to the poverty line, and compelling states to maintain present levels of supplementation. However, it would offset some of this by ending food stamp eligibility. In addition, it would end the 33 percent benefit reduction for recipients who live in the households of others but who do not pay for services. This last proposal should encourage family cohesion and reduce the incidence of nursing home usage where full costs are paid by Medicaid.

The President's Commission, on the other hand, views SSI as a necessary but transitional program. It too wants to improve benefits—in its case, federal SSI benefits would rise to the poverty line. If I understand this correctly, this implies an end to state supplementation, but the Report makes no reference to this. The Commission sees SSI as largely transitory: as MUPS matures, it will reduce the SSI caseloads, and the combination of MUPS and Social Security will ultimately enable the elderly to achieve the Commission's retirement income goal without resorting to public charity.

#### *The Bottom Line on the Actuarial Deficit*

Both groups were acutely aware of the long-term actuarial deficit in Social Security and the impelling need to do something about it. Of course, no 75-year projection can be taken at face value, but it can be a useful planning tool. SSA's actuaries were kept busy making estimates, and both groups obviously tailored their proposals with an eye on the actuarial balance. The intermediate set of assumptions, with slight modifications, was used in their bottom lines. This always makes me a bit nervous, as I believe them to err on the optimistic side, even in the long run (but I should be delighted if I were wrong). The National Commission shares my feelings of insecurity on this, and recommends that SSA actuaries experiment with new ways of displaying a range of possibilities.<sup>17</sup>

The score on the actuarial balance of the OASDI program, as percent of taxable payroll, is:<sup>18</sup>

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<sup>17</sup>National Commission on Social Security, *Final Report*, pp. 75-77.

<sup>18</sup>President's Commission on Pension Policy, *Coming of Age*, table 24, p. 58; National Commission on Social Security, *Final Report*, table 4-23, pp. 101-102.

President's Commission: -0.24%  
National Commission: +0.24%

This compared favorably with the current long-term balance of -1.58 percent. Like all such projections, these balances are sensitive to assumptions regarding economic interactions, such as labor market responses, to program interactions, and to the future course of events. Actuaries and economists could undoubtedly quarrel with the details. The largest single gain in both packages comes from the increased retirement age.

The actuarial balances do not tell the whole story, however. Both Commissions' proposals on Social Security shift costs to general revenues. The National Commission's recommendations on Medicare shift substantial costs to general revenues, as well as increasing its total cost. Reform of SSI also, quite naturally, comes out of general revenues. As for the President's Commission, its SSI reform, at least until MUPS matures, comes from federal general revenues, offset largely by reductions in the cost of federal pensions due to less favorable COLA adjustments. However, its proposal to make employees' shares of the Social Security tax deductible, as noted earlier, are initially very costly at \$25.6 billion from general revenues. In the long run, taxation of benefits will recoup some of this, but the long run is far away.

Thus we cannot escape the cost of supporting an elderly population at decent standards of living. We can redistribute the cost as between Social Security and general revenues, and we can subsidize the accrual of pensions and other retirement saving from general revenues. The former involves economic judgments about the advantage of payroll taxes versus other taxes and political judgments regarding the distribution of the burden. The desirability of the latter course of action (the two can be complementary, not mutually exclusive) rests on economic judgments regarding the contribution of retirement saving to capital formation, since this may lighten the burden, and on political and ethical judgments regarding compulsory saving and income redistribution.

The MUPS proposal is to complement Social Security and SSI (ultimately reducing the latter) with mandatory pensions that, unlike Social Security, create property rights for those not fortunate enough to have achieved voluntary pension coverage. It is the principal difference between the two Commissions' proposals on retirement. Here they diverge, and I now turn to this divergence by looking at MUPS.

## Minimum Universal Pension System

The proposal by the President's Commission is a bold and far-reaching one. It aims not specifically at the segment of the labor market where pension coverage is trivial or nonexistent. This is concentrated in low-wage, small-employer enterprises where employment tends to be intermittent, thus preventing significant accumulation of vested rights even if pension plans were in place. Career workers in such situations tend to have relatively flat age-earnings profiles. That is, they do not face career ladders wherein the expectation of rising wages enables or induces them to engage in retirement saving. Accordingly, when they reach retirement age, they will have to rely on Social Security benefits alone, or on such other supplements that society is willing to offer. Although Social Security benefits are skewed in their favor, these were never intended to be the sole support of the aged. Hence, many among them will require SSI.

When Social Security reaches its worst years after the turn of the century, it may not be a strong reed to lean on. Even assuming that our intergenerational pact survives the strain—and both Commissions' proposals for reform are helpful in that direction—SSI will be insecure. We have already noted what can happen to political tastes for social programs after a long period of economic stagnation. Unless the years after 2000 will coincide with considerable economic growth, the strain will manifest itself in the form of intergenerational conflict.

Indeed, one of the intriguing aspects of MUPS is that it is, in the long run, a substitute for SSI. SSI for the aged is funded on a current basis and thus largely represents an intergenerational transfer. It is an income transfer from the well-off to the poor. MUPS presents a different image. Since it requires a tax subsidy, as all pension plans do, it partly retains a component of income transfer, but primarily on an intragenerational basis. This may minimize intergenerational conflict. Furthermore, it creates a new property right, i.e., a genuine entitlement as we view it from a free enterprise perspective. This makes it different from Social Security, which is a pseudo-property right. Of course, even property rights are subject to diminution by taxation or by events like inflation. Nothing in this world is really secure. But the MUPS claimant will receive what is his or hers. It will have been subsidized by his own age cohort and not by the succeeding generation of workers, just as today's homeowners were subsidized by other members of their generation.

It may be argued that this is an exercise in semantics. What we are

really doing is shifting the timing of the subsidy. Perhaps this is so. Still, symbols matter. The founders of Social Security hoped to give the illusion of a benefit entitlement in order to enhance dignity and to protect beneficiaries from year-to-year legislative pressures. Private pensions are subsidized to the tune of \$15 billion per year. Subsidizing MUPS is not qualitatively different.

It would be a mistake to assume that MUPS is primarily or solely aimed at potential SSI claimants. The target is far wider than that, but its focus remains at the lower end of the earnings distribution. If successful, it would enable some claimants to be somewhat better off than they otherwise would be.

### *Highlights of the Plan*

Before any further analysis is done, it may be useful to sketch out the highlights of the proposal. It mandates:

- minimum employer contributions of 3 percent of payroll to a pension plan
- coverage of all employees over age twenty-five with at least one year's service and 1,000 hours of work per year
- immediate vesting and full portability
- no integration of the minimum with Social Security
- no cash-out of benefits over \$500 unless rolled over
- preretirement and postretirement spouse benefit rights, unless waived by both parties
- divisibility of entitlements earned during a period of marriage, upon divorce
- a Public Employee Retirement Income Security Act

In order to facilitate the plan, there should be:

- a three-year phase-in, to minimize the economic impact of the plan
- a tax credit of 46 percent to employers, up to 3 percent of payroll
- a portability clearinghouse run by the Social Security Administration
- a publicly administered investment fund to receive contributions from employers who do not want the hassle of setting up their own fund; investments to be made in private sector securities

Furthermore:

- all pension plans should be allowed to raise the normal retirement age in tandem with the proposal to raise the Social Security

entitlement age, with actuarial reductions for early retirement—ERISA’s prudent investment rules should be widened to allow pension funds to consider the broader social interests of plan participants when making investments.

### *Benefits*

The benefits of the proposal are apparent. Once it matures, several decades hence, workers who have spent the bulk of their adult years in the labor market, but were excluded from other pension coverage, will receive supplementation, as a matter of right, to their Social Security benefits. The penalty for job changing (and withdrawal from labor markets for child rearing) will be diminished. Most vesting provisions create penalties for mobility in three ways. One is to transfer wealth from workers who do not achieve vesting to those who do. The second occurs when vested workers change jobs in the absence of portability. Here the vested portion left behind loses the implicit preretirement indexing that comes from rising nominal (and real) wages that would have occurred if the worker did not move. The third occurs when the mobile worker faces another year of waiting for coverage at the new job.

The diminution of two of these penalties by MUPS removes some of the inequities suffered by job changers. By lowering the barriers to labor mobility, it may increase the efficiency of the labor market as a resource allocation device, with some payoff in terms of greater productivity. How great the effect would be is hard to measure. It may not be very great, since lower-wage earners tend to have greater interfirm mobility than high-wage earners. For the latter, only the MUPS portion of the pension would increase mobility, but even a marginal change might be an improvement.

The really important benefit—and here we are on very problematical grounds—would occur if the MUPS were to have the desired positive effect on saving, investment and capital formation. As I pointed out in my digression, there is no especial magic to advance funding unless it acts to increase the future flows of consumable goods and services to be divided between the economically active and inactive households.

A special study made for the President’s Commission estimates that the net potential effect on saving is very small. Depending on what proportion of the additional cost of MUPS is shifted back to workers in the form of lower wages and/or other benefits, gross savings would be increased by 2 percent to 3 percent. The greater

the proportion shifted to workers, the closer we come to the high end of this range. Low-wage workers cannot save much out of current wages and cannot, therefore, offset MUPS by reducing current savings.<sup>19</sup>

It is not clear whether this study considered the effects of the 46-percent tax credit for MUPS that the President's Commission recommended. If not, then gross savings should be slightly higher, but at the cost of the lower tax revenues. Unless this decrease in tax revenues is matched by an equivalent reduction in government spending, it may not increase savings in the sense of national savings. The latter requires a reduction in budget deficits in order to crowd security purchases into the private capital market.

Hence, unless the savings estimates are grossly underestimated,<sup>20</sup> MUPS cannot get its support on the basis of its contribution to capital formation.

### *Costs*

In the first iteration, MUPS behaves like any wage increase in raising the unit cost of labor: it will have a disemployment effect. Over a longer time period, part or most of the cost may be shifted backward in the form of relatively lower compensation, which would reduce the disemployment effect.

The study cited above<sup>21</sup> estimated the short-run job loss at about 160,000, with a longer run effect ranging from 29,000 to 58,000, depending on the degree of cost shifting. This is a small amount unless, of course, the job that is lost is one's own. The distribution of job losses is interesting, if predictable. The bulk would occur in establishments hiring fewer than 100 employees, and among workers earning less than \$10.50 per hour in 1982 dollars. Thus, most of the

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<sup>19</sup>ICF, Incorporated, *Potential Effects of a Minimum Universal Pension System*, Draft Final Report (January 23, 1981 process), pp. 44-47.

<sup>20</sup>The study cited above used the DRI model to arrive at its estimates. Supply-side economists may not agree that this is the most proper model to be used.

<sup>20a</sup>After my paper was completed, my attention was drawn to Thomas C. Woodruff's "Macroeconomic Effects of Retirement Income Policy," a working paper prepared by the President's Commission (1981). This was a model that integrates the PCPP's retirement income model with the Hudson-Jorgenson-Anderson macroeconomic growth model. The findings appear to be at variance with those cited in footnote 19 (above) and show higher rates of saving due to MUPS, but within the context of the entire set of PCPP proposals, including the tax changes. If the Woodruff study is the more accurate one, then my reservations concerning MUPS are lessened thereby.

<sup>21</sup>ICF, Incorporated, *Potential Effects of a MUPS*, Draft, pp. 41-44.

people who would be hurt are those who are in greatest need, and some would require other forms of income maintenance. Again, it is not clear whether the study incorporated considerations of tax subsidy to the employers. If this consideration was omitted, then the disemployment effect might be even smaller in the short run, and virtually nil in the long run.

### *Other Problems*

The President's Commission was very aware of the fact that administrative costs of pension plans are subject to economies of scale. The smaller the employer, the greater the per capita costs of creating a pension plan and operating it. The dimension of these costs is easily exaggerated; a simple defined contribution plan such as a Simplified Employer Pension Plan (SEP), for example, does not add much of an administrative burden.

However, to simplify matters even further, the Commission proposes to create a publicly administered fund to accept the contributions through the existing payroll tax mechanism, but for investment in the private capital market.

And thus the camel's nose makes its entry into the tent.

Americans, more so than Europeans, are extremely sensitive to the role of government in private capital markets. They accept government as a regulator of the securities market, and even as an allocator in particular instances. But they generally shy away from the federal government as a direct owner of enterprises or of private sector securities.<sup>22</sup> The reasons for this feeling are both practical and profoundly ideological. It is noteworthy—and hardly coincidental—that the advance funding plan for Social Security that Martin Feldstein has proposed carefully avoids investment in private sector securities. The reason given by him, and shared by many others, is that ownership of equities would involve the government in the management of private enterprise.<sup>23</sup> Indeed, the possibility of having the original and advance-funded Old Age Reserve Fund invest in private securities was rejected by the founders of Social Security in their 1935 deliberations. In the words of Senator Arthur Vandenberg,

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<sup>22</sup>There seems to be no corresponding objection to state/local pension fund ownership of private sector securities.

<sup>23</sup>Martin S. Feldstein, "The Optimal Financing of Social Security: Discussion Paper No. 388," (Harvard University, Institute of Economic Research, 1974 process).



“that would be socialism.”<sup>24</sup> After all these years, the climate of opinion on this issue has not changed.

The Report of the President’s Commission does not give any detail on the management of such a fund, except that it would be administered by independent trustees. Any serious consideration of the proposal entails the question of how independent such trustees would be and, indeed, of the very meaning of the word independent. During the period in which the fund would, on net balance, be growing, it is quite conceivable that it might be holding over \$100 billion in securities or more, depending on the proportion of employers who choose this option, and depending on future yields.<sup>25</sup> As Senator Dirksen used to say, a billion here and a billion there, and pretty soon you’re talking about real money.

The Commission’s Report also gives no details about the way in which a portability clearinghouse would function. This may seem to be an administrative detail, but there can be a lot of action in administrative details. The complexities can be enormous once we cross the boundaries of multiemployer plans and enter a world in which workers move from defined benefit to defined contribution plans and vice versa. If the Commission has solutions to these problems, then a detailed explication would be useful. Absent such an explication, I must reserve further comment.

Underneath these and other problems, there lie some fundamental issues that need to be resolved. MUPS compels people to save, to save for a particular purpose, and to invest such savings in a manner predetermined by their employers. It does this on top of the compulsion to participate in the Social Security system.<sup>26</sup>

The rationales for compelling people to save are that they cannot or will not do it themselves, and that the result of this failure to save is socially undesirable. It is undesirable because the resultant poverty

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<sup>24</sup>U.S. Congress, House, Committee on Ways and Means, *Hearings on H.R. 4120, Economic Security Act*, Murray W. Latimer testimony, Senate Library, vol. 699, 1935, p. 203.

<sup>25</sup>If half of employers with fewer than 100 employees choose the option then, after the three-year phase-in, \$4.75 billion will be contributed per year, assuming no growth in the labor force. At a conservative yield of 7 percent, this gives a fund of \$195 billion, minus the payouts to those who retire in the interim. Hence, \$100 billion is a ballpark figure.

<sup>26</sup>Parallel points were raised by Milton Friedman with respect to Social Security. See Milton Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press, 1962), pp. 182-189. Although I do not agree with Friedman that compulsory social insurance is, *per se*, objectionable, I am not so confident of my beliefs where an additional layer of compulsory saving is concerned.

is either offensive or unesthetic to the rest of the community, or because it imposes a transfer cost in the form of public or private charity—the former more likely than the latter.

People cannot be forced to do something that cannot be done. Hence, “cannot” really resolves itself into “will not.” Unfortunately, this carries with it moral overtones that give off more heat than light in what I hope is a pragmatic discussion. “Cannot” really implies that people in the lower end of the earnings distribution operate at the margin of a socially minimal standard of living. Societal pressures—not to mention advertising—encourage them to maintain as high a current consumption level as possible and to skimp on saving.

If this is a correct view of behavior, the compulsion may be preferable to the alternative of removing our existing support structure for the unaffluent aged. The latter can be done by ending SSI and making the Social Security benefit earnings-related rather than progressive. I expect that such a policy would induce—virtually compel—more personal saving, but not enough to make up for the shortfall. I doubt whether it is politically feasible or socially desirable. Score one for compulsion.

However, since MUPS includes a subsidy, we are making an intertemporal change in the timing of the income transfer. The advantage of doing this is not clear. There may well be an advantage if 1) MUPS contributes to capital formation, or 2) if the current population cohort is more capable of making the subsidy than the cohort that will face the retirement strains that are coming down the pike. On the first of these, it appears on the available evidence that MUPS will not do much for capital formation. The second is a distinct possibility. However, it requires the hope that some development or other will lead to the necessary increase in consumable output. Absent such a development, the owners of unindexed annuities will still be at a disadvantage and supplementation may remain necessary. Such supplementation will involve compulsion in the form of taxes.

The out—if there is an out—is that the total dependency ratio is not likely to change during the critical period after 2010. There will be fewer children and more aged persons. If resources can be allocated from the latter to the former, then the problem of supporting the aged will be eased. Since MUPS creates property claims rather than statutory social welfare entitlements, some of the reallocation can be achieved through the market mechanism.

It will be remembered that the compulsion to save, as envisaged by MUPS, includes the compulsion to accept the investment vehicle

chosen by the employer. This is also true with ordinary pensions, although some element of choice is available to workers in choosing among jobs. Such choice encompasses not only cash wages and working conditions but also fringe benefits.

The population to be covered solely by MUPS has a similar choice, except that individuals cannot opt for jobs without the minimum pension. The employer and the worker do not necessarily have a common motive to maximize yields, subject to constraints of prudence. Indeed, if employers do not use pensions as a personnel management device (and these are the ones who do not now offer them), their self-interest may impel them to choose plans that are best for them, and not for their workers. To put it more bluntly, a proliferation of small plans is an invitation to malfeasance and can create an enormous and costly policing problem.

An alternative might be to allow employees to choose the investment vehicle and to let financial institutions compete in terms of the plans they can offer. My guess is that most purely MUPS plans would, in any event, be defined contribution plans. These lend themselves to IRAs or similar devices. The employer could send the contribution to the financial intermediary designated by the worker, or some other administrative device could be found—in this approaching age of electronic fund transfers—that could accomplish the objective cheaply.

As the foregoing shows, I have mixed feelings about MUPS. I like some of its goals—more adequate retirement income for workers now without pension coverage, and less reliance on social assistance. I am a bit queasy about adding another layer of compulsory social insurance on top of the present one. Hence, on net balance, my reaction is negative. But I am willing to reconsider this negative feeling on a persuasive showing that the positive supply-side effects of MUPS are likely to be so strong that its goals can actually be achieved.

## **Discussion, Summary and Conclusions**

As I write this, I get the feeling that events may be overtaking analysis. On April 7, 1981, the House Subcommittee on Social Security reached tentative agreement on a package of major changes in Social Security. One of the changes is a proposal to raise the age of full benefit entitlement to sixty-eight, using a ten-year phase-in beginning in 1990. What is especially interesting about this is its departure from both Commissions' reports. The phase-in is over a ten-

year period, not a twelve-year period. Benefits would remain available at age sixty-two, at a lower rate than now, progressing to 100 percent at age sixty-eight. At sixty-eight, the earnings test would be dropped (this is somewhat consonant with the President's Commission) as an incentive to keep working. However, the 3 percent earnings credit for work past the full benefit age would also be dropped—a disincentive to work. At about the same time, a Senate panel approved a new inflation adjustment for Social Security and federal pensions—the lowering of the CPI or average increase in wages.<sup>27</sup>

At this point, it is far too early to analyze—or even predict—the course of forthcoming legislation. It suffices to say that the need for some fundamental reform of Social Security is now being perceived by Congress. Until 1977, reform was virtually identical with expansion of the system. In 1977, the first incremental step toward retrenchment was taken. Future benefits, in terms of replacement ratios, were reduced and the growth in replacement ratios was halted. A move toward a higher age of full benefit eligibility, or lower inflation adjustment, is a further step toward retrenchment.

I assume that the purpose of the exercise is not to return, step-by-step, to year zero but to achieve a Social Security system that, in an uncertain world, is rather more likely than less likely to be viable. By viable, I mean that there is some high probability that the promises made today will be kept tomorrow. Obviously, a less generous promise is easier to keep than a more generous one. However, if the promise is niggardly enough, it becomes pointless. Today's set of promises can therefore serve as a useful baseline. For the bulk of the population, the existing system appears to satisfy the need for a retirement income base upon which additional provision for retirement can be made. This, despite the host of anomalies, inequities and dysfunctional behaviors that bedevil it.

The order of priority, as I see it, is:

1. The achievement of a long-term stability of the Social Security system, one that people can have some confidence in when they make long-term plans. Primarily, this involves some mix of higher revenues and reduced benefits.
  - a. On the financing side, the options are found between higher tax rates and general revenues. If the system is to be largely self-sustaining, and not subject to the annual politics of budget making, then general revenues are the less desirable option.

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<sup>27</sup>*New York Times*, April 8 and 10, 1981.

However, general revenues—and interfund borrowing—can be useful to get through short-term rough patches. Universal coverage can also inject some funds, at least during the start-up phase.

- b. On the benefit side, the primary mix of options lies in a higher age of eligibility and a lower benefit indexing factor. The first is a long-term issue. The second is important in the short term, unless we anticipate a long-term stability or decline in real wages. With regard to the higher eligibility age, it is important to note that there will remain a need to provide for hard-to-employ older workers, either within or outside Social Security. Hence some of the saving from the higher age is spurious, since other income support systems will be needed to pick up the slack.
  - c. There are other benefit cuts that are possible, of course. Ending the Survivors Insurance benefit at age eighteen is prominently mentioned these days. My own view is that such a benefit cut, if desirable, should be phased in rather than immediately enacted; SI figured in life insurance decisions that families made a long time ago, so that a sudden curtailment of the benefit makes Social Security insecure. Ending the windfall benefit to civil servants can be accomplished over the long haul by universal coverage. If this is not achievable, then the windfall can be phased out by counting federal earnings as part of the benefit computation. Finally we reach the nickel-and-dime stage, such as the now vestigial death benefit.
  - d. Making employee contributions tax deductible, and taxing benefits, involves general revenues, not the viability of Social Security. There may be good and persuasive reasons for such a move, but they lie outside the need to secure Social Security.
2. The adaptation of Social Security to the long-term change in family structure and the role of women in the labor market. The most promising direction of change seems to be some form of earnings splitting. Providing credits for child rearing, the alternative proposed by the National Commission, is a disguised children's allowance, since it reduces the cost of staying home to the child-rearing spouse. This may be desirable, but there is no *a priori* reason for shifting the cost to Social Security.
  3. Provision for the indigent aged. This is one of the principal reasons for the MUPS proposal, and it underlies the progressive Social Security benefit structure. I have the impression that there are old

people out there with special needs that cannot easily be met by broadly distributed cash transfers. These include elderly persons whose assets are locked up in a house of modest value, who could be helped by devices like reverse mortgages. There are also people with great pharmaceutical needs not covered by Medicare, who do not qualify for—or need—the whole panoply of Medicaid. What I am getting at—and I operate here from a vast area of ignorance—is some targeting of aid to those of the aged poor who, despite SSI and food stamps, live in really grinding poverty.<sup>28</sup>

In a similar vein, I would advocate any reasonable set of proposals that encourages the able-bodied elderly poor to remain economically active and to live outside of nursing homes for as long as possible. This involves reducing work disincentives, providing greater incentives for families to take care of their own (e.g., ending the benefit cut when an SSI recipient lives with a child or better-off sibling) and similar measures. I am uneasy about the role of Medicaid as the grand dumper of the unwanted aged into nursing homes—indeed I am uneasy about the whole nursing home syndrome. I do not claim to have a well-thought-out plan for this. However, the National Commission's proposals on SSI move in the desired direction.

### *Pensions*

As indicated earlier in the paper, I have some reservations about compulsory Minimum Universal Pensions, even though there may be merit in a proposal that compels retirement saving in exchange for a subsidy and a property right to the resultant asset. I should be less hesitant if I could be persuaded that the saving—capital formation—productivity links would have the desired output effects in the future. It would, I think, be a pity if we compelled lower wage earners to reduce their current living standards further (disemploying some in the process) and then disappointed them at the far end with pensions of little real value.

No such reservations extend to inducing more retirement saving, with better tax incentives for low-wage earners, on a voluntary basis. It is not even necessary to attach such a mechanism to an employer plan, although it may be desirable to facilitate it with the option of

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<sup>28</sup>There may be a million people—or more—who fall into this category. See Alvin Rabushka and Bruce Jacobs, "Aging and Public Policy: Rethinking Issues and Programs." Hoover Institution Reprint Series No. 33 (1980), p. 153.

regular payroll deductions.<sup>29</sup> Since tax shelters are subsidies, there is no inherent vice in tying some strings to the subsidy, such as equitable treatment of spouses.

Pensions and Social Security are interacting systems. The basic Social Security reforms that, in effect, reduce benefits, may lead to compensating responses from the pension sector. It would be helpful if we could better envision the final shape of our retirement system. But, being mortal, we must plan ahead with the information that we have in hand.

### *Concluding Comments*

If Social Security is worth keeping, then it is worth making a secure part of the nation's retirement system. Both the President's Commission and the National Commission have addressed themselves to this need, as shown by their convergent views on many policy options.

Security means enabling people to make long-term plans. Reforms aimed at making the system secure should be, where possible, in the nature of long-term changes, with sufficient lead time to allow people to adjust their plans. Since the greatest single threat to Social Security is the demographic crunch coming in the early twenty-first century, there is time to set long-term changes in place.

Some shorter term changes, such as more realistic indexing of benefits, may also be necessary. The combination of inflation and stagnation has persisted for a long enough time to qualify as a long-term phenomenon, and some adjustment for this in Social Security is called for in the near term. The change in the role of women and in the structure of the household (and its economic behavior) is clearly a secular trend; again, some adaptation of our retirement system is necessary now if it is to function well in the future.

What should be avoided, in my view, is year-by-year, piece-by-piece, tinkering in response to temporary problems. Social Security is a poor fiscal policy device, regardless of whether it is inside or outside the unified budget of the federal government. The challenge to policymakers is to create a reformed system that is likely to withstand the test of time.

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<sup>29</sup>Some people welcome the opportunity to compel themselves to save. Witness the use of Christmas Clubs, payroll savings plans, and similar devices, including the often inadvertent overdeduction of income taxes and the subsequent gratification with which income tax refunds are received.

Our ultimate ability to maintain desirable living standards for our young and old population lies in our ability to reenter upon a path of economic growth. Should we succeed, then retirement problems will become easier to solve. Should we fail, then all problems will become acute.



# **President's Commission on Pension Policy: Bomb or Balm?**

(Many Good Recommendations; One Real Clinker)

William C. Greenough

## **Introduction**

As a member of the President's Commission on Pension Policy I've been inundated with articles, books, testimony, and comments relating to pensions. There are several foot-high stacks of material on my desk. The interesting thing is that the Employee Benefit Research Institute material keeps bobbing to the top of the piles. This is because I find it useful, thoughtful, and credible. So I thank Dallas Salisbury and all of his colleagues for work well done.

This panel today is also an example of a considered approach to pension problems. If all of us do our work well, we will together have covered Social Security, private pension plans, MUPS, savings and capital formation, taxes, and other relevant issues. In fact, I've looked over the experts who are speaking, and their topics, and I find that only taxes are left for me to discuss. Now, let me take you into my confidence. A good many years ago I decided every executive has a right to have a blind spot, some area of information relevant to his job that he decides he won't conquer. I chose taxes. Therefore I can approach the subject of taxes unhampered by meticulous knowledge as to rules, regulations and practice.

So I write today as an economist, trying to present a broad, rounded, consistent set of recommendations as developed by the President's Commission on Pension Policy.

## **Tax Policy**

What should be the objectives of tax policy in connection with retirement security for all our people?

1. To raise enough revenue to meet the full expenditures of Social Security.
2. To distribute taxation with respect to Social Security in such a way as to be as fair as possible to the "transferred froms," the

- workers currently paying the bill, and the “transferred tos,” the recipients of benefits.
3. To encourage employers to establish private and public employee retirement systems as strong supplements to basic Social Security benefits.
  4. To encourage employee contributions to private plans where necessary to make such plans adequate.
  5. To encourage additional private savings as supplements to Social Security and employer plans.
  6. To encourage capital formation and productivity.

Current tax laws and regulations do not meet these tests. The President’s Commission’s recommendations have been carefully designed to accomplish these objectives. They constitute the first consolidated look at tax policy. I believe the tax recommendations of the President’s Commission are much fairer than the present hodge-podge of conflicting tax philosophies, that in the long run they will raise adequate revenues from those better able to pay, and that by following the President’s Commission’s recommendations, our tax laws would then encourage greater growth and productivity in the society, more savings and investment, and far greater self-reliance in retirement.

In addition to being a member of the President’s Commission, I am Chairman of a special subcommittee on pension policy of the Committee for Economic Development. This subcommittee has about completed its work, but the Research and Policy Committee and Board of the CED have not yet acted. I expect their tax recommendations to be parallel in most respects to those of the President’s Commission.

The PCPP, the CED, all other responsible private groups, and all governmental groups continue to approve of, in fact to assume as given, the present tax treatment of employer contributions and all investment earnings of retirement plans. This means the continued tax deferral of employer contributions and pension investment earnings.

The President’s Commission looks to a three-legged stool as the base for retirement income security. It would place substantially greater emphasis on individual savings than has been true for the last forty years. So the first recommendation has to do with individual savings.

“Contributions and benefit limitations for all individuals should be treated more consistently for all types of retirement savings.”

“The tax treatment of savings specifically for retirement should be the same as the tax treatment of pension plans.”

The Commission goes further than this, saying:

“The Commission believes the tax system provides an appropriate means of encouraging individual retirement saving. However, current policies do not sufficiently encourage retirement savings for those in most need: low- and moderate-income wage-earners. And, workers who are participants in pension plans have no incentive under current tax laws to lessen the impact of inflation on their retirement income by supplementing employer contributions with their own.

New government policies are needed to provide greater incentives to all individuals to participate directly in providing for their own retirement income needs. Individual savings must be strengthened as a source of retirement income for all workers, regardless of income or form of savings. The Commission believes this direction for public policy is consistent with other national goals encouraging and supporting individual effort and strengthening the economy.”

This emphasis on individual effort and responsibility for some portion of retirement income is consistent with the very high income objectives chosen by the Commission.

The “Commission believes that the replacement of preretirement disposable income from all sources is a desirable retirement income goal.” As my comments on the report stated, that is “A pleasant goal to contemplate—yes; a realistic one—no. If accomplished, it would mean that a large number of people would live in retirement better than they ever had before except just prior to retirement. Fairness in our society means balancing fairness to young families at lower early earnings who are buying homes and educating their children while paying for Social Security, as well as fairness to the retired.”

The question can reasonably be asked as to whether encouragement of individual savings will ever provide much retirement security. It never has, historically. In the 1930s, over 90 percent of our elderly people were poor and dependent on relatives, charity or welfare. Since then we have developed an entitlement society, with extensive income assurance plans providing financial protection against unemployment, disability, old age, and health expenses. Our people are now being led to expect continuance of their highest

preretirement standard of living during retirement. The President's Commission moved this expectation forward, unwisely I believe. But it did assign part of the responsibility to individual savings, and suggested tax inducements to help individuals achieve their own goals.

### **Exclude Employee Contributions**

This brings us naturally to an important recommendation, one also closely related to individual effort but promising much greater results. This is that employee contributions to retirement plans would be excluded from current taxable income, within acceptable limits, of course.

The rationale behind this recommendation is very strong. There should be no distinction between employer and employee contributions as to current tax consequences. Economists can debate vigorously as to who actually pays for the employer and employee tax. But nobody really disputes the idea that the contributions for retirement are a wage-related cost.

A deferral of taxable income for employee contributions would meet social as well as economic tests. It would encourage individual savings through employer retirement plans for old age income. By doing that, it would help increase the GNP and the power to finance retirement income. Thus the end result would be a more productive economy, based on individuals' own savings for their own retirements, which in turn would make them more secure and reduce the burden of transfer payments in our society.

#### *Treasury's Opposition*

The Treasury has always opposed the exclusion from taxable income of employee contributions to retirement plans. Part of the Treasury's opposition is on the basis of revenue that would be lost currently to the Treasury. The fact of the matter is that the Treasury policy has been a disaster. Let me spell this out a bit.

In the first place, there are very few contributory retirement plans in the private sector, largely due to the Treasury's effective opposition to any change in tax status for employee contributions. Thus the revenue loss of a change would not be great. The bulk of contributory plans are in the area of 403(b) plans in the nonprofit and some of the public-sector employment where the individual can ask the employer to place his contributions under the employer plan and thereby defer tax on them. Many general public plans also are contributory.

The vanishing of employee contributions has contributed to no fewer than three serious deficiencies in private pension plans:

1. Lack of spread of such plans to marginal and other noncovered employments—small companies, emerging companies, those of weak financial backing, and even for part-time and temporary employees and employments. It would do a good deal to help extend coverage and improve adequacy of retirement benefits if employers in these areas could join with their employees and jointly meet the costs of retirement through deferral of employee as well as employer contributions. Private pension coverage in these areas has not been strong, mostly because of the size and financial standing of the companies and the character of the jobs themselves, but also because of ERISA, the nondeferability of employee contributions, the non-availability of efficient small-plan arrangements, and the marginal costs of doing business.

Let me mention some relevant statistics for the college world. In the college world, 99 percent of the staff members are at institutions with retirement plans, and 88 percent of the plans are contributory. Even the smallness of the employer is not a problem; 32 percent of our educational institutions (1,068) have fewer than 10 participants and 79 percent (2,771) have fewer than 100 participants.

2. The Treasury's attitude has had an adverse effect on vesting. Employee contributions are immediately vested, and therefore are portable by the individual among his job changes. Employer-pay-all plans, encouraged by the Treasury's attitude, usually do not vest the benefits until the minimum vesting requirements under ERISA have been met. Lesser vesting of retirement benefits means lesser retirement security.

3. In discouraging employee contributions and thereby reducing coverage and vesting, the general result has been to lose the capital formation that could have occurred with larger employee contributions and wider adoption of plans.

Therefore, during all these years, the inclusion of employee contributions in taxable income has accomplished very little in revenue, and has had substantial adverse effects on private pension planning.

### **Deferral of Social Security Employee Taxes**

Quite a different impact exists with respect to the current taxability of contributions to Social Security. Here, the employee contributions to Social Security are in total very large, and the federal income tax

collections on these contributions is likewise large. Any change would represent a substantial loss in federal revenue. Therefore, the question is: Would such a loss be feasible and fair?

Let's look at what has happened since 1937. We hear a good deal now about social contracts, and the idea that successive Congresses have made social contracts with our elderly to provide them with fully escalated Social Security benefits at age 65 for all time to come. It is suggested that any change in retirement age, cost of living escalation, or level of benefits would be an abrogation of a social contract. But there is another social contract. It is with the American workers who are currently defraying the cost of Social Security, and with workers who will be doing so ten, twenty, thirty, fifty years from now. How has their social contract worked out? In 1937, when Social Security was first enacted, the employee contribution was 1 percent on the first \$3,000 of taxable income, or a total of \$30 per year. Provisions for modest tax increases were included in the original law. The tax at the upper level is now 6.65 percent on the first \$29,700, or a total of \$1,975 on each worker at the maximum. This is 66 times as large as the original tax at the maximum.

Added on top of the huge increase in tax to support the current level of Social Security transfer payments is the additional burden that these tax payments are themselves currently taxable income to younger workers. Most workers at and above the \$29,700 level are in a 30 percent to 50 percent earned income tax bracket. Therefore the marginal federal income tax they pay on their \$1,975 Social Security contribution may be another \$600 to \$1,000. Since so many couples now work, the combined cost of Social Security to them can be, at the maximum, nearly \$6,000, added to their employers' tax of \$3,950, for a total of \$10,000 for the couple.

The PCPP and the CED both recommend that employee contributions to Social Security be excluded from current taxable income. The cost is large, \$25.6 billion in 1982 dollars, with long-term offsets from including benefits in taxable income. Later in this talk I will propose incorporating this important tax change in the Administration's proposals.

### **Consistent Tax Treatment**

The Commission also recommends that the tax treatment for all kinds of real savings for retirement be made consistent. If this were carried to its logical conclusion, it would mean that a specific percentage of current earnings could be deferred at all income levels.

Such percentage would be a total, overall amount covering such things as regular retirement plans, profit-sharing retirement plans, Keogh and IRA plans, and deferred compensation plans. Where total contributions to all of those types of savings did not equal the total deferral rate, the individual could fill up the remainder by deferring taxable income on individual savings in Keogh, IRA, or additional voluntary contributions to regular retirement plans.

If this were done consistently, it would bring all people within the same tax treatment. It would have some problems. For example, defined benefit plans are based upon steeply progressive contributions between younger ages and older ages. In fact, for persons who receive substantial salary increases at upper ages, perhaps through promotion to a high-level position, current tax treatment allows extremely large deferral of income for current contributions. This level would exceed any reasonable percentage deferral rate. The choice for policymakers would be whether to allow the percentage deferral to rise a good deal at, say, ages over 55 because of the operation of defined benefit final average salary plans and also because individuals show far greater interest in retirement savings at those ages.

#### *Treasury Opposition*

The Treasury asks a valid question here. Will greater individual deferral limits discourage the spread of employer retirement plans? I really doubt that it would so discourage such plans. The employers where such plans are not now in existence, small employers and less well-financed ones, are the very areas where encouragement for employee contributions through tax deferral would help the employers and employees to set up good, regular, retirement plans.

#### **Tax Credits**

The President's Commission makes two additional recommendations not listed above.

1. "A refundable tax credit for low- and moderate-income people to encourage voluntary individual retirement savings through employee contributions to plans is recommended. At the time of tax filing, the employee would choose the higher of a tax deduction or a tax credit."
2. For Social Security, "at the time of filing, the employee would choose the higher of a tax deduction or a tax credit for the Social Security employee contribution."

For private pensions, these recommendations would go much farther than the mere exclusion of employee contributions from current taxable income. They are, for low-income persons, a sort of negative income tax treatment. That is, a *refundable* tax credit would provide actual cash income to persons who would fall below the zero bracket for federal income tax, (if they filed a tax return—not further defined). This would be a powerful inducement at the lower ends for establishment of employee retirement plans and for encouragement of individuals to save. Perhaps this would be justified. I am not ready to ask that much.

As to the effect for Social Security, it would have the same results as an intrusion of general revenue financing. It would directly offset taxes otherwise payable for general governmental expenses. I believe the deduction from current earned income would be a substantial and a sufficient step in the right direction.

### **Include All Benefits in Taxable Income**

If all contributions, employee as well as employer, and all investment earnings on retirement savings are to be excluded from current income, it is appropriate and fair to include all benefits resulting from these sources in taxable income.

Whenever this is suggested, especially in connection with Social Security, the cry goes up that “You are proposing to tax the elderly poor, a terribly harsh approach.”

If the elderly are receiving only average Social Security benefits, they do not get into taxable income brackets. For an elderly couple, the standard deductions plus the double dependency allowance above age 65 bring the total exclusions to \$7,400, only slightly less than the maximum primary Social Security benefit of \$7,848 for a person retiring at 65 after June 1980. The spouse’s benefit, if age 65, is an additional \$3,924. As the couple’s income rises above the \$7,400 level, the President’s Commission has concluded, as has the CED, tentatively, that the additional income should be subject to progressive taxes. There seems to be no reason to give an elderly couple a far greater tax break than a young couple. At the present time, a young couple with two children gets into taxable brackets at the \$7,400 level. An elderly couple, by contrast, can receive Social Security benefits, which can be as high as \$11,772, plus other income up to \$7,400, or a total of up to \$19,172, before they get into a taxable bracket. It seems hard to defend the proposition that the young couple raising a family, buying a house, and going through all of the



early expenses, should also have to transfer a substantial amount of earnings through Social Security taxes, and pay federal income tax on those taxes, to a couple that is not taxable until substantially higher income has been reached. This approach would not hurt lower income people at all, but would allow higher income older as well as younger people to carry their share of government expenses.

### *Phase-In*

One major problem does exist. Those persons now retired or soon to retire have had to include their contributions to Social Security in taxable income during their working years. It would be widely considered unfair now to include their benefits in taxable income, thereby hitting this generation twice. Actually, under Social Security, the rationale could be presented for doing exactly that. To date, Social Security taxes do not and have not supported the total actuarial costs of benefits. But in order to be politically feasible, a long phase-in period should be used.

Private pensions are not a problem. Tax treatment already provides for including in taxable income during retirement all sums not so included during working years. So benefits resulting from employer contributions, any nontaxed employee contributions, and investment earnings will be automatically included in taxable income during retirement.

### **Eliminate Employment Test**

If, but only if, the tax on employee contributions to Social Security is eliminated and the benefits are included in taxable income, then and then only should the employment test be eliminated. The redundancy is for emphasis. I cannot emphasize strongly enough that this is a package. A good many of the proposals now pending in Congress take one or two or three of these ideas separately from the others—this is not appropriate public policy.

The work test, or employment test, or earnings test, has always been controversial. There are several grounds for controversy; I will mention the three most prominent. One is that Social Security participants say “I’ve paid for the benefit, I deserve to get it.” A second argument is that it is unfair that only workers’ earnings and not earnings on investments or other sources lead to loss of Social Security benefits. The third is that it is a disincentive for older people to work.

First, let me comment on the argument that “I’ve paid for the benefits, I ought to get them.” This is a misconception of the nature of the Social Security program, which is and quite properly so a social transfer program from workers to nonworkers. The Social Security Administration and government officials “sold” the original plan as an “insurance” scheme, without disclosing what it was *not* insured against. The contributions have paid for insurance against being unemployed at a particular higher age, or disabled, or, for survivors, benefits to replace the lost earnings of the wage earner.

Social Security is designed to *replace* earnings from employment, not *add to* such earnings. It was never proposed that transfers should be made from *workers* to *workers*. Here again, fairness to younger workers trying to raise a family, buying a house, and meeting other needs should be part of our tax approach.

In connection with the arguments related to nonearned income, the philosophy of the Social Security program is that it is an earnings related program. To take away the rights of persons who are thrifty (or lucky) enough to have saved money on their own would be a direct tax on and disincentive to personal savings. The way to “bet against the system” would be to divest oneself of all personal savings, and then receive Social Security benefits. Do you suppose this would be the final blow against personal savings in America?

The Commission was of strong opinion that the earnings test is an important disincentive to work. It is! It represents a 50 percent tax on earnings from the lowest earnings against which no offset is made up to the level at which Social Security is no longer paid. If, in conjunction with other changes, the earnings test is dropped then this problem is also solved. This change would substitute a progressive tax for a proportional tax.

These recommendations should be implemented only in connection with moving up the early retirement age in tandem with the normal retirement age. Once again, the package approach is crucial. Some proposals now being made would leave the retirement age at 65 normal, 62 early. Whenever this is proposed, elimination of the earnings test should be vigorously opposed.

## **Inflation as a Tax**

Since others are covering the topic of inflation, I will allude to it only briefly.

Any discussion of taxes on retirement income would be incomplete without discussion of the cruelest tax of all—inflation. America has

seen some vigorous tax revolts, for example, the Boston Tea Party, related to “taxation without representation.” Inflation is an example of taxation without representation. Nobody specifically and openly votes for it, although a very large number of people vote for inflation unconsciously, or force their representatives to, by sponsoring and approving inflationary policies.

There can be no real solution of retirement income problems in this country without a solution to the problem of inflation.

### **President’s Ten-Ten-Ten Tax Program**

The timing for these comprehensive and wholly warranted but somewhat expensive tax changes for Social Security and private pensions is perfect. They would fit in neatly with the Administration’s program for personal tax reductions and encouragement of capital formation through savings.

The mechanisms for eliminating employee contributions from taxable income are available and easy to handle. They simply would be to eliminate from gross income the employee contributions to Social Security and private or governmental employee pension plans. The 10 percent Administration tax reduction, either for the first or the second year, could be adjusted to take into account the revenue losses from exclusion of employee contributions from taxable income.

The advantages of doing this are many. American workers who are now transferring substantial amounts of their earnings to retired people through Social Security would not in addition have to include the sums so transferred in their taxable income. Taxes that they saved could in turn either be spent currently or saved to enhance their own retirement through private pension plans. The exclusion from current taxable income of employee contributions to private plans would currently have little revenue impact since, as already noted, the unfavorable tax treatment of employee contributions has pretty well driven contributory pension plans out of existence. And the new treatment would encourage the improvement of the adequacy of benefits of private pension plans by inducing many more pension plans to have employee contributions either on a compulsory or a voluntary basis. Any such additions would be increases in capital formation and the savings rate for the economy, a very real advantage.

## **Include Benefits in Taxable Income**

During retirement all retirement benefits, whether private or Social Security or governmental plan benefits, would eventually be included in taxable income. This would result in substantial tax revenues, brought in under the progressive federal income tax rates that levy no taxes on the poor. There would need to be a transition. Persons who are already retired or are nearing retirement under Social Security have over the years included their contributions to Social Security in taxable income. Therefore they would consider it unfair if they now have to include the benefits in taxable income. No *additional* loss of revenue will occur if the benefits are not included in taxable income for a fairly long transitional period. This would fit with the Administration's program of tax reductions to be enacted over the next three years. Eventually, Social Security benefits would be included in taxable income, and the recapture from the progressive income tax would be substantial.

As far as governmental employee and private pension recipients are concerned, no change needs to be made. Present tax formulas allow for the exclusion from taxable income during retirement of the amount of employee contributions already paid, and then the inclusion of all benefits whether resulting from employer contributions, employee contributions, or investment earnings.

A macro-economic advantage of this change would be to eliminate the expensive and inappropriate subsidy to Social Security resulting from the fact that neither Social Security benefits nor employer contributions are ever taxed. This would place Social Security on the same status as private plans. The long-term implications of this would be to make tax treatment of private and public plans the same, thereby leading to greater popularity of private plans and better capital formation.

This whole program does not automatically call forth applause in all circles. It will take some explaining. But I am willing to venture that in two or three years—hopefully even less—it will be accepted as conventional wisdom just as fully as delaying the retirement age under Social Security is now. The delayed retirement age idea five years ago was anathema; it will be passed into law within a relatively short period of time now.

## **Basic Recommendations**

In this paper I have analyzed the broad sweep of tax proposals made by the President's Commission. In recent talks I have empha-

sized different recommendations,<sup>1</sup> but I will now comment briefly on some of these recommendations of the President's Commission.

There is one recommendation of the President's Commission with which I especially disagree—MUPS, or Minimum Universal Pension System. All of our Commissioners' dissents were pretty well hidden in the original report, and dropped out entirely from the short-version report without even a mention that there were dissents by eight of the ten active Commissioners on one or another topic.

My major dissent was on MUPS, which is, I believe, "A Real Clinker."

"The Commission recommends that a Minimum Universal Pension System (MUPS) be established for all workers. The system should be funded by employer contributions. The Commission further recommends that a 3 percent of payroll contribution be established as a minimum benefit standard. All employees over the age of 25, with one year of service and 1,000 hours of employment with their employer would be participants in the system. Vesting of benefits would be immediate."

The design of the recommended private plan, if mandated, is excellent. If we are to have a federally mandated private pension system on top of Social Security, it should provide immediately vested benefits of real substance. It should be simple to administer, as is the case with defined contribution plans. It should not require coverage for persons under age 25 or in their first year of service or part-time persons working fewer than 1,000 hours a year.

But here my support for MUPS ends. Let me quote my dissent from the President's Commission report:<sup>2</sup>

"In the 1930s over 90 percent of our elderly people were poor, and dependent on relatives, charity or welfare. That ratio is now almost reversed. 'In-kind' benefit income still further reduces poverty among the aged. Social Security is mainly responsible for this dramatic improvement, but employer pension plans, life and medical insurance and personal savings share the credit.

Through Social Security, the federal government has already made major decisions for almost all American workers as to how

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<sup>1</sup>President's Commission on Pension Policy, *An Affirmation of Private Sector Action* (March, 1981); *Pension Problems, Issues and Options* (October, 1980); *An Interim Report* (May, 1980).

<sup>2</sup>President's Commission on Pension Policy, *Coming of Age: Toward a National Retirement Income Policy* (1981), pp. 62-63.

much of their earnings they can use currently for themselves and their families, and how much will be transferred from them through Social Security taxes to people already retired. The recommendation of a Minimum Universal Pension System would mandate, by federal government action, additional shifting forward of life income from a person's working years to the retirement years. The time has come to let tens of millions of families and their employers decide that question.

Unfortunately the President's Commission continues to use a figure of only 45 percent of the private sector work force actually participating in a pension plan, thereby showing a large 'gap' of uncovered people. But the 'gap' is largely young, short-service, part-time, or low-paid workers in small establishments. Half of the noncovered workers are under age 25 or have less than one year of service. Seventy-nine percent are in firms with fewer than 100 employees (Chart 6 of the Report). I do not believe the case has been made for adding current financial burdens over and above Social Security coverage on employment toward the lower end of the economic scale.

The relevant figure to use is that nearly 70 percent of full-time American workers are already participating in private pension plans or will be when they reach age 25 and have one year of service. The majority of the remaining uncovered are part-time or low-paid workers in smaller establishments for whom Social Security is the crucial coverage."

Static figures on coverage of pension plans, as was insisted on by the staff of the President's Commission, make no sense. EBRI provided excellent studies to the Commission, as well as some of the other people testifying. All that was needed was for the Commission to accept the fact that persons who are age 23 become age 25; many persons in their first year of employment will continue on to the second year; and other people will become eligible for private pensions either with their present employer or with a following one.

I believe it highly unlikely that the MUPS proposal will achieve any general support in Congress at this time. It is a reasonable question to ask what approach I would use so let me once again quote from my dissent:

"Instead of the Commission's recommendation of a Federally mandated Minimum Universal Pension System, I would favor continued voluntary effort to develop coverage through funded, private pension plans. I would seek ERISA simplification espe-

cially for smaller employers, a more precise targeting of the groups that need additional protection beyond Social Security, earlier vesting in present retirement systems, a slower phased-in vesting for new plans, and continued diversity among savings, thrift, and profit-sharing plans, defined contribution, and defined benefit retirement systems. I would add carefully targeted tax policy, including tax credits and incentives for lower-paid employees and deferral of taxability of employee contributions to retirement systems.’’

## **Other Recommendations**

### *Vesting and Portability*

The Commission recommended voluntary movement toward shorter vesting schedules, especially for mature plans. This is a thoroughly responsible recommendation. Those who believe in voluntary action and private pensions can never defend themselves against Social Security “inroads” so long as they maintain long vesting schedules in those plans. Three arguments against earlier vesting persist.

1. “The employer has no responsibility for people who don’t stay with him many years.” The fact of the matter is that for private pensions to mean anything, they must provide benefits for all periods of substantial service in employment. Otherwise Social Security will continue to have the argument of full portability and meeting of real human needs.

2. “We want to tie our people to us and discourage mobility.” The argument can be made on an efficiency basis—training is expensive. But those who have thought their way through the vesting questions may come to a contrary decision—that late vesting does not hold the kind of able people who can get other jobs quickly, and merely holds persons who are only adequate or less in their jobs.

3. It is also said that vesting is too expensive. There are two answers to this. The first is that the cost of vesting is there regardless of who pays it. If a plan provides early vested benefits, the employer and employee join in providing good retirement benefits. If on the other hand there is no early vesting, the employee picks up the cost in the form of foregone benefits if he leaves before being vested. The other argument is a realization that under defined benefit plans, actual vesting is mostly illusory at early ages. When a person leaves em-

ployment under a defined benefit plan, even if vested, he or she is provided with "cold-storage vesting." That means that the amount vested is related to his lower average salary just before leaving, not his final salary. And it also means that investment earnings will carry most of the cost of the benefit; the employer will have contributed little.

### *Spouses' Benefits*

The President's Commission has several recommendations to make about spouses' benefits. Benefit and coverage gaps were noted in instances of divorce and death before retirement. The conclusion was that joint income options should be normal and it should take signatures of both spouses in order for one to waive such benefits. Recommendations for additional survivorship benefits were made. And upon divorce, the pension entitlements earned during the marriage should be divisible.

In the case of Social Security, "The Commission recommends earnings sharing be used upon divorce and inheritance of earnings credits be provided to surviving spouses of two-earner couples."

The staff did not study and the Commission took no action on a current controversial issue, that of unisex retirement benefits. Almost all pension plans use sex-distinct actuarial tables in computing all periodic benefits or all optional periodic benefits. In the case of defined contribution plans, all annuities are directly related to the mortality tables for men and women at all ages and under all options. The effect of this is that monthly benefits for similarly situated men and women choosing single life annuities are larger for men, but continue on the average for a longer time for women because of their longer average life span. Joint options, the preferred selections by participants under retirement plans and the recommended option by the President's Commission, provide generally equal monthly benefits for spouses of about the same ages. Under defined benefit plans, however, the single life annuities are the only ones that do provide the same monthly benefits. All the joint options, in the vast majority of defined benefit plans including public plans, provide a *larger* monthly benefit for the woman employee and her husband than for the male employee and his wife. And this *larger* monthly benefit is at greater cost. There is no provision in federal law or regulation for this kind of discrimination in favor of women.

Two Commissioners commented on this. Martha Griffiths recommended that the monthly benefits be evened out regardless of the



longer life span and greater cost for women. I recommended the either/or approach used for so many decades by the federal government and other regulatory and private pension experts. Under this approach, either the benefits or the contributions can be “equal.”

#### *Ownership and Control*

This is a topic that will be receiving more and more attention in months to come. Scarcely a day goes by without some stories relating to targeted, or regional, or social investing of public plan funds. The question of “social investing” and voting of corporate shares and participation by beneficiaries in investment decisions is not an easy one to come to grips with. I will not discuss it here; merely acknowledge it.

#### *Social Security*

I will merely indicate my own agreement with the President’s Commission’s suggestions to:

Raise the normal retirement age to 68 and the early age to 65 by the turn of the century.

Change the tax treatment, as earlier discussed, and then eliminate the earnings test.

Achieve Universal Social Security Coverage. This should have been done forty-five years ago; it certainly should be done now.

Amend and stiffen the disability provisions.

Readjust indexing to a more realistic cost-of-living escalation.

#### *Retirement Ages*

One of the most important of all the Commission’s recommendations has to do with retirement ages. The Commission calls for a discontinuity in the long-time persistent trend toward earlier and earlier retirement. In 1900, 70 percent of men were in the labor force; the figure is now one in six. In the long run this trend cannot, in the estimation of most experts, be financed. Even if it *can* be, it would presumably require far larger transfers from young workers to older people once the demographic bulge of workers moves into retirement. A reversal in this trend could be the most important recommendation of the President’s Commission with respect to sound financing of the future of all retirement plans.

As outlined in the President’s Commission report, we should make real efforts to develop appropriate employment for older workers. These should include generous relocation, retraining, sabbatical leave, terminal adjustment pay, reassignment, administrative or desk jobs, and better disability and unemployment arrangements.

## Conclusion

“The power to tax is the power to destroy.” But it is also the power to create, to guide, to encourage, to strengthen.

I believe tax policy should be designed to achieve the objectives mentioned earlier: to finance Social Security adequately, to be fair both to the “transferred froms” and the “transferred tos,” to encourage greater savings toward retirement by employers and employees through individual efforts and to stimulate capital formation and productivity.

Current tax policy is faulty; it does not meet these tests.

Let me review the tax policy that I believe would carry us strongly through the next four months, four years and forty years.

1. Continue Social Security as a work-related basic transfer plan with both taxes and benefits related to a wage base.
2. Exclude from current taxable income all employer *and employee* contributions to Social Security and to employer pension plans and private retirement savings, as well as earnings on any of the funds. Establish one overall maximum covering all deferral of employer and employee contributions and individual retirement savings.
3. Include in current taxable income all proceeds and income from previously excluded retirement income sources: Social Security, employer pensions, and private retirement savings.
4. Then and then only, eliminate the Social Security earnings test.

I am aware that any such rationalization of tax policy would result in hundreds of hours of Congressional hearings, hundreds of pages of text, and thousands of pages of rules and regulations. But perhaps if we can keep the basic tax objectives in mind, we can achieve stronger financial security for all our elderly people.

# The Long-Term Prospects for Social Security

Colin D. Campbell

## Introduction

The most important problem facing the Social Security system is its exploding cost. As shown in Table 1, during the 1970s the payroll tax rate (employer and employee combined) for old-age, survivors, and disability insurance (OASDI) was increased sharply—from 8.4 percent in 1970 to 10.16 percent in 1980; including hospital insurance (HI), the tax rate was increased from 9.6 percent to 12.26 percent. At the same time, the taxable wage base was increased from \$7,800 in 1970 to \$25,900 in 1980—over three times. Because of increases in the taxable wage base, the percentage of covered workers with their entire earnings taxed has risen from about 64 percent in 1965 to 85 percent in 1977, and will rise to more than 90 percent as a result of the increases in the taxable wage base legislated in 1977.<sup>1</sup>

The upward trend in payroll taxes will continue during the 1980s. The payroll tax rate for OASDI is scheduled to increase from 10.16 percent in 1980 to 12.4 percent in 1990; the tax rate for OASDHI is scheduled to rise from 12.26 percent to 15.3 percent. The taxable wage base was raised to \$29,700 in 1981, and after 1981 it will increase with the rise in average wages.

Despite the scheduled increases in payroll taxes, they are not expected to be large enough to cover either the short-run or the long-run needs of the system. In the 1980 Annual Report of the Board of Trustees of the OASDI Trust Funds, it was estimated that the OASI fund would be depleted in 1980 or 1982.<sup>2</sup> Although it is hoped that the depletion of the OASI trust fund can be avoided by shifting

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<sup>1</sup>*Social Security Bulletin, Annual Statistical Supplement, 1977-79*, p. 88.

<sup>2</sup>The Board of Trustees is required by law to submit to Congress an annual report on the status of the OASDI trust funds. The members of the Board are the Secretary of the Treasury, the Secretary of Labor, and the Secretary of Health and Human Services. The Commissioner of Social Security is the Secretary of the Board. The annual reports of the Board include five-year estimates of income and outgo as well as estimates of OASDI expenditures as a percent of taxable payroll for the next seventy-five years. For the financing of the Social Security system to be in balance, the payroll tax rates scheduled in the future must be high enough to cover the future costs of the system.

**TABLE 1**  
**Social Security Tax Rates for OASDHI, Employee and Employer Combined, 1969-1990**

Year	Tax Rate (excluding HI) (percent)	Maximum Wage Base (dollars)	Tax Rate (including HI) (percent)
1969-1970	8.4	7,800	9.6
1971	9.2	7,800	10.4
1972	9.2	9,000	10.4
1973	9.7	10,800	11.7
1974	9.9	13,200	11.7
1975	9.9	14,100 <sup>a</sup>	11.7
1976	9.9	15,300 <sup>a</sup>	11.7
1977	9.9	16,500 <sup>a</sup>	11.7
1978	10.1	17,700 <sup>a</sup>	12.1
1979	10.16	22,900	12.26
1980	10.16	25,900	12.26
1981	10.7	29,700	13.3
As scheduled in the law			
1982-1984	10.8	a	13.4
1985	11.4	a	14.1
1986-1989	11.4	a	14.3
1990	12.4	a	15.3

<sup>a</sup>From 1975 through 1978, automatic increases in the maximum wage base were made each January following automatic increases in benefits. The amount of the increase was determined by the rise in average taxable wages between the first quarters of the two previous years, rounded to the nearest multiple of \$300. The substantial increases in the maximum wage base from 1979 through 1981 were legislated in 1977. After 1981 the maximum wage base will again be increased automatically in line with average wages.

Source: *Social Security Bulletin, Annual Statistical Supplement, 1977-79*, p. 34.

revenues to it from the DI trust fund, it is not certain that this will be enough. Over the long run, the Social Security system has been operating with a seventy-five-year actuarial deficit ever since 1973 (see Table 2). According to the intermediate forecast in the 1980 Annual Report, payroll tax rates scheduled over the next seventy-

five years are 1.52 percentage points too low.<sup>3</sup> The financial problems of the system will become especially serious after the year 2030. Although it is estimated that there will be a surplus of 1.19 percent of payroll from 1980 to 2004, and a small deficit of 1.17 percent from 2005 to 2029, there will be a very large deficit of 4.58 percent of payroll from 2030 to 2054.<sup>4</sup>

### **The 20-Percent Increase in Benefits in 1972**

An underlying cause of the system's financial difficulties during the 1970s was the 20-percent increase in benefits enacted by Congress in 1972. Benefits had also been increased 15 percent in 1970 and 10 percent in 1971.

An interesting aspect of the system's present difficulties is that in the early 1970s there was no awareness of any financial problems.<sup>5</sup> In 1972, both the five-year and the seventy-five-year forecasts in the Annual Report of the Board of Trustees were very optimistic.<sup>6</sup> The Trustees expected that over the next five years, payroll tax revenues would exceed expenditures by substantial amounts. Over the next seventy-five years, using dynamic assumptions of rising earnings and prices, the Trustees predicted that an average payroll tax rate for OASDI of only 9.23 percent would be adequate and that the OASDI program was overfinanced by about 10 percent.

Looking back, the 20-percent increase in benefits in 1972 was a serious mistake. The year 1972 was an election year and there were undoubtedly political pressures behind the increase.<sup>7</sup> As a result of this increase in benefits, Social Security replacement ratios—the ratio of benefits to preretirement earnings—were raised sharply above the levels that had previously existed. If they had not been

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<sup>3</sup>The Board of Trustees presents long-range cost estimates based on three alternative sets of demographic and economic assumptions. Alternative I is known as the optimistic set of assumptions; Alternative II, the intermediate set; and Alternative III, the pessimistic set.

<sup>4</sup>1980 *Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Trust Funds*, p. 78.

<sup>5</sup>Colin D. Campbell, "The Exploding Cost of the Social Security System," in William Fellner, Project Director, *Contemporary Economic Problems, 1981* (Washington, D.C.: American Enterprise Institute, forthcoming).

<sup>6</sup>1972 *Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Trust Funds*, pp. 18-21, 32.

<sup>7</sup>Martin Feldstein, "Can Federal Spending Be Reduced?" *Wall Street Journal*, February 2, 1981, p. 16.

raised, tax revenues in the 1970s would probably have been large enough to cover the unanticipated rise in cost.

**TABLE 2**  
**Estimated Average Expenditures, Average Scheduled Tax Rate, and Actuarial Balance for the Next 75 Years, Expressed as a Percentage of Taxable Payroll, OASDI, 1972-1980<sup>a</sup>**

Year of Forecast	Estimated Average Expenditures	Average Scheduled Tax Rate	Actuarial Balance
1972	9.23	10.27	1.04
1973	10.95	10.63	- 32
1974	13.89	10.91	- 2.98
1975	16.26	10.94	- 5.32
1976	18.93	10.97	- 7.96
1977	19.19	10.99	- 8.20
1978	13.55	12.16	- 1.40
1979	13.38	12.19	- 1.20
1980	13.74	12.22	- 1.52

<sup>a</sup>Using intermediate set of assumptions about future economic and demographic developments.

Source: *Annual Reports of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds* for years 1972 to 1980.

### Unexpected Demographic and Economic Trends

Starting in 1974, it became apparent that several unexpected demographic and economic trends were going to raise the cost of the system very sharply unless changes were made. These trends are (1) the decline in the birthrate, (2) the accelerated inflation and its effect on adjusting benefits for inflation, and (3) the decline in the real wage differential (the difference between the rate of increase in average wages in covered employment and the rate of increase in the Consumer Price Index). The flaw in the method of indexing benefits was corrected in the 1977 Amendments. No changes have yet been made to adjust the system to the decline in the birthrate or the decline in the real wage differential. Two other developments that are adding to the system's financial difficulties are the decline in the mortality rate and the continuation of the trend toward earlier retirement. The following section discusses in more detail these unexpected problems.

## The Decline in the Birthrate

The 1974 Annual Report of the Board of Trustees was the first one to show that the Trustees realized that future costs were going to be much higher than had been expected, even though they were still unaware of how serious the problem was. As shown in Table 2, the estimated long-run deficit for OASDI was raised from .32 percent to 2.98 percent of taxable payroll. A deficit of this size meant that payroll tax rates scheduled in the law for future years were about 3 percentage points too low.

The sharply higher long-range cost estimated in 1974 was the result primarily of changes in projections of population trends. Table 3 shows the rise in the birthrate in the United States from 1940 to 1957 and the sharp decline from 1957 to 1978. In 1972, the birthrate projections used to estimate long-range costs were still based on the high birthrates before the downturn.<sup>8</sup> If Congress had used realistic birthrate assumptions in that year, there would have been a seventy-five-year actuarial deficit rather than the reported surplus, and Congress might not have raised Social Security benefits 20 percent.<sup>9</sup> In 1974, the actuaries reduced their forecasts of fertility rates, and the predicted long-range actuarial deficit jumped several percentage points.

It is not surprising that the system's actuaries were slow to adjust their projections based on the birthrate. As shown in Table 3, there had been a rise in the birthrate from 1940 to 1957. When the birthrate started to decline, the actuaries did not know that it would fall further. What is astonishing is that they did not begin to revise their birthrate projections until seventeen years after the decline started. Of course, members of Congress would not have welcomed forecasts of higher costs based on lower birthrate projections. The higher costs would have required higher payroll tax rates.

The decline in the birthrate since 1957 would not have increased estimated future costs if the Social Security system were funded rather than financed pay-as-you-go. In the pension systems of state and local governments and private institutions that are well funded,

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<sup>8</sup>In 1972, the actual birthrate was 30 percent below the average of the high and low projected birthrates assumed by the Social Security actuaries. See Robert S. Kaplan, *Financial Crisis in the Social Security System* (Washington, D.C.: American Enterprise Institute, 1976), p. 5.

<sup>9</sup>Robert J. Myers, "Social Security's Hidden Hazards," *Wall Street Journal*, July 28, 1972. Myers was Chief Actuary of the Social Security Administration from 1947 to 1970.

**TABLE 3**  
**Birthrate, United States, 1940-1978**

Year	Rate per 1,000 population	Year	Rate per 1,000 population
1940	19.4	1960	23.7
1941	20.3	1961	23.3
1942	22.2	1962	22.4
1943	22.7	1963	21.7
1944	21.2	1964	21.0
1945	20.4	1965	19.4
1946	24.1	1966	18.4
1947	26.6	1967	17.8
1948	24.9	1968	17.5
1949	24.5	1969	17.8
1950	24.1	1970	18.4
1951	24.9	1971	17.2
1952	25.1	1972	15.6
1953	25.0	1973	14.9
1954	25.3	1974	14.9
1955	25.0	1975	14.8
1956	25.2	1976	14.8
1957	25.3	1977	15.4
1958	24.5	1978	15.3
1959	24.0		

Source: U.S. Bureau of the Census, *Historical Statistics of the United States, Colonial Times to 1970* (Washington, D.C.: U.S. Government Printing Office, 1975), p. 49; and *Statistical Abstract of the United States, 1979*, p. 60.

the decline in the birthrate would not cause their future costs to rise. In these systems, for each person a large enough fund is accumulated to cover the cost of his future benefits (assuming average life expectancy), and the contribution rate would not be affected by the birthrate. Although there were other reasons to prefer pay-as-you-go financing, one would not expect the architects of the Social Security system to have foreseen the financial difficulties caused by the sensitivity of costs in a pay-as-you-go system to changes in the birthrate.

In a pay-as-you-go system, changes in the birthrate affect the future cost of the system by altering the ratio of the number of beneficiaries to the number of workers paying taxes. The sensitivity



of the payroll tax rate to this ratio may be illustrated by the formula for the payroll tax rate shown in equation 2. In a pay-as-you-go system:

Total payroll tax receipts = Total benefits

Total payroll tax receipts = The payroll tax rate ( $t$ ) *times* the number of workers ( $N_w$ ) *times* the average covered wage ( $W$ )

Total benefits = Number of beneficiaries ( $N_b$ ) *times* the average benefit ( $B$ )

Therefore:  $t \cdot N_w \cdot W = N_b \cdot B$ , (1)

and  $t = \frac{N_b}{N_w} \cdot \frac{B}{W}$ . (2)

In equation 2, the payroll tax rate is equal to the ratio of the number of beneficiaries to the number of workers multiplied by the ratio of average benefits to average covered wages.

The decline in the birthrate since 1957 will eventually have a very significant effect on the ratio of beneficiaries to workers. In 1980, there were approximately 35 million OASDI beneficiaries and 114 million persons paying Social Security taxes—a ratio of 30 percent.<sup>10</sup> Fifty years from now, according to the intermediate cost projections, this ratio is expected to rise to 52 percent. At that time, those persons born during the baby boom in the 1940s and 1950s will have retired and the labor force will be relatively small because of the decline in the birthrate in the 1960s and 1970s.

As equation 2 shows, if the ratio of benefits to average covered wages is held constant, the payroll tax rate must rise if the ratio of beneficiaries to workers increases. At the present time, because the ratio of beneficiaries to workers is approximately 30 percent and the ratio of average benefits to average covered wages is 36 percent, a payroll tax rate of 10.8 percent (the OASDI rate scheduled for 1982) roughly balances receipts and expenditures. If the ratio of beneficiaries to workers rises, as predicted, to approximately 50 percent and the ratio of average benefits to average wages is held the same (at 36 percent), a payroll tax rate of 18 percent would be necessary.

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<sup>10</sup>1980 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Trust Funds, p. 85.

## Problems with Indexing of Benefits for Inflation

In the 1975 Annual Report of the Board of Trustees it was realized without any doubt that the system's financial problems were very serious. It was widely reported in the press that the system was "on the road to bankruptcy." As shown in Table 2, in 1975 the seventy-five-year actuarial deficit was increased from 2.98 percentage points to 5.32 percentage points. A new problem had emerged—known as the flaw in the indexing system enacted in 1972.<sup>11</sup>

In the 1975 Annual Report, the higher estimated long-range costs were said to be due primarily to "unintended results in the automatic benefit adjustment provisions enacted in 1972." Although the 1972 Amendments did tie benefits automatically to consumer prices, it was also the use of the traditional method of adjusting benefits for inflation that resulted in overindexing.

In 1976 and 1977, the estimated deficits over the next seventy-five years rose further. As shown in Table 2, in 1977 the estimated long-range average expenditures as a percentage of payroll rose to 19.19 percent—more than double the rate estimated in 1972. When the flaw in the indexing system was corrected in 1977, the estimated long-range expenditures fell from 19.19 percent to 13.55 percent of payroll and the long-range actuarial deficit fell from 8.2 percent to 1.4 percent of payroll.

The reason why the actuaries were not aware of the flaw in the indexing system in 1972 is that the old technique for adjusting benefits for inflation worked satisfactorily if future rates of increase in consumer prices were assumed to be only 1 or 2 percent a year. The overindexing problem became apparent as soon as actuaries adjusted their long-range projections to the acceleration in the rate of inflation that started after 1965.<sup>12</sup>

The actuaries were again slow to change their projections. They viewed the more rapid inflation as temporary and expected the economy to return to the low rates of inflation that had prevailed before

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<sup>11</sup>The overindexing problem was first publicized in 1973. See Geoffrey N. Calvert, "New Realistic Projections of Social Security Benefits and Taxes, Their Impact on the Economy and on Future Private Pensions" (Address before the American Pension Conference, New York, December 4, 1973).

<sup>12</sup>For an explanation of the overindexing problem and an illustration of the sensitivity of Social Security expenditures as a percent of taxable payroll to the rate of inflation, see U.S. Congress, Senate, Committee on Finance, *Report of the Panel on Social Security Financing*, 94th Cong., 1st sess., February 1975, pp. 15-18.

1965.<sup>13</sup> If the actuaries had assumed higher rates of inflation in their seventy-five-year projections in 1972 when indexed benefits were legislated, they would undoubtedly have discovered at that time the flaw in the way benefits were being adjusted for inflation.

From 1975 to 1977, the large long-run actuarial deficits were considered less urgent than the need to promptly raise additional payroll tax revenues. In the 1976 report, it was stated that the long-term deficits “should be interpreted with caution because they are based upon future benefit levels which are much higher, relative to pre-retirement earnings, than are currently prevailing benefit levels and which will not materialize if realistic legislation is enacted to redress the imbalance.”<sup>14</sup>

The way in which overindexing increased the cost of the system is by increasing the ratio of average benefits to average covered wages. As shown in equation 2, given the ratio of beneficiaries to workers, if the ratio of average benefits to average covered wages rises, the payroll tax rate necessary to cover the cost of the system will rise.

The reason why the old method of adjusting benefits for inflation was overindexed before the 1977 Amendments is that the promised benefits of workers *who had not yet retired* rose not only because they were adjusted periodically for increases in the Consumer Price Index, but because inflation increased a worker’s average monthly wages on which benefits were based.<sup>15</sup> For those still employed, a worker’s average monthly wage rose as the higher wages earned in more recent years were added to the lower wages earned in earlier years. Because this effect was very gradual, the impact of overindexing was primarily on the trend of costs over the next seventy-five years rather than on the immediate cost of the system.

Even with overindexing, the old method of adjusting benefits for inflation did not cause the ratio of average benefits to average covered wages to rise in the seventy-five-year projections if future rates of inflation were assumed to be low—1 percent or 2 percent a year. At these low rates of inflation, average benefits tended to rise less rapidly

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<sup>13</sup>Martha Derthick, *Policy-Making for Social Security* (Washington, D.C.: The Brookings Institution, 1979), pp. 392-3.

<sup>14</sup>1976 *Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Trust Funds*, p. 2.

<sup>15</sup>If benefits rose solely because of increases in consumer prices, inflation would not normally cause the ratio of average benefits to average wages to rise. Because wages usually rise faster than consumer prices, average benefits would rise less rapidly than average wages.

than average covered wages. But, at higher rates of inflation the difference between the rate of expansion in prices and wages gets smaller. For example, if consumer prices are assumed to rise at 6 percent a year and wages at 8 percent (assuming a 2 percent increase in the productivity of labor), prices and thus average benefits would rise three-fourths as fast as wages instead of one-half as fast as wages if consumer prices are assumed to rise at 2 percent a year and wages at 4 percent. As a result, at the higher rates of inflation, it does not take much overindexing to cause average benefits to increase faster than average covered wages. At higher rates of inflation, the increase in the average monthly wage of workers as a result of steadily rising wages combined with the rise in benefits as a result of the increase in the Consumer Price Index will cause the future trend of benefits to rise faster than the trend of wages.

The 1977 Amendments made major changes in the indexing technique for calculating the benefits of persons who have not yet retired. For persons who are retired, benefits are still indexed for inflation in the same way as before the 1977 Amendments—benefits are increased each year in line with consumer prices. For persons not yet retired, the principal change made is that benefits are no longer increased by adjusting the percentages allowed, shown in the first column of the two examples in Table 4(a). Instead, in the new benefit formula the average monthly wage of a worker is indexed to average total wages of all workers. Each prior year's wage is multiplied by the ratio of the average total wage of all workers two years prior to that in which a worker reached age 62, to average total wages in the year the wage was earned.

With the new benefit formula shown in Table 4(b), if, for example, the average total wages of all workers rise 10 percent because of inflation, the average indexed wages and the promised benefits of those still employed would go up the same percentage. As a result, average benefits will not rise faster than average wages, and benefits are not overindexed.<sup>16</sup>

### **The Relatively Low Growth of Wages Compared to the Increase in Consumer Prices**

The recent decline in the rate of growth of wages compared to the increase in consumer prices is the third major change that has ad-

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<sup>16</sup>There could be some problem if there was a difference between the rate of increase in average covered wages and average total wages of all workers.

**TABLE 4**  
**Old and New Social Security Benefit Formulas**

Retiring January 1, 1977		Retiring January 1, 1978	
Percentage Allowed <sup>a</sup>	Level of Average Monthly Wage (dollars)	Percentage Allowed	Level of Average Monthly Wage (dollars)
137.77	First 110	145.90	First 110
50.10	Next 290	53.06	Next 290
46.82	Next 150	49.58	Next 150
55.05	Next 84	58.30	Next 100
Total	634 <sup>b</sup>	32.42	Next 38
			688 <sup>b</sup>
			Primary Insurance Amount (dollars)
			160.49
			153.87
			74.37
			58.30
			12.32
			459.35

(b) New Social Security benefit formula, 1981<sup>c</sup>

Percentage Allowed <sup>a</sup>	Level of Average Indexed Monthly Wage <sup>e</sup>	Primary Insurance Amount
90	\$ 211	\$189.90
32	1,063	340.16
15	Remainder above 1,274	—

<sup>a</sup>In the old formula, the percentages allowed were adjusted upward in line with consumer prices.

<sup>b</sup>Maximum average monthly wage possible.

<sup>c</sup>This is the formula for persons reaching age 62 in 1981. Until 1983, persons may use either the old formula or this formula.

<sup>d</sup>These percentages in the new formula will not be changed.

<sup>e</sup>The amounts in this middle column of the new formula will be changed in line with average total wages of all workers.

Source: Senate, Committee on Finance, *Staff Data and Materials Relating to Social Security Financing*, 95th Cong., 1st sess., p. 5; and *Social Security Bulletin*, January 1981, p. 1.

versely affected the financial condition of the Social Security system. It has been an important cause of the system's short-range financial difficulties.

The first recognition of serious short-run financing problems was in the 1975 Annual Report. In this report, the Board of Trustees predicted that additional revenues would be needed to prevent the exhaustion of both the OASI and DI trust funds soon after 1979.

A major objective of the 1977 Amendments was to avoid exhausting the OASDI trust funds by increasing payroll tax rates. The combined employee-employer payroll tax rate for OASDI is now scheduled in the law to rise to 12.4 percent in 1990, and the rate for OASDHI is scheduled to rise to 15.3 percent.<sup>17</sup> The 1977 Amendments also rapidly increased the taxable wage base in three steps from \$17,700 in 1978 to \$29,700 in 1981. In addition, the portion of the payroll tax rate allocated to disability insurance was increased and the portion allocated to hospital insurance was decreased. In the 1978 Annual Report, the first following the 1977 Amendments, the Trustees state overoptimistically that "The Social Security Amendments of 1977 have restored the financial soundness of the cash benefit programs over the short-range and medium-range periods, beginning in 1981, and have greatly improved the long-range actuarial status."<sup>18</sup> By 1979 and 1980, the confidence of the Board of Trustees in the results of the 1977 Amendments was fading rapidly. In 1980, it was estimated that in each of the next five years OASI expenditures would exceed income, and the assets in the OASI fund would become insufficient to pay benefits in late 1981 or early 1982.

In contrast with the expected depletion of the OASI fund, both the DI and HI funds were expected to increase over the next five years. To avoid depleting the OASI fund, the Trustees recommended that Congress take action to permit interfund borrowing or to reallocate payroll tax rates from the DI program to the OASI program. The Trustees hoped that they could avoid either increasing payroll tax rates or resorting to general revenue financing. In June 1980, there

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<sup>17</sup>The OASDI payroll tax rate for the self-employed is approximately 75 percent of the combined employee-employer OASDI tax rate (or one and a half times the employee rate). See Colin D. Campbell, *The 1977 Amendments to the Social Security Act* (Washington, D.C.: American Enterprise Institute, 1978), pp. 21-22.

<sup>18</sup>1978 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Trust Funds, p. 53.

was only \$27.5 billion in the OASI trust fund and \$7.5 billion in the DI trust fund.<sup>19</sup>

The reason for the unexpected shortfall in the OASI fund is that the economic assumptions underlying the 1978 forecast turned out to be too optimistic. As shown in Table 5, the real wage differentials from 1977 to 1979 were much lower than those in even the pessimistic cost estimates made in 1978. Consumer prices rose more rapidly than expected, while wages in covered employment did not rise more rapidly than forecast. As a result, expenditures increased faster than tax receipts.

Table 6 shows the sharp drop in the average real wage differential from 2 percentage points in the 1960s to zero in the 1970s. If consumer prices rise faster than wages, as they have in some years, the Social Security system is obviously in trouble. Because the benefits of those already retired are indexed to consumer prices, average benefits would rise faster than average covered wages. As is shown in equation 2, this would increase the cost of benefits as a percent of payroll and require higher payroll tax rates.

The decline in the growth of wages relative to the growth in consumer prices in the 1970s is unusual and is a type of change that one would not have expected the actuaries to have foreseen. Throughout most of the history of the United States, wages have risen faster than prices because of increases in productivity. The reasons for the decline in the growth of productivity during the 1970s are varied and still not well understood.<sup>20</sup> It is also not known how long the decline in productivity growth will continue.

### **Other Causes of Increasing Cost**

Two additional trends that may raise the cost of Social Security are the decline in the mortality rate and the continuation of the trend toward earlier retirement. The decline in the mortality rate has been a major development during the 1970s. The number of years that an average person at age 60, for example, can expect to live increased more than one year between 1969-71 and 1978 (for white males, from

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<sup>19</sup>*Social Security Bulletin*, November 1980, pp. 39-40.

<sup>20</sup>John W. Kendrick, "Productivity Trends and the Recent Slowdown: Historical Perspective, Causal Factors, and Policy Options," and Edward F. Denison, "Where has Productivity Gone?" in William Fellner, Project Director, *Contemporary Economic Problems, 1979* (Washington, D.C.: American Enterprise Institute, 1979), pp. 17-77.

**TABLE 5**  
**The Pessimistic Economic and Demographic Assumptions in the 1978 Annual Report of the Board of Trustees, Compared With Actual Conditions, 1977-1979**

Calendar year	Pessimistic Assumptions, 1978 Annual Report				Real wage differential <sup>a</sup> (percent)	Average annual unemployment (percent)	Total fertility rate <sup>b</sup>
	Real GNP	Wages in covered employment	Consumer price index	Average annual percentage increase			
1977	4.9	7.7	6.5		1.2	7.0	1,789
1978	4.7	7.2	6.1		1.1	6.3	1,745
1979	4.1	8.2	6.8		1.4	6.0	1,737
1977	5.3	6.9	6.5	Actual Conditions	0.4	7.0	1,795
1978	4.4	8.1	7.6		0.5	6.0	1,775
1979	2.3	8.3	11.5		-3.1	5.8	1,789

<sup>a</sup>The difference between the percentage increase in average annual wages in covered employment and the percentage increase in the average annual Consumer Price Index.

<sup>b</sup>The number of children who would be born to 1,000 women in their lifetimes if they were to experience the observed age-specific birthrates and were to survive the entire child-bearing period.

Source: *1978 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*, May 16, 1978, p. 25; and *1980 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*, June 17, 1980, pp. 41 and 43.



**TABLE 6**  
**Real Wage Differential, 1960-1979**

Calendar year	Average annual percentage increase in Average wages in covered employment	Average annual percentage increase in Consumer price index	Real wage differential <sup>a</sup>
1960-64	3.4%	1.3%	2.1%
1965-69	5.4	3.4	1.9
1970-74	6.3	6.1	0.2
1975	6.5	9.1	- 2.5
1976	8.4	5.8	2.5
1977	6.9	6.5	0.4
1978	8.1	7.6	0.5
1979	8.3	11.5	-3.1

<sup>a</sup>The difference between the percentage increase in average annual wages in covered employment and the percentage increase in the average annual Consumer Price Index.

Source: *1980 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*, June 17, 1980, p. 41.

16.07 years to 17.2 years).<sup>21</sup> This improvement in life expectancy will add to the cost of Social Security by increasing the ratio of beneficiaries to covered workers.

During the past decade, the trend toward earlier retirement has also raised the cost of Social Security. The labor-force participation rate of men age 55 to 64 dropped from 83 percent in 1970 to 73 percent in 1979.<sup>22</sup> During the same period, the labor-force participation rate of men age 45 to 54 dropped from 94 percent to 91 percent. While the labor-force participation rate of men 65 years of age and older has been declining over the past eighty years, the drop in labor-force participation of men before age 65 is a new development. The trend toward earlier retirement is partially related to the increase in the number of persons receiving disability insurance.

<sup>21</sup>*Vital Statistics of the United States, 1978*, Volume 2, Section 5. See Mark Perlman, "Some Economic Consequences of the New Patterns of Population Growth," in William Fellner, Project Director, *Contemporary Economic Problems, 1981* (Washington, D.C.: American Enterprise Institute, forthcoming).

<sup>22</sup>Robert L. Clark and David T. Barker, *Reversing the Trend Toward Early Retirement* (Washington, D.C.: American Enterprise Institute, forthcoming), tables 8 and 9.

## The 1977 Amendments

As a result of the unexpected financial crises that developed during the 1970s, the Amendments to the Social Security Act enacted by Congress in 1977 had two main objectives—both of them financial: (1) to avoid exhausting the OASDI trust funds, and (2) to reduce the long-term deficit.<sup>23</sup> To raise additional revenues immediately, the Amendments raised the combined employee-employer payroll tax rate for OASDHI scheduled for future years, increased the taxable wage base in three steps from 1978 to 1981, and transferred funds from the hospital insurance trust fund to the disability insurance trust fund which had been on the verge of depletion. To correct the flaw in the indexing system and reduce the estimated seventy-five-year deficit, a radically new technique for indexing Social Security benefits was adopted. Although Congress did not attempt in 1977 to eliminate completely the estimated seventy-five-year deficit, it established a National Commission on Social Security to study, investigate, and review all of the issues concerning the Social Security system.

## Major Recommendations of the National Commission on Social Security Relating to Financing

The National Commission on Social Security's major proposals to restore the Social Security system's financial solvency are for an increase in personal income tax rates and for a later retirement age. The Commission would also change the indexing of benefits so as to reduce automatic increases when prices rise faster than wages.<sup>24</sup>

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<sup>23</sup>In 1974, the Senate Committee on Finance appointed the Panel on Social Security Financing, and in 1975 the Senate Committee on Finance together with the House Committee on Ways and Means appointed a second Consultant Panel on Social Security to study the financial problems of the system. These panels (both headed by William C. Hsiao) produced two major studies of the Social Security system: *Report of the Panel on Social Security Financing to the Committee on Finance*, United States Senate, 94th Cong., 1st sess., February 1975; and *Reports of the Consultant Panel on Social Security to the Congressional Research Service, Prepared for the Use of the Committee on Finance of the U.S. Senate and the Committee on Ways and Means of the U.S. House of Representatives*, Joint Committee Print, 94th Cong., 2d sess., August 1976.

<sup>24</sup>As stated in the National Commission on Social Security's *Summary of Major Recommendations*, January 11, 1981, p. 4, "The automatic benefit increases resulting from changes in the Consumer Price Index should be limited when, over a two-year period, the CPI has risen more rapidly than wages. The increase should equal the two-year average rise in wages. This procedure should only be used when the benefit increase is 5 percent or more. There should be a retroactive 'catch up' in future years, if wages rise more rapidly than the CPI, to make up for such reductions."

### *Higher Tax Rates*

To raise additional revenue, the National Commission recommends a 2½ percent surcharge added to the federal personal income tax. These revenues would be used to finance one-half of the cost of the hospital insurance program and would release funds to the OASDI program.

This proposal runs directly counter to the Reagan economic program of cutting tax rates and avoiding further increases in the percentage of income paid in taxes. In the 1970s, the rise in the cost of Social Security was a major factor contributing to the increase in federal taxes as a percent of net national product.<sup>25</sup> In fiscal 1979, payroll tax collections for OASDHI amounted to \$119 billion, 25 percent of total federal tax revenues. Because of the size of the Social Security system, when the cost of Social Security rises, the federal tax burden also tends to rise. Even without the 2½ percent increase in personal income taxes recommended by the National Commission, the increases in payroll tax rates already scheduled for the 1980s will make it difficult for the Reagan Administration to achieve its objective of bringing to a halt the upward trend in the federal tax burden.

Also, according to the new supply-side view of federal tax policy, raising tax rates as proposed by the National Commission could worsen rather than solve the financing problems of the Social Security system. Although in the past, whenever additional revenues were needed, they were obtained by raising either payroll tax rates or the taxable wage base, tax rates are already so high that further increases may be counterproductive. This is because higher tax rates may erode the tax base. The high income and payroll tax rates that now prevail already appear to be causing people to work fewer hours a week, to take longer vacations, to retire at an early age, to take jobs where the conditions of employment are pleasant, or to move to attractive areas of the country where the climate is mild. Also, recent studies of the underground economy indicate that high tax rates are eroding the tax base by encouraging widespread tax evasion.

A major cause of the system's financial difficulties during the 1970s was the decline in the real wage differential. This is largely the result of the decline in the increase in the productivity of labor. While many factors have contributed to this decline, the supply-side effects of

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<sup>25</sup>For an analysis of the rise in the federal tax burden, see Rudolph G. Penner, "The Future Growth of Government Budgets," William Fellner, Project Director, *Contemporary Economic Problems, 1980* (Washington, D.C.: American Enterprise Institute, 1980), pp. 103-33.

high tax rates may be one of them. If high tax rates are an important cause of the decline in the real wage differential, raising payroll tax rates would not be an effective way of correcting the system's financial imbalance.

### *Later Eligibility Age*

The Commission's second proposal that has significant financial effects is the recommendation to raise the eligibility age for full retirement benefits from 65 to 68. The minimum age for early retirement benefits and spouses' and widows' benefits would be similarly increased. It was proposed that this change be phased in gradually between 2001 and 2012.

Raising the eligibility age would reduce the cost of the system and make it possible to bring the income and outgo of the system into closer balance. However, the proposal of the National Commission to raise the eligibility age does not reduce costs sufficiently to avoid increasing income tax rates, and it does not start until the year 2001. Costs will rise sooner than the year 2001 if the decline in the real wage differential continues, or if the decline in the mortality rate or the trend toward earlier retirement turns out to be more significant than anticipated. The proposal of the National Commission to raise the eligibility age starting in the year 2001 appears to be designed solely to offset the increased cost expected to arise in the next century as a result of the decline in the birthrate.

It is often suggested that if old dependents merely replace young dependents, the increasing ratio of Social Security beneficiaries to workers as a result of the decline in the birthrate is not as serious a problem as is usually claimed. An increase in the tax burden caused by a rise in the ratio of Social Security beneficiaries to workers might be offset by a decrease in the tax burden because of a reduction in the ratio of children to workers. The dependency ratio including both old and young dependents is usually measured quite rigidly by counting all persons under 18 years of age and those age 65 and over as dependents (with all persons age 18 to 65 classed as nondependents). Projections of the dependency ratio measured in this way (assuming total fertility at the replacement level and net immigration at 400,000 a year) show little change in the dependency ratio from 1975 to 2050—41 percent in 1975, 39 percent in 1990 and 2000, and 41 percent in 2025 and 2050.<sup>26</sup>

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<sup>26</sup>Robert L. Clark and Joseph J. Spengler, "Changing Demography and Dependency Costs: The Implications of Future Dependency Ratios and Their Composition," in

Despite the relative constancy of the dependency ratio, changes in the composition of dependents may have significant effects on the tax burden. According to estimates by Robert L. Clark and Joseph J. Spengler, the per-capita public cost of transfers to the elderly is about three times as great as public expenditures for youths.<sup>27</sup> The changing composition of the dependent population will also affect the levels of government differently because state and local governments administer the bulk of the public expenditures on children, and the federal government pays for most of the expenditures on the elderly population. In addition, there is a difference in attitude toward children as dependents and the elderly as dependents. Public expenditures on children (mostly for education) are usually viewed as an investment in the future citizens of the country, while Social Security benefits and other payments to the elderly are regarded as transfer payments (not necessarily restricted to persons who are involuntarily dependent). Also, the popular acceptance of Social Security is based on the concept of Social Security as an insurance program in which the tax payments made by individuals will affect the amount of the benefits they receive when they are retired.<sup>28</sup>

### *Revised Indexing*

The proposal to revise the indexing system is designed to alleviate the system's short-run financial problems resulting from the more rapid increase in consumer prices than in wages. If such a policy were enacted immediately, the increase in the cost of the system in July 1981, when benefits are automatically increased, would be sharply reduced. Also, such a policy would contribute to the short-run financial stability of the system if consumer prices in future years continue to rise more rapidly than wages. Although the relationship between consumer prices and wages in the future is uncertain, it is a type of contingency that the Social Security system should be prepared for. Because of the Commission's proposal for a retroactive catch up in future years when wages rise faster than consumer prices, this proposal does not reduce the long-range cost of the system—a major problem. One would expect that eventually increases in the

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*Aging and Income: Programs and Prospects for the Elderly*, ed. Barbara Herzog (New York: Human Science Press, 1978), pp. 55-89.

<sup>27</sup>Clark and Spengler, in Herzog, *Aging and Income*, pp. 6 and 16.

<sup>28</sup>William C. Mitchell, *The Popularity of Social Security: A Paradox in Public Choice* (Washington, D.C.: American Enterprise Institute, 1978).

productivity of labor will return to more normal levels than in the 1970s and wages will rise faster than consumer prices.

## Conclusion

A basic problem in all types of long-range plans (including those made by Social Security systems) is adjusting to unexpected developments. The current period is such a time for the Social Security system. The very slow adjustment thus far to the important changes that have occurred—the decline in the birthrate, the higher rate of inflation, the decline in the real wage differential, the decline in the mortality rate, and the continued trend toward early retirement—is not reassuring.

It may be especially difficult for Social Security systems to adjust effectively so as to keep the benefits they have promised within their financial resources. As F. A. Hayek pointed out in a chapter of a book that he wrote twenty years ago, because membership in the Social Security system is compulsory and the system is a national institution, the competitive conditions that force most institutions that must make long-range plans to adjust to changes effectively may be very weak.<sup>29</sup> Also, there is a tendency for Social Security systems to overexpand, and it is difficult ever to reduce benefits. This is because individual benefits are determined primarily by the political process. But, as both the cost of benefits and the tax burden on the working population increase, so will the possibility that the taxpayers will eventually object and the retired generation will not get the benefits they expected. The future of the Social Security system will not be assured unless this kind of instability is avoided.

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<sup>29</sup>F. A. Hayek, *The Constitution of Liberty* (Chicago: University of Chicago Press, 1960), pp. 285-305.

# **Balancing Public/Private Sector Roles**

Robert A. Beck

## **Introduction**

The ability of the United States to meet retirement income needs is of concern to the business community, and all Americans. For that reason, as the Chairman of the Business Roundtable Social Security and Pension Task Force, I welcome this opportunity to comment on the recommendations of the President's Commission on Pension Policy and the National Commission on Social Security.

Let me first review our general positions. First, The Business Roundtable believes that all Americans should receive an adequate and secure retirement income. The sources should be Social Security, private pensions and personal savings.

Second, we believe that a strong and productive economy is essential to achieve this objective. We also believe that high levels of inflation destroy the ability of society to maintain this objective.

Third, the Roundtable supports the Social Security program in its critical role to provide a floor of retirement income for all workers. Once a floor of protection has been mandated through a program such as Social Security, additional retirement income should be provided through voluntary means such as private pension plans and individual savings. Private pension plans and individual savings provide a valuable and significant source of capital formation essential for a strong and productive economy. In addition, they offer flexibility to meet the diverse needs of American workers and their families.

Fourth, we believe that private pension plans and individual savings should not be mandated but should be voluntarily encouraged through properly designed incentives, legislation and regulations.

## **Demographics**

Both the Carter Commission and the National Commission properly emphasized the demographic challenges that will be faced by our retirement income programs. These demographic challenges are the result of the well-documented baby boom, the subsequent baby bust and continuing improvements in mortality among the elderly.

Because of demographics, future working generations will face impossible funding burdens and future generations of retirees will face insecurity and hardship, unless fundamental changes are made in our retirement income programs.

### **Policy Alternatives**

The Business Roundtable agrees with the Carter Commission that our nation's retirement programs are dangerously dependent on pay-as-you-go systems such as Social Security. We also agree with the Commission that emphasis should be placed on the expansion of capital producing private pension plans and individual savings.

We disagree, however, with their means to achieve the expansion of private pension plans. We oppose the Carter Commission recommendation that another layer of mandatory retirement income programs be imposed, even if funded through private pension plans. Instead, we recommend that the voluntary expansion of private pension plans and individual savings be achieved through properly designed incentives, legislation and regulations.

We oppose the Minimum Universal Pension System (MUPS) recommendation for several reasons:

First, it is becoming increasingly apparent that our country cannot afford to mandate a solution to every problem we perceive. We must do a far better job of allocating our limited resources to those issues with the very highest priority.

Second, because of the fact just mentioned, the Roundtable recommends that the responsibility of mandatory retirement income programs be limited to providing a floor of protection. We already have a mandatory program that accomplishes this, namely, Social Security.

Third, once a floor of protection has been provided through a mandatory program, the role of government should be to provide incentives and an economic environment that encourages individuals to have a reasonable opportunity to meet their own diverse retirement income objectives.

Fourth, the additional costs of MUPS would be imposed most heavily on small employers and their employees. These businesses are struggling for survival and the additional unwarranted burden of MUPS would likely result in business failure, lower wages to already low-paid workers, and widespread unemployment among the very people who are the intended beneficiaries of the proposal.

Fifth, the recommendation was based on the premises that private plan coverage would not grow and incentives to encourage



individuals to save for their retirement would not be successful. We do not agree with these premises and recommend that properly designed incentives be given the opportunity to prove their success. They have and do work in other major industrialized nations.

Private pension plans have achieved remarkable growth during their relatively short existence despite the dramatic growth of the Social Security benefits and costs. Approximately 70 percent of full-time nonagricultural workers who meet ERISA participation requirements of age 25 and one year of service now participate in private plans. Many of those who are not participants are lower-wage earners for whom Social Security benefits replace a very large percentage of net disposable income. If spouse benefits are included, Social Security benefits replace more than 100 percent of the net, preretirement earnings of low-wage workers.

Most other major industrialized countries have provided incentives for individual saving. Their experience indicates that individuals at all levels of income are capable of setting aside significant savings. This experience is also supported by the experience of thrift plans in the U.S. The Prudential Savings/Thrift plan achieves almost 90 percent participation at all income levels. The Business Roundtable surveyed a large number of companies and found similar effectiveness common.

Furthermore, the Carter Commission failed to give proper recognition to the very high incidence of homeownership in their analysis. More than 70 percent of those over age 65 live in their own home and more than 80 percent of those homes are mortgage free. This is a very significant form of individual saving and should not be disregarded.

Finally, it should be noted that the National Commission on Social Security opposed the MUPS recommendations for many of the same reasons I have mentioned.

### **Long-Term Savings**

Again, let me note that we agree with the Carter Commission that the nation is dangerously dependent on Social Security, the existing mandatory program. Instead of recommending yet another mandatory program, we believe the Commission should have focused more attention on whether our country will be able to afford the current level of mandatory benefits. Once the baby-boom generation has fully retired, we estimate that current Social Security benefit promises are likely to require total taxes of approximately 30 percent of

payroll. This is not a legacy we should be leaving for our children and grandchildren.

We also agree with the Commission that emphasis should be placed on the expansion of capital formation producing private pension plans and individual savings. Therefore, the Roundtable strongly endorses the Commission's recommendation to provide tax incentives to encourage individuals to save for their retirement.

More specifically, the Roundtable recommends that legislation be enacted to permit tax-deferred employee contributions to either an Individual Retirement Account or to a qualified pension plan. The present IRA contribution limits should be substantially expanded. At a minimum, they should reflect inflation since first enacted in 1974. Preferably, they should be increased to \$5,000 or 15 percent, whichever is less. HR10 KEOGH Plan limits should be raised to \$15,000 or 15 percent, whichever is less. In order to achieve widespread use of incentives to encourage individual retirement income saving, the legislation should be kept as simple as possible, mandatory contributions should be eligible for tax-deferred treatment and contribution limits should be the same for persons covered by qualified pension plans as for those who are not covered.

There are numerous advantages to such legislation. Net savings would increase thereby providing an additional source of capital formation essential to create jobs and improve the productivity of the economy. Inflationary pressures would be alleviated. In the short term, the amounts saved would result in less immediate consumer demand. In the long term, the additional capital would improve productivity. A valuable additional source of retirement income would be provided thereby alleviating pressure on the already overburdened Social Security program. Unlike most other tax reduction programs, taxes would merely be deferred, not completely forgiven.

Canada provides incentives similar to those that we have recommended. Their experience indicates that persons at all income levels are capable of saving. Approximately three-quarters of those using the incentives in Canada had incomes of less than \$25,000 in 1977. Furthermore, their rate of individual saving, which was below the U.S. rate ten years ago, is now approximately twice the U.S. rate.

### **Social Security**

The Social Security program now faces major problems. First, there is a significant lack of public understanding as to the purpose, nature and financing of the program. The program is essentially an

intergenerational transfer program designed to meet social objectives. The public should be made aware of this fact, and the cost of the program, now and in the future, should be acknowledged.

Second, largely because of this lack of public understanding, there is little confidence in the program. A public-opinion poll conducted for the National Commission indicated that three-quarters of all workers between the ages of 25 and 44 have little or no confidence that funds will be available to pay future benefits when they retire. The elderly are terrified about the prospects of substantial benefit reductions even though no responsible individuals or groups are advocating such reductions for present retirees.

Third, the program faces cash flow problems in the near future. These developed because of the fact that CPI adjusted benefits increased more rapidly than wages.

Fourth, because of demographic trends discussed above, long-term financing problems are expected.

Significant changes will have to be made to assure the long-term financial viability of the program. The Business Roundtable recommends that legislation be enacted now to place the program on a financially sound basis for both the short- and long-term. This type of legislation is needed to restore public confidence vital to the continued support of the program. Both the Carter Commission and the National Commission have recommended actions that the Roundtable supports. For example:

Interfund borrowing has been proposed by both Commissions as a solution to substantially alleviate short-term financing problems. We agree that this should be done.

The National Commission recommended that benefit increases be limited to wage increases when wages do not increase as rapidly as prices. We support this modification in indexing without qualification and without special companion adjustments. If this had been enacted in the 1977 Amendments the cash flow problems now being experienced would not have developed.

Both Commissions have recommended approaches to extend Social Security coverage to government workers who are not covered by the program through their government employment. We support this initiative.

Both Commissions support the retirement earnings test. The National Commission supported it directly while the Carter Commission indirectly supported it by suggesting that it not be eliminated until Social Security benefits were made taxable. Again we support the retirement earnings test.

Most significantly, both Commissions recommended a gradual future increase in the age at which full Old-Age benefits would be received. The Roundtable recommends that this reform be adopted now so that by the year 2000 the retirement age will be 68. Such timing will give those affected adequate time to adjust their personal and financial planning.

Unfortunately, most of the publicity given to these reasonable Social Security recommendations has been given to the National Commission recommendation that one-half of the Hospital Insurance benefits be financed with general revenues. It is worth noting that this recommendation was adopted by a 5-to-4 vote.

We strongly recommend that Social Security benefits continue to be financed by equally shared payroll taxes. Payroll taxes are visible and offer a degree of fiscal discipline that has not characterized government programs during the past two decades.

General revenue financing would undermine the basic principle that benefits are paid as a matter of earned right rather than need, as typically required under programs financed by general revenues. General revenue financing would not reduce overall taxes since benefit commitments must ultimately be met. Ultimately, new taxes or an increase in existing income tax rates would be required to raise the necessary revenues.

It should be noted that the Carter Commission opposed general revenue financing and supported equally shared payroll taxes as the means to finance Social Security.

## **Conclusion**

A strong and productive economy is the fundamental base of our retirement income programs. Those programs should be designed and financed to strengthen the economy. Public policy should encourage the voluntary expansion of private pension plans and individual savings as they offer means to improve the productivity of the economy and to recognize the diverse needs of Americans. In addition, significant legislation should be enacted to assure the continued financial viability of the Social Security program.

# Retirement Income, the Budget and Small Business: Conflict or Harmony?

Senator Slade Gorton

## Introduction

The United States faces many challenges in the '80s. Among the most severe is the provision of income security for a growing elderly population. Maintaining a balance between meeting wants and needs on the one hand and affordability criteria on the other will not be easy. Retirement income issues are inseparable from an overall consideration of the economy and the strength of American business—especially small business. What can the nation afford to spend on retirement income? What can business provide? What can the government provide? What can the individual provide? Most important, what level of activity in each area can the economy support without adverse consequences?

The economy was the key to the results of the 1980 Presidential and Congressional elections. Double-digit inflation and soaring interest rates have caused large corporations, small businesses, families and individuals to step back and reevaluate their economic planning. The cost of maintaining a business and the cost of living have reached rates unequalled by any other period in the last 60 years. The Reagan Administration and the 97th Congress are currently charting a new course for the federal budget in hopes that a projected total national debt of one trillion dollars can be brought under control. The sins of budgets past—increased deficits, rising taxes and the slow-to-improve Gross National Product—must give way to stringent evaluation and reform. The pressures to produce working remedies are intense. The remedies *must* be found or retirement income will become a very secondary issue.

## Retirement Income

The time has come for a revitalization of our economy, a reduction in federal regulations, and an increase in incentives to encourage individuals and businesses to participate more fully in planning for retirement futures. Inflation needs to be controlled and reduced. Productivity must be raised. Unemployment must be lessened.

Due to their claim on the federal budget, income security programs are at the heart of any effort to control federal spending. Pursuant to the current budget for fiscal year 1981, an estimated \$219.9 billion will go to income security programs; \$137 billion of which is allocated to Social Security, \$9.6 billion to food stamps and \$18.7 billion to unemployment compensation.

While working to preserve the "safety net" that income security programs provide, efficiencies must be sought. The process has begun, with the Reagan Administration proposals, to cut an initial \$5.9 billion from these programs. Social Security is already confronted with potential bankruptcy unless the Federal Government finds additional sources of funding, or reduces benefits further. Depending on economic developments, the retirement and disability trust funds may be as much as \$71 billion short through 1990 if decisive action is not taken. The deficit could balloon to as much as 14.2 percent of taxable payroll from 2030 to 2054. Changing demographics place added pressures on tax rates as a smaller number of workers support a larger number of retirees from the baby-boom generation of the 1950s. By 2030 the number of workers for each beneficiary—currently 3.3—could drop by more than one-half, to 1.5. There are short-term proposals that can help the situation: one, to include new federal workers in the Social Security system; and two, to provide current beneficiaries with an annual cost-of-living increase based on the rise in either prices or wages, whichever is lower. (Currently, the adjustment is tied to the Consumer Price Index.) Should inflation not be brought under control, absolute reductions in indexing, however undesirable, may be essential.

Other income transfer budget issues subject to future debate include the status of minimum benefits, death benefits and student benefits. The Administration proposes to eliminate the Social Security minimum benefit and payments to adult students—a potential savings of \$1.7 billion. Medicaid spending will also be controlled with reductions up to \$1 billion, bringing its current \$15.5 billion budget to \$14.5 billion. These reductions will only represent a beginning if the economy is not revitalized.

### **Small Business and the Economy**

Private pension funds and individual savings, ravaged by inflation's insatiable appetite, are also damaged by our current economic situation. While every individual American and every business is affected, the impact on small business is particularly harsh. Rising

Social Security payroll taxes adversely affect small business. Employers have historically made up for payroll tax increases by charging consumers higher prices, suffering reduced profits, giving fewer and lower pay raises, eliminating certain employee benefits, or by avoiding the addition of new benefits. Couple this payroll tax effect with inflation, higher labor costs and lower productivity gains and the result could be devastating to the survival of small business and its competitive position. Any other mandated cost increases could have the same effect.

Small business' role in the total economic scheme is significant. Small business helps to achieve a desirable competitive balance as there is less for it to protect and more room for innovation. The National Science Foundation found that between 1953 and 1973, small firms produced 23 times as many innovations per research dollar as large firms. It is small business which prods the "giants" in terms of technological innovation, marketing initiatives and price competition. Desirable qualities of small business are its high degree of personalization, and its adaptation to innovation with little protection of the status quo. Mobilizing the capital necessary to create a small business and to sustain its growth, however, is a challenge of the greatest difficulty.

Small companies, employing one to twenty persons, provide an estimated two-thirds of the total jobs generated in this country. Small firms, particularly the young ones, harbor a great reservoir of jobs and innovation; the key to the reindustrialization of the U.S. economy may be in them. Since 1974, nearly seven million Americans have become their own bosses. This surge in small business is partly the result of the entry into the work force of the independent minded "baby-boom" generation. Another factor has been the nation's shift from a manufacturing economy to a service-oriented one.

David Birch, of the Massachusetts Institute of Technology, examined 5.6 million businesses which represent 80 percent of all private-sector employment. He found that firms with fewer than 250 workers provided 90 percent of the 6.8 million jobs created from 1969 to 1976. Companies with less than 20 employees accounted for two-thirds of new jobs and the majority of these jobs were in firms less than three years old.

### **Small Business and Retirement Income**

The role of small business as a provider of retirement income is growing steadily. The small-plan sector accounts for nearly 97 per-

cent of the total universe of private pension plans on a numerical basis, while accounting for only an estimated 11 percent of the total population of pension plan participants. The very small plans, which cover 10 or fewer participants, account for 69 percent of private pension plans, while only 1 percent cover 1,000 or more participants. Most private pension plans are single-employer sponsored—96 percent of all private plans. Ninety-four percent of all private plans are not collectively bargained.

The motivations of the small employer in establishing a pension plan generally encompass one or more of the following considerations: to increase employee productivity, to fulfill a social obligation in providing for the retirement needs of employees, to secure favorable tax advantages, and to satisfy the personal goals of top management. Almost 70 percent of prime age, full-time, private sector wage and salary workers participate in a pension plan.

The growth of private pension plans among small employers covering ten or fewer participants has risen dramatically. In recent years, the number of small defined benefit plans has increased by 78 percent and defined contribution plans have risen by 43 percent. Plans covering between ten and thirty participants have also increased: a 36 percent gain in defined benefit plans and a 111 percent gain in defined contribution plans. *These statistics indicate that small business represents the main opportunity for increasing the number of career workers who can participate in pension plans.*

#### *Administrative Restraints*

While there are many factors indicating a positive development of small business private pension plans, major impediments exist that stifle its growth. While net plan formation has been positive and can be expected to continue, it is held back by a number of conditions. The first is the impact of the Employee Retirement Income Security Act (ERISA). ERISA, implemented in 1974, is the most comprehensive piece of legislation to ever affect employee benefit plans. ERISA has a beneficial purpose, but it is in need of revision for small business. There is compelling reason to believe that ERISA may have significantly impacted the costs of establishing and operating a private pension plan. There is also a growing concern over the impact of ERISA on the administrative costs of small plans, as well as the effect of these costs on the future benefit levels, operation and growth of the private-plan sector.

The cost of designing and implementing a retirement plan and trust fund is virtually unaffected by the number of persons covered. The



cost of administering the plan, either insured or trustee, will reflect the size of the employee group to a large extent, but the per-capita cost for a small group will invariably be higher. The average cost to administer a small retirement plan (under 100 participants) rose by 72 percent between 1974 and 1976. The increased costs of establishing and maintaining a pension plan may lead to one or more of the following courses of action: to reduce the effective amount of employer contributions which are available for funding benefits; to cause sponsors of small plans to consider or effect a termination of their existing plans; or to have an adverse, long-term impact on the growth and formation of new pension plans. In many instances, a higher level of administrative costs may override the anticipated tax advantage associated with a given plan and hence reduce the incentive to continue the operation of an existing plan, or to create a new plan, particularly if other mechanisms are available for accomplishing the employer's objectives in a more cost efficient manner. To the extent that employer dollars available to devote to retirement income are eroded by excessive costs of establishing and administering a plan, the value of tax incentives is diminished for the small employee group.

### *Tax Incentives*

Tax incentives have usually encouraged the development of private retirement income programs. But, for the small employer, the incentive is not so clear. Small businesses generally have lower corporate income tax rates than larger businesses. Small businesses that earn less than \$100,000 have a marginal tax rate ranging between 17 percent and 40 percent. Large businesses are usually in the 46 percent marginal tax bracket, earning over \$100,000. For the firm that earns less than \$25,000, for example, each dollar of retirement income expense that is tax deductible would consist of only 17¢ savings in corporate income tax rates and an 83¢ reduction in net resources available to the organization.

Some suggest that tax incentives should include tax credits for small business contributions to qualified retirement income plans to mitigate adverse cost consequences. But in 1978, over 200,000 small businesses paid no taxes against which a credit could be applied. The IRS projects even greater numbers of small businesses paying no taxes for 1979 and 1980. The moral of this story is that the lower the corporate tax rate, the less important the tax advantage of offering retirement income benefits on a tax-deferred or tax-credit basis. Due

to the nature of small businesses, present tax incentives cannot be viewed as being strong incentives.

ERISA impacted most heavily on the start-up of new plans by small businesses. The Business Roundtable recently conducted a study of the cost of government regulations on private companies. It found that the incremental administrative costs of ERISA for the smallest employers were almost seven times greater than the incremental costs for the largest.

### **Priorities for the '80s**

The policies of the '80s must encourage small business plans to increase productivity without harming competition. More incentives need to be implemented. Serious consideration must be given to providing additional tax incentives attractive to the small employer, possibly making mandatory employee contributions to pension plans tax deductible, and increasing IRA and KEOGH limits.

The private sector can meet the retirement income challenge for career workers if given the opportunity.

First, we must bring the federal budget under control. Second, we must make the tax changes to rebuild the economy. Third, we must stabilize the Social Security system and many other income-transfer programs. Fourth, we must provide an environment in which small business can prosper—adding new jobs, improving productivity, enhancing competition, and continuing to create additional private retirement income programs. Fifth, we must reassess some of our basic assumptions in the retirement area which have long-term economic implications, including retirement ages and work opportunities for older Americans.

### **Conclusion**

The strength of the economy during the '80s will be a principal determinant of the future of employee benefits. Continued high inflation would jeopardize Social Security *and* private pensions. The fact that one system is automatically indexed and the other is not does not represent a statement of success and failure. Over the long-term, society cannot afford the luxury of full indexing if high rates of inflation persist.

Further, we must carefully assess how best to accommodate various segments of the population in providing retirement income. Only through such careful treatment can we develop the appropriate roles

for public programs versus private initiative. For example, a significant portion of the “working population” has a tenuous relationship with the work force. These persons are either very young, very old, or spend very little time with any one employer. Private pensions should not be expected to accommodate this group and should not be judged on a full work force basis. Public assistance programs and the redistributive components of Social Security are the vehicles meant to accommodate noncareer workers.

Provision for the aged population represents one of the nation’s great success stories. When all support is considered, 4 to 8 percent of the aged now live in poverty, a rate much lower than the total population. There is more to accomplish but we must not lose sight of our historical success!

The period ahead will hold the promise of challenge and change for the economy, small business and retirement income programs. They are intertwined and will rise or fall together, such that great care must be taken.

The combined effects of economic, political and population changes will not and cannot be ignored. America will remain a land in which promises are kept.

# **Pensions in the Economy: Resource Allocation, Output and Distribution**

Simon Rottenberg

## **Introduction**

Before the enactment of Social Security legislation and the spread of private pension plans, people provided for their old age either by (1) working into the very late years of their lives, (2) by setting aside funds during their working years that would sustain them in old age, (3) by being cared for by income transfers from within the family or (4) by being accepted into institutions for the care of the indigent aged.

Mandatory forced-savings arrangements, mandatory arrangements for the transfer of income from the working population to the retired population, the negotiation of collective bargaining agreements providing for the creation of pension programs, and the unilateral use by firms of prospective pension enticements with lagged vesting changed the whole complex of incentives and generated behavioral adjustments.

By and large, this paper will not be concerned with the ethical principles of compulsion to participate in pension arrangements, although that is a question that should be taken into account by policymakers. The paper will discuss the allocational consequences of pension policies with special reference to their labor-market effects and to their income and wealth distribution effects.

I do believe, however, that voluntary arrangements in which individuals freely choose how they will order their lives and distribute income and consumption over their lifetimes are much to be preferred to compulsory arrangements.

## **Compensation in Labor Markets**

Workers' time, skill and effort are exchanged or transacted in labor markets. Workers provide services and are given compensation in exchange that is composed of cash wages which are current claims on commodities, deferred claims on commodities, in-kind services such as health care, and amenities at work.

Employers are interested in paying least-cost total compensation to employees for given labor services. Employers will be interested

in the composition of the compensation package only insofar as the composition affects the package's total cost.

Workers are interested in maximizing total compensation packages. They are interested in the composition of the package only insofar as it affects the total package receipts for their services.

In competitive labor markets, the bids for and offers of labor services produce not only some equilibrium price for each class of labor services that clears the market; it produces, also, an equilibrium composite of compensation components.

The components of these packages are imperfect substitutes for one another and they are traded off against one another. If, other things being equal, one is caused to rise, another or others will fall.

Pension rights are one component of the wage-and-salary package. If pension rights are subsidized, they might rise without being accompanied by a decline in the size of some other package component; if, however, pension rights are mandated (and not subsidized) they will tend to be matched by a falling off in the size of other components.

A recently published monograph<sup>1</sup> treats the effects of legal minimum wages upon other components of the compensation package received by workers. That report states that a rise in the minimum wage can be expected to be offset by reduced fringe benefits and the deterioration of working conditions. That is to say, the legal specification of cash wage rates may leave the whole compensation package unaffected. Analogously, pension rights mandated by law can be expected to be offset by diminished cash wages (or diminished rates of rise in cash wages) or by deteriorating conditions of work. As in the case of minimum wages, the total compensation package is left unaffected. This expectation is confirmed by a recent empirical study of eighty-six city and county employers in Pennsylvania.<sup>2</sup> That study finds that the magnitude of the negative relationship between salaries and pension promises is close to unity; that is to say, an increase of a dollar in the capitalized value of a pension promise is associated with a decline of a dollar in the cash salary that is currently paid for labor services.

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<sup>1</sup>For a discussion of the theory and processes of trading off cash compensation payments, fringes, and conditions of work, see Walter J. Wessels, *Minimum Wages, Fringe Benefits, and Working Conditions* (Washington, D.C.: American Enterprise Institute, 1980).

<sup>2</sup>Robert Stewart Smith, "Pensions, Underfunding, and Salaries in the Public Sector," Conference Paper No. 100, duplicated (National Bureau of Economic Research: February 1981).

In competitive labor markets, labor is paid a wage that is equal to the value of its marginal product.

Let mandatory pensions now be introduced. The wage is now some aggregate of current and deferred payments. The deferred payments will be made far in the future for some. The present value of those payments requires discounting. If deferred payments were not uniform and universal, workers with strong preferences for the present over the future would sort themselves out among firms until they encountered a combination of present and future payments that was to their liking. Let deferred payments be uniform and universal, however, and sorting-out processes are forestalled. Then workers who prefer the present strongly can escape a dispreferred composition of compensation only by withdrawing from the labor market or, possibly, by withdrawing from wage- to self-employment if the uniform and universal deferral arrangement does not apply to self-employment or can be more easily avoided there. If coverage is complete and effective and there is no low-cost method of escape, workers who strongly prefer the present to the future must be paid a higher lifetime real wage to induce their participation in labor market activities.

Retirement income used to be provided principally by personal saving and intrafamily transfers. The system was socialized in the 1930s with the adoption of Social Security.

### **Labor Force Participation of the Elderly**

Michael Boskin has constructed a statement in summary form of the changes that have occurred in the American economy since the enactment of Social Security legislation in 1935 that have important effects for Social Security.<sup>3</sup>

“the continual growth in real per capita income; a rapid general growth in government, especially in income security programs; a sharp increase in the labor force participation of married women; an increase in marital instability; a trend toward earlier retirement; an increase in the life expectancy of the elderly; an enormous growth in private pensions; and a sharp decline in the birthrate.”

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<sup>3</sup>Michael J. Boskin, “Social Security: The Alternatives Before Us,” in *The Crisis in Social Security: Problems and Prospects*, ed. Michael J. Boskin (San Francisco: Institute for Contemporary Studies, 1977), p. 175 ff.

These ideas are further developed in Michael J. Boskin, “Social Security and the Economy,” in *The United States in the 1980s*, eds. Peter Duignan and Alvin Rabushka (Stanford: The Hoover Institution, 1980), p. 181 ff.

He reports that, in 1935, half of all men over 65 were in the labor force; that fraction is now only one in five. More now receive their first Social Security benefit payments at age 62 than at 65. Life expectancy of those who reach the age of 60 has increased by two years. The mean length of the period of retirement has been increased by one-third.

The lengthened period of retirement has not been accompanied by increased personal saving, according to Boskin, because increased taxation of income derived from capital and the expectation of receipt of Social Security benefits have both created disincentives for saving.

At the same time, there is a tendency for young people to stay in school longer than formerly. The length of working life has been shortened at both ends. Later entry into the labor force and the decline in the birthrate after the sharp increase in that rate immediately following World War II, which has greatly changed the age composition of the American population, have combined to put a greatly enlarged burden upon the working population for the care of the enlarged number and longer-surviving elderly population. That burden is especially evident in the Social Security case since a large fraction of benefits received by the retired are income transfers from the working population.

The output of the economy—measured Gross National Product—is partially determined by the fraction of the population that is employed in the production of goods and services.

The Social Security tax is levied only on income paid for personal service. It produces an incentive to engage in the consumption of leisure or to engage in nonmarket activities in which imputed income is earned.

Social Security benefits are reduced for those whose personal service earnings during retirement exceed some sum. This means that the tax on the earnings of employed older persons is very high. The system generates strong incentives for withdrawal of the elderly from the labor market.

The withdrawal of the elderly from work by early retirement will cause output to be lower than it would be if retirement were delayed.

The rise in Social Security benefits, the fact that those benefits are income tax free, and the fact that benefits are taxed at a high rate if earnings from work exceed some specified amount, encourages labor force withdrawal and the consumption of leisure.

This effect is magnified by the assumption of diminishing marginal utility of income. Increments of income produce successively less utility as income rises. As retirement benefits rise in magnitude, the

income increments that would be produced by continued working have less value as generators of utility. The price of leisure in retirement falls, therefore, as retirement benefits rise. More leisure will be consumed. The rate of labor force withdrawal by the elderly will rise and output of the economy will fall.

The Campbells, in a paper published in 1976,<sup>4</sup> discuss the divergent findings of employees of the Social Security Administration and of the academic economists on the effects on withdrawal of the elderly from the labor market of the receipt of Social Security benefits. The Social Security personnel, using interview techniques of discovery, find that withdrawal occurs because the elderly are "in bad health," or "they have difficulties finding a job," or "they have reached compulsory retiring ages," or "their jobs were eliminated," or "their businesses were doing poorly."

The research of the Social Security Administration staff is uninstructed by theory. It produced bad results that did not appropriately instruct policy.

The academic research on old-age insurance effects on labor force participation of the elderly was more soundly based. It examined the allocation of time between work and leisure as it would be affected by the availability of pension benefits during retirement periods. Theory tells us that if income is offered, if and only if one retires, an increment of retirement will occur at the margin. Beyond that, if one is told that there is a work-income test for receipt of pension benefits, the incentive to retire becomes stronger and the marginal response of withdrawal will be larger. The theoretical expectation is confirmed by experience. The Campbells report that between 1947 and 1974 the percentage of those over 65 who remained in the labor force fell from 48 to 22. This is not a surprising finding.

The Campbells' findings are confirmed by those of Michael Boskin.<sup>5</sup> He tells us in the summary abstract of his paper:

"One of the most striking features of the postwar U.S. economy has been the rapid decrease in the labor force participation of the elderly at a time when the health of this group has been improving. In spite of this, previous research, based on interviews with the retired population, usually concludes that poor health accounts for the overwhelming majority of retire-

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<sup>4</sup>Colin D. Campbell and Rosemary G. Campbell, "Conflicting Views on the Effect of Old-Age and Survivors Insurance on Retirement," in *Economic Inquiry*, vol. XIV, no. 3 (September 1976), p. 369 ff.

<sup>5</sup>Michael J. Boskin, "Social Security and Retirement Decisions," in *Economic Inquiry*, vol. XV, no. 1 (January 1977), p. 1 ff.



ments. This paper suggests that nothing could be further from the truth . . . We find that the two key policy parameters of the Social Security system—the income guarantee and the implicit tax on earnings—exert an enormous influence on retirement decisions . . . Our results suggest that a decrease in the implicit tax rate on earnings from one-half to one-third would reduce the annual probability of retirement by about fifty percent . . . The Social Security system has been the major factor in the explosion in earlier retirement.’’

The withdrawal of older persons from the labor force as a result of the combination of the availability of benefits during retirement and the application of the work earnings retirement test reduces the number of people engaged in the market production of measured output. The magnitude of the negative output effect of retirement-benefit-induced withdrawal is now small, but it will become significantly larger when the post-World War II generation reaches retirement age. If induced withdrawal persists then, and when it is combined with lower rates of capital formation generated by the transfer payment process of Social Security, the adverse output effects in the economy might be very substantial.

Many sources have recently suggested that Social Security and private pension plans be redesigned to give incentives for prolonging working life and postponing retirement. These changes have been suggested because the population of the United States is aging and the rate of the elderly to the younger working sector is rising and will continue to rise.

Prolonged work and postponed retirement will increase the economy’s output and relieve somewhat the mean burden on the young for the income transfers that permit the nonworking elderly to consume at some level. So would an increase in the quantity of capital use in combination with working labor for production. So would earlier entry into the labor force and into productive activity of young workers. And, so would the formation of larger amounts of human capital in the young by more intensive training of them.

It is not clear that postponed retirement is the best of all possible options. Policy affects the other options, too. Capital taxation policy affects the rate of capital formation; minimum wage policy that generates massive unemployment among the young and produces disincentives for their on-the-job training affects the rate and the quality of participation of the young in productive work; subsidies to higher educational institutions and to their students through grants and loan guarantee programs and the relative growth of heavily subsidized public higher education in the college and university community has grossly distended the academy, put large numbers in post-secondary

schooling who would be more socially productive elsewhere, and delayed entry into the labor force of the young.

These alternatives to raising the age for qualifying for pension benefits need to be more actively explored.

Taxes, including Social Security taxes, have incentive effects on the supply side of the labor market. Some econometric estimates have revealed that the labor force participation rates of adult males are not affected by tax rates. But labor force participation is not the whole story for the determination of labor supply. Is it possible that taxes affect other components of supply? Do they affect the length of the work week? The age of entry into the labor force? The age of exit? The intensity of effort at work? Occupational choice? The quantity of schooling and of on-the-job training? The mobility of labor? And does it affect the availability of women for work, many of whom are engaged in part-time offers of service, by affecting the number of weekly hours they spend at work?

These are questions that surely warrant investigation in the design of pension policy.

Conventional economic theory instructs us, of course, that a tax on work that is proportional to effort will change the relative prices of goods and leisure and generate a reallocation of time away from work that produces income and claims on goods and towards leisure. Taxes that are functions of income from work, as Social Security taxes are, create avoidance incentives. More work is needed to see whether experience is consistent with those implications of the theory.

### **The Incidence of the Cost of Pensions**

In the short run, a mandatory pensions policy will increase the cost of labor and will fall upon consumers and shareholders. It will affect the quantity of employment adversely and diminished employment will fall most heavily upon young workers, older workers, women workers, and, in general, upon the less skilled. It will also most heavily affect labor-intensive industries.

The long-run effect of mandatory pensions upon the cost of labor is less clear. Brittain<sup>6</sup> found in a study of payroll tax incidence paid by employers in a number of industries and a number of countries that “the hypothesis that in the aggregate the entire employer tax is

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<sup>6</sup>John A. Brittain, “The Incidence of Social Security Payroll Taxes,” in *American Economic Review*, vol. LXI, no. 1 (March 1971), p. 110 ff.

shifted to labor” is “strongly supported.” If this is true, the cost of labor to firms is left unaffected by pension payroll taxes. The level of employment and of unemployment is also unaffected, as is the allocation of resources among sectors and industries and the combination of inputs in production. But payroll taxes paid by the employer would then be neutral in these respects only with respect to decisions made by firms. The employment decision is, however, a joint decision. Workers selling their services and firms buying them jointly affect outcomes. If workers’ money earnings fall when prospective pension earning streams rise, workers might discover that they have a compensation package in which the components appear in a dispreferred compositional mix. The incentive structure confronting them will have changed and the decision to which they are led in the sale of their services may be altered.

Brittain, himself, acknowledges that “many other economists, Social Security specialists, employers, and labor unionists” hold an “agnostic view” that the whole Social Security tax falls upon labor. If they are right, the cost of labor is caused to rise by the payroll tax. It is no longer neutral in its effects upon decisions of firms and it has consequences upon variables in the economy that derive directly from firm behavior. In either case—whether the payroll tax is borne wholly by workers or, rather, is partially borne by employers—it has employment, allocational, and input combination effects in the economy.

A payroll tax is a tax on employment of labor; so is a mandated payroll “contribution.”

To the extent that the tax is borne by employers of labor, the price of labor will rise relative to the price of other inputs. Employers will be induced to choose input combinations that are less labor-intensive by substituting other inputs for labor. The payroll tax does not apply to the use of those other, substitute inputs.

To the extent that the tax incides upon employees, people will find a different relative price set confronting them in the choice of alternative uses of time. The price of leisure, schooling and other non-market activities which is mainly determined by earnings foregone when other activities are substituted for the sale of labor services in the labor market, will be lower. More time will be spent, in given periods, at substitute activities and less time will be spent at work in the market.

However the incidence of the tax on employment is distributed between buyers and sellers of labor services, there will be less employment.

## **Pension Rights and Risk**

Pension rights are risky. Because they are long-delayed before their receipt, especially for younger workers, there is less than complete certainty that benefit payouts will occur. They are risky, in addition, because some pension rights are underfunded. Workers with underfunded pension rights are compensated for their risk by larger current wage payments.<sup>7</sup>

Also, because they are delayed in their payment, pension rights have a present value, at the time that funds are contributed for their payment, that discounts at some rate the income stream during retirement of which the rights consist.

Workers differ from one another in the intensity of their aversion to risk and in the discount rates that express for them the painfulness of postponement.

Policy that requires pension rights of some magnitude—either in the form of specified earnings replacement rates or specified vesting terms—will disadvantage those workers with more intense aversion to risk or with high discount rates. Such workers would prefer to take their compensation in the form of larger and more certain claims upon current consumption and smaller and less certain claims on future consumption than policy might permit them to have.

This form of mandated dispreferred compensation package is more likely to occur in a universal system than in one in which variance is permitted. If the proportions of current and future claims on commodities in compensation packages is permitted to vary among firms, workers can search out those that conform to their own personal preference sets. If uniform pension standards are made universal among firms, a subset of workers having the properties described above will be made worse off for it.

## **Lagged Vesting**

Logue tells us<sup>8</sup> that the efficiency of worker performance can be expected to decline as Social Security benefits rise. This is because private pension benefits provide retirement income supplements above Social Security benefits. As Social Security benefits become

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<sup>7</sup>Robert Stewart Smith, *op. cit.*

<sup>8</sup>Dennis E. Logue, "How Social Security May Undermine the Private Industrial Pension System," in *Financing Social Security*, ed. Colin D. Campbell (Washington, D.C.: American Enterprise Institute, 1979), pp. 288-289.

higher, the value in utility of the private pension benefits become smaller; this follows from the assumption of diminishing marginal utility of income. Workers have smaller incentives, for private pension benefits of a given magnitude, to work efficiently and with care and prudence in order to avoid dismissal and, therefore, in order to acquire pension rights which do not vest shortly after initial employment with a firm. Alternatively, additional real resources must be employed to supervise and monitor the performance of such workers. Rising Social Security benefits, therefore, have some adverse effects upon the performance of the economy.

Personal labor services are inputs in the production of commodities and services. They have alternative uses in the economy, some of which are more highly valued than others. As with any input, the economy's output will be maximized, given its resource constraints, if labor services are put to their most highly valued uses. In principle, this occurs in competitive labor markets if there is active "bidding" for the services of labor and free and active response by workers to those bids.

This has been taken to mean that constraints on the movement of workers among employments have adverse output effects and that lagged vesting of pension rights—such as arrangements that require some years of service with a given firm before property rights in pension benefits come into existence—induce workers to remain in their current employments when alternative opportunities in which they would be more productive make themselves available.

The question of the lagged vesting effects on workers mobility must, however, be approached with some care.

The cost of moving is always a positive quantity. Apart from transport and search and negotiating costs, workers will often reject employment with higher earnings prospects because they are psychologically habituated to the state of the world they currently confront or because they find their current neighborhood comfortable or their children find the quality of instruction of a high standard in their current schools.

A utility- or welfare-maximizing community should surely have workers take variables such as these into account when they come to decide whether to stay or move to other employment.

Lagged vesting performs as an analogue variable. It reduces turnover rates.<sup>9</sup> Therefore, it diminishes recruitment and training costs

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<sup>9</sup>Olivia S. Mitchell, "Fringe Benefits and the Cost of Changing Jobs," Conference Paper No. 96, duplicated (National Bureau of Economic Research: February, 1981).

and tends to preserve the privacy of information that loses its value, if it is diffused. It gives employees an incentive to perform well so that they shall not be dismissed before the period which qualifies them for pension rights is completed. Therefore, it diminishes supervision and monitoring costs.

It may, indeed, be a common experience that the resource savings to society in recruitment, training, security, and supervision are of sufficiently large magnitude, relative to the losses that inhere in the failure of workers to remove to more productive employment, that it serves the social purpose to design constraints on movement and incentives to stay. It is not impossible that lagged vesting serves such a purpose; immediate vesting might generate a socially suboptimal quantity of movement.

### **Replacement Rates**

The higher the fraction that pension benefits are of earnings from work, if retirement is delayed, an approximate measure of which is the replacement rate ratio of benefits to earnings immediately prior to retirement, the larger is the incentive to withdraw from the labor force. The President's Commission on Pension Policy has recommended full replacement rates. One would expect higher rates of retirement as an outcome. It is true that the Commission also recommends delayed retirement. What we should see, as a combination of these two recommendations, if they are adopted into policy, is a large increase in disability claims. If pension benefits are larger but are to come later in life, claims of ill health and earlier qualification for benefits should burgeon.

A policy that seeks to achieve full replacement of preretirement income from all sources seems to be clearly excessive.

Bureau of Labor Statistics studies of "equivalent income scales" for families of different sizes and ages indicate that there is a 13.5 percent difference in the "needs" of couples age 55-64 and those 65 years or older. In addition, retired persons no longer find it necessary to continue retirement savings regimens.

Taking account of these differences and, as well, of the reduced federal and state income tax burden imposed upon retired persons, James Schulz has estimated the appropriate replacement rate to be about 65 to 70 percent of middle-income workers.<sup>10</sup> Omitting the

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<sup>10</sup>James H. Schulz, *The Economics of Aging*, 2nd ed. (Belmont, Calif.: Wadsworth Publishing Company, 1980), pp. 77-78.

reduced income tax variable for retired persons would cause these percentage numbers to rise somewhat, but they will still fall substantially short of 100 percent replacement of disposable income.

## **Retirement Income and Saving**

The expansion over time of Social Security, both in coverage and in the size of benefit payments, can be expected to have inhibited total private saving, either because payroll taxes reduced disposable income and, therefore, reduced both consumption and saving, or because Social Security, by providing prospective retirement income, increased the real wealth of households, and, therefore, increased current consumption from disposable income.

The Social Security system is both an implicit and an explicit substitute for private pensions. It is an implicit substitute in the sense that an expansion of Social Security benefits lowers the incentive for the provision of retirement income through private pensions. It is an explicit substitute in the sense that the two systems are integrated and rise in Social Security benefits triggers, in the pension plans of many companies, a reduction in private pension contributions and benefits. Formal integration intensifies the adverse effects of Social Security on saving and capital formation, where private plans are funded and Social Security operates on a pay-as-you-go arrangement.<sup>11</sup>

Social Security and private pensions are substitute strategies for arranging retirement income.

The "expansion" of Social Security by increasing benefits through indexing and increasing the maximum base income subject to Social Security taxes tends to reduce the provision of private pensions.

This adversely affects the rate of saving in the economy.

The existence of funding of private pension systems means that institutional saving replaces diminished saving by individuals in anticipation of retirement benefits. But Social Security is not funded; it operates on a pay-as-you-go basis. Thus reduced saving by individuals in anticipation of Social Security benefits is not compensated for by Social Security institutional saving.

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<sup>11</sup>On the integration of Social Security and private pensions, see Dennis E. Logue, "How Social Security May Undermine the Private Industrial Pension System," in *Financing Social Security*, ed. Colin D. Campbell (Washington, D.C.: American Enterprise Institute, 1979), p. 265 ff.

The community's saving rate is, therefore, reduced by the relative expansion of Social Security in the aggregate retirement income system.

Capital is accumulated at a lower rate. The productivity of the economy which is, in large measure, a function of the quantity of mechanical energy with which workers are combined in production, is lower than it would otherwise be. The reduced rate of growth of productivity, other things being equal, makes commodities and services produced in the American economy less successful in the market competition against products produced in other countries in both the United States domestic market and in the markets of other countries.

The question of the effect pension plans have on the nation's future supply of capital was examined by Munnell in a paper published in the *Journal of Political Economy* in 1976.<sup>12</sup>

She concluded that, for men age 45 to 59, private pension coverage discourages other forms of saving and so does Social Security. The examination of the saving behavior of people of that age class she thought important because that is the class for which saving for retirement is proportionally large. Therefore, "these should be the people whose saving behavior is more sensitive to pension coverage."

Since private pensions are usually funded, however, she found that diminished personal saving was swamped by enlarged funded institutional saving in this form. Private pension plans increased aggregate saving on net balance and contributed to the accumulation of capital. On the other hand, since Social Security is not funded, Social Security benefits diminished personal saving without the counteracting tendency of institutional saving. Social Security had a clearly negative effect on aggregate saving.

The rise in Social Security benefits in recent years has been very substantial. Munnell reports that from 1952 to 1976 Social Security benefits, as a percentage of earnings in the year before retirement, rose from 30 to 51 percent in retail trade, from 29 to 41 percent in service industry, from 22 to 40 percent in manufacturing and from 19 to 31 percent in the construction industry.<sup>13</sup>

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<sup>12</sup>Alicia H. Munnell, "Private Pensions and Savings: New Evidence," in *Journal of Political Economy*, vol. 84, no. 5 (October 1976), p. 1013 ff.

<sup>13</sup>Alicia H. Munnell, *The Future of Social Security* (Washington, D.C.: The Brookings Institute, 1977), p. 64.



She tells that there has been a “dramatic decline” in the proportion of all savings that is accounted for by private pension saving; that proportion was 30 percent in the 1960s and 22 percent in the 1970s.<sup>14</sup> It was a period, of course, in which there were large increases in Social Security benefits.

Martin Feldstein<sup>15</sup> developed, in a more complex and sophisticated form than Harrod, the implications of Roy Harrod’s life-cycle hypothesis that “Social Security, by providing income during retirement, reduces the amount of saving during the working years.” Social Security taxes reduce disposable income and, thus, both consumption and saving during working years. The prospect of Social Security benefits reduce personal saving yet further; Social Security substitutes for personal saving. Feldstein found empirically that the rate of personal saving was reduced by one-half as a consequence of Social Security. That is a large reduction that has serious implications for capital formation and the national product. Feldstein estimated that halving personal saving would reduce total private saving and the nation’s private capital stock by 38 percent. The output of the economy was diminished by 11 to 15 percent.

It is true, of course, that other estimators have found that Social Security has left personal saving unaffected and, therefore, the question is still unsettled. But Feldstein’s work has strong theoretical underpinnings and he has found consistency between the implications of theory and observed experience in the world. The fact that some have found opposite results do not constitute sufficient warrant for the cavalier rejection of possible adverse Social Security effects upon the formation of capital in the economy; the National Commission on Social Security does, however, offer cavalier rejection.

The saving rate in the United States is now, apparently, lower than that of other industrialized countries. If it were not for investment in the United States by foreigners, this would mean that the rate of capital accumulation in the United States would also be smaller than in other countries, with consequent relatively adverse effects upon productivity and economic output.

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<sup>14</sup>Alicia H. Munnell, “The Future of the U.S. Pension System,” in *Financing Social Security*, ed. Colin D. Campbell (Washington, D.C.: American Enterprise Institute, 1979), p. 264.

<sup>15</sup>Martin Feldstein, “Social Security, Induced Retirement, and Aggregate Capital Accumulation,” in *Journal of Political Economy*, vol. 82, no. 5 (September/October 1974), p. 805 ff.

The Social Security system seems to have been a significant factor in diminishing the American saving rate.

One way to correct for this effect has been suggested. This is to separate the minimum income support aspects of Social Security from its rhetorically, originally-intended purpose to provide for the compulsory purchase of annuities. That is to say, the two purposes might be separated. The provision of annuities might be funded, with options opened to workers as to the size of annuities which they desire to provide for themselves, perhaps subject to some minimum size constraint. The annuity to be received would be only that which worker contributions and interest earned on those contributions will buy. It is estimated that average benefit receipts of retirees under Social Security now are five times their contributions plus interest; the current system is in no sense a social insurance program based on entitlements. Accompanying the size-of-annuity option would be open competition among annuity providers of the sale of annuity rights and freedom of workers to choose among bidders. They would not be compelled to buy from a nationalized system. Workers could extract market rates of return on their annuity investment rather than being compelled to accept the rate of return offered by the nationalized system. The other purpose—income support—is in the nature of a welfare arrangement. It should be financed from the general revenues, as, indeed, supplemental security income is now financed.

If Social Security were transformed in this way to a genuine entitlement program, people who did not need supplementary assistance would receive in annuities only what they paid for.

Those who needed supplementary assistance would receive it from the general revenues, but only if need were exhibited.

Currently, of course, need is not examined when Social Security benefit payments are made in excess of those that have been truly “purchased” by payroll tax contributions. The result is that income transfers are sometimes made from the population that is currently employed to retirees who are substantially better off than they are.

### **Social Security and Output**

Martin Feldstein<sup>16</sup> has constructed some interesting estimates of the adverse effects upon the output of the economy because Social Security operates as a pay-as-you-go system.

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<sup>16</sup>Martin Feldstein, “Social Security,” in *The Crisis in Social Security* (San Francisco: Institute for Contemporary Studies, 1977), p. 17 ff.

The Social Security claim on benefits is part of household wealth. That claim reduces the private accumulation of wealth to provide for retirement years. Feldstein estimates the private wealth reduction induced by Social Security entitlement at 40 percent. As a result less capital is accumulated. That reduces output. For 1975, he estimates that the output of the economy is diminished by about 30 percent of total consumer spending. The reduction occurs because a Social Security program with a low implicit yield is substituted for additions to the stock of the country's plant and equipment on which the yield would be much larger.

The redistribution processes that inhere in Social Security, mainly from younger workers to elderly retirees, thus has the unintended effect of greatly reducing output and income for the aggregate population of the country and, therefore, it tends to intensify poverty.

### **Distribution Effects of Social Security**

Social Security payroll taxes are imposed on earnings from rendering labor services up to a ceiling, but not on earnings beyond that ceiling. There are no exemptions or deductions from earnings in computing tax liability. That part of the tax contribution nominally paid by employers actually incides upon workers. On its face, the system appears to be regressive. But Boskin reminds us,<sup>17</sup> one must also look at the benefit side of Social Security to determine its complete distribution effects. Benefits are not paid proportionally to earnings and "the benefit formula is heavily weighted toward low-income workers." Also, as a pay-as-you-go and unfunded plan, the system provides for intergenerational transfers in which working younger people are taxed to provide benefits for older retired people. Since real per-capita income rises at a rate of about 2.5 percent per annum, these transfers imply that a relatively better-off generation is providing the means of subsistence for a relatively worse-off generation. On balance, the whole system appears to be very progressive.

Social Security implies the transfer of commodities from the working population to the retired population. Income is transferred from the one to the other. The burden of this transfer on working people is partially dependent upon the demographic composition of the

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<sup>17</sup>Michael J. Boskin, "Social Security and the Economy," in *The United States in the 1980s*, eds. Peter Duignan and Alvin Rabushka (Stanford: The Hoover Institution, 1980), p. 181 ff.

country's population. It is reported that there are now 3.25 working people for each retired person; when the post-World War II generation reaches retirement age, there will be only 2 working people for each retired person. The burden upon workers will then be enormously larger than it is now; if the current relationship of benefits to wages persists until then, workers will be giving up some 20 percent of their income to maintain the retired population.

Compounding the demographic change is the increased duration of the period of retirement. This occurs partly because people have been retiring earlier and partly because elderly people live longer than they used to.

"The replacement of preretirement disposable income from all sources" that is recommended by the President's Commission on Pension Policy would likely have the effect of significantly enlarging the burden borne by the young for the maintenance of the elderly. The redistributive consequences of that goal, advantaging the older population at the expense of the young, appears to be of sufficient magnitude to raise serious questions about its warrant.

The work earnings retirement test of Social Security has redistribution effects that are regressive. Earnings from other sources such as rents, dividends, and interests are not implicitly taxed by the system; earnings from work are taxed. Those who have invested in physical assets are not taxed; those who have invested in human capital are taxed. The assets of the poor are proportionally heavily composed of human capital; the assets of the well-to-do are proportionally much more heavily composed of physical assets and claims on physical capital. The system, therefore, tends to implicitly tax the poor and leave the rich untouched. This implicit marginal tax rate on the poor is, of course, very high.

The reduction in the country's capital stock as a result of Social Security, on Feldstein's estimate, alters the relative scarcities of factors of production. Capital is made relatively more scarce and labor is made relatively more abundant. The rate of return on capital would be expected to rise and the real wage of labor would fall.

These effects would tend to be counteracted by increased and earlier retirement induced by Social Security, but Feldstein estimates the magnitudes of this adjustment to be small.

On net balance, on this analysis, Social Security redistributes income from owners of labor services to owners of capital.

Replacement rates that currently prevail provide less income during retirement years than that received just prior to retirement and, it is likely, less than the income that would be received if retirement

had been postponed for some years. By inducing earlier retirement than would otherwise occur Social Security tended to reduce the measured income and consumption of the elderly. When one adjusts for the utility value of leisure and the disutility value of work it is clear that the elderly who retired earlier were made better off by the decision. If this were not so they would presumptively have gone on working and would not have opted for earlier retirement.

### **Lifetime Consumption Patterns**

It is common experience for individuals and households to distribute their earnings over the lifetime so that consumption rises gradually. The usual lifetime pattern of earnings is much less gradual. Earnings rise sharply early in life and decline sharply late in life, with gradual rising occurring on a kind of plateau in the middle years. A fairly constant rate of growth in consumption is made to be consistent with less gradual changes in earnings by dissaving in the earlier and later years and saving in the middle years.

This appears to be the preferred arrangement since it is observed that many organize their lifetime consumption patterns in this way.

A mandated universal pension system would require people to alter this arrangement. On top of Social Security prescriptions that specify how much of current earnings of those who are working shall be set aside for the support of those who are retired, people will then also be required to set aside some incremental fraction of their early earnings to provide retirement income for themselves. That increment, since it would exist only because it is coercively mandated by government, is presumably one that many people disprefer. A mandated universal system thus would lead to a diminution of welfare for many. Young workers would be required to dissave less than their own perception instructs them would maximize welfare for them over their lifetimes.

To the extent that policy intervenes by either compelling or encouraging behavior to affect the distribution of income over the lifetime of individuals, as by causing less to be consumed early so that there might be more later, it ought to be designed to avoid draconian outcomes. If some people, but only some, do not of their own accord, set aside earnings to provide for their sustenance when they are old, is it not inappropriate to set standards that are applied to all people, that govern the lifetime distribution of income?

Given the diversity of preference sets among individuals in the distribution of income and consumption over their lives, social utility

is much more likely to be served by voluntary, rather than mandated, systems, and by pension offerings characterized by diversity in their contribution payout, vesting, and yield, adjusted for risk, properties, rather than by universal and uniform systems.

The freedom to choose and the availability of a large opportunity set of pension alternatives from among which choice is made are qualities that should not be underestimated in their service to social welfare.

Since they differ from one another, it is to be preferred that individuals and households decide how their incomes and consumption shall be distributed over their lifetimes, rather than having time-patterns ordered by the public authorities. This is especially true if the state employs instruments of compulsion to impose its will. Voluntarism is surely to be preferred to coercion. The recommendations of the President's Commission on Pension Policy of retirement income goals and of a minimum universal pension system that shall be required at some minimum standard for all employers (and, therefore, all employees) are not, of course, consistent with those principles.

## **Conclusion**

What is wanted is the systematic design of policy that will denationalize the retirement income system to open diverse sets of alternatives, will permit individuals and households to order their own affairs, will permit them freedom of choice among alternatives, will provide a set of annuity options that are funded and actuarially sound, will provide income transfers to those who are genuinely in need from diverse sources, including intrafamily transfers, private philanthropy and, to the extent that this comes from public sources, will come from the general revenues, and will avoid disincentives to work, to acquire skill, and to provide for their own needs.

The Commissions that have recently reported on pension policy and Social Security seem not to have been instructed by these salutary principles.

## Forum Discussion

### Benefit Adequacy

MR. SCHULZ: My comment relates to assessing the adequacy of Social Security benefits, particularly with regard to low- and middle-income workers. We have to be very cautious in using the concept of replacement rates and make sure we understand the meaning of the concept. I'm as guilty of this as anybody else.

We banter replacement rate numbers around and then try to draw very important policy implications. In the Business Roundtable report there is the implication that for low- and middle-income people, the Social Security replacement rate is high enough to do a relatively good job of maintaining the standard of living of people when they go into old age.

You mentioned in your remarks (Mr. Beck) that the Social Security replacement rate for a low-income couple is greater than 100 percent, and the report states that for middle-income workers there is about 90 percent replacement. I think these are probably inaccurate.

MR. BECK: They're not.

MR. SCHULZ: I don't agree with either replacement rate for a variety of reasons, but I'd have to see all the assumptions under which they were calculated. I think the one thing we would agree on is that the replacement rate was calculated to be greater than 100 percent for a one-earner family and does not take into account families where both the man and the wife are working. Therefore, total family income is greater than the husband's or the wife's alone. That is not an insignificant qualification. We know that among low-income families, the norm is dual-worker families. To correctly convey the adequacy of Social Security we should look at dual-earner families rather than single-earner families. It's a technical point. I'm not sure I agree with the replacement rate approach even given that qualification. I'm just saying that there is another replacement rate that's relevant for a very large proportion of the lower-income earner families.

MR. BECK: I think that's a very legitimate point to make. All you have to do is change a few of your assumptions and you can throw all of the ratios out the window.

The American Council of Life Insurance made a very detailed study of this and we've used parts of it in making our presentation. I would agree that in the area of the two-earner family you get different numbers, but the low-income worker reaching age 65 has a replacement ratio of 75 percent in his or her own right. For a 65-year-old single-earner married person it's 105 percent. If someone made the exact average of the average single worker in the United States today and retired at age 65, the ratio is 66 percent, and with a spouse, it's 92.2 percent. It slides down very rapidly once you get up to the \$25,900 taxable wage base maximum.

MR. SIMMS: The replacement ratios that we are talking about here are the Social Security benefit compared with an individual's gross earnings. A more valid replacement ratio can be found if you examine spendable income before and after retirement. You get a different set of replacement ratios which, in general, will be higher because you have taxes on earnings while working plus work-related expenses.

Professor Schulz may claim that Mr. Beck's ratios are overstated. But if you use a spendable income replacement ratio you find that the ratios move up considerably at virtually all levels of earnings.

MR. BECK: I'd accept that, but our ratios were net earnings after all taxes.

MR. SEIDMAN: Before the large increase in Social Security benefits which occurred from the late sixties into the early seventies, the poverty ratio among the elderly was twice that of the total population. Whenever you see comparisons between what's happened to Social Security benefits as compared to increases in the cost-of-living during that period, bear that in mind. We ought to consider whether we want to go back to that situation or whether we want to have a situation in which the elderly are not required to drastically reduce their incomes when they retire.

I would remind you that the typical Social Security beneficiary today is an elderly woman who lives alone. The average benefit for that elderly woman is approximately \$310 a month.

I ask you to also look at the special problems of the group that is called the old-old and the frail elderly, the over-75 group. That's the fastest growing group among the elderly. They're not people for whom work incentives will mean anything at all. They have special needs which increase as they become older for cash income and for services. The disparity between men and women increases as that group becomes older.



MR. BECK: I'd like to speak to the broader point. We've scared the American public a lot about Social Security by talking about cutting benefits. No one has recommended significantly cutting benefits of those currently retired.

MR. SEIDMAN: Cutting the adjustment to inflation?

MR. BECK: When you're talking about cutting the adjustment for inflation from the CPI to wages, whichever is less, you're still talking about benefits that will increase, but not increase as much as they would under the present program.

When we talk about increasing the retirement age we propose grandfathering all people who are within twenty years of retirement. This does not increase the retirement age enough to bring it up to the equivalent of what it was in terms of longevity when Social Security started. It only brings it 60 percent of the way by the year 2000. We estimate that given the average longevity for adults in the United States the equivalent to 65 in 1937 will be age 70 by the year 2000. Raising the retirement age only recognizes some movement in that direction.

MR. KING: I'd like to suggest that one of the toughest jobs is determining what is an adequate replacement ratio. I would suggest that we might judge when replacement ratios are adequate by looking at the age at which people retire. We have found that people are beginning to retire at lower and lower ages.

I agree with Bert Seidman that we certainly need to look carefully at adequate replacement ratios for the old-old: those who are truly retired.

I think when we look at replacement ratios among lower paid people we find that they are high. As these persons get older and as their income becomes more adequate, they tend to retire earlier. I submit that an awful lot of low-income people who are drawing down Social Security are not totally retired.

We have a lot of things to look at that are very difficult to measure. We can't overlook them as we move into the future.

MR. MUELLER: I might call your attention to a brochure that was passed out to all the participants. It says *The Coming Revolution in Social Security*. I'm not here to promote Haeworth Robertson's book. I'm not exactly sure what he means by the coming revolution, but we've certainly had, if not a revolution, a tremendous evolution.

In most instances Social Security replacement rates have increased by a factor of 20, 30, 40 percent since the mid-sixties. For example,

in 1966, the replacement rate was about 42 percent for an average wage worker. Today, that replacement rate is 72 percent, 71 percent greater.

We also have to take savings into account and differential living expenses. When you do, for an average worker, that percentage is increased by 30 percent. If not a revolution, that's an evolution of major proportions.

MR. WOODRUFF: One of the issues that came up in discussion of the Commission's work points to the lack of understanding and knowledge about the likely income distribution impact of changes. Research at the Commission found the distributional questions to be among the most troublesome. There is a lack of good data and appropriate models.

EBRI could make a significant contribution by providing new data on the distribution of benefits, forfeiture of benefits, affordability questions and benefit design questions. These are areas in which good data is not available. You never can get the best information and data from public surveys.

No matter how good a model someone develops, we're all constrained by data. That's an area in which EBRI could make a unique contribution.

## Capital Formation and Savings

MR. GREENOUGH: The question of capital formation bothers me a good deal. There seem to be many government officials and academic economists who believe that unless the data are absolutely conclusive that every pension plan contribution dollar is a net addition to savings, then it isn't and it's bad.

The tentative conclusions of Mordecai Kurz' savings study for the PCPP showed a net addition to savings of about 86 or 87 percent: a pension plan provides net new savings that are very, very high.

I suspect the burden of proof should be on the foot of those who question whether savings, pensions and capital formation do anything other than cause a different kind of transfer payment during retirement.

MR. PAUL: Do you want to respond to that, Bruno?

MR. STEIN: I haven't seen the Kurz paper so I can't comment on that directly. Munnell some years ago showed that the rise of pension plans meant a net contribution to savings. That is principally during

the start-up phase. As the pension plans mature they reach the dissavings stage.

MR. WOODRUFF: This is not intended to be a point/counterpoint discussion. I primarily want to present a summary of the findings of two research reports that the Commission staff issued this week. They bear on the prepared papers for this meeting and on misconceptions about the Commission's findings and conclusions.

One of the papers was prepared for SRI, Inc., by Professor Mordecai Kurz of Stanford University. It assessed the effects of Social Security and pensions on individual savings behavior. The findings differ significantly from the findings of Martin Feldstein which were included in Dr. Rottenberg's paper.

Kurz found, somewhat in consensus with economists from the Social Security Administration, that up to about the age of 40, for individuals and families, Social Security seems to have a displacement effect on savings on the order of 10¢ for every dollar of Social Security wealth. After that age, the effect seems to be insignificant.

The other issue that he addressed was whether funded employee pension plan savings displaces individual and family savings. In terms of the macroeconomic effects of pension policy this is a very important issue. Many economists, many of whom don't appear to get beyond Econ 101, continue to believe that all savings are equal and that if individuals are forced to participate in a retirement program, they would choose to cut back on their own personal savings.

Kurz finds that the exact opposite is true. Every dollar of pension wealth that families accrue tends to displace only about 10¢ of personal asset accumulation. In other words, for every dollar of pension wealth that people accumulate, about 90¢ of that is net new savings for the family. I think these are fairly dramatic findings.

*Editor's Note: Mr. Kurz has refined his work and has found that the highest private net new savings is 56¢ for married couples. The effect varies dramatically for alternative demographic groups.*

Kurz concluded in his analysis that people seem to view pension savings very differently than they view other savings. I believe it affects the potential impact of both this Commission's and other groups proposals to increase retirement savings on capital formation and has implications for much of the literature on the labor force participation rate of older workers.

Many economists believe that if you make people more wealthy through pension plans they will leave the labor force believing that all wealth is equal. Again, I think that these findings have implications for that research and should be looked at very carefully.

Kurz also concluded that the life cycle hypothesis that is referred to by most economists almost as a religious term doesn't appear to hold up when you look at the asset accumulation of families. To fully understand the asset accumulation and savings behavior of families, we need to understand intergenerational transfer issues much more clearly.

We found that people over the age of 75 still had significant asset holdings compared to those at earlier ages. I believe that simplistic models and analysis based on the so-called life cycle model of savings and consumption probably won't get us very far in understanding the effects of pension and retirement policy on savings behavior.

The other paper that we've just issued is a paper that I prepared along with consultants from ICF, Incorporated, on the macroeconomic effects of the major recommendations of the Commission.

We incorporated voluntary savings proposals and tax reduction proposals. We incorporated the mandatory pension proposal, as well as the Commission's retirement age recommendations.

The findings were somewhat surprising to us in terms of the order of magnitude of the impact of just these changes on such macroeconomic variables as savings, investment, GNP, consumption and other variables relating to labor market conditions.

We found that some of the Commission's proposals would add about \$20 billion in new savings to the economy by 1985 in 1981 dollars.

We were surprised, for instance, to learn that the total effect by the turn of the century was estimated to increase GNP somewhere between 5 and 8 percent. This seems to be a very large effect for what appear to be fairly small retirement income policy changes.

What the Commission has proposed actually makes a lot of sense as economic policy as well as retirement income policy. We essentially have combined tax cut proposals with the compulsory savings proposal and a delay of the retirement decision in the population.

We also ran the simulations separately for each proposal and found that the combination of the Commission's proposals had a more significant so-called supply side effect on the economy than tax cuts alone.

One *caveat* then on the critiques of the Commission's report: it's very difficult to pull people out of a practice where we're all used to looking at one proposal at a time from the perspective of our own disciplines. Relative to the prepared papers for this meeting I would complain that they don't look at the combined effects of many of

these proposals, even though the processing of all of these proposals through Congress would inevitably be piecemeal.

That's the nature of the business, unfortunately.

MR. LENKOWSKY: I just wanted to ask Mr. Woodruff to clarify a point with regard to the macroeconomic impact. Did you compare alternate economic programs? For example, a general across-the-board tax cut as compared to the Commission recommendations?

MR. WOODRUFF: No, we did not. There could be different effects on savings and investment if you targeted other tax cuts than we did in this model.

### **Corporate Response to Retirement Income Policy**

MR. RYAN: My brief commentary will deal principally with how the private sector will react to inflation, revitalization of our industrial community given adverse demographics and changing attitudes of the work force with regard to work.

The theme is that there is a need to modify a growing philosophy of entitlement to an enhanced philosophy of self-reliance in relation to income in retirement.

In the context of today's discussion, should the individual attempt to provide more for himself through personal savings or should people primarily rely on Social Security, MUPS and other mandatory programs?

Of the concerns that we as individuals in the private pension community have, probably the biggest problem is that of inflation. Inflation, to the extent that no compensation is provided for it, will reduce income levels.

I'd like to give you an example of what one plan actually has done in relation to providing for inflation. I'd like to go back to 1970 and give you the numbers in relation to a typical GM worker retiring at age 65 that year. He would have received just ten short years ago \$189.80 from Social Security and a GM pension of \$168, for a total of \$357.80. In the period since he retired, the CPI has gone up 137 percent. His retirement income has gone up 131.9 percent. Taking into consideration the total increase in the CPI, this individual who retired with thirty years of service in 1970, has almost precisely kept pace with the inflation that otherwise would have withered away his income.

Now he's done that at a substantial increase in Social Security costs. He's also done that at a substantial increase in contributions received from General Motors. In any event, he has not retired into obscurity and he has not retired into the poorhouse.

For GM employees who retired earlier than 1970 increases of Social Security and GM plan benefits substantially outpaced increases in the CPI. If we look at those who have retired since 1970, they have not kept pace with a full increase in the CPI.

Widespread automatic indexation of private-sector plans is unlikely. Pressures for "social investing" are likely to increase over the years. Social investing is somewhat new to many of us. It may have come principally from the *North Will Rise Again*. In the period since that book, principal unions in several national negotiations in the United States have taken a position in bargaining that there should be added employer concern with "social investing." In certain of these cases, they have asked that the union be granted the right to dictate to the pension trustees the particular stocks of an individual company or companies which should not be invested in.

Because of demographics firms may need to, at least in marginal businesses, be concerned with employing our workers far beyond their average retirement ages of today.

For example, in General Motors over the last several years, the average age of retirement has been under age 60. There was expressed to us a number of years ago, by Howard Young and his associates, a philosophy called phased retirement. Individuals, as they advance in age, would spend several months in retirement, working only eight or ten months in a year. In subsequent years they would spend longer and longer periods in retirement. It's possible that we may need to adopt something like that in order to have sufficient workers to man available jobs.

As increases in retirement income are provided to an ever-growing retiree group by a smaller and smaller worker group, so to speak, it's possible that it will be necessary to shift a part of the actual cost from those who are working to those who are retiring.

For example, in 1976, there was a provision in our contract with the UAW whereby after the Chrysler agreement had been in effect for three years and could not be reopened, those who were working contributed to a fund to provide a lump-sum, one-time payment to those who are retired.

Again, in our negotiations in 1979 when the contract for pensions was opened, because of the magnitude of the increases provided to those who were retired and those who were yet to retire, the agree-

ment provided for an offset of the cost-of-living whereby the working group shares with those who are retired a part of its ongoing increases in income.

We should be allowed to individually, based on our corporate philosophy and our corporate income, provide the plans that we as individual companies see fit to provide, subject to the process of negotiation with principal unions representing our employees.

### **ERISA and Private Retirement Income Provision**

MS. NOBBE-ASHER: When ERISA was enacted in 1974 what effect did it have on small pension plans? I'm asking this in reference to the government party line which has been that it had a very minimal effect and that it did not really put many small pension plans out of business.

MR. PAUL: Bob Nagle, do you want to comment on that?

MR. NAGLE: Our experience at PBGC was that within the first two years after ERISA was enacted there was a substantially higher rate of plan terminations than occurred prior to ERISA or since then. I think in many cases that was attributable to terminations of plans that did not want to amend to meet ERISA requirements.

MR. BECK: Could you repeat the last part? We couldn't hear that.

MR. NAGLE: Yes, I think our analysis suggested that the higher number of terminations we saw in the first couple of years after ERISA was passed was primarily due to employers being unwilling to amend the plans to comply with the higher vesting and other standards that ERISA imposed. After the first couple of years, the number of terminations seems to have dropped off and has now leveled off.

SENATOR GORTON: I have received a surprisingly high number of complaints from small business constituents about high administrative costs and about great difficulty in competing with other similarly situated small businesses which do not provide such plans.

MR. BECK: Our own company experience would parallel the point that the Senator raised. Even though we heard some of the points about vesting contributing to the decision, there were more small employers that specifically mentioned the cost of administration and that it wasn't worth it to them to continue to plan. They decided to

take out an IRA for themselves and let the rest of it go, and that's unfortunate. I think we do need specific relief in terms of administration for small plans.

MR. HURD: In addition to the two factors identified, a highly significant one was the enactment of a plan termination insurance program. The great bulk of plans that have terminated have been defined benefit plans which have been affected by plan termination insurance. There still is a tendency for smaller business to adopt defined contribution programs instead of defined benefit plans because of ERISA.

MR. SEIDMAN: I want to comment on what can be done about the future, specifically the proposal that was in the Williams/Javits Bill in the last Congress which dealt with the idea of developing a standard plan which would relieve administrative burdens for small plans. I'd be interested in reaction as to whether that's a promising approach.

SENATOR GORTON: Well, obviously anything that would ease administrative difficulties and expenses would be appropriate. I'm in no position to comment on that specific proposal about which I know nothing.

### **Retirement Ages and Patterns**

MS. BORZI: One comment that I heard recently regarding raising the retirement age was made by Congresswoman Mary Rose Oakar. She noted that raising the retirement age is somewhat short-sighted because it discriminates against men, since most men don't live to age 68.

Would you care to comment on that?

MR. STEIN: It does dreadful things to blacks since most blacks don't live as long as whites. It does things to smokers as well. There are any number of ways of reducing benefits. We can go from wage-indexing to price-indexing of the benefit computation formula if you prefer smaller checks for a longer period of time to larger checks for a shorter period of time.

MR. PAUL: It doesn't particularly change the proportion of lifetimes. Woman's lifetime still is X percentage more than man's whether you do it at 65, 70 or at 60. You don't really shift the bias one way or the other merely by changing the retirement age.



MR. AARON: Moving up the retirement age doesn't discriminate materially against blacks or other minorities, although life expectancy for blacks is less than that of whites, and for men, it's less than that of women. The life expectancy at age 65 for blacks and whites is quite similar. The issue includes much broader questions than the point made about men and women.

MR. SEIDMAN: There are a number of points I'd like to comment on.

I'm glad, first of all, that Bruno Stein stated it as it is: an increase in the retirement age is a cut in benefits. It's a cut in benefits for everybody and a denial of benefits for some.

Second, I think a lot of the talk about raising the retirement age is from the point of view of workers who really want to continue working. The people I talk to in the labor movement are people who have been working in physically demanding jobs all their lives. They are just waiting for age 62 when they can begin to collect Social Security benefits at reduced levels rather than go on working. Those are the people that we should be thinking about.

Third, while it is true that life expectancy is increasing, there has been no indication that the health of older people is improving. Life expectancy in and of itself is not a reason to raise the retirement age unless the people who are at those older ages are really able to work. If they're not able to work (but are not disabled), they will be denied all income or will have to depend on some kind of a means tested system. I don't think that workers who have never had to go on welfare all their lives should have to go on welfare when they retire.

MR. ROSS: I think you have to be precise about what you mean by retirement age. To me, the biggest political problem is not raising the 65 to 68, but raising the 62 to 65. Sixty-two has become the norm, not 65. The recent House bill raises the 65 to 68, but leaves the 62. This simply puts a deeper discount into the 62 retirement benefit. I find that kind of an adjustment to the retirement age very disturbing. If we continue to have a high early retirement rate with deeper discounts and lower benefits, then as people are in retirement longer increasing numbers of elderly will at some point have to shift onto SSI and welfare. If the goal is to move the normal retirement age up, we might concentrate on trying to restore 65 as the norm.

MR. KING: One suggestion made here was that we ought to raise the retirement age to 65 totally, rather than going to 68. I think that's an interesting idea. It follows my thesis that for many people retire-

ment income is perhaps more adequate than it should be if we are to solve our real problem of financing Social Security into the future.

MR. GWIRTZMAN: Howard Young's point about not providing for the baby boom doesn't bear up under analysis. We did provide for a baby boom that didn't come. We built hospitals which we're trying to find out how to use. We built schools which we're now having to close. We built a highway system based on estimates of 12, 14 and 16 million car sales a year. So, we did do that.

It's quite different with an increase in something as important as an increase in the retirement age. We have to admit that when we talk about 1 percent or 6 percent, we all know we don't know what we're talking about.

The advantage of raising the retirement age is that if the demographics work out in a more beneficial way we can always lower it.

MR. YOUNG: With regard to raising the retirement age, it seems to me there's an analogy here to the point that Bruno Stein made in his paper, which I thought was very well done. That is, funding makes sense if it enlarges the pie. To what extent would raising the retirement age enlarge the total amount of output in the economy, particularly expressed on a per-capita basis? Would we get enough additional output to justify the change?

MR. GWIRTZMAN: I don't think we can be sure that there is still a trend toward early retirement. If anything, the research that our Commission did indicated that there is the beginning of a turnaround on that. Earlier retirement was very heavy in the sixties and the early seventies. It was deliberately planned by some corporations to make way for the baby-boom workers. That was a good corporate strategy.

Now it's turning around because of inflation, longevity and because Congress has set a national policy in that respect by raising the mandatory retirement age to 70.

MS. WOLFSON: I think that we have to find ways to more effectively look ahead and to anticipate the extent to which we are going to see continuing changes in the directions that have already begun. Such expectations need to be taken into account in formulating public policy.

I have two questions of Professor Campbell (One, why are you so pessimistic about "raising the normal retirement age" having any effect;) and second, what specific changes would you suggest in terms of cutback of benefits in Social Security?

MR. CAMPBELL: There are quite a few problems related to raising the retirement age. For example, a lot of people may shift from old-age insurance to disability insurance. You don't know how many are going to just shift from one category to another. Raising the retirement age is just an offset for the increase in longevity. Therefore, it doesn't get at the problem of the decline in the birthrate. If the change is phased in very slowly it's quite possible that added longevity may absorb most of the impact so people will still receive benefits for the same length in time.

A proposal that deserves a lot more consideration is reindexing the taxable base over the work life.

### **Retirement Income Program Financing**

MR. AARON: The last two Social Security Advisory Councils (under Presidents Ford and Carter) recommended the financing of Medicare with general revenues. The political composition of those two advisory councils, however, was rather different. I think there's a strong appeal for this which was persuasive to both a relatively conservative and a relatively more liberal advisory council. The payroll tax taken by itself is not a terribly appealing tax. There is a strong appeal, however, for using the payroll tax to finance earnings-related benefits. There's a less persuasive case, I think, to be made for using the tax to finance benefits that are not earnings-related. The President's Commission reached the position that only part of the Medicare program should be payroll tax financed. That position was also embodied in suggestions recently put forward by Congressman Pickle. I can see an argument for using general revenues only for part of the Medicare system in order to preserve a sense of fiscal discipline that would come from retaining the payroll tax as a financing device for part of the cost. Bert Seidman has made the argument that it would also preserve the idea that the benefits were somehow an earned right. For these two reasons, keeping some payroll tax financing has appeal.

I would urge that the Business Roundtable think again about its opposition to this particular approach. I don't think there is a very compelling case for relying exclusively on payroll tax financing for this nonearnings related benefit, and I think we could improve the structure of our tax system by introducing general revenues.

MR. BECK: We considered this at great length before concluding that the position we took was the right one. We concluded that

shifting the tax burden to general revenues would not solve any of our problems. It would only magnify some of the difficulties that are present in the budget cost reductions now being considered by the Congress.

MR. SEIDMAN: I want to say one thing about the question of Social Security and general revenue. There's been a myth, and I can't call it anything but a myth, that if you have general revenue expenditures for a program as opposed to payroll tax expenditures, then somehow or other you're going to lose all fiscal discipline. This has never been true. All you have to do is to look at the present situation where the whole argument is about cutting down on general revenue expenditures. There's no reason to think that there is any more or less fiscal discipline with payroll taxes as compared with general revenues. You can make an argument one way or another on general revenues versus payroll taxes for other reasons, but certainly not on that basis.

MR. BECK: Well, I just don't agree. The evidence of the last twenty years suggests that people just have not been giving that same kind of discipline.

MR. SEIDMAN: Is that so? That's why we're spending so much more on AFDC as compared with Social Security?

MR. BECK: Well, I'm not talking about a specific program, but generally.

MR. SEIDMAN: That's what we're talking about. We're talking about programs which provide benefits for people.

MR. MUELLER: We're talking about another evolution or revolution of major proportions when we talk about cost increases into the future. Bob Beck said that Social Security payroll taxes may rise from 13 percent to 30 percent. These are the intermediate assumptions used by Social Security, by the way, folks. That's at a 4-percent average increase in the cost-of-living into the future. Assuming a 6-percent increase in the cost-of-living, the current actuarial deficit of 1.58 percent expands four times to more like 6 percent. When the demographics and the economics are put together, I think maybe Haeworth Robertson may be more on point.

If the economics and demographics prove to be different than the intermediate assumptions, we will have a major restructuring of society. I think we have to recognize that.

Now the solution being proposed today as in the Pickle bill is to finance the program through general revenues. But, we don't have

any general revenues. We just have general deficits, so we would fund Social Security through general deficits. So we would inordinately protect the retired segment of the society versus the working population. All workers do not have, as in some quarters, cost-of-living protection.

I also think that we are comparing the adequacy of Social Security and other retirement programs on the wrong basis. If you look at the individuals in society who did work and look at the benefits they're actually receiving versus their disposable income just before retirement, you find that Social Security has done quite a fine job. In fact, more than a fine job with today's replacement ratios in the 70-percent area.

I think Haeworth is probably correct. If there is not a revolution today to solve the problems we'll certainly have a changed society twenty or thirty years from now when 30 percent of everybody's paycheck is taken merely to maintain the Social Security benefit levels of today.

MR. SEIDMAN: There was a reference by Mr. Beck to what has been called the demographic challenge. You've all seen these numbers about what's going to happen to the ratio between retirees and active workers. I want to make the point that what we should be looking at is not the elderly dependency ratios but the total dependency ratio. If you look at the total dependency ratio which consists of retirees and children under the age of 18 you get a totally different picture in the early years of the twenty-first century.

Now, what is the significance of this? It does not mean that we will automatically be able to finance a decent level of Social Security benefits for retirees. This would only be achieved if we're prepared to develop mechanisms for transferring resources which, if there were more children, would be spent for children, to the retirees. This includes both the private and public resources that would have been spent for that larger number of children. I don't see any way of doing this except through the tax system and through using general revenues for Social Security. I can't imagine that we could do it in any other way, but it seems to me that we should look at this before we simply accept the idea that we have to lower benefits.

MR. STEIN: First, a relatively minor point. I have the impression from Senator Gorton's presentation that he assumes that the employer's share of Social Security tax is inevitably passed forward. The conventional wisdom in economics, and I'm not prepared to defend conventional wisdoms these days, is that it's passed backward

in the form of lower wages. My own feeling is that I don't quite know where it falls, but some of it is probably passed forward, and some is probably passed backward. In short, I don't think an argument can be made that rests entirely on the proposition that costs are exclusively passed forward.

SENATOR GORTON: As a matter of fact, I think I rather explicitly recognized exactly what you're saying.

MR. STEIN: Okay, I'm sorry if I misread you there. On the second issue, you put very high priority on bringing the federal budget under control. In that case, may I ask, Senator, whether you approve of the Kemp-Roth tax cuts?

SENATOR GORTON: I am not committed to the President's tax program without change. I have noted with interest the exchange with the previous speaker. I do, however, regard myself as committed to very substantial tax cuts, probably on the order of Kemp-Roth. I am not persuaded that Kemp-Roth is that particular form of tax cut best designed to induce a growth of productivity in the economy and my own support will focus in that direction.

MR. STEIN: I take it then that you believe that tax cuts will help to bring the budget under control. That's a point of disagreement I would have.

SENATOR GORTON: The problem that we face, it seems to me, is a very complicated one. If we had only inflation and not stagnation, we could concentrate only on the budget. But we have both, and it's a rather difficult challenge.

MR. STEIN: You've just hit my third point, so I'll pass.  
(Laughter)

MR. YOUNG: I also wanted to touch on the question of where the payroll tax ends up, because we just heard some startling figures. I think that the 30-percent figure is the pessimistic assumption. My understanding is that the intermediate assumption produces a total cost impact that's somewhere between 15 and 20 percent.

Now we can't have it both ways. We either have to assume that the employer pays the full share, which means you're talking about people contributing 10 percent of payroll in order to finance a retirement system that we would hope they have confidence in, or we have to believe that the money is shifted back. If people are putting aside 20 percent, then, in fact, their total compensation is 10 to 20 percent higher when we impute to them everything the employer spends for them which doesn't show up in the paycheck.

I don't know any worker who thinks he's contributing 12 percent to Social Security. I think that if you go out and talk to anybody on the street they will assume they're contributing whatever the employee rate is. So I think the question of when the burden is going to become crushing has to be put in perspective.

There have been some interesting figures published as to what the Social Security expenditures represent as a percent of Gross National Product. The GNP percentage doesn't go up anywhere near as fast as the payroll tax rates. I think that's a very telling comparison.

Finally, Bert Siedman raised the question of the total dependency ratio. There's another perspective that ought to be looked at in the total picture. I suspect that if we had continued high birthrates and didn't have this "demographic time bomb," instead of sitting around this table worrying about supporting elderly people, we'd be sitting around worrying about the population explosion.

It seems to me that we may have to view the cost of supporting a larger proportion of retirees as one of the offsets to the benefits of not having overpopulation. We have to put the whole thing together. I certainly don't see us facing a revolution, except one of confidence. I don't think that the worries people have about benefits being cut comes about for the man in the street from an analysis of the financial aspects of Social Security. I think it comes about from reading newspapers and statements of people who are advocating these changes, whether it be moving the retirement age back, changing the indexing, or in some other way cutting back benefits or restricting the growth of benefits in nominal terms, which means cutting them in real terms. I think high inflation has taught the average individual the difference between real and nominal.

SENATOR GORTON: I don't quarrel with anything you have said. One of the marvelous paradoxes of living in a civilized society is that the solution to one problem simply gives us the privilege of dealing with a number of problems which arise out of it. The failure to solve them makes us do over and over again what we failed to do before.

MR. AARON: Empirical research on who bears the payroll tax indicates that the full tax, whether it's levied on the employer or the employee, eventually is borne by the employee. Those results were sent to Milton Friedman who wrote back: "I'm glad you found those results. If you'd come up with anything else, I wouldn't have believed them." I think you can find general agreement that the burden of that tax ends up being borne almost entirely by workers.

Two comments on what Mr. Mueller said. First, Social Security is a very important and emotional question, making it doubly important to exercise some care that one is accurate when one uses statistics. The statistics that Mr. Mueller used were consistently wrong. The 30-percent number that he referred to was taken from the last trustees' report. It's the pessimistic assumption and those are very pessimistic assumptions, indeed.

We're raising taxes somewhat during the 1981-2010 period, and we will begin to accumulate reserves which we will need, indeed, for a later period. But, to hold out this imminent specter of financial catastrophe is misleading.

Second, I think it to be a common misperception that inflation is doing terrible damage to the Social Security system. What is doing damage to the system is the slowdown in productivity growth. That is the difference between the rate of increase in wages and the rate of increase in prices. If both wages and prices go up by the same number of percentage points, Social Security gains a little bit. The 2 percentage point increase in inflation that could produce the kind of effect that Mr. Mueller mentioned has to be one that is not accompanied by any change in the rate of increase in wages. That amounts to saying that we move into a protracted period where productivity declines. Output per worker goes down year after year and decade after decade. That is a problem, but beyond Social Security the nation would be in very deep trouble if that were true.

Let me suggest another way of looking at the nature of the Social Security problem. I agree with all of the speakers so far that it is serious and large and deserves immediate attention.

If we wanted to balance the Social Security system without cutting benefits (I am in favor of some reductions in benefits), it would take an increase in payroll taxes of a little over 1.5 percentage points for the next seventy-five years to put the system in balance (based upon intermediate assumptions). That comes out to less than 1 percentage point of Gross National Product. I don't think we ought to balance the system that way, but if we wanted to, that's how big a problem it is.

In the eight years between 1970 and 1978, government revenues as a percentage of Gross National Product in the United States went up 2 percentage points. Since 1978, revenue has gone up another 1 percent, a total of 3 percent in eleven years (total government revenues including federal, state and local). So in a period of eleven years, an adjustment has occurred more than three times as large as the size of the tax rate increase necessary to balance the Social Security system.



I'm not espousing a raise in taxes as the solution, but if we're talking about a deficit over a seventy-five-year period that could be solved by less than 1 percentage point of Gross National Product spread over that seventy-five-year period, I suggest that the rhetoric ought not to be apocalyptic. We ought to approach this as a big problem since 1 percentage point of the Gross National Product is a lot of money.

Let's put the system in balance, but let's not scare everybody to death.

SENATOR GORTON: I would like to point out in connection with what I thought were the very trenchant comments of Mr. Aaron, that an increase in the percentage of the Gross National Product taken in government revenues of 3 percent in eleven years is not in my view a particularly modest increase.

It's been accompanied by the longest double-digit inflation in the history of the country and with economic stagnation. I'm not here to state that there's a direct immediate cause and effect relationship between the two, but those who believe that they are unrelated have a rather heavy burden of proof.

One percent additional increase might be very modest to solve the problem of the Social Security system if that problem existed in the federal government in isolation. It doesn't. It is a major portion of the subject matter of this conference, but it is only one of thousands of competing demands on federal revenues.

MR. AARON: During the same period that government grew by 1.8 percent in the United States the fraction of government growth in other major developed countries, many of whom had much better economic performance than our own, were as follows: 8.8 percentage points in France, 9.7 percentage points in Germany and 9 percentage points in Japan.

I'm not suggesting that a growing public sector helps inflation or spurs economic growth, but I am suggesting that there are other factors at work which may be at least as important.

MR. SCHULZ: It was primarily state and local, not federal anyway, isn't that true?

MR. AARON: Primarily, yes.

MR. CAMPBELL: My comment is also about Henry Aaron's figure about the long-range deficit. I think your figures do not include hospital insurance. If you include hospital insurance you have about 4 percentage points. This makes it much more serious.

MR. SWENSON: I am Chairman of the American Academy of Actuaries' Social Insurance Committee and feel compelled to address the issue of long-range cost projections for Social Security.

First, once the baby-boom generation has fully retired, by the year 2030, the intermediate cost projections for Social Security indicate the payroll tax would be 25½ percent of payroll. The pessimistic assumptions lead to a cost estimate of 36½ percent of payroll. Many people, including myself, feel that the intermediate assumptions are quite optimistic. During his tenure with PCPP Tom Woodruff was quoted in *Fortune* as suggesting that they were overly optimistic as well, as does Haeworth Robertson in his recently published book.

Henry Aaron's point was that 1 percent of GNP would cover the deficit for the OASDI program. There's a very substantial deficit in the HI program that would remain uncovered.

MR. ROTTENBERG: I have a comment on something that Bert Seidman and Howard Young said about dependency ratios early in the twenty-first century. It is true that children and the retired elderly are consumers who do not produce. They are dependents of the working population. But, when children are provided for as dependents it is fundamentally an act of free choice on the part of parents who decide they will have children.

The Social Security program is not a free choice arrangement. Those who work and are covered are compelled to provide for the retired elderly. That is a fundamental difference.

MR. SEIDMAN: We have to decide whether we're a civilized society or we're not. If we have fewer children and other people who are clearly dependent, we're going to have to decide whether we're going to take care of this latter group. The rational and compassionate thing to do is to devote the resources that would have been used to raise children to support the elderly.

MR. ROTTENBERG: There are lots of social purposes which are involved. One is to provide for those who ought to be provided for, like children and the retired elderly. Another is to do it by methods of free choice by avoiding coercion as much as we possibly can. We have to think about multiple purposes.

We tried the totally voluntary way for a long, long time, and it didn't work. You have to have a basic compulsory social insurance program, and I wouldn't do away with ours.

MR. YOUNG: The issue that has been put on the table is that there is going to be an intergenerational conflict and breakdown because people will be unwilling to bear the burden of a 25 percent payroll

tax. The possibility of that kind of a conflict is a function of what people perceive as their burden. If people don't care because they never got the money in the first place then this conflict is unlikely. The extent to which active workers are reluctant to pay for retiree benefits will be a function of the payroll tax that they perceive, whether or not it is actually higher.

MR. ROTTENBERG: Yes, but surely you as a representative of workers want to have them fully and truthfully informed.

MR. YOUNG: Sure, and I'm also perfectly willing to say to them that I think it's money well spent, but that's their decision.

MR. CAVUTO: Professor, are you for or against mandatory private pensions?

MR. ROTTENBERG: I don't like mandatory arrangements and coercive arrangements. That doesn't give you an explicit answer to your question, but it spells out my general principle.

MR. YOUNG: You (Simon Rottenberg) don't even raise the possibility that workers may perceive the Social Security system as a good. You talk only about the tax as a burden and a reduction of income. Isn't it conceivable that there may be people who perceive this as a method of arranging for retirement that may not otherwise be available to them in an equivalent form?

The possibility ought to be raised that people are willing to pay for Social Security and may desire to engage in covered employment to have Social Security.

MR. ROTTENBERG: I think you're operating on the assumption that the working population of the United States is homogeneous. I don't believe that to be true. Even if some people prefer to be participants in compulsory systems, others may not.

MR. YOUNG: Some compulsory systems only work if they're compulsory for everybody.

MR. ROTTENBERG: If that's so, then you go in that direction as the last resort.

MR. GWIRTZMAN: I wonder if you could expand, Professor Rottenberg, on your statement that Social Security redistributes income from workers to the owners of capital. If you could prove that there might be quite a change in feelings in this room and elsewhere about Social Security. It's the first time I ever heard it.

MR. STEIN: It's in Feldstein's paper.

MR. ROTTENBERG: The intellectual defenses for it are in that paper.

MR. MILLER: Mr. Young seems to think that workers really won't mind paying an extra 1 or 2 percent of their income for Social Security. For people in my generation there are things we don't like about Social Security. The tax rates have gone up, but we aren't sure that the benefits are going to be there when we're ready to retire. Indeed, proposals to increase the normal retirement age from 65 to 68 are evidence that the benefits are not going to be there.

If we're going to have a mandatory Social Security program there should be a legal entitlement to what we donate.

MR. NAGLE: I agree.

MR. YOUNG: I don't think I disagree at all. I guess, because I'm opposed to raising the retirement age.

If you were assured that the benefits would be there, would you oppose paying the taxes?

MR. MILLER: I will never be against paying taxes towards something that I am assured will be there, but there's no assurance that Social Security is going to be there.

MR. YOUNG: Well, maybe there should be a legal assurance.

MR. MILLER: If there's an assurance, fine. I don't think you're going to have a problem.

MR. RYAN: How will you deliver that, Howard?

MR. YOUNG: You can sign anything, but signing and delivering may be greatly different. I guess people who invested in Pennsylvania Railroad thought they had an assurance too. What are you going to depend on?

MR. BODIE: I think there is a point to be clarified with regard to whether Social Security redistributes income away from workers towards the owners of capital. For people who are retired, if they own anything at all, it's capital. People who are paying taxes into the Social Security program are workers. There's nothing controversial about this.

MR. RYAN: Retired people don't contribute to Social Security.

MR. BODIE: No, the point is that their contributions, in a sense, have been capitalized in the form of a claim on Social Security. When they retire, they are no longer workers.

MR. KALMAN: I'd like to get back to the issue of volunteerism in Social Security. I'd like to ask Mr. Rottenberg about a situation we have right now. Volunteerism in Social Security is provided for state and local government employees, for nonprofit organization employees, and two-and-a-half million federal employees who are outside the system. I'd like to know your views on continuing that situation as opposed to bringing them into Social Security so that the system is truly universal.

MR. ROTTENBERG: If there is less coercion in the system from which they can opt out, I'm in favor of permitting them to opt out. The paper repeatedly says that I'm opposed to mandating universality. There is diversity among us. You ought to permit people to exercise diversity in an institutional arrangement if that choice can be made available.

MS. GILL: I agree with Mr. Miller about the reaction of the baby-boom generation to Social Security. I would simply encourage anybody who is involved in legislative changes to the Social Security program to be aware that there is a great deal of educating to be done through the press and other media.

MR. CAGAN: One of the ways in which you can cut the benefits that Professor Campbell has referred to and which was suggested by the National Commission was to index the benefits by the lesser of wages or prices. I think this is a very good idea. It hardly seems credible to continue to index benefits at prices so that the beneficiary suffers no decline in real income while the rest of the economy suffers a considerable decline.

However, as a contribution to the long-run deficit of a system, I don't think this will make a contribution. Over a seventy-five-year period, on the average, prices will not rise faster than wages. Therefore, indexing by the lesser of the two is going to make no contribution to the long-run deficit problem at all.

MR. TOLO: I'd like to ask Professor Campbell to elaborate on controlling benefits in Social Security. He addressed one way, namely a change in the approach to indexing. Another approach that sometimes has been suggested is a modified price index for Social Security adjustments.

For example, in Sweden, you now have a situation where after October 1980 increases in energy prices are not included in the price index for Social Security.

MR. CAMPBELL: I certainly think a new index could be useful. Of course, it depends upon how much you modify the current indexes.

MR. GWIRTZMAN: On the question of indexing, you're not going to prevent the Congress from raising benefits if the older people suffering from inflation get after them, so I don't think that ending automatic indexing is the right idea. Some adjustment of the 100 percent automatic index, however, is important. If prices continue to outrun wages over a long period of time, there's not only no hope for Social Security, but there's no hope for private pensions either, and there's very little hope for the economy.

The real answer to many of these questions is doing what's necessary for better economic performance for the country as a whole. We need to dispel the gloom for Social Security and all the income maintenance programs.

MR. YOUNG: I have advocated that postretirement adjustments be something like the mean of inflation and wage indexing. I thought it was a good idea in the past, and I still think it's a good idea.

MS. HOBBS: My remarks are directed to Professor Campbell. I want to call to everyone's attention the fact that Professor Campbell has done extensive research on the Social Security earnings limitation which the House Aging Committee has found very useful. I want to publicly thank him for submitting comments at our hearing last year.

You mentioned two solutions to the financing problem, raising taxes and reducing benefits. Could you see removing the Social Security earnings limitation as a possible solution to the funding problem? The House Ways and Means Committee is now marking up a bill that would remove the earnings test for persons 68 and over. Should they?

MR. CAMPBELL: Removing the earnings limitation would increase the cost of benefits and usually the point of view that the cost would exceed the tax revenues that you get by having older people work longer.

MS. HOBBS: What about reversing the trend towards early retirement?

MR. CAMPBELL: I don't think that removing the earnings test will reverse the trend toward early retirement. You had the trend toward early retirement before Social Security was even set up. I don't think you can attribute the trend towards early retirement just to Social Security.

MR. LOVE: Colin Campbell's paper, and he is rightfully recognized as one of the pioneers, is a piece of security analysis or financial disclosure. The wondrous thing about the marketplace is that disclosure is such a large part of it. In effect, this paper and others like it have said that we have an enterprise in Social Security which for many years fooled the clients, fooled the stockholders, and, in fact, fooled management itself. The paper points out that the reaction of the Social Security Administration to changes in demographics and to changes in inflation was very, very, very late.

I would submit that the Social Security black box has now been opened. We now have many institutions forecasting and analyzing its problems and disclosure in the future should not be the problem that it has been in the past.

There are those that may think that this is rather farfetched but I think the stock market is telling us that America cannot pay for defense, pay for all the future benefits that have been promised in one way or another, and also reindustrialize in a meaningful way. The stock market is betting on which one of those things will not happen.

Phil Cagan's remarks included a very insightful analysis about the dynamic of linking increases to wages or prices and whether or not there is catch-up. The idea of linking the increase to either has been promulgated on the basis of fairness and equity. However, it goes much, much deeper than that. Analysis of the impact of inflation in the economy is generally perceived through models which look only at expected inflation. They make no economic differentiations about the impacts of unanticipated versus anticipated inflation, and do not look at stochastic or unforecastable impacts of things that happen to the economy.

If Social Security is indexed only to prices it insulates retired people from major sources of risk in the American economy. Given that the total amount of risk in the American economy is a given, government and other institutions can only reallocate that risk.

Social Security has insulated the retired segment of our society from risks, which means that the people who are still working bear those risks disproportionately in real terms. Linking cost of living adjustments to wages or prices is a very important device for making sure that everybody in society absorbs the risk of that society.

MR. SCHULZ: I want to compliment Mr. Campbell for the excellent paper. It's a rather pessimistic paper. My reaction is that the situation is even worse than this paper says, because, as he indicated, he restricted himself to Social Security. There is anxiety about Social

Security, anxiety about private pensions because they cannot be guaranteed against full inflation, and unmentioned today, there's the usual laundry list of vesting, portability, reinsurance and survivors benefits that have differential impacts on various covered workers depending on the firm that they work for. There are also problems with our state and local pension plans. Many are inadequately funded and some will not be able to meet the current high level of benefits promised.

So the situation is rather bleak. How should we react to that? One thing I think we have to always keep in mind is that there's going to be a very differential impact depending on the population group being looked at.

The General Motors adjustment for inflation, for example, illustrates that some corporations have the capacity to deal with one of the major problems of Social Security.

I wonder how secure Chrysler workers feel about the very basic issue: if Chrysler went under how well would PBGC do? A lot of these workers' benefits go far above the maximum that's guaranteed by the PBGC reinsurance scheme.

I think Mr. Seidman hit the issue right on the head when he noted that one of the basic questions we always have to ask is who gains and who loses. One reaction to the problems lying ahead is to cut benefits, but it's not clear when you say that's the answer that you want to cut benefits across the board. There will be some people for whom benefits will be cut a lot more than for others, and all of us would like to know which group we're going to be in when that happens.

Another illustration is the shift to later retirement. Who is impacted and to what degree depends on how we adjust SSI, how well disability insurance can deal with some of the residuals, and how employers react.

The research sponsored by EBRI, and the research issues it raises, are very appropriate and very interesting. It's very encouraging to see this kind of work growing in magnitude.

My more negative reaction is that I didn't feel very comfortable about the comments that suggest an increased emphasis on self-reliance as a solution. It seems to me that much of what has been discussed today indicates the complexity of the issue, particularly the difficulty of these issues being solved by individuals. Hence, I think there is a large consensus around the idea of collective action. The cutting edge is the mix between employer pensions and social programs. That's the relevant issue.



## **Retirement Income Provision: Mandatory or Voluntary?**

MR. HURD: Out in Des Moines, Iowa, we view the goings on in Washington with mixtures of fear and admiration. The central and most controversial recommendation in the PCPP report is a recommendation for mandatory pension plans. Via a few grapevines I've reached the conclusion that this isn't very likely to happen within the next half-dozen years. But, I would like to get some feel from this group as to whether others here think that's wrong.

MR. SULLIVAN: The gentleman from Des Moines, whose sentiments I share, raised an interesting question. Will there be a MUPS in the next five or six years?

*Editor's Note: Approximately 90 percent indicated that they did not think a system would be enacted.*

MR. LEHRMAN: I have a couple of comments to make in that regard. As somebody who works for Chairman Claude Pepper who just introduced a mandatory pension bill, I look at it from a very different perspective.

One of the Commission's recommendations was to provide a tax credit for retirement savings. I think all of us here acknowledge that the role of savings and pensions should be greater than now. We've reached a consensus that Social Security has reached its limit. It may be too generous, it may not be generous enough, but Social Security has reached its limit. I think we all agree that there should be real incentives to save and to promote private pensions.

The adequacy of Social Security is not a question for high-income people. It's a question for low- and moderate-income people, and these are the people for whom these incentives have to be real.

We've heard a lot of people talk about incentives for savings. We heard about the Prudential plan, we heard about a Connecticut General plan, we heard about the savings incentives in West Germany. There are two things that these plans share in common. First, the incentive is equal across income groups. Second, participation is roughly equal across all income groups. This is despite the mitigating factor that upper-income people have more disposable income with which to part. Low- and moderate-income people do want to save. They want to save in other countries and they want to save here. Low- and moderate-income savers have 40 percent of all the accounts in savings and loans. But, the current incentives for retirement savings aren't equal across income groups. They're effectively very

regressive due to the progressive nature of our tax system. A worker in the 50 percent tax bracket receives a much greater incentive to save than a worker in the 14 percent tax bracket. Consequently, participation attached to further retirement savings goes along these lines.

We've heard a lot about increasing tax incentives and reducing administrative burdens. I think all of us share those concerns, yet there's a feeling in our Committee (House Aging) that the private pension system is only taking care of a very limited number of people. We need an approach that provides assurance that people across all income levels will receive these benefits, whether we do it by mandating them, through nondiscrimination or through stricter vesting schedules. There will be pressure.

MR. LOVE: Everything that you mention as a desirable outcome of MUPS can be achieved either through tax policy, mandatory Social Security coverage or other means. What is it that MUPS guards against or does that's unique to MUPS? If it's mandatory, presumably it protects somebody who doesn't otherwise save. But, what does a MUPS provide that a combination of other policy measures that have already been discussed doesn't? What and whom does it protect?

MR. LEHRMAN: What we have been doing so far hasn't been working. If there's a better way to do it (short of MUPS), I haven't heard of it.

MR. WOODRUFF: Our forecasts show that about 98 percent of the people who move through the grit of life in the private sector would end up with a benefit from a MUPS system. MUPS speaks partly to the question that Simon Rottenberg raised in his paper: at what levels and from what sources does society want to place and provide some sort of a minimum income standard. The Commission's report concluded that Social Security as a source, has exceeded that point. Further, that we need to dramatically shift emphasis away from income transfer and pay-as-you-go programs to advance funded programs.

Our forecasts show that when the baby boom starts retiring in the 2020s, without policy changes either voluntarily or mandatorily, somewhere in the order of 500,000 new retirees will rely primarily on Social Security.

There is a risk in deferring the decision because ten to fifteen years would probably be a necessary gestation period for new tax incentives. If you only make a dent in coverage and benefit receipt, where

will you be? We will have only pay-as-you-go or significant reductions in life style as options.

I think that a majority of the Commission made the judgment that we need at least to put a mandatory funded, minimum benefit in place.

In my opinion MUPS would not significantly reduce the flexibility of employers to provide flexible and custom designed employee benefit plans. MUPS is really only intended in combination with Social Security to be an adequate benefit for the career, minimum wage worker. Above that level MUPS would provide an inadequate income.

MR. GREENOUGH: The topic that's on the table is MUPS and coverage for lower-paid people. You can look at the figures in various ways. While I opposed MUPS and still oppose it, the thing that the Commission was trying to do makes a great deal of sense: get enough benefits out of funded programs to support people during retirement. The differences of opinion have to do with how many people are now covered or will potentially be covered by retirement plans. Is it less than 50 percent as the Commission staff says or is it 70 percent as I believe? Vesting—how many will be vested in one or more plans, by the time they get to retirement? You shouldn't count a person who is now 24 as never likely to be in a retirement system since the majority will be at 25.

MR. YOUNG: I raise a question about MUPS which relates to advocacy of a system where everybody saves their own money till retirement. It struck me that in all the discussion of MUPS nothing was published on what kind of benefits it would provide as a percentage of final pay. What does one really get if one puts aside 3 percent of pay for forty years?

MR. ROSS: There's another aspect to the President's Commission's report which hasn't been brought out which I think is fairly important.

Realistically, Social Security has reached its limits and is going to be scaled back. I think the attitude of the founders that somehow Social Security would expand and expand and take care of the nation's total retirement income needs is no longer something that anybody really ascribes to.

We're more likely to get increased tax incentives and expansion in both private pensions and individual savings. But, there will be a shortfall there in terms of total replacement. I think that what that tells you is that there's going to have to be some additions to the three-legged stool. I think the elderly will be given more opportunity

to work and that earnings will become an effective fourth leg of the retirement income stool.

Then we have to acknowledge that there's a fifth leg to the stool which will become increasingly important: welfare will have to be regarded as an important component of the retirement income system.

To meet income needs we are going to have to target our actions. If you really look underneath the data on the mandatory private pension proposal (MUPS) the kind of people that the President's Commission is trying to help are more likely to be reached by a more targeted welfare system than by trying to force the private system into that area. These are people who are lower earners, marginal to the work force, or in more marginal or fragile parts of the economy. They're people who the normal private pension plan is not designed to help that much. They're people who do need something in addition to Social Security, and they're not people who are going to be able to use the fourth leg of working longer to help themselves. We are going to have to do a much better job on making respectable the SSI approach of targeted welfare.

I don't regard that as a bleak picture. I think we've already seen some studies that tell us that the SSI program does work with a great degree of dignity for the recipients and a great degree of efficiency in terms of delivery. I think that a five-legged stool is a realistic long-term characterization of what the nation's retirement income system is going to look like.

## **Tax Treatment of Retirement Income Programs**

MR. RYAN: I'd like to have Mr. Beck reconcile the Roundtable's support of enlarging tax incentives for IRAs to the business communities general support of the Administration's budget and tax proposals. Aren't you afraid that you will dislodge what we're looking for in relation to the Administration's proposals?

MR. BECK: I think that's a very good question to raise. The business community and the Roundtable totally endorse the President's program. But, we regard the development of consensus on issues as a long-term effort. We want to develop consensus among large numbers of people in our society around our belief that benefits can come to the nation from building incentives rather than restrictions.

We will push retirement savings after the main program is in place.

MR. RYAN: That was the point that I wanted to make, that the retirement push should come after the main program is in place.

MR. BECK: Yes, incidentally, I've heard so many people raise the question: how do you prove that tax incentives really do produce value and add to capital formation? How do you prove that it does add to savings?

When you examine what's happened in West Germany, France, Japan, Great Britain and Canada, it's very hard to ignore the pure cause and effect that took place when savings incentives were introduced.

It doesn't take a lot in this nation to encourage people to save. Our company has a thrift plan. An employee will make a contribution of 3 percent of income and we'll match that 3 percent. Then if the employee wants to save additional monies they can save up to an additional 10 percent. There are no deductions for the employee contributions, and the only tax benefit comes from the fact that earnings on the fund during its period of accumulation are not taxed. The average savings rate for the over 90 percent of our people who participate in this program is 10.3 percent and it doesn't drop down very significantly at lower levels. In fact, for people who earn less than \$10,000 the average savings rate under this thrift plan is 9.7 percent.

I submit to you that it doesn't take a lot to encourage people to get involved. If you give them any reason at all to save and defer taxes until a later time, they will do so.

MR. RYAN: Bill Greenough, you apparently have borrowed quite heavily in formulating your tax recommendations from Canada, am I correct?

MR. GREENOUGH: No. You can come to the idea that when you defer income, you ought to defer tax on that income, quite independently of whether Canada or Germany or anybody else does it, it's just a hell of a good idea on its own basis.

MR. JOHNSON: Bill, if you simultaneously reduce taxes the working population is paying into Social Security and tax the old age population on their benefits, then you get a very strange result. Quite naturally the political system would be very hostile.

I'd like a little more information on how the transition to this new tax policy, which I personally think is a very good approach, would occur.

MR. GREENOUGH: As to transition, who was it who was asked, "How can you get rid of the German submarines" during World War I, and they thought a minute and said, "Well, you boil the ocean." "That's fine," replied the questioner, "but how do you suggest we boil the ocean?" "That's just an administrative detail" came the reply, "I told you how to get rid of the submarines."

The objective is frequently clearcut. One, you start conditioning people. The Commission was very, very careful all the way through to include Social Security benefits in taxable income. That left all the poor and near poor out of paying any material taxes.

Anybody who's retired already has, on an actuarial basis, gotten a pretty good bargain. The lack of bargains starts now and moves forward. There won't be too much complaint.

MR. STEIN: I'd like to get back to the point that Jim Schulz raised about issues on taxation. As I understood the proposals by the President's Commission, the phase-in would basically be the old principle: if it was taxable in, it's tax free out. That's a long phase-in period, but it makes sense one way or the other. I'd like to remind people that there's an equity question involved. The higher earners paid a progressive income tax going in. They received progressively scaled down benefits coming out. I'm liberal enough to believe in redistribution of income, but once around is enough. Twice is pushing it a bit. If you want to raise taxes let's do it honestly. If you want to tax the windfall the present retirees get, then do that.

I would propose to you that savings can be increased by raising taxes rather than by lowering them. Feldstein, with whom I generally heartily disagree, at least points out that if you move in the direction of a balanced budget you are crowding investment out of the risk free T-bill public sector and forcing investment into riskier and more productive private capital investments. What I'm suggesting is that not all of the options for capital formation have been explored. If capital formation is a crucial issue we've got to go outside the system as well as inside the system to see how it can best be accomplished.

MR. AARON: My comment is in response to Bill Greenough's proposal to exempt from income tax current payroll tax payments. I'd like to suggest that it has an argument against it that has not been presented. Generally speaking, if you want to cut taxes by a given amount, you can either cut the tax base, or you can cut tax rates. The proposal that Bill Greenough is suggesting is a proposal to cut the tax base. That leaves the rates higher than they would be if you cut rates instead.

A somewhat more important point is that the distortions caused by taxes are a function of rate. Therefore, if you collect a given amount of revenue from a narrower base at a higher rate you are imposing greater economic distortions on the economy than you do if you have a broader base tax levied at a lower rate. At present the personal income tax base is substantially smaller than the payroll tax base. I think we should be careful about narrowing that tax base still more.

Indeed, I think we ought to be looking at devices whereby we could broaden the personal income tax base so that the additional revenues could be used to cut rates and thereby reduce the distortions that the tax system imposes on us.

# Forum Participants

## Welcome & Introduction

Dallas L. Salisbury  
Executive Director  
Employee Benefit Research  
Institute

## Moderator

Robert D. Paul  
Vice Chairman  
Martin E. Segal Company

## Speakers

Robert A. Beck  
Chairman  
The Prudential Insurance Company  
of America

Colin D. Campbell  
Professor of Economics  
Dartmouth College

The Honorable Slade Gorton  
United States Senate

William C. Greenough  
Trustee  
TIAA/CREF

Simon Rottenberg  
Professor of Economics  
University of Massachusetts

Charles E. Ryan  
Director, Pensions Life &  
Disability and Stock Programs  
General Motors Corporation

Bruno Stein  
Professor of Economics  
New York University

## Participants

Henry Aaron  
The Brookings Institution

Vance Anderson  
House Committee on Education &  
Labor

Martin Bael  
Eastman Kodak

Preston Bassett  
President's Commission on Pension  
Policy

Zvi Bodie  
National Bureau of Economic  
Research

Phyllis C. Borzi  
House Subcommittee on Labor  
Management Relations

Barbara Boyle-Torrey  
Office of Management & Budget

Phillip Cagan  
American Enterprise Institute

Elliot Carlson  
NRTA/AARP

Neil Cavuto  
Investment Age

Edward W. Cleary  
Boise Cascade Corporation

Adrian A. Collins  
Exxon Corporation

Donald Crowley  
Xerox Corporation

James A. Curtis  
Milliman & Robertson, Inc.

Ed Davey  
Mobil Oil Corporation

William Dreher  
Peat, Marwick, Mitchell & Co.

Charles Edwards  
House Select Committee on Aging

Tom Edwards  
TIAA/CREF

William Eiseman  
Morgan Guaranty Trust Company  
of New York

The Honorable John N. Erlenborn  
U.S. House of Representatives



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Fred Feinstein House Subcommittee on Labor Management Relations	John K. Kittredge The Prudential Insurance Company of America
Bill Finerfrock Legislative Assistant to The Honorable Roger Jepson	Susan Koralik Hewitt Associates
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House Select Committee on Aging

Robert Thomas  
Legislative Assistant to The  
Honorable Slade Gorton

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Policy

Howard Young  
United Auto Workers

**EBRI Staff**

Marsha K. Brawer  
Educational Programs Coordinator

Patricia M. George  
Research Coordinator

Sylvester J. Schieber  
Research Director

Jamie M. Thomas  
Special Projects Coordinator

A. Catherine Thomson  
Research Coordinator

# Appendix A

## Advisory Council on Social Security A Summary of the 1979 Report\*

### Financing

Mindful of the extent and nature of concern about the financing of the Social Security system, the council has reviewed its financial soundness, projections of its future condition, and the history of Congressional and public attitudes toward Social Security financing. After reviewing the evidence, the council is convinced that all current and future Social Security beneficiaries can count on receiving the benefits to which they are entitled.

The council also believes that the financial soundness and equity of the system would be improved by financing at least part of Social Security benefits from general revenues. It also believes that the ad hoc increases in the earnings base, the maximum amount of earnings subject to Social Security taxes, should be repealed. Specifically, the council recommends:

- Financing the hospital insurance (HI) program (part A of Medicare) entirely from earmarked portions of the personal and corporation income taxes, rather than from payroll taxes.
- Allocating part of the current HI payroll tax to the old-age and survivors' and disability (OASDI) cash benefits programs.
- Repealing the balance of the HI payroll tax.
- Repealing the ad hoc increases in the earnings base scheduled for 1980 and 1981. In the future, the earnings base would be increased only to reflect increases in the level of average wages.

The combined effect of these recommendations would be a significant reduction in the Social Security taxes scheduled to be paid in the next few years. As shown in Table 1, under the intermediate assumptions of the 1979 trustees' report, the total tax rate for employers and employees (each) could be set at 5.6 percent. Under present law, the rate for OASDHI is scheduled to be 6.13 percent in 1980 and 6.65

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\*Taken from the final report of the 1979 Advisory Council on Social Security.

**TABLE 1**  
**Effect of the Council's Proposals**  
**On the Tax Rate and Earnings Base**  
 (Based on 1979 Trustees' Report Intermediate Assumptions)

**Tax Rate (Employer and Employee Each)**

	OASDI		HI		Total	
	Present Law	Council	Present Law	Council	Present Law	Council
1979	5.08%	NC	1.05%	NC	6.13%	NC
1980	5.08	5.6	1.05	0	6.13	5.6
1981	5.35	5.6	1.30	0	6.65	5.6
1982	5.40	5.6	1.30	0	6.70	5.6

**Earnings Base**

	Present Law	Council
1979	\$22,900	NC
1980	25,900	\$24,900
1981	29,700	27,000
1982	32,100	29,100

NC: No change.

percent in 1981. The earnings base would be \$24,900 in 1980, rather than \$25,900 as scheduled under present law, and \$27,000 in 1981, rather than \$29,700. The council recognized that the future direction of the economy is uncertain as its report was being prepared. If, at the time the Congress is considering action, economic projections are less favorable than those in the 1979 trustees' report, the appropriate tax rate may be somewhat higher than 5.6 percent.

If the Congress does not implement its proposal to finance hospital insurance entirely from earmarked corporation and personal income taxes, the council recommends that, at a minimum, the increase in the HI payroll tax rate scheduled for 1981—0.25 percent for employ-

ers and employees each—be replaced with general revenues. Elimination of this increase alone would reduce the total (OASDHI) tax rate for employees and employers each in 1981 to 6.4 percent, rather than the 6.65-percent rate in current law.

Despite the fact that the payroll tax falls more heavily on those with low incomes than does the federal income tax and that the payroll tax can contribute to inflation, the council believes that the payroll tax continues to be an appropriate source of revenue for the Social Security cash benefit programs: “These programs pay benefits that are related to a person’s earnings, and the council believes that they should be financed by a tax on those same earnings.”

However, the council believes that this logic does not apply to the hospital insurance program, because everyone who is eligible receives the same protection. Benefits are related not to prior earnings but to the medical care received.

Although it believes general revenues should be used to finance hospital insurance, the council believes that the taxes used to generate those revenues should be earmarked, both to provide a measure of fiscal restraint and to ensure that benefits will be paid without a means test.

In recommending repeal of the ad hoc increases in the earnings base, the council noted that “Social Security was designed from the beginning to work in combination with private pensions and saving. Increasing the earnings base beyond its current level would extend Social Security coverage to a level of income where forced saving is unnecessary and where the provision of additional retirement income is better left to private saving and pensions.”

The council also recommends that the payroll tax rate continue to be the same for employees and employers and that, as long as inflation remains a serious problem, the earnings base also be equal for employees and employers. A narrow majority of the council believes elimination of the ceiling on which employers pay taxes should be considered once inflation abates. These members argued that the employer tax should be considered a contribution to the system as a whole, rather than on behalf of individual employees.

To protect Social Security against economic fluctuations, the council recommends:

- Making payments to the trust funds from general revenues if reserves are less than 60 percent of annual outlays, in the manner proposed by the Administration in 1977. This would help compensate the system for revenues lost because of high unemployment. This provision would reduce the need to raise payroll

taxes during a recession, reduce the level of reserves ordinarily needed for safe operation of the system, and introduce general revenues into the OASDI programs in a way that strictly limits their use.

- Authorizing the trust funds to borrow from the general fund if reserves fall below about three months' outlays. Repayment of such a loan would begin whenever the balance in the funds reached about five months' outlays. If the loan were not repaid within two years, then the council recommends that payroll taxes be increased automatically to repay the amount outstanding, provided that the national unemployment rate is below a specified level—say 6.5 percent.
- Combining the old-age and survivors' trust fund with the disability insurance trust fund to permit revenue transfers between the two programs. This would prevent the need for legislative action to readjust taxes when one fund is low and the other is amply financed.

The council also:

- Recommends that the Social Security cash benefits programs be brought into long-run actuarial balance by scheduling a payroll tax rate increase beginning in the year 2005.
- Rejects the use of a value-added tax to finance Social Security.
- Finds that the methodology now used to make financial projections is sound and that the assumptions are reasonable.
- Recommends continuation of 75-year forecasts.
- Recommends continuation of current-cost financing, and recommends that reserve balances be maintained at a level equal to about 75 percent of outlays to provide protection against a recession. (If the council's proposals for use of general revenues and borrowing authority during a recession were adopted, a reserve of 60 percent of outlays would be sufficient.)

### **Structure of Social Security Benefits**

The council supports three basic principles to govern the pattern of Social Security benefits.

First, the council endorses the traditional principle that Social

Security should reflect a balance between adequacy and equity goals. Low-wage earners should continue to receive proportionately higher benefits than high-wage earners receive. The council rejects the recurrent proposal to make Social Security benefits strictly proportional to earnings—a proposal that would force an unacceptably high proportion of the aged and disabled to rely on means-tested programs. The council also rejects proposals to pay flat rate benefits that would bear little if any relation to prior earnings; the council believes benefits should bear a reasonable relationship to a worker's prior standard of living.

Second, the council believes that those who work full time for at least 30 years and earn hourly wages equal to about the federal minimum wage should be assured a retirement benefit at age 65 that keeps them out of poverty. The council does not believe, however, that Social Security should be expected to assure a poverty level income for those who do not work full time most of their lives in covered employment.

Third, the council believes that all current and future workers should be able to expect that Social Security benefits generated by increased earnings will provide a reasonable return on the increased employee tax payments on those earnings. As a worker's earnings increase, he or she should expect additional benefit protection that represents a reasonable return on the additional taxes he or she will pay on the basis of those additional earnings.

Although the present benefit formula is in accord with the first principle, it does not satisfy the second and third. Single persons who have worked full time at the federal minimum wage do not now receive a benefit sufficient to keep them out of poverty. And for those now entering the labor force who do not marry and who have earnings consistently at or near the taxable maximum, increases in taxes paid will not necessarily lead to equivalent increases in benefits received.

The council therefore recommends a new Social Security benefit formula that would guarantee long-service workers with average earnings at or somewhat below the federal minimum wage benefits at least equal to the poverty threshold. The formula also would assure most high-wage workers a better return on additional Social Security employee tax payments.

Under present law, a worker retiring at age 65 will receive a benefit that replaces 90 percent of the first \$180 of his or her average indexed monthly earnings (AIME), plus 32 percent of the next \$905 of AIME, plus 15 percent of AIME above \$1,085. The new benefit formula would replace 61 percent of the first \$442 of AIME plus 27 percent

of any additional AIME. Further, the council recommends that, as under present law, the brackets be increased annually to reflect increases in average wage levels so that average benefits for future retirees will increase at the same rate that average wages are increasing.

The council also recommends liberalizing the special minimum benefit for those with long histories of work at low wages.

*Taxation of benefits.* Because Social Security benefits are derived from earnings in covered employment, just as is the case with private pensions, the council believes Social Security benefits should be subject to taxation in the same general way that private pension income is taxed. The accumulated employee tax payments of workers now entering the labor force will amount to no more than about 17 percent of the benefits that the workers can expect to receive (for the self-employed, they will amount to no more than about 26 percent). The difference between the amount of taxes that they themselves pay and the amount of benefits they can expect to receive represents: (1) the amount of their employers' payroll tax payments and (2) a sum which is analogous to interest earnings on both employer and employee tax payments. If Social Security benefits were taxed in the same way as private pensions, about 83 percent of an employee's Social Security benefit (and 75 percent of a self-employed person's benefit) would be subject to taxation.

Because of lack of necessary data, taxing Social Security benefits in exactly the same fashion as private pensions would be quite difficult. It would also result in taxing more of the benefit than most people would consider appropriate. Therefore the council recommends including half of all Social Security benefits in income of a couple or of an individual that is subject to federal income taxes.

The elderly are allowed double tax exemptions. In combination with the zero bracket—the amount of income all filers are allowed before any income tax liability results—this guarantees that virtually no aged persons or couples today would pay any additional income tax if Social Security were their only source of income. If a couple's only income were from Social Security, its benefits would have to exceed \$14,800 before there would be any income tax. Of the 24.2 million filing units (individuals and couples filing jointly) receiving Social Security benefits, 10.6 million would pay additional taxes. The average increase for those who would pay increased taxes would be \$350. The estimated additional revenue to the general fund from this provision would be about \$3.7 billion per year.



*Averaging period.* In calculating Social Security benefits, workers must count all years between 1950 or the year they turn 21 up until the year they turn 62, die, or become disabled. Five years of low or no earnings may be excluded from this calculation, but if a worker has more than five years of low earnings or of work outside covered employment, these low or zero years must be entered into the calculation. Young workers may exclude a disproportionately high number of years from the averaging period because by dropping five years from a work life as short as seven years, their benefit can be based on only their two highest years of earnings. This policy thus results in higher benefits for young disabled workers and the survivors of young deceased workers than are awarded to older retired or disabled workers and their survivors with similar earnings records. The council thus recommends that workers be allowed to drop one year from the averaging period for each six years elapsing between age 22 and the age of eligibility for benefits.

*Semiannual cost-of-living increases.* A narrow majority of the council recommends that, as soon as administratively feasible, Social Security benefits be increased twice a year—in March and September—whenever prices have risen by at least 3 percent since the last cost-of-living adjustment was made.

*Double-decker plan.* The council considered and rejected a double-decker plan under which each aged and disabled person and surviving child would receive a flat grant paid from general revenues, with an additional benefit directly proportional to past covered earnings paid to Social Security contributors but not to their dependents or survivors. The council believes that the weighted benefit formula in the present system performs its functions well and sees no need for the kind of radical change embodied in the double-decker plan. In general, the majority believes that the major upheaval such a change would entail would have the potential of creating important and needless risks, such as reduced benefits for many dependents and survivors, lower benefits for workers, increased reliance on means-testing, and substantially higher program costs.

## **Women**

As more women work, as divorce becomes more common, and as the economic value of homemaking is increasingly recognized, concern about the way in which Social Security benefits are paid to

women has grown. The council spent more time on these issues than on any other. The council notes that the adequacy and equity of benefits for women can be measured against several criteria. On the most fundamental level, the Social Security law is largely sex-blind. With few exceptions (which the Administration and the council recommend be eliminated), benefits are not paid on the basis of sex, but rather on the basis of labor force attachment and family status. The council also notes that as a group, women get as good a return on the Social Security taxes they pay as do men. Indeed, if separate systems were established for men and women, women workers would have to pay Social Security taxes that are about 9 percent higher than men would pay. Because the average wages of women are lower than men's, a greater portion of their wages is replaced by benefits because of the weighting in the formula for low-income workers. Also, because women tend to live longer, they collect more benefits than men. These two factors outweigh the fact that more dependents' benefits are paid on the basis of men's wage records than are paid on the basis of women's wage records.

However, if the adequacy and equity of benefits for particular groups of women are examined, major problems become apparent:

- The increasing frequency of divorce has dramatized the long-standing problem of the inadequacy of dependents' benefits for divorced women.
- Benefits for widows, regardless of age, also are inadequate. About one in three aged widows and widowers is living in poverty—even if they receive Social Security benefits. And benefits for elderly women who have never married are generally lower even than benefits for widows.
- Women who stop working to rear children are penalized for their childcare years.
- Not all women who work receive higher retirement benefits than they would if they did not work.
- If two couples have the same earnings, the couple where only one spouse worked will receive higher retirement benefits than the couple where both husband and wife worked.

Further, as marriage increasingly is viewed as an economic partnership, concern has risen that homemakers are not insured against disability and that their survivors are not entitled to benefits when they die. This view of marriage also has made it philosophically

distasteful to many women to receive benefits as economic dependents of men.

After reviewing a wide range of alternatives, the council concluded that a system to base Social Security benefits for husbands and wives on half of couple's combined earnings represents the most promising approach to addressing these issues relating to women.

Although the council believes that the need to improve the treatment of women in the Social Security system is urgent, it did not endorse a full-scale earnings-sharing plan at this time. Most council members were unwilling to make an unqualified recommendation that a full-scale earnings-sharing plan be adopted until they could be convinced that acceptable ways exist to address adequately some of the issues remaining in any of the specific plans developed so far. The council also believes that because earnings sharing would represent a fundamental change in the structure of Social Security, it should not be implemented until it has been more widely debated and understood by those who would be affected by it.

*Limited approaches.* However, a narrow majority of the council does recommend two elements of a full-scale earnings-sharing system for immediate implementation. These proposals would permit persons divorced after at least ten years of marriage to receive retirement benefits based on shared earnings from the years they were married and permit aged widows and widowers to receive benefits based on the couple's combined earnings. A substantial minority of the council believes even these more limited approaches should not be implemented without further public debate and without resolution of the remaining technical problems with their implementation.

Although these two elements would not address all of the issues relating to benefits for women, they would address several of the more critical problems, and their enactment would be consistent with subsequent implementation of a full-scale earnings-sharing system.

The first proposal would permit either partner of a marriage that ended in divorce after at least ten years of marriage to receive benefits based on half the couple's combined earnings for the years of the marriage.

Under this limited form of earnings sharing, the credits gained or lost through sharing would not affect eligibility for either disability or survivors' benefits or the level of disability or survivor benefits. But these credits would affect the level of retirement benefits: Divorced women generally would receive higher retirement benefits and divorced men lower benefits on the basis of their shared earnings than they would receive under present law. Now, a divorced woman

is eligible for a retirement benefit equal to only half her ex-husband's benefit.

The second proposal would permit a survivor to inherit the earnings credits of his or her deceased spouse. All of the earnings credits of the deceased spouse that were earned in years during which the two were married would be added to the earnings credits of the surviving spouse. Thus surviving spouses of couples where both partners worked would receive higher benefits than they would under present law, where the benefit is based only on the earnings of the higher paid spouse.

A narrow majority of the council also recommends that serious consideration be given to proposals that would permit parents to drop one or more years spent caring for children from the averaging period.

## **Minorities**

The council has examined the allegation that members of minority groups fare less well than others under Social Security and concludes that it is unfounded.

This allegation stems first from the fact that persons from racial and ethnic minorities, notably blacks, Hispanics, and American Indians, have shorter life expectancies than whites. It also stems from the tendency of minority persons to begin working sooner than whites and thus to pay Social Security taxes for longer periods than whites.

The council finds that the shorter life expectancy of minorities does mean that they are somewhat less likely than others to receive retirement benefits. However, this is offset by the fact that minorities are more likely to receive disability and survivors' benefits. Further, the Social Security benefit formula provides workers with lower earnings a higher benefit relative to their previous earnings than is provided to those with higher earnings. Thus, as long as minorities continue to be paid or to experience more unemployment than the average worker, the weighting in the benefit formula provides minorities the advantage of higher benefits relative to taxes paid than is true for others.

Any differences in the treatment of minority and nonminority persons does not flow from the deliberate design of the Social Security program, because the Social Security law is color-blind. Rather, the question of whether minorities are treated fairly relates to the effect of color-blind law on groups who have suffered and who, though there have been improvements, continue to suffer from

discrimination and continue to earn less on average than whites. The consequences of such discrimination are deplorable and demand the continued priority attention of the nation. It would be neither appropriate nor desirable to try to use the Social Security system as a means to deal with these problems. Nevertheless, it is important that laws drafted without the intent to discriminate not do so inadvertently.

The council therefore urges that the effect of changes in Social Security on minorities receive explicit attention whenever proposals for change are being considered. The council believes many of its recommendations will be of particular assistance to minority group members, but it rejects introducing into Social Security explicit differentiation among groups on the basis of race or ethnic origin.

The council also recommends that the Social Security Administration give high priority to further research and analysis concerning the extent to which minority groups benefit from Social Security programs.

## **Disability**

The disability program is difficult to design and administer because objective medical and vocational standards cannot distinguish perfectly between those who are and are not able to work. For example, personal motivation is very significant in determining whether a person can work, yet motivation cannot be precisely measured. It is inevitable that some who could work will be found to be disabled and that some who cannot work will be denied benefits.

Because personal motivation is so important, the council is concerned that incentives to return to work be strong for those who have some hope of returning to self-sufficiency. Most obstacles to finding employment are outside the Social Security system. Nevertheless the initial determination process, benefit levels, review procedures, and all other aspects of the disability program must be structured to foster efforts to return to work, while at the same time not denying benefits to those who cannot be expected to return to gainful employment. Benefits must also be structured so that the severely disabled—and their dependents—are not impoverished. In its recommendations the council has attempted to balance these concerns.

*Family maximum on disability benefits.* The council recommends that benefits paid to a family on the basis of an individual worker's disability be limited to a greater extent than they are under the old-

age and survivors' program, but a narrow majority of the council believes that the limit should be not more strict than a maximum of 90 percent of the worker's highest five consecutive years of wage-indexed earnings. A substantial minority of the council favors a stricter limit at 80 or 90 percent of averaged indexed monthly earnings or 150 percent of the primary insurance amount, whichever is less.

The council also recommends that a similar limit be applied to each family's receipt of all federal disability taken together.

The council believes these limits are necessary to ensure that benefits paid to a disabled worker's family do not exceed the worker's after-tax income before he or she became disabled. If the program replaces more income than was lost, monetary incentives for the worker to seek employment are lost.

*Definition of disability.* The council recommends that the definition of disability under Title II be liberalized for older workers by applying to those aged 55 to 60 the same criteria now applicable to those older than 60. In the SSI program, where disability benefits generally are lower and are paid only to those with little or no other income and only limited assets, standards for eligibility need not be as strict as for the Title II program. The council therefore recommends that HEW develop a definition of disability for the SSI program that is less strict than the definition used under Title II.

*Work incentives.* The council endorses several proposals supported by the Administration that have been adopted by the House of Representatives. These include provisions that would encourage disabled persons with residual work capacity to return to work by allowing them to deduct work-related expenses in determining whether the work effort constitutes "substantial gainful activity"; by permitting automatic reinstatement of benefits in the first year after cash benefits have stopped; by extending the trial work period to widows and widowers; by indexing the dollar level used to determine substantial gainful activity; and by extending eligibility for Medicare and Medicaid. The council also recommends that SSA be given the funds and authority to experiment with other work incentive proposals.

*Attendant care.* The council believes that greater efforts should be made to provide attendant care to the disabled, but believes attendant care should be viewed as a social service rather than as an entitlement under the Social Security or SSI disability programs. The council also believes that in many cases the spouse of the disabled worker is the most appropriate person to provide attendant care. In cases where the spouse is providing care for an SSI recipient, the council

believes compensation to the spouse for providing the care should not be considered income available to the SSI recipient for purposes of calculating the recipient's SSI benefit.

*Private rehabilitation services.* The council believes that HEW or another appropriate federal agency should be given the authority and funds to review federally financed rehabilitation programs and to assess ways in which public rehabilitation services could be improved.

*Periodic review.* The council recommends that SSA improve its review of the continued eligibility of disabled beneficiaries who may recover from their impairments. If additional staff and funds are needed to perform these reviews, they should be provided, by legislation if necessary.

*Disabled spouses and disabled widows and widowers.* Disabled widows and widowers now are eligible for survivors' benefits when they reach age 50, but their benefits are permanently reduced if they first apply before they are 65 years old. The council believes that the requirement that disabled widows and widowers be 50 years old to be eligible for benefits should be eliminated and that the full benefit should be paid regardless of the individual's age.

Disabled spouses of disabled or retired workers are not eligible for benefits as dependent spouses. Like nondisabled spouses of retired or disabled workers, they are entitled to benefits only when they reach age 62 or if they are caring for a child under 18 (or a child disabled before age 22). The council believes disabled wives and husbands of disabled and retired workers should be eligible for benefits regardless of age.

*Waiting period.* A narrow majority of the council recommends that the waiting period between the time a worker becomes disabled and the time he or she becomes eligible for benefits be reduced from five to three months.

*Recency-of-work.* A narrow majority of the council also believes serious consideration should be given to liberalizing the requirement that applicants have worked in covered employment for 20 out of the last 40 quarters to be eligible for disability.

## Coverage

The council finds that the nation's income Security goals can be achieved fully and equitably only if all employment is covered by

Social Security. At present, 10 percent of all jobs are not covered by Social Security—primarily civilian employees of the federal government, some employees of state and local governments, and some employees of nonprofit institutions. This lack of universal coverage leads to several major problems:

- Some plans that are alternatives to Social Security offer considerably less adequate protection than Social Security provides.
- Those who move back and forth between covered and noncovered employment may not be protected by either system for extended periods and they may retire with lower benefits than they would receive if they had worked exclusively under either system.
- Some who work in both covered and noncovered employment receive Social Security benefits that replace a very high fraction of their earnings in employment covered by Social Security—the high replacement rates that are intended for regular low-wage workers.

In order to alleviate these problems the council recommends that Social Security coverage be extended to all federal employees either through mandatory coverage of all new employees or through a transfer-of-credit plan and it recommends mandatory coverage for all newly hired employees of state and local governments and of nonprofit institutions. The council believes that extending Social Security coverage in this way will preserve the rights of present employees of federal, state, and local governments and of nonprofit institutions and allow employers to develop supplemental plans which, together with Social Security, offer newly hired workers a level of protection roughly equal to that provided presently.

*Interim steps.* Until all workers are covered by Social Security, the council recommends as interim steps that:

- An earnings offset be instituted for those who have earnings under both Social Security and noncovered employment.
- All current and future agreements implementing coverage for state and local workers be made irrevocable. (If this is not adopted, terminations should only be permitted after a vote of affected employees.)
- The divided retirement system procedure be made available to all states.



- The payment of an employee's Social Security tax (FICA) by an employer should be taxed and credited as wages for Social Security purposes except in the case of domestic employment.
- Employers be required to pay employer taxes on the full amount of tips received by their employees.

The earnings of farm workers be taxed and credited under Social Security from the first dollar of earnings if the farm operator has expenditures of \$2,500 annually for farm labor; the farm operator should be considered to be the employer of workers furnished by a crew leader.

### **Retirement Policy and Other Benefit Issues**

A narrow majority of the council recommends that consideration be given to enactment now of an increase in the retirement age of 68, effective after the turn of the century. Present demographic projections indicate that the cost of financing the Social Security system will rise sharply in the 21st century if the normal retirement age is not increased (and the benefit payable to those retiring at age 65 is not reduced). The council majority believes that action must be taken in the near future if workers are to have ample time to adjust to a new retirement age. Other council members believe there is no demonstrable need to increase the retirement age. At the very least, they believe consideration of a change should be postponed until jobs for older workers are more abundant and until the health of older persons has improved.

*Early retirement.* The council recommends continuation of the actuarial provisions which allow retirement benefits to be drawn as early as age 62 (with an actuarial reduction for persons retiring before age 65). It recommends consideration of a special program to provide long-term unemployment benefits for those who are approaching the normal retirement age but are unable to find a job. Such a program would pay benefits until a worker turned 65, as long as he or she were willing and able to work, and would be sufficient to make it unnecessary for older workers to claim early retirement benefits.

*Earnings test.* In addition, the council recommends no increase in the earnings (or retirement) test for workers 65 or older but suggests that the earnings test for those younger than 65 be increased so that it is the same as for those older than 65. Although it recognized that

the earnings test is one of the most unpopular and controversial aspects of the Social Security system, the council believes elimination of the test would, by definition, help more those who need help least since, by definition, those who would benefit are those with substantial earnings.

The council therefore believes a relaxation of the earnings test should not take priority over other benefit improvements. However, the council saw no reason why the test for those younger than 65 should differ from that for those older than 65.

*Administration OASI proposals.* The council also rejected Administration proposals to:

- Phase out the regular minimum benefit more rapidly than would occur under present law.
- Provide the lump-sum death benefit only to SSI recipients and their survivors. Further a narrow majority of the council recommends not only that the lump-sum death payment be continued but also that it be increased from \$255 to three times the primary insurance amount or \$500, whichever is less.
- Phase out benefits for students aged 18 to 22 who are children of retired, deceased, or disabled workers.
- Phase out benefits for mothers caring for nondisabled children aged 16 to 18.
- Eliminate benefits to young survivors of those who die after earning currently insured status, but who had not yet earned fully insured status.

*Program Administration.* With regard to the administration of the Social Security programs, the council:

- Recommends that SSA pursue further efforts to improve the quality and clarity of the notices sent to beneficiaries concerning awards, changes, and denials.
- Recommends that those provisions of the House-passed disability bill that related to disability determinations be considered minimum steps toward providing more efficient, speedy, just, and humane service and that direct federal administration of the entire disability insurance program be seriously considered.
- Supports efforts by the Social Security Administration to increase public participation in the development of SSA's policies

and procedures, provide greater protection of the rights of applicants and beneficiaries, and improve service to non-English-speaking persons. The council recommends that SSA establish ongoing panels as a means of improving the communications between SSA and the public.

- Recommends that SSA increase its efforts to administer its programs in a way that reflects awareness of and sensitivity to the special circumstances of minority groups.
- Recommends that increased emphasis be placed on the responsiveness of SSI program administration to the special needs and vulnerabilities of the aged, blind, and disabled.
- Endorses SSA's efforts to inform people who are about to enter the work force about the value of Social Security protection and their obligations as Social Security taxpayers.

## **AFL-CIO Statement on Maintaining the Balance in Social Security (Part One)**

*by Larry Smedley\**

At a time when the Social Security system still enjoys unprecedented popularity, it is also a topic of widespread criticism and concern. Part of the problem is a misunderstanding of the principles that have been the basis of the Social Security program since its inception almost 50 years ago:

*Individual equity:* Benefits should be provided to both the rich and poor as a matter of right, not charity, and should be related to wages earned and contributions paid to the system, but only on a certain portion of income (wage base).

*Social adequacy:* At the same time, Social Security accepts the principle that low-income persons require larger benefits proportional to earnings than high-income people.

These principles represent two different concepts about how benefits should be allocated among beneficiaries. Individual equity holds that contributors should receive benefits related to their wage levels and amounts of contributions. Social adequacy holds that benefit levels should provide all beneficiaries with a minimum level of living. These two principles are balanced in uneasy coexistence within the system.

If totally dominant, the individual equity principle would create a system with the characteristics of a private insurance company—more benefits to those who can afford to buy more coverage—and such a mechanism would be incapable of meeting Social purposes. Conversely, total dominance of social adequacy would create a welfare type program resulting in many of the same problems that plague our welfare programs today. As long as neither principle becomes dominant, both the well-off and the poor will feel they have a stake in the system. This is a major factor in the popular acceptance of Social Security.

Because of these limitations, many object to Social Security playing any major role in eliminating poverty because they claim it is inefficient. In other words, given expenditures through other pro-

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\*LARRY SMEDLEY is the associate director of the AFL-CIO Department of Social Security. This article is taken from his statement to the Advisory Council on Social Security.

grams would make a greater impact on poverty at less cost since they can be targeted to reach only the poor. The issue should not be decided solely on efficiency but on which programs will secure public acceptance and will do an acceptable job of reducing poverty. Enhanced prospects for legislative approval and receipt of benefits with dignity are two good reasons that Social Security is preferable to a means test approach to poverty prevention as long as the basic principles of the program are not impaired.

*Though the objectives* of Social Security are much broader than preventing poverty, it has been one of the most effective programs in doing so. More than 12 million beneficiaries are kept out of poverty by their Social Security benefits. But the program alone cannot be expected to resolve the nation's poverty problems, which require a multiple program approach and the more effective each individual program, the more circumscribed the problem and the more amenable to total resolution.

The Supplemental Security Income Program (SSI) is a good example of the multiple program approach. This program established a uniform federal supplemental minimum benefit program for the adult categories (aged, blind and disabled) in place of the state welfare programs for those groups and transferred the administration of those programs to the Social Security Administration. Other forms of income such as dividends, interest, pension and Social Security benefits are subtracted from the minimum and any deficiency is covered by a supplemental federal payment from general revenues.

Though still inadequate—some states are above the federal minimum and are required to maintain supplemental programs in order to maintain previous benefit levels—the program comes close to lifting all the adult categories out of poverty. By establishing minimum benefits for the first time in all parts of the nation, the legislation has clearly laid the foundation for a guaranteed income program above the poverty level for the aged, blind and disabled. One major priority of sound security of the future should be to raise the SSI benefits to at least poverty level.

### **General Revenue Financing**

*A major factor in the popular acceptance* enjoyed by the Social Security program is that all beneficiaries earn protection by working and by paying contributions on earnings. Thus, both the public and beneficiaries look upon benefits as a earned right.

Critics say the Social Security contribution rate is regressive because workers with low earnings pay a larger percentage of their total incomes than higher paid employees. They concede the benefits are progressive since they are weighted in favor of low-income workers but emphasize that contributions paid by low-wage workers bear heavily on already low incomes during the long period of their working years. The AFL-CIO, like these critics, is concerned about the burden of the Social Security tax on low- and middle-income workers during their working lives.

The best way to relieve the payroll tax burden and to secure additional funding would be to use general tax revenues with these revenues raised as much as possible by progressive taxation. It seems inevitable that Congress will have to resort to some general revenue financing. A major causative factor will be pressures on the payroll tax arising from the low birthrate. The fertility rates of recent years are expected to stabilize at a rate that will eventually produce zero population growth. In the future, this means a sizable increase in the number of retired workers relative to active workers. The 1977 ratio of approximately three workers for each beneficiary may decline to about two to one in the next century. In short, fewer people at work will have to support more retired people than in the past.

But the extent of the economic burden has been exaggerated. In any society, the working population has to support those who can't work: the children, disabled, unemployed and the like. This future dependency ratio will change little—and in fact may be more favorable—than it is at present. This ratio will include more older people but fewer in the other categories. In short, the economic burden for active workers will not change much. For the economy as a whole, increased costs for supporting the elderly will be largely offset by a decline in costs for the other sectors of the nonworking population, particularly children. Expenditures will decline for schools, day care and child-related services and these savings can be used to support the larger retiree population.

*These compensating gains* are not reflected in increased income to the Social Security program itself. For the total economy the cost problems are not that serious but it is a serious problem for the Social Security program because of the circumscribed manner in which it is financed. Exclusive reliance on the payroll tax would require major tax increases and would place the entire increased burden on a reduced proportion of wage earners. The problem is how to shift these compensating gains from a declining birthrate to the Social Security program to help pay for the increased costs for the greater

number of retirees. General revenue financing is the most feasible way to transfer to the program these financial gains elsewhere in the economy and at the same time provide greater tax equity.

Many European countries supplement employer-employee contributions by providing general revenues to their social insurance systems. The idea of using general revenue contributions for Social Security has also long been contemplated in the United States. The Committee on Economic Security, the group which drafted the original Social Security Act, anticipated the system would eventually need general revenue financing. Almost every Social Security Advisory Council has recommended some general revenue financing. Such contributions are already being used to meet a significant portion of program costs, wage credits for military service, hospital insurance for the noninsured, matching funds for the Medicare premium and for special benefits at age 72.

However, we believe that proposals to finance the disability and Medicare programs totally from general revenues without any worker contribution would undermine the social insurance principle of benefits as a matter of right. If adopted, it could in time lead to income and means tests. A major factor in Social Security's popularity is the absence of a welfare stigma. The public looks upon benefits as an earned right because workers have made contributions during their working lives. Therefore, organized labor historically has opposed general revenue financing of any of the Social Security programs that does not maintain the contributory principle—although labor strongly favors general revenue supplementing payroll taxes.

An excellent source of additional revenue would be to tax the full payroll of employers. The wage base is necessary to determine the employee contribution and the average wage on which benefits are based but it plays no role in the employer's tax. An employer's responsibility for the welfare of employees should be based on the total payroll, not just a portion of each worker's earnings. Employees must pay federal income tax on their contributions to Social Security but employers deduct their tax as a business expense. Thus there is every reason the employer should pay Social Security tax on the entire payroll.

### **Social Security and Private Pensions**

*Few of the aged* have significant supplemental sources of income. Though about half of U.S. workers in private jobs are currently covered by private pension plans, only about 24 percent of those

over 65 are receiving private pension payments. For the foreseeable future, Social Security will be the only retirement system for a majority of the retired population.

A major issue since the inception of the program has been the future relationship between Social Security and private pensions—whether the program should be made more adequate for those earning average and above-average wages, and thus reduce the role of private pensions.

A national public retirement system is the most socially efficient way to provide for pension protection. Private pensions tend to have defects that make it difficult, if not impossible, to effectively achieve major worthwhile social objectives. Most private pension plans, for example, (1) hold workers to jobs and reduce labor-force mobility, (2) do an inadequate job of providing income for survivors, (3) prevent portability of benefits, and (4) have major difficulties in keeping benefits up-to-date with increasing wages or the cost of living.

Pension plans have been established by most large employers and major industries, particularly those characterized by strong unions. Thus, the future growth of private pensions will depend largely on the willingness of small employers to start pension plans. But most lack a strong financial base and union pressure to provide pension protection. Though the vesting and other standards of the new pension reform law will insure that more pension plan participants receive entitlement to benefits, the law may also discourage the creation of new pension plans since its requirements, though laudable, create additional costs and burdens to employers.

*Recent Social Security* improvements and the growth of private pensions are no guarantee that the next generation of beneficiaries will be any better off than the previous generation. They will receive higher benefits than the earlier generation but in comparison with their customary standard of living these benefits may still be just as inadequate.

The elderly are always relatively worse off vis-a-vis the working population because of the lower productivity during their worklife than that of the next generation. Thus, the ability of any generation to save for old age is more restricted than that of the generation that follows. In addition, the savings and pensions acquired over these less productive worklives have been eroded by rapid inflation. Higher rates of inflation than in the past seems a permanent feature of our economy. This makes it more difficult to save for old age and to maintain living standards over much longer retirement periods.



*Even if inflation* is slowed or prices stabilized, the economic status of the aged will decline relative to those at work since the wages of workers increase in accordance with productivity and those who are retired do not share in these increased living standards. Thus, the greater the economic growth and the longer the retirement period, the wider the gap becomes in the economic position of the elderly relative to the working population. In short, the elderly now have a shorter worklife in which to accumulate savings, experience more rapid erosion of the value of these savings than in the past, both during and after their worklives, and must make provision to spread them over a longer retirement period. Such problems can be effectively balanced only by a national public system such as Social Security.

The Social Security program should be the primary retirement system for the nation's retired population. Clearly, private pensions will remain a significant factor in the overall retirement picture but their primary purpose should be to supplement Social Security benefits. The nation needs to discard the myth that Social Security benefits are only a minimum floor of protection and that the typical retiree can fill any gap by income from pension, investments and savings. Social Security benefits should be increased until older people can maintain a decent standard of living on these benefits alone.

## **Early Retirement**

*At the beginning of* the century only one out of three males aged 65 or over had left the labor force. Now more than two out of three do so. The ratio between work and nonworking time depends primarily on a nation's level of economic development—on labor productivity and the ability to which an economy can support its citizens in nonworking pursuits. Thus, labor-force participation is greatest in agricultural nations and lowest among the economically advanced.

Labor-force participation continues to decline in industrial countries not only because of earlier retirement but also because of greater education and training given the young before worklife begins. At the same time, improved health services that accompany industrialization also increase life expectancy. In fact, for the first half of the 20th century in the United States, both the working and nonworking lives of men increased and only in the second half has there been a decline in the time spent in the labor force by men.

The length of the retirement years is growing with more and more workers retiring early. In 1978, about 60 percent of U.S. working men who retired on Social Security did so “early” or before age 65. Since wives usually retire somewhat earlier than their husbands, many people now spend one-fourth, or even one-third of their lives in retirement.

Yet, planning and preparation for income in retirement—through private means or public programs—has been poor and the results are reflected in the economic situation faced by the elderly. Under the best of circumstances, the retirement years are often a hard time of life. Many of the elderly feel unwanted without a traditional role or status because they regard themselves as no longer having a useful function. Many are sick; even more are lonely.

*The trend toward early retirement* has resulted in pressure for an across-the-board reduction in the age 65 requirement for full benefits since a large majority of workers retire before that age. Such legislation, it is urged, would assist in meeting the overall problem of unemployment, would help a large group of persons who are unable to maintain the production pace of younger workers, and would help the many older persons who have chronic ailments not severe enough to qualify for disability benefits but severe enough to restrict their ability to secure and hold a job.

Obviously, when a worker should retire depends on many inter-related factors that vary greatly from one individual to another. Because of the physical demands of the job, the retirement decision of a laborer or coal miner may differ substantially from that of a white-collar worker. During their later working years, many older workers find the pace of their jobs beyond their physical ability. Large numbers of them also suffer from chronic ill health. The figures show that a large majority of workers who retire early do so involuntarily—a majority because of poor health and another large group because of layoff or discontinuance of jobs.

*The Social Security system* should provide more adequate protection for the victims of these problems. By introducing a greater degree of flexibility, the system could facilitate coordination with retirement and disability programs achieved through collective bargaining as well as other forms of social insurance so the special problems faced by many older workers could be more easily resolved.

The large number of early retirements because of ill health clearly demonstrates the need for improvements in the disability program. At the present time, the definition of disability is very stringent,

requiring that workers be unable to participate in any substantial gainful activity. This is particularly hard on older workers who frequently suffer from chronic ailments, are unable to work in their usual occupations, and cannot secure other employment because of age and ill health.

They are disqualified for disability because theoretically they might be able to work in some kind of job, no matter how unrelated to their previous occupation or how unavailable such a job is. A change in the definition of disability should be made to allow older workers to receive benefits if their impairments bar them from their regular occupation. Permitting older workers the right to receive disability benefits when unable to engage in their usual occupation—if coupled with provisions allowing retirement at age 60 at less than a full actuarial reduction—would, in effect, establish a zone of retirement after age 60.

This approach would allow also older workers more rational choices in retirement decisions based on their own individual circumstances. And it would avoid the problems of wholesale retirement at earlier ages that would develop from adoption of an across-the-board age reduction. The intent is to target program benefits to deal with social problems and avoid encouraging healthy workers to retire early.

*The employment problems* of older workers are inseparable from the national problems of unemployment. It is difficult to expand job opportunities for older workers when the job market is tight for all. Such efforts will work only in a favorable economic framework, for older workers cannot be placed in jobs that don't exist. Economic growth and expansion, and not raising the age of retirement, are the key factors which would keep older workers in the labor force.

Raising the age of eligibility for full Social Security benefits would save the system money but would break faith with workers who have paid benefits most of their lives on the assumption that they could retire at a specified age on full Social Security benefits. The proposal would also be at the expense of some of the poorest and most deprived of our older citizens.

In 1961, Social Security first began paying actuarially reduced benefits, permitting men to collect benefits at age 62 instead of age 65 if they were willing to accept permanently reduced monthly benefits. More men retired on reduced benefits than on regular benefits during the first year. The proportion of early retirees has increased so that now 60 percent of men retire on Social Security before age

65. And, as mentioned, more than two-thirds of them do so for two reasons: 54 percent because of poor health and 13 percent because of layoff or discontinuance of jobs.

These individuals would be the primary victims of raising the age of benefit eligibility. The solution is effective economic policies that will enable people to work. The result would be more income for the trust funds and more older workers remaining in and reentering the labor force from voluntary choice and not from economic coercion.

## **Women and Social Security**

*Recently, several Supreme Court decisions have done much to correct differential treatment between men and women by the Social Security law. But there is still a lot that can and should be done to improve the situation.*

The various provisions of the Social Security Act relating to the treatment of men and women can be divided into two categories. Those that contain specific reference to sex for the deliberate purpose of treating men and women differently, and those that make no specific reference to sex but indirectly result in differing treatment of men and women because of economic and social conditions extraneous to the law.

With regard to specific reference to sex, the AFL-CIO has long taken the position that all legal rights that flow from a worker's wage should be the same whether that worker is male or female. Therefore, the AFL-CIO recommends that all differences in the benefit treatment of men and women should be removed from the law. This would insure equality of treatment for all benefit purposes and would mean improved benefits for men as well as women.

The second category is much more difficult to deal with. It is difficult, in some cases impossible, to modify the Social Security Act to deal with all the socioeconomic imbalances that have arisen for reasons unrelated to Social Security.

Provisions which make no distinction as to sex still have a much different impact on women than on men. They reflect the economic and cultural differences of our society—some fair, some unfair. As society changes and discriminatory practices are eliminated, so will the impact of these provisions change. However, a number of improvements can be made that are desirable for all beneficiaries but at the same time strengthen Social Security protection for women. In the interest of furthering this objective, the AFL-CIO recommends the following changes:

- Eliminate the recent current work test (generally 20 out of 40 quarters) to qualify for disability insurance. The insured status requirements for disability particularly affect women. Because women frequently have interrupted employment due to child-bearing and child-rearing responsibilities, most do not qualify for disability protection. Only about 40 percent of women are covered by disability insurance compared to about 90 percent of men.

- Make disabled widows and disabled surviving divorced wives eligible for Social Security without regard to age and without an actuarial reduction in benefits. (This would also apply to males in the same categories.) There is no justification for withholding benefits until a disabled widow (or widower) reaches age 50 and then actuarially reducing them from each year prior to age 62. The reduced benefit amounts payable under these provisions are in many cases so low as to be of little help to the disabled beneficiary. Also, in many cases, the need of the younger disabled widow may be greater than that of the widow between age 50 and 60, since the wage earner who dies at an early age, leaving a younger widow, would have less opportunity to accumulate assets that might provide some resources for the widow.

- Provide benefits to disabled spouses of beneficiaries. A wife of a retired or disabled Social Security beneficiary who has not herself reached retirement age and is not caring for a young child is capable of working and supporting herself. This is not the case for a wife who is totally disabled. In many cases the husband's Social Security benefit is practically the only income available to help meet living costs of the couple.

- Modify the present benefit formula by increasing the number of drop-out years to better relate benefits to more current earnings. In calculating the average wage on which benefits are based, the Social Security law allows dropping out only five years of low or no earnings. This can be very harsh on workers who are for periods of time out of the labor market—particularly married women workers with children. Additional drop-out years would be particularly helpful to women workers who are unemployed or marginally employed for part of their working careers.

- Provide for optional computation of benefits based on the combined earnings of a working couple with a 20-year record of covered earnings after marriage but not in excess of the maximum wage base. Such a proposal was once adopted by the House Ways and Means Committee in 1972. It is possible for a working couple to receive less in benefits than another couple with only the husband working, even

though both couples have the same earnings and paid the same amount in payroll taxes. This inequity should be corrected and would be of help to working couples, particularly to working wives.

## **Retirement Test**

*The retirement test* is one of the most controversial and least understood provisions of the Social Security Act. This test provides that Social Security benefits are payable in full if a person's annual earnings remain below an exempt amount—\$4,500 for those over 65 and \$3,480 for those under 65. This amount is automatically increased periodically in accordance with increases in covered wages. If earnings exceed that level, the Social Security benefit is reduced \$1 for each \$2 of earnings in excess of the exempt amount. Many economists oppose the retirement test on the grounds it has an adverse impact on labor-force participation.

The Social Security program is an insurance program that insures against the loss of income from work and that pays benefits when the loss occurs. In other words, the purpose is to provide insurance against the loss of earnings because of retirement, disability or death of the worker. Like other forms of insurance, the program insures against specified risks and it does not pay benefits unless the risk against which it insures actually occurs.

It is true that the retirement test applies only to earned income. By paying benefits regardless of other financial resources, Social Security serves as a base on which other forms of protection such as investments, savings, insurance and private pensions can be built. Withholding benefits because of sources other than nonwork income would reduce incentive for savings and would make it impossible for most people to make provisions for a more financially secure old age than would be possible by Social Security benefits alone. It would also jeopardize the eligibility of private pension recipients to receive Social Security benefits. It might also increase the danger of the introduction of a means test for Social Security recipients.

*Repeal of the retirement test* would increase the cost of the Social Security program by billions of dollars a year now and more in future years. But only a very small percentage of total retirees have any benefits withheld under the retirement test. Its elimination would benefit inordinately that small group of people who would be eligible for benefits even though they are working full time.

As mentioned earlier, the large majority of aged persons are unable to work because of poor health or lack of employment opportunities. Obviously, this is a group for whom full-time work cannot be expected to be a satisfactory means of supplementing Social Security benefits. More adequate cash benefits are what is needed. This would help all beneficiaries including the large majority who do not work after retirement and would not be helped by elimination or undue liberalization of the retirement test.

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AFL-CIO AMERICAN FEDERATIONIST

## **AFL-CIO Statement on the Administration's Social Security Proposals\* (Part Two)**

Mr. Chairman, my name is Sol C. Chaikin. I am President of the International Ladies Garment Workers' Union, a Vice-President of the AFL-CIO and Chairman of the AFL-CIO Social Security Committee. It is in the latter capacity that I am testifying today. I appreciate the opportunity to present the views of the AFL-CIO on the Reagan Administration's Social Security proposals.

American workers regard Social Security as one of the most important programs the Congress has ever enacted. Only a generation ago, few workers had any protection for retirement, disability or for the family in the event of death. Today, practically every American is either a beneficiary, a contributor or the dependent of a contributor. The Social Security program is the foundation on which the retirement Security of virtually all Americans depends.

There is general agreement that the system has operated successfully over the nearly 50 years of its existence. It enjoys overwhelming public acceptance. In spite of its popularity, nobody would contend the program is perfect. It does have a financing problem. But program opponents, have resorted, to irresponsible and exaggerated statements in order to scare contributors and beneficiaries into believing that massive cuts are required to deal with this problem.

The most apt and recent example is the Reagan Administration's rhetoric accompanying its proposed slashes in Social Security protections. These proposals represent the strongest and most direct attack on the program since it was established. The proposed slashes are estimated to total \$81.9 billion in the five years starting in 1982. This is wrecking on a massive scale.

The centerpiece of these proposals is the cutbacks in benefits for workers taking early retirement. Millions of Americans now approaching the age of 62 would receive drastically reduced early retirement benefits. Under current law, persons retiring at age 62 receive 80 percent of full benefits—an actuarial reduction. The Reagan plan would cut this to 55 percent of full benefits. Other proposed changes in the benefit computation formula would actually reduce the amount to well below 50 percent of the full benefit. A full

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\*Statement presented by Sol Chaikin, Chairman, AFL-CIO Social Security Committee, before the Subcommittee on Human Resources, House Select Committee on Aging on June 1, 1981.



benefit for a worker retiring at age 65 today is about 41 percent of final wages. So we are talking about a slash in benefits which would result in a benefit equal to 20 percent of a single worker's wages or 30 percent for the worker with a spouse.

The stated purpose of the proposal is to "encourage" people to continue working. But studies have shown that more than 70 percent of workers retire before age 65 for several reasons—poor health or layoff or discontinuance of jobs. In short, these workers lack the physical ability to work at their usual occupations or can't find jobs and are not likely to find another job given their health and/or age.

The House Select Committee on Aging projects, based on Social Security Administration and Department of Labor data, that 7,650,000 individuals in the work force age 55-61 are expected to retire before age 65 in the years 1982-1990. Seventy-five percent of these retirees or 5.7 million workers will be unable to remain in the labor force or reenter once they are out due to ill health or other employment related problems.

The large size of the projected savings for this proposal is clear evidence the Administration knows this group will remain large and bear the burden of the cuts. This burden will be most onerous indeed for the maximum benefit payable in 1982 under the Administration's proposal to an age 62 retiree would be below the official poverty threshold.

Though the Reagan proposal may not pass, we are opposed to all compromises that would raise the age of retirement, increase the amount of the actuarial reduction or any other proposals that tamper with the early retirement provisions of the law. The result of such proposals is to place a disproportionate burden on those in poor health and on blue-collar workers whose jobs require strenuous physical efforts. In addition, such proposals would have a profound impact on collectively bargained pension plans and would devastate the value of their early retirement provisions.

Mr. Chairman, a great deal of attention has been paid to the Reagan Administration's early retirement proposal and perhaps, as a result, not enough to the other proposals for serious major program cuts. For example, the Administration would change the formula for determining benefits for retirees of all ages. As proposed, the change would reduce benefits over a five-year period from 1982 to 1987. The present replacement ratio for average earnings (\$13,800) is 41.4 percent and the Administration would phase this down to 38 percent over five years. That lower ratio would then apply to all future retirees.

In addition, the Reagan Administration would also postpone next year's cost-of-living increase by three months. Reagan wants to modify the escalator formula in a way that would reduce benefits by 1987 in an amount between 4 and 9 percent. Reagan wants to cut the minimum benefit for present and future beneficiaries and to eliminate student benefits for children of deceased workers and to restrict eligibility for the death benefit.

The overall impact of these proposals is devastating to the program and to those protected by it. Disability benefits are cut by about one-third and early retirement by 43 percent. Overall benefits, would be cut by 21-23 percent—more than twice the amount necessary to balance the system for the next seventy-five years.

Not only does the Administration lack the compassion to recommend liberalizing eligibility requirements for disability to mitigate the serious impact of its early retirement proposal on those who don't have the option of working, but it actually recommends severe tightening of the already too stringent requirement. It should not be forgotten that 80 percent of those who apply for disability benefits and are denied eligibility never work regularly again.

## **Financing**

The AFL-CIO recognizes the necessity for strengthening the financing of the old-age and survivors part of the Social Security system. This can and should be done without reducing benefits for recipients or protections for contributors. There are alternatives to the Administration's negative and defeatist approach consisting of massive program reductions.

The AFL-CIO has long been convinced that the use of general revenue to partially finance the Social Security system is the best way both to achieve greater tax equity, and to channel financial gains elsewhere in the economy, to the support of the Social Security program. The AFL-CIO supports the introduction of general revenue financing into all of the Social Security programs (OASDHI).

A good first step toward that objective would be to partially finance Medicare out of general revenue. Many individuals who oppose general revenue financing of the cash benefit programs do not object to this kind of financing for Medicare because benefits are not related to wages or contributions paid. The United States is one of the few advanced industrial nations in the world in which the Social Security system is financed almost entirely from payroll taxes.

We urge, in addition to 50 percent financing of Medicare from general revenues, the following back-up actions, to insure that Congress will not again be forced to deal with a short-term financing problem:

1. Authorize interfund borrowing to provide flexibility and support, in the event actuarial and economic forecasts are inaccurate. The Disability and Medicare Trust Funds are both running an actuarial surplus and these surplus funds could be transferred to the Old Age and Survivors Trust Funds which would significantly reduce the cost of resolving the short-run financing problem.
2. Insulate Social Security financing from the effects of high unemployment and economic downturns by compensating the trust funds during such periods for the decline in income in the absence of full employment that otherwise would be forthcoming. This concept was recommended by President Carter in 1977 and by the last Advisory Council on Social Security.
3. Include a provision in the Social Security Law stating that Social Security benefits, like interest on the national debt, will be paid from general revenues in the event payroll taxes are insufficient. The present moral obligation should be a legal one. This would reassure beneficiaries and contributors and strengthen public confidence in the program. This kind of provision was actually part of the law from 1944-1950.
4. Enact a refundable tax credit equal to 20 percent of the employee's and 5 percent of the employer's Social Security tax. The AFL-CIO approach, though providing a smaller overall tax cut, does far better by low- and middle-income workers than the Administration tax bill because the latter is heavily weighted in favor of the well-to-do. In addition, the difference between the two approaches would be more than sufficient to finance the proposed general revenue contribution to Medicare.

We believe that enactment of the recommendations we are making for shoring up the financing of the system will assure the financial soundness of the Social Security system for the next 25 or 30 years. Many of our suggestions would do much to resolve the long-range financing problem. But full resolution of this problem should wait until the most important variables can be judged with a greater degree of certainty. Very small differences in economic and demographic assumptions can lead to great variations in estimating the long-term costs. There is still plenty of time in which to determine the extent

to which present projections are valid and to take corrective action.

If it should be thought important that the 75-year actual projection show an exact actuarial balance, one possibility would be to set a tax rate in the next century that would fully finance the cash benefit programs. This is a device Congress has used in the past and which the last Advisory Council on Social Security recommended. But it should be understood that such a rate would only be a guess about conditions 50 to 75 years from now and would probably have to be adjusted at some future date.

### **Conclusion**

Because the Administration proposals are so horrendous, there is a danger the shock effect may encourage the American people to accept major cuts in their Social Security protection. In fact, this now appears to be the strategy of the Administration as they now state that their proposals are "negotiable." They may be to the Administration, but not to the AFL-CIO.

American workers have a direct stake, in fact an earned right, in the Social Security system. It is the foundation on which their retirement security rests. Now, that earned right and security are threatened. Social Security is based on a moral compact between the government and its citizens. Workers contribute during their working years on the expectation they will receive promised benefits when they are unable to work because of old age, death or disability. The government must keep its word to its citizens.

The AFL-CIO believes the Congress should meet the problem head on and, in our opinion, is honor bound to protect the system's financial integrity and commitments. There are effective ways to fully finance the benefits without cutting benefits. We urge you to support them.

## **Business Roundtable Retirement Income Policy Positions**

The Business Roundtable believes that all Americans should receive an adequate and secure retirement income. This retirement income should be provided by a balanced program of Social Security, private employment-based pension plans and individual savings.

The Business Roundtable also believes that the fundamental base for support of these programs is a strong and productive economy. Therefore, retirement income programs should be designed and financed in ways that will strengthen the economy.

Consistent with these beliefs, it is recommended that the proper role of Social Security is to provide a floor of retirement income for all workers. Once a floor of protection is provided through a mandatory program such as Social Security, additional retirement income should be provided by voluntary means such as through private employment-based pension plans and individual savings. Private pension plans and individual savings should be actively encouraged because they provide a valuable source of capital formation essential to assure a productive economy and offer greater flexibility to meet individual desires and circumstances.

### **Role of Social Security**

*The proper role of Social Security is to provide a floor of protection for all workers to replace a reasonable portion of income lost because of retirement. Further expansion of current Social Security benefit levels is neither necessary nor desirable.*

The Business Roundtable supports a mandated program such as Social Security to serve the essential role of providing a floor of retirement income. As evidence that Social Security is currently providing a reasonable floor of retirement income, studies have indicated that approximately 4 percent of the elderly receive income below the official poverty line compared to 6 percent of all other persons after adjustment for taxes, transfer payments and in-kind benefits. Remaining needs of those in poverty are best met through an expanding economy and means-tested programs targeted specifically to meet needs rather than through a general expansion of Social Security benefits.

Social Security benefits to middle-income wage earners replace a significant share of preretirement earnings particularly when adjustments are made for taxes, work-related expenses and the need to save for retirement. For example, studies of the President's Commission on Pension Policy indicate that Social Security benefits now replace 64 percent of the adjusted preretirement earnings of a single worker, age 65, whose earnings increased 6 percent each year to \$15,000 in 1980. If the worker was married, and the spouse was also age 65, the percentage of adjusted income replaced by Social Security increased to 90 percent.

The high incidence of homeownership among the elderly should also be considered when evaluating Social Security benefit levels. Among those age 65 and over, 72 percent live in their own homes and 84 percent of those homes are mortgage free. When this is recognized, it must be concluded that Social Security benefits provide a very substantial floor of income for those who are retired.

To assure that the Social Security program continues to serve its essential function, not only for this generation but for future generations as well, benefits must be maintained at levels that the working generation is willing and able to support. The demographics of the U.S. will require that an ever-expanding portion of the incomes of wage-earners be allocated to maintain existing benefit levels. In recognition of this, Social Security benefits should not be further expanded. In fact, actions such as those described later were recommended so that current workers and the children and grandchildren of those workers will not be faced with a financial burden they will be unable or unwilling to pay.

### **Role of Private Pensions and Individual Savings**

*Additional retirement income is best provided by advance-funded, private pension plans and individual savings. Private plans and individual savings should not be mandated but should be encouraged through properly designed incentives, legislation and regulations.*

Advance-funded private plans and individual savings provide a valuable source of capital formation needed to create jobs and improve the productivity of the economy. The pay-as-you-go funded Social Security program does not provide a source of capital and probably inhibits the accumulation of needed savings. Since a strong and productive economy is essential, additional retirement income

should be provided by private pensions and individual savings rather than through an expansion of Social Security benefits.

Once a floor of protection has been provided through a mandatory program such as Social Security, the allocation of additional resources for retirement income should be encouraged but not mandated. Mandating that additional resources be currently allocated to provide retirement income will place the heaviest burden on those least able to afford it, small businesses fighting for survival and young workers who are struggling to raise and educate children while facing the grossly inflated costs of homeownership. The opposition to Social Security tax increases is evidence that the public does not wish to be forced to devote additional resources to retirement income.

In addition, one of the principal advantages of private plans and individual savings is the flexibility they offer to meet different needs and circumstances. Mandatory plans would eliminate some of this desired flexibility. The determination of whether additional resources should be currently allocated for retirement income is best made by the free choice of individuals and their employers.

Voluntary private employment-based pension plans have achieved remarkable growth during the last several decades. They now cover approximately two-thirds of those employed full-time who meet ERISA participation requirements of age 25 and one year of service. While growth in private plan coverage slowed during the last decade, it should be recognized that there were major impediments to their growth such as the very rapid expansion of Social Security benefits and costs,\* ERISA and its substantial regulatory requirements and unfavorable economic conditions. Under more favorable economic conditions, a stabilized Social Security program and an improved regulatory environment, renewed voluntary pension plan growth should be anticipated. The government should adopt policies and programs that encourage, rather than discourage, the voluntary expansion of private employment-based pension plans.

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\*Social Security replacement ratios for average wage earners increased by almost 50 percent between 1970 and 1977. Maximum Social Security taxes more than quadrupled during the decade of the 1970s.

## **Incentives to Encourage Individual Savings**

*Legislation should be enacted that would permit tax-deferred employee contributions to either a qualified pension plan or to an IRA.*

Employee contributions to qualified pension plans should be tax-deferred to the extent permitted by an IRA. Also, employees who do not participate in plans that involve such contributions should be eligible to participate in an IRA. IRA limits should be expanded to recognize inflation since first enacted in 1974.

There is a substantial need to encourage additional sources of capital formation in the U.S. to improve the productivity of the economy. Individual savings represent a potentially significant source of capital formation. Unfortunately, the rate of individual saving in the U.S. is only approximately one-third to one-half that of many other major industrialized countries. In addition, the rates of saving in those countries have been increasing while the rate of saving in the U.S. has been decreasing. This is because most of those countries have provided incentives to encourage individuals to save.

Besides serving as a valuable source of capital formation, the individual savings generated by the recommended incentives would provide an additional source of retirement income. The experience of other countries indicates that persons at virtually all income levels are capable of accumulating significant savings given the proper incentives. This experience is confirmed by the experience of thrift plans in the U.S. even though the incentives to maintain the savings are modest. If employees were encouraged to share in the financial obligations of the pension plan, employers would be more likely to adopt new pension plans or to expand existing plans. This would alleviate pressure on the Social Security program.

The proposed legislation would also help control inflation. In the long term, the capital thus created would improve economic productivity. In the short term, the amounts saved would result in less immediate consumer demand.

## **Inflation**

*The adverse impact of inflation upon retirement income should be alleviated by effective control of inflation rather than by general indexation of all retirement benefits.*

Continuing high and unexpected rates of inflation create tremendous problems for many sectors of the economy, particularly for



those involving long-term obligations and savings such as the retirement-income sector. It is a fundamental responsibility of government to provide a currency that retains value to assure the survival of our economic system. Since governmental actions are largely responsible for creating inflation, governmental actions must be taken to control inflation.

Private pension plans should not be required to index benefits for inflation. Such indexation would only serve to institutionalize inflation and make its control more difficult. In addition, the financial uncertainties involved with such a requirement would discourage the adoption of new plans and would likely result in the termination of many existing plans. Instead of being required to index benefits, private plans should continue to be permitted to respond to inflation through ad hoc adjustments in benefits and through benefit formulas that recognize both inflation and the financial capability of the plan sponsor.

Social Security benefits should continue to be indexed for inflation to protect the retiree's floor of protection. However, many economists believe that the CPI overstates the impact of inflation on retirees. In addition, when inflation is caused by external forces, such as large OPEC price increases, those who are not protected by CPI indexation are required to bear a disproportionate share of the resulting financial burden. As a consequence, serious consideration should be given to developing a more appropriate measure of inflation as it affects retirees. In addition, Social Security benefit increases should be limited when average wages do not increase as rapidly as prices. The short-term financing problems of Social Security are largely the result of "real wage" losses, and any solution to the problem should reflect this fact.

### **Issues Involving Private Plans**

As indicated earlier, legislation and regulation should encourage rather than discourage the adoption and expansion of private employment-based pension plans. Private pension plans and individual savings provide means to assure a strong and productive economy. In addition, private plans and individual savings can alleviate the burden and dependence on the Social Security program and thereby reduce the potential for intergenerational conflict inherent in that program.

Any legislative or regulatory changes affecting private pension plans should be analyzed from the perspective of whether they en-

courage the adoption and expansion of these plans. Some proposed changes would be counterproductive, as they would impede the development of private plans. It is this concern that results in the conclusions and recommendations that follow.

*Improved vesting should be attained through voluntary rather than mandatory means, and legislation that would require full and immediate vesting of private plan benefits is not warranted.*

Employers provide pension plans to attract and retain capable employees. Current vesting requirements provide a reasonable balance between providing protection of retirement benefits and encouraging job stability, thereby enhancing worker productivity. Legislation to require full and immediate vesting would discourage employers from adopting new plans and would probably result in the termination of existing plans.

Full and immediate vesting would result in many small pieces of a pension with little value. The value of these benefits would not warrant the additional administrative expenses.

It should be recognized that most employee turnover occurs among young, short-service employees. It is not essential that pension credits be earned at this stage in workers' careers. However, as age increases, job stability also increases and valuable vested pension rights are earned at a stage in workers' careers when they are meaningful.

Proposals to improve vesting are frequently related to proposals involving portability of pension rights. These proposals sometimes involve the recommendation to establish a central portability clearinghouse. While portability is a complex issue warranting further study, use of existing mechanisms, such as IRA Rollover Accounts, should be encouraged instead of creating of a new federal agency.

*Effective private pension plan design can be accomplished only if private plan benefits and Social Security benefits are allowed to be integrated in an equitable manner.*

Social Security benefits replace a higher percentage of income for lower-income wage earners. In addition, no Social Security benefits are credited on earnings in excess of the maximum wage base. In recognition of these facts, the Internal Revenue Code permits private plan benefits to be coordinated with Social Security benefits so that

the combined benefits are reasonably related to preretirement earnings. That is, current integration rules allow private plans to pay proportionately higher benefits to higher income workers to recognize the fact that Social Security benefits to those workers are proportionately lower. However, the current integration rules are quite complex, and they do not permit the entire primary Social Security benefit to be recognized in the design of the private plan benefit structure.

Proposals have been made that would further restrict the ability of private plans to coordinate benefits with the Social Security program. Many of these proposals are counterproductive as they would require employers to provide a combined Social Security and private plan benefit that may actually exceed preretirement earnings for lower paid workers in order to provide a reasonable combined benefit for higher-income workers. If adopted, these proposals would discourage the expansion of private plan coverage.

If changes in integration rules are to be made, they should encourage private plan expansion and seek to simplify the current complex set of rules. In addition, the entire primary Social Security benefit should be permitted to be recognized to facilitate the most rational pension plan design. For example, a reasonable rule would simply state that the combined primary benefit from Social Security and the private plan should not be permitted to increase as a percentage of earnings, as earnings increase.

*Pension plan assets should be prudently invested on behalf of plan participants based upon proper analysis of risk and return relationships, and those with the fiduciary responsibility for investments should exercise ownership and control responsibilities.*

It is important to recognize that the primary objective of pension plan investment is to assure the payment of benefits promised to plan participants. This is the most important objective of the pension plan, and this objective must not be compromised by the introduction of conflicting "social" objectives intended to promote other interests. That is, investment return, for a given level of risk, must not be sacrificed in attempts to attain other objectives.

Similarly, ownership and control responsibilities are best managed by investment professionals with fiduciary responsibility. This will assure that the financial security of the benefits of plan participants will not be jeopardized in the pursuit of other objectives.

## Recommended Social Security Program Changes

The Business Roundtable supports a sound, adequately financed Social Security program and consequently, recommends the following changes. These changes will enable the program to serve the essential function of providing a floor of protection for all workers for this generation and future generations as well.

*The age at which full Old-Age benefits are available should be gradually increased for persons who are 20 or more years from retirement, but the changes should be enacted now so that those affected will have adequate time to adjust their personal and financial planning to the changed circumstances.*

Old-Age benefits are provided by a transfer of funds from the working portion of the population. The tax levels required to support the transfer must be kept at a reasonable level. As the number of workers relative to the number of persons receiving benefits declines, the burden could become intolerable.

The number of workers relative to benefit recipients, currently three to one, is projected to decline substantially and eventually reach two to one. This is the combined effect of improved longevity, the post-World War II baby boom and the subsequent decline in birthrates. For example, by the turn of the century, the life expectancy of individuals in their early 70s is expected to be the same as those age 65 when that age was originally selected for the program.

As a consequence, even scheduled tax increases are predicted to become inadequate to support the benefits. Further substantial tax increases would be required in the next century that would double or triple the current tax rates unless action is taken now to increase the age at which full benefits will commence in the years to come. (Comparable adjustments should also be made in other age requirements.) It seems neither fair nor wise to promise benefits which will require our children and grandchildren to pay a level of taxes which we ourselves are unwilling to pay.

The demographics of the country will likely result in future labor shortages. Our country will then need to encourage productive older members of our society to continue to work to produce needed goods and services. All policies of business and government, including those involving retirement income, should begin to be designed to encourage continued labor force participation.

*Mandatory universal Social Security coverage is recommended, to be accomplished in a manner which avoids creating benefit anomalies for the employees involved.*

All workers, including those in federal, state and local government, should be covered by Social Security. It is recognized that achieving this is not a simple matter, and it should be accomplished in a manner which protects the benefits accrued under existing benefit programs. Further, those existing programs should be modified to coordinate with Social Security.

Mandatory universal Social Security coverage would eliminate undesirable gaps in benefit coverage and provide a floor of protection which is transferable if employment changes take place. In addition, all workers would share in the responsibility inherent in the Social Security program of meeting some of the basic employment income replacement needs of the nation. Furthermore, universal coverage would avoid the problem of disproportionately large Social Security benefits resulting from second careers of short duration combined with a Social Security benefit formula favoring low average wage earners and also providing minimum benefits. If mandatory universal coverage is not adopted, legislation should be enacted to correct this "windfall benefit" problem.

## **Conclusion**

The Business Roundtable believes that all Americans should receive an adequate and secure retirement income. A strong and productive economy is the fundamental base to achieve this objective. Retirement income should be provided by a balanced program of Social Security, private pension plans and individual savings.

Private employment-based pension plans and individual savings offer means to improve the productivity of the economy and to recognize the diverse needs of Americans. Therefore, it is important that private plans and individual savings be actively encouraged through properly designed tax incentives, legislation and regulation. In addition, the government must assume responsibility for controlling inflation to create an environment that encourages the expansion of private plans and individual savings.

## **Business Roundtable Social Security Policy Positions**

The Business Roundtable supports the Social Security program in its role to provide a floor of protection to meet the basic need for replacement of employment income following retirement, disability and death. It should be properly designed and financed so that it continues to perform this essential function.

Legislative actions, beginning with the 1977 Social Security Amendments, are commended as they have made progress toward assuring the financial viability of the program. It is apparent however, that further actions are needed to enable the program to remain financially sound.

To assure that the program serves its essential function not only for this generation but for future generations as well, the Business Roundtable is pleased to furnish this statement of principles and recommendations.

### **Financing**

*Under our present tax structure Social Security should continue to be financed by payroll taxes shared equally by employers and employees.*

Equally shared payroll taxes are the most appropriate means for financing Social Security benefits. They are visible and enable the public to recognize the relationship between benefits and their costs. Payroll taxes also encourage fiscal and legislative responsibility and are capable of raising the large revenues required to finance benefits.

Current actuarial projections predict that the Old Age, Survivor Insurance Trust Fund will run out of money beginning in late 1982. Therefore, it is important that scheduled increases in payroll taxes be permitted to become effective unless there is a corresponding reduction in benefits. In addition, proposals to reallocate payroll tax rates among the three Trust Funds or to permit interfund borrowing provide reasonable solutions to substantially alleviate the predicted OASI short-term cash flow problems.

Some of the solutions for the short-term financing difficulties would require the introduction of general revenues. General revenues should not be introduced as they would weaken the relationship between benefits and their financing. Also, their use would undermine the basic principle that benefits are paid as a matter of earned

right rather than need, as typically required under programs financed by general revenues.

It is important to recognize that the introduction of general revenue financing would not result in an overall reduction in taxes, since benefit commitments must be met. Ultimately, new taxes or increases in income tax rates would be required to raise the necessary revenues. In the short run, a further increase in already substantial deficit spending is possible but would be inflationary, further weakening the dollar and confidence in our economy.

Similarly, proposals have been made to provide general revenue tax credits based upon some portion of the Social Security payroll taxes. This would represent an indirect form of general revenue financing. Therefore, these proposals should not be enacted.

## **Benefits**

*Social Security should provide a floor of protection to meet basic retirement, disability and survivor income needs, with additional needs best met by private employee benefit plans and individual savings.*

The basic benefit levels currently provided by the Social Security program are generally reasonable and further benefit expansion is not necessary or desirable. In a social insurance transfer program such as Social Security, a benefit formula favoring lower-wage earners is appropriate. Other aspects of the program designed to provide benefits that meet basic needs, instead of benefits directly related to taxes paid by or on behalf of the individual, may also be appropriate. Congress and the Administration should not accept the argument that a direct relationship between benefits and taxes paid is necessary, desirable or even possible. Benefit provisions should be reviewed critically to determine if they are really necessary to meet the basic need for replacing employment income. Some benefits may have been added to meet needs which are now met through other programs or best met through alternative means.

Social Security benefits should continue to be indexed for inflation to protect the floor of protection. However, many economists believe that the CPI overstates the true rate of inflation, particularly as it affects retirees. In addition, when inflation is caused by external forces, such as large OPEC price increases, those who are not protected by CPI indexation are required to bear a disproportionate share of the resulting financial burden. As a consequence, serious consideration should be given to developing a more appropriate

measure of inflation as it affects retirees. In addition, Social Security benefit increases should be limited when average wages do not increase as rapidly as prices. The short-term financing problems of Social Security are largely the result of "real wage" losses and any solution to the problem should reflect this fact.

Additional income, beyond the floor of protection provided by Social Security, is best provided through private employee benefit plans and individual savings rather than through governmental programs requiring additional taxes. Private plans and individual savings should be actively encouraged as they offer greater flexibility to meet individual desires and circumstances. In addition, these plans provide capital essential to create jobs and to improve the productivity of the economy.

### **Commencement of Old-Age Benefits**

*The age at which full Old-Age benefits are available should be gradually increased for persons who are 20 or more years from retirement, but the changes in the law should be enacted now so that those affected will have adequate time to adjust their personal and financial planning to the changed circumstances.*

Old-Age benefits are provided by a transfer of funds from the working portion of the population. The tax levels required to support the transfer must be kept at a reasonable level. As the number of workers relative to the number of persons receiving benefits declines, the burden could become intolerable.

The number of workers relative to benefit recipients, currently three to one, is projected to decline substantially and eventually reach two to one. This is the combined effect of improved longevity, the post-World War II baby boom and the subsequent decline in birthrates. For example, by the turn of the century, the life expectancy of individuals in their early 70s is expected to be the same as those age 65 when that age was originally selected for the program.

As a consequence, even scheduled tax increases are predicted to become inadequate to support the benefits. Further substantial tax increases would be required in the next century that would double or triple the current tax rates unless action is taken now to increase the age at which full benefits will commence in the years to come. (Comparable adjustments should also be made in other age requirements.) It seems neither fair nor wise to promise benefits which will



require our children and grandchildren to pay a level of taxes which we ourselves are unwilling to pay.

### **Mandatory Universal Social Security Coverage**

*Mandatory universal Social Security coverage is recommended, to be accomplished in a manner which avoids creating benefit anomalies for the employees involved.*

All workers, including those in federal, state and local government, should be covered by Social Security. It is recognized that achieving this is not a simple matter, and it should be accomplished in a manner which protects the benefits accrued under existing benefit programs. Further, those existing programs should be modified to coordinate with Social Security.

Mandatory universal Social Security coverage would eliminate undesirable gaps in benefit coverage and provide a floor of protection which is transferable if employment changes take place. In addition, all workers would share in the responsibility inherent in the Social Security program of meeting some of the basic employment income replacement needs of the nation. Furthermore, universal coverage would avoid the problem of disproportionately large Social Security benefits resulting from second careers of short duration combined with a Social Security benefit formula favoring low average wage earners and also providing minimum benefits. If mandatory universal Social Security coverage is not adopted, legislation should be enacted to correct this "windfall benefit" problem.

### **Retirement Test**

*Old-Age benefits should not be paid to persons who continue to have significant earnings from employment.*

As already mentioned, the primary purpose of the Old-Age Social Security program is to replace employment income. Consistent with this purpose, Social Security benefits should not be paid if significant employment income is present. It is difficult to justify transferring tax-free money from younger workers to older workers, particularly since unemployment rates are currently very high and short-term cash flow problems are predicted.

A retirement earnings test is now in the law. The 1977 Social Security Amendments scheduled a future liberalization in the age at

which the retirement test would no longer apply, reducing the age from 72 to 70 beginning in 1982. The liberalization should be repealed and the age 72 limit on the earnings test should be retained.

### **Public Understanding of Social Security**

*Greater efforts should be made to inform the public as to the purpose, nature and financing of the Social Security program.*

A very important problem confronting Social Security is the lack of public understanding of the program. Many of the criticisms of the program reflect this lack of understanding.

The program is essentially an intergenerational transfer program designed to meet desirable social objectives. Income is transferred from those presently working to those who were once workers and to the dependents or survivors of former workers.

It is unlikely that necessary changes can be made in the Social Security program as long as the present lack of understanding exists. The cost of the Social Security program, now and in the future, should be acknowledged. The future of the program depends upon public confidence in it and a willingness to pay for it.

### **Conclusion**

The Business Roundtable supports a sound, adequately financed Social Security program. It is apparent that legislative action will be required to assure the continued financial viability of the program. Therefore, it is hoped that this policy statement will be of assistance in determining the proper design and financing of the program.

**Chamber of Commerce of the United States**  
*Statement on Social Security Options\**

**Summary**

It is important that Congress act this year to resolve the very serious crisis confronting Social Security. As we testified to this subcommittee last March, this crisis can be met without increasing taxes or resorting to the improper remedy of general revenue financing by taking the following steps:

- (1) Put into effect accounting and administrative changes to redistribute existing revenues in a manner designed to postpone the exhausting of Social Security trust funds.
- (2) Eliminate certain unearned Social Security benefits, including student benefits and the minimum benefit. Make further improvements in the Disability Insurance program and begin long-range efforts to amend early retirement benefits. Also, modify the current method of providing cost-of-living increases to end unintended escalation of benefits.
- (3) Require all federal, state, and local government employees to participate in Social Security, i.e., provide for universal coverage.

This three-part package, if enacted, will overcome the impending cash shortfall, eliminate present inequities and make a major contribution toward meeting the critical long-term financing problems that are expected to confront Social Security in the next century.

In this supplementary statement, we compare our proposals with the Administration's proposals. In most instances, the Chamber proposals complement and support the Administration proposals.

We are extremely pleased to note our total support of the Administration's decision not to attempt to use general revenue financing to solve the Social Security financing problem. General revenue financing is not a solution. It would simply paper over the problem and bring higher inflation, higher interest rates, higher unemployment, and higher federal deficits.

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\*Taken from a June 12, 1981 submission to the Subcommittee on Social Security of the House Ways and Means Committee. Prepared by Michael J. Romig, Director, Human Resources and Employee Benefits Section.

## **Recent Administration Proposals We Support**

The U.S. Chamber's Board of Directors, in action taken on Wednesday of this week, endorses and fully supports the following Administration proposals:

- (1) Change computation points for average indexed monthly earnings from age 62 to 65.
- (2) Increase bend points in primary benefit formula by 50 percent (instead of 100 percent) of wage increases, 1982-1987.
- (3) Eliminate benefits for children of retired workers aged 62-64.
- (4) Make family maximum provisions of the disability program applicable to survivor and retirement cases.
- (5) Require "medical only" determination of disability, i.e., exclude vocational factors.
- (6) Increase disability waiting period from five months to six months.
- (7) Require disability prognosis of 24-month duration (instead of 12 months).
- (8) Require 30 quarters of coverage out of the last 40 quarters for disability benefits (instead of 20 out of last 40).

All the foregoing proposals are consistent with our conviction that we must contain the growth of Social Security's costs if we are to solve its serious financial problems.

## **Administration Proposals That We Recommend Be Amended**

The following Administration proposals would be improved with certain modifications. If amended as we recommend, we would fully endorse their enactment. These proposals and our suggested modifications are the following:

- (1) *Setting a benefit rate of 55 percent of primary benefit for those who retire (and 27 percent for spouses) at age 62, beginning next January.* Although the timetable is too abrupt, we concur in the Administration's objective of not encouraging early retirement. While it is actuarially appropriate to lower the benefit for age 62 retirees, it is equally important to raise the retirement age from 65 to 68 to recognize the increased life expectancies.

Thus, we would support full benefits at 68 with actuarial reductions for retirement before that age. For example, a 62-year-old would be eligible for a benefit equal to 64 percent of the full benefit at age 68 rather than 55 percent of the full benefit at 65 as suggested by the Administration.

Most importantly, we would delay implementing the proposals until about 1990, and phase them in over a period of years rather than abruptly imposing them next year. This would allow individuals and their employers time to make compensating changes in their planning and benefit packages without major cost implications or disruption of long planned retirements. This alternative matches that of Chairman Pickle in his Social Security proposals (H.R. 3207).

(2) *Move the date for automatic benefit increases from June to September 1982 and use a 12-month average.* As we testified in March, a fundamental revision of the Social Security COLA provision is absolutely essential. The problems facing Social Security are of such tremendous magnitude that it seems entirely appropriate to call upon current beneficiaries to help solve them. Since the COLA provisions played a significant role in creating the problem, correcting the over-escalation of benefits can now help resolve it. Hence, we recommend that, in addition to changing the effective date of the COLA, Congress change the formula to the lesser of the increase in yearly wages or prices. Both changes should become effective in 1982.

(3) *Eliminate the windfall portion of benefits for persons with pensions from noncovered employment to reduce the revenue loss of Social Security as a result of "double-dipping."* While we support this proposal, it merely addresses the symptoms and ignores the real problem which is the lack of mandatory coverage of federal, state and local government employees.

Universal coverage has numerous Advisory Council endorsements. Immediate coverage is recommended by the National Commission on Social Security, the President's Commission on Pension Policy and an H.H.S. Universal Study Group.

We need not tell you how important mandatory coverage of public sector workers is. It is impossible to see how Social Security could be reformed without eliminating this basic inequity. It is clearly unfair to exempt public sector workers from the nation's second largest tax while permitting them to enjoy windfall benefits through minimal coverage by Social Security.

Accordingly, we recommend that the Administration proposal be amended to provide for mandatory coverage of all public sector

employees, with coverage for new employees beginning as early as possible. For current workers, this would require an integration of civil service and Social Security benefits, which is the normal practice in the private sector.

### **Administration Proposals We Oppose**

The proposal to increase Social Security taxes by subjecting sick leave to the FICA tax is a tax increase at a time when tax cuts are needed. Although this change would yield a temporary small increase in revenues, it would, in the long-run, cost much more in benefit obligations. For employers, there is the added cost of hastily revising complicated payroll procedures.

We also oppose an Administration proposal to impose a full user fee upon any employer seeking earnings histories of his employees. The current Social Security Administration practice is to charge a portion of the expense to the requesting employer and remainder as an overhead expense of the OASDI trust funds. In some instances, no charge is assessed the requesting employer.

Employer requests are made mainly because of federal government requirements. ERISA requires an employer sponsoring a pension or profit sharing plan to maintain sufficient records on participating employees to calculate the accrued and vested benefit of any employee. Thus, the real user of the requested data is the federal government and the employee whose rights the federal government safeguards through ERISA. In addition, the administrative costs of Social Security have already been paid for out of the Social Security taxes imposed on both employers and employees.

### **Conclusion**

We would appreciate your consideration of our views. Our staff is available to assist the Committee on Ways and Means and its staff as you proceed with your deliberations to assure the solvency of the Social Security system.

# **Minimum Wage Study Commission A Summary of the May 24, 1981 Report, Volume I**

## **Projections of the Minimum Wage Population**

Determining what the number and distribution of minimum wage workers might be in five or ten years is fraught with uncertainty. Nonetheless, estimates may be made using labor supply projections that take account of the changing composition of the labor force and BLS unemployment forecasts together with some assumptions about the age and sex of minimum wage workers. Using the BLS labor force projections (Flaim and Fullerton 1978) under the intermediate growth scenario with the aggregate unemployment rate forecasts for 1985 (4.9 percent) and 1990 (4.5 percent), hypothetical employment distributions by age for those years were derived (Table 1-16).

The projections for 1985 and 1990 show an increase of about 2.5 million in the number of workers at or below the minimum wage but a decline to 11.5 percent in their proportion of total wage and salary employment from 12.4 percent in 1980. This is the result of offsetting trends among demographic groups. The decline in the number of youths aged 16-24, who have a relatively high propensity to be at or below the minimum, offset the increase in middle-age groups, primarily women, who are less likely to be earning the minimum wage. Both male and female teenagers, who accounted for 30 percent of all minimum wage workers in 1980, are expected to make up less than 25 percent by 1990. The proportion of those 20-24 years old is expected to drop from 17 percent to 14 percent, while the proportion of men and women aged 25-64 will rise from 12 to 13 percent and 33 to 43 percent, respectively.

## **Recommendations**

1. The Commission unanimously recommends that the Department of Labor on a regular basis provide tables and analyses on the basic characteristics of minimum wage workers including age, sex, race, family relationship, household income, and poverty status. Particularly important is the linking of statistics on employment status and earnings of minimum wage workers with their family income.

**TABLE 1-16**  
**Wage and Salary Employment of Persons At or Below the**  
**Minimum Wage by Age and Sex, Second Quarter 1980,**  
**and Projections for 1985 and 1990**

Age and Sex	(Numbers in thousands)					
	1980		1985		1990	
	Number	Percent	Number	Percent	Number	Percent
All Minimum Wage Workers <sup>1</sup>	10,615	100.0	12,615	100.0	13,147	100.0
Percent of all employed	12.4	—	11.7	—	11.5	—
<b>Men</b>						
16 Years & Over	3,895	36.7	4,118	32.6	4,042	30.7
16-19 Years	1,505	14.2	1,435	11.4	1,351	10.3
20-24 Years	788	7.4	675	5.4	580	4.4
25-64 Years	1,287	12.1	1,570	12.4	1,681	12.8
65 Years & Over	315	3.0	438	3.5	430	3.3
<b>Women</b>						
16 Years & Over	6,721	63.3	8,497	67.4	9,105	69.3
16-19 Years	1,762	16.6	1,831	14.5	1,080	13.8
20-24 Years	1,062	10.0	1,277	10.1	1,168	8.9
25-64 Years	3,535	33.3	4,957	39.3	5,629	42.8
65 Years & Over	362	3.4	432	3.4	431	3.3

Note: Individual items may not add to totals because of rounding.

<sup>1</sup>See Note 2, Table 1-1.

2. The record does not justify the establishment of a youth differential.

Also, there is no evidence that areas with the highest youth unemployment rates would be the most likely beneficiaries of a youth subminimum.

3. The Commission recommends that the minimum wage be indexed on the basis of average hourly earnings in the private economy and adjusted each year on the basis of the previous year's overall rate of change in this index. The Commission further recommends



that Congress confer with the Bureau of Labor Statistics to devise a suitable index that incorporates both average hourly earnings in the private nonfarm business sector and in the farm sector. The Commission concludes that regular and predictable increases in the minimum wage would be noninflationary and would be easier for business to adjust to than the irregular increases of the present system.

4. The Commission recommends eliminating the conglomerate test for those individual exemptions it has found justified because of the type of job, industry, or worker involved. The Commission also recommends eliminating the conglomerate test for those exemptions designed to protect small businesses. For that purpose, the sales cutoff test at the enterprise level, already present in the retail trade exemption, should continue to be used. Accordingly, sec-13(g), which denies the minimum wage exemptions for certain small farm, retail, and service businesses owned by conglomerates meeting specific criteria, should be removed.

5. The Commission views the overall level of noncompliance with the Fair Labor Standards Act as unacceptable. It is our view that Congress should address this issue by attempting to increase the cost of not complying with the Act. To this end, the Commission recommends that Congress consider raising the liquidated damages that may be awarded in successful FLSA litigation. Furthermore, Congress ought to consider increased self-enforcement through, for example, legislation, to allow class-action suits by aggrieved employees. Such a possibility would have the dual advantage of sponsoring self-enforcement and simultaneously increasing the cost of noncompliance to violators of the Act. Lastly, the Commission believes that the high incidence of noncompliance within the retail trade and service sectors may provide useful information for the Department of Labor as it considers the best means of allocating FLSA field investigators.

The Commission did not develop reliable data on child labor violations since it is not a part of our mandate to study child labor. But the Commission believes that exploitive child labor is such a pernicious practice that it should always have a high priority in the Department of Labor's enforcement activities.

The Commission notes that the Department of Labor has reported to Congress that over the past four years the number of workers subject to the Fair Labor Standards Act has increased about 16 percent; simultaneously, the number of the Department's FLSA field investigators was reduced 4 percent. This evidence, coupled with the

noncompliance findings of the 1979 Noncompliance Survey, leads the Commission to conclude that the noncompliance problem cannot be resolved without concerted effort. It is the Commission's view that changes in the enforcement provisions as recommended above, increases in investigative resources and/or a directing of enforcement resources toward those sectors identified as significant violators will encourage increased compliance with the Fair Labor Standards Act.

## **National Commission on Social Security A Summary of the 1981 Final Report\***

### **A. Financing the Social Security and Medicare Programs**

- (1) The tax rate schedule for Old-Age, Survivors, and Disability Insurance (OASDI) should be changed so that the program is adequately financed over the next 75 years and maintains, on the average, a contingency reserve of at least one year's outgo (see Table 4-5 in Chapter 4 for details on the tax schedule).
- (2) One-half of the cost of the Hospital Insurance program should be financed from general revenues, beginning in 1983.
- (3) The other half of the Hospital Insurance program should be financed from payroll taxes. The payroll tax rate schedule for Hospital Insurance (HI) should be revised so that the program is adequately financed over the next 75 years and maintains, on the average, a contingency reserve of at least one year's outgo (see Table 4-5 in Chapter 4 for details on the tax schedule).
- (4) In general, the reduction in the HI payroll tax rates (as described in Recommendations 2 and 3 above) should be utilized for the purposes of financing the OASDI program (as described in Recommendation 1 above).
- (5) In recognition of the general-revenues cost for reducing the employee tax rate for Hospital Insurance, a 2½ percent surcharge should be added to the Federal personal income tax.
- (6) The combined employer-employee tax rate for OASDI and HI combined should not exceed 18 percent—9 percent for employers and 9 percent for employees. When this would otherwise occur, the excess over 18 percent is financed from general revenue payments to OASDI (see Table 4-5 in Chapter 4 for details on the tax schedule).
- (7) The tax rate for the self-employed should continue to be 1½ times the employee rate for OASDI and the same as the employee rate for HI (see Table 4-6 in Chapter 4 for details on the tax schedule).

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\*Taken from the final report of the National Commission on Social Security (March 1981).

- (8) The maximum taxable earnings base for both OASDI and HI for both 1985 and 1986 should be maintained at its 1984 level (estimated to be \$39,000) and then automatically adjusted thereafter.
- (9) Borrowing should be authorized among the OASI, DI, and HI Trust Funds, on a permanent basis, repayable with interest.
- (10) As an emergency measure only, borrowing should be authorized by any of the trust funds from the General Treasury until the end of 1985, the loans to be repayable with interest.
- (11) The operations of the OASI, DI, HI, and Supplementary Medical Insurance Trust Funds should be removed from the unified budget of the United States government.
- (12) The chief actuarial officers should provide a certification in the annual Trustees Reports as to the assumptions and methodology used in preparing their actuarial cost estimates and valuations.
- (13) No changes should be made in the financing of the Supplementary Medical Insurance program, because it is now adequately funded.
- (14) Payments to the Railroad Retirement Account under the financial interchange provisions between the Social Security and Railroad Retirement programs should not be made in those cases where the Railroad Retirement program does not pay benefits to the individuals for whom such payments are made (e.g., divorced widows).

## **B. Retirement Age under Social Security**

- (1) Beginning in the year 2001, the minimum age at which unreduced retirement benefits are available should be increased gradually from 65 to 68, reaching 68 in 2012. The corresponding minimum ages for other types of benefits (including those for spouses, widows, and widowers) should similarly be increased, and this should also be done in tandem for persons claiming reduced benefits at earlier ages.
- (2) Larger increases in benefits should be available for persons who delay retirement beyond the normal retirement age. (Those reaching 65 before 1982 would not qualify because under present

law they are more favorably treated in the computation of benefits with regard to earnings after 65.)

### **C. Earnings Test under Social Security**

- (1) The earnings test, which measures whether a worker has retired, should be retained.
- (2) The age at which the earnings test no longer applies, which is scheduled to be lowered from 72 to 70 in 1982, should be left at age 72 (until 2001, when it should move up in tandem with the minimum age for unreduced retirement benefits).
- (3) To partially offset the effect of the earnings test in withholding tax-free Social Security benefits, a refundable credit under the Federal income tax should be provided, increasing with the age of the individual. (This would not be available to those reaching age 65 before 1982 for the reason stated in Recommendation B-2 above).

### **D. Benefit Amounts under Social Security**

- (1) The Maximum Family Benefit for disability cases should be increased, so that it is the smaller of (a) 80 percent of the highest five consecutive years of earnings (indexed) or (b) the maximum applicable to retirement and survivor benefits.
- (2) The special minimum benefit, applicable to persons with long periods of coverage and low earnings, should be changed by increasing the maximum number of years creditable therefore from 30 to 35 and by permitting up to ten years of child care (for care of children under age 6) to be counted as creditable years for these purposes.
- (3) Widows' and widowers' benefits for persons who are widowed before age 60 (and before the deceased spouse reached age 60) should be computed by indexing the earnings record of the deceased worker by wages during the period between death of the worker and the time benefits are payable. (At present, such indexing is done by prices.)
- (4) The automatic benefit increases resulting from changes in the Consumer Price Index should be limited when, over a two-year

period, the CPI has risen more rapidly than wages. (The increase should then be reduced by the excess of the two-year average annual rise in the CPI over that in wages.) This procedure should only be used when the benefit increase which would be based on the CPI rise is 5 percent or more. There should be a retroactive ‘‘catch up’’ in future years, if wages rise more rapidly than the CPI, to make up for such reductions.

- (5) The automatic benefit increases resulting from changes in the CPI should be based on the CPI for all urban consumers, rather than on that for urban clerical and manual workers only.
- (6) A special index to measure price changes for the elderly should be constructed and considered for use in indexing Social Security benefits. Separate indexes should not be used for every beneficiary group.
- (7) The windfall portion of benefits arising from periods of noncovered government employment in the future (due to the weighted benefit formula) should be eliminated.

#### **E. Disability Benefits under Social Security**

- (1) For the purpose of determining continued eligibility for disability benefits, the dollar amount of Substantial Gainful Activity should be raised to the exempt amount under the retirement earnings test for persons under age 65.
- (2) The dollar amount used in determining whether a month is included in the trial work period should be indexed for future years by changes in average wages.
- (3) The Maximum Family Benefit applicable to disability cases should be liberalized (see Recommendation D-1 above).

#### **F. Social Security Hearings and Appeals**

- (1) In disability cases, applicants should be informed of their right to have their treating physician comment on the findings of consultative examinations ordered during the adjudicative process.
- (2) Administrative Law Judges should hold prehearing conferences when requested by disability applicants who are represented by counsel.

- (3) A new Social Security Court should be established to take over the functions of the Federal District Courts in appeals of Social Security cases.
- (4) Hearings under the Supplementary Medical Insurance program should be conducted by a Federal employee, instead of a representative of the insurance carrier.

### **G. Miscellaneous Social Security Benefit Provisions**

- (1) Child's benefits payable to children aged 18-21 because of school attendance should be suspended for months when the beneficiary is not attending school full time, and greater efforts should be made to collect overpayments of child school-attendance benefits.
- (2) When either spouse elects to receive a separate benefit check, the total benefit payable to the two spouses should be divided equally between them.
- (3) Marriage and remarriage should be eliminated as terminating events for Social Security benefit entitlement.

### **H. Extension of Social Security and Hospital Insurance Coverage**

- (1) Hospital Insurance coverage should be extended in 1982, on a mandatory basis, to all governmental employees (Federal, state, and local).
- (2) Social Security coverage should be extended in 1982 (on a mandatory basis) to all governmental employees not now under a retirement system.
- (3) Social Security and Hospital Insurance coverage should be extended in 1982 (on a mandatory basis) to the President, the Vice President, members of the Cabinet, the Commissioner of Social Security, and members of Congress. Civil Service Retirement benefits and contributions for these officials should be reduced by the Social Security benefits accruing and the Social Security taxes, respectively.
- (4) Social Security and Hospital Insurance coverage should be extended in 1982 (on a mandatory basis) to all employees of non-

profit organizations (except that any such organization operated by a religious sect which is opposed to public insurance could opt out).

- (5) Social Security coverage should be extended in 1985 to all new governmental employees in positions which are covered by a retirement system now in existence.
- (6) The option for state and local governments and nonprofit organizations to withdraw from coverage that had previously been elected should be eliminated, after a one-year grace period.
- (7) The portion of benefits accruing for governmental employees who have future periods of noncovered governmental employment which are windfalls should be eliminated (see Recommendation D-7 above).
- (8) A Federal Employee Benefit Protection Board should be created to review and make recommendations to the President and Congress on the implementation of coverage for Federal employees and how the existing government-employee plans should be modified and coordinated with Social Security and Medicare. The Board should include representatives of Federal employee organizations.
- (9) The minimum-earnings requirements for coverage should be increased as follows: domestic workers, from \$50 per quarter to \$150; casual labor, from \$100 per year to \$150 per quarter; and self-employed persons, from \$400 per year to \$600. (The test of \$150 per year for farm workers should be retained, but the alternate test of 20 days per year of work for one employer should be eliminated.)
- (10) All payments made directly by an employer to an employee on account of sickness should be considered wages, but only for periods up to six months after the last month worked.

## **I. Medicare Benefit Provisions**

- (1) The minimum age for eligibility for Medicare benefits, except in disability cases, should be moved up gradually from 65 to 68, beginning in 2001, in the same manner as Social Security retirement benefits.



- (2) The waiting period for Medicare benefits coverage for disabled beneficiaries should be reduced from 24 months on the Social Security roll to 12 months.
- (3) A catastrophic cap should be placed on a person's annual cost-sharing payments for Hospital Insurance and Supplementary Medical Insurance. It should be \$2,000 for 1982, to be indexed in subsequent years by the change in the CPI.
- (4) Hospital benefits should be determined on a calendar-year basis, rather than a spell-of-illness basis. No more than one initial deductible should be payable in any one year.
- (5) The daily coinsurance for hospital benefits should be changed from 25 percent of the initial deductible for days 61-90 (and 50 percent for the lifetime reserve of 60 days) to 10 percent for days 51-100 and 5 percent for days 101-150, with no lifetime reserve days. The initial deductible would remain the only cost sharing for the first 50 days.
- (6) Home health visits should be reimbursed under Supplementary Medical Insurance, except for persons who have only Hospital Insurance, who would be reimbursed under that program.
- (7) The maximum benefit for outpatient psychiatric services under Supplementary Medical Insurance should be increased from \$250 to \$375 per year. The services of community health centers should be reimbursed.
- (8) Benefits should be paid for hospital care outside of the United States which is not now covered. The maximum amount of the benefit would be at the rate of 50 percent of the initial deductible per day of hospitalization, less the usual cost-sharing payments.
- (9) The costs of laboratory services for hospital inpatients should be billed under the Hospital Insurance program, rather than under Supplementary Medical Insurance, even when the services are provided through an outside laboratory.

## **J. Medicare Reimbursement and Health Care Costs**

- (1) Experiments with negotiated fee schedules for physicians and prospective reimbursement for hospitals should be continued and extended.

- (2) Medicare and Medicaid should not be used as instruments to limit the rise in health care costs. However, the programs should encourage further experimentation with groups like Health Maintenance Organizations. Federal and state governments should encourage competition in the delivery of health care services in order to restrain cost increases.
- (3) Hospitals participating in Medicare should retain the right to nominate intermediaries.

### **K. Supplemental Security Income**

- (1) Payments under the Supplemental Security Income program should be increased by 25 percent, and recipients should no longer be eligible for food stamps. States should be required to maintain their current level of supplementation.
- (2) The assets test for eligibility in the basic payment when the recipient lives with others should be eliminated.
- (3) The reduction of one-third in the basic payment when the recipient lives with others should be eliminated.
- (4) The general income disregard should be increased from \$20 to \$40 and, in the future, should be indexed by the CPI.
- (5) The earned income disregard should be indexed to changes in the level of wages, beginning in 1981.
- (6) SSI payments should be indexed in the same manner as Social Security benefits, including a maximum limit in periods when wages rise less rapidly than prices.

### **L. Medicaid**

- (1) All individuals whose income is 65 percent or less of the poverty standard should be eligible for Medicaid. This should be a requirement for Federal approval of a state's Medicaid plan.
- (2) The "medically needy" should be eligible for Medicaid (with a spend-down provision), with a maintenance-of-effort provision being applicable to the states.
- (3) Medicaid eligibility for disabled recipients of Supplemental Security Income should not terminate before the person becomes

entitled to Medicare, in cases where ineligibility is based solely on receipt of Disability Insurance benefits.

- (4) The states' option to base Medicaid eligibility for SSI recipients on 1972 Medicaid standards, resulting in some SSI recipients not being eligible for Medicaid, should be eliminated.
- (5) Reimbursement to physicians for Medicaid should be raised to the levels paid by Medicare.
- (6) Coverage of abortions under Medicaid should be the same as that for any other covered medical procedure.

#### **M. Program Administration**

- (1) An independent government agency should be established to administer the Social Security, Medicare, Supplemental Security Income, and Medicaid programs.
- (2) Additional resources should be made available to improve the administration and delivery of services to beneficiaries. Arbitrary limits on personnel and resources for the administration of these programs should be eliminated.
- (3) Social Security District Offices should have at least one specialist in disability cases and also staff trained to provide information about Medicare, and efforts should be made to tell beneficiaries that such information is available.
- (4) The W-2 income tax forms should provide more specific information as to the meaning of terms and the allocation of the Social Security and Hospital Insurance payroll taxes.

#### **N. Private Pensions**

- (1) Employers should not be required by law to establish pension programs for their employees.
- (2) The present \$1,500 annual limit on contributions which can be made under the Individual Retirement Account (IRA) program should be increased.

## **O. Other Recommendations**

- (1) The states should be encouraged to establish standards of eligibility under needs-tested programs for persons who divest themselves of assets, within the limits prescribed under present law.
- (2) A separate program should be established to provide long-term care for the aged and the chronically disabled. It should include nursing home services, home health and homemaker services, adult day-care, and nutritional services.

## **National Commission on Social Security Summary of Nationwide Survey of Attitudes Toward Social Security\***

### **Retirement Attitudes**

Although more Americans look forward to retirement than do not, they tend to have some reservations about the quality of retirement life. Most people are more concerned about not having enough money than about having enough to do in retirement.

Most Americans retire involuntarily. About two out of three of the retirees surveyed say they retired because of poor health or because of a mandatory retirement age or because they lost their jobs.

About one out of two Americans say they find early retirement (at about age 60) appealing. Early retirement is particularly appealing to blue-collar workers, to people covered by pension plans, to people between the ages of 35 and 54, and to people with high family incomes (over \$17,500).

Early retirement seems less appealing after retirement to people who are retired than to those who have yet to retire.

Only one-third of Americans find the idea of postponing retirement until age 70 appealing. Four in ten people say they would consider late retirement if they could receive significantly higher benefits as a result. In general, there is a close relationship between income and attitudes toward retirement; those who have or expect greater financial resources are generally more positive about retirement.

### **Retirement Income**

Nine out of ten nonretired Americans expect to receive Social Security in retirement, and 60 percent expect it to be a major source of retirement income. Among those already retired, 75 percent find it to be a major source of income. Only among nonretirees with family incomes over \$25,000 is Social Security overshadowed by other sources of expected retirement income. About one-third of retired Americans say their income allows them to live comfortably, about one-third say it is only enough to pay monthly bills and obli-

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\*Taken from *The Final Report of the National Commission on Social Security*, Appendix A (1981). This report was prepared for NCSS by Peter D. Hart Research Associates, Inc.

gations, and a slightly smaller number, 25 percent, say it is not enough to pay their monthly bills and obligations.

### **Knowledge of Social Security**

Most Americans have a good working knowledge of the Social Security system. Most understand the main features of the system and its underlying philosophy, although some do not know about specific details.

- Most people know that there is a relationship between the amount of Social Security benefits and the amounts of previous wages and salaries.
- Most realize that Social Security is intended to supplement other retirement income rather than to serve as the sole source of income.
- Most are able to volunteer that funds for Social Security come from taxes paid by employees, and when asked directly, about two out of three know that such taxes are paid by employers as well.
- About three out of four know that there is no needs-test to qualify for benefits.
- Most Americans know there have been increases in both Social Security benefits and taxes over the past ten years. They tend to say that benefits have increased “somewhat” and that taxes have increased greatly during that period. They tend to anticipate similar increases in both taxes and benefits over the next ten years.
- Many are aware of nonretirement benefits provided by Social Security, such as disability and survivors’ benefits and Medicare.
- About two out of three know that Social Security taxes are not set aside in individual accounts for future retirees, but are used to pay benefits to current retirees.

In two areas, however, substantial numbers of Americans are misinformed.

- Most do not know that federal employees are not covered by Social Security.

- Most are not aware that Social Security benefits increase automatically with the cost of living.

### **Satisfaction With Social Security**

Most Americans are neither extremely satisfied nor totally dissatisfied with Social Security. Respondents' overall impressions, however, are favorable. They are able to volunteer more advantages than disadvantages of Social Security and they tend to express a low level of objection to Social Security taxes in comparison with other taxes.

The most frequent complaints are about benefit levels. Although most Americans recognize that benefits are intended to supplement other sources of retirement income, most feel that Social Security alone should provide enough income to meet retirees' basic needs and obligations. Also, many Americans believe that Social Security disability and survivors' benefits are inadequate; this belief is particularly prevalent among those with low incomes, who are unlikely to have other protection against those eventualities. On the other hand, there is no great dissatisfaction with the fact that the system pays higher benefits to those who have earned more and paid more in taxes. About two-thirds of Americans recognize that the system works this way, and they believe that it should.

### **Confidence in the Future of Social Security**

Many Americans are concerned about the ability of the program to deliver future benefits at the levels now authorized. Sixty-one percent of the nonretired have little confidence that funds will be available to pay their retirement benefits. These doubts were expressed by almost three-quarters of those between ages 25 and 44. On the other hand, most Americans indicate that they expect Social Security to provide a significant part of their retirement income.

The large majority of people express basic support for Social Security. Only 19 percent say that, given the choice, they would leave the Social Security program, and fully 75 percent oppose ending the program altogether; 67 percent strongly oppose doing so.

### **Level of Social Security Taxes**

In general, only about one in four Americans say that current Social Security taxes are too high, given the retirement, disability,

survivors', and Medicare benefits provided by the program. Given the choice of higher Social Security taxes or lower future retirement benefits, higher taxes are selected by 63 percent. If the choice were between higher taxes and raising the retirement age, only 36 percent would favor raising the age for full retirement benefits from 65 to 68. A narrow plurality (43 percent to 35 percent) would favor financing Medicare from income taxes and other federal tax sources rather than raising Social Security taxes. When the choice is between two revenue sources to pay for benefits, pluralities favor the payroll tax over the federal income tax (49 percent to 26 percent) and over a national sales tax (45 percent to 31 percent).

### **Opinion of Social Security Administration**

Almost half of all adult Americans have had some contact with the Social Security Administration, and the agency receives high marks from these people in terms of efficiency, service, and courtesy. Respondents tend to rate the Social Security system the same as or better than the other government agencies with which they have had contact.



**Ontario, Canada**  
**Royal Commission on Pensions**  
**A Summary of the 1981 Final Report\***

The Commission's thinking can be distilled into three basic points:

1. All retirement income provision should be viewed as a *system* so that:
  - each element of the system—government programs, employer plans, individual savings—can be analyzed as to its effectiveness;
  - the overall result can be assessed against some well-defined principles and objectives.
2. *Disclosure* of all relevant information is essential. Without full and accurate information, an individual cannot make judgments about his retirement needs and the level of savings needed to achieve desired retirement income levels.
3. *Cost-benefit* relationships must be recognized. Long- and short-term costs must be taken into account to ensure fairness between succeeding generations. Government programs must be designed on the basis of actual needs rather than on the principle of universality, especially given economic realities.

Although not explicitly mentioned, other themes that pervade the Commission's conclusions and recommendations are:

- emphasis on the primary provincial pension role rather than federal, albeit with full federal and interprovincial cooperation.
- intergenerational transfer for basic benefits (including minimum, OAS and CPP) is not a problem, but all other benefits to be fully funded.

### **Goals for a Retirement System**

The Commission believes that the provision of retirement income should be viewed as a *combined* responsibility of the individual and

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\*Taken from the Towers, Perrin, Forster & Crosby Bulletin, February 1981.

government. The government should design any social programs to achieve two goals:

—to guarantee a *minimum* level of pension; and

—to replace a measure of preretirement income.

A system designed to meet these goals should not deny the *primary* responsibility of the individuals but should recognize that some individuals will always be unable to make adequate provision without government support.

## The Commission's Plan for the Future

### —*Guaranteed Minimum Income*

The Commission believes that the goal for the minimum income and the immediate need to ameliorate the plight of the elderly poor can be best achieved through the fully indexed income-tested supplements provided under the Old Age Security Act and the ancillary guarantees at the provincial level (the Guaranteed Annual Income System or "GAINS" in Ontario). Any improvements should be based on *actual* needs and *available* income, taking account of other subsidies built into the tax and other programs. The Commission shuns improvements in universal payments such as OAS, which would provide monies regardless of need and thus dissipate resources.

### —*Retirement Income*

The Commission has put forward a multi-pronged approach to achieve the replacement income goal:

- *Continuation of Canada Pension Plan benefits* at the present level—funded on a "pay-as-you-go" basis. The Commission rejected both the expansion and the full funding of CPP.
- *Establishment of a Compulsory Provincial Plan* for all workers, employed and self-employed, the Provincial Universal Retirement System (PURS). The system would be a "money-purchase" plan requiring employee and employer contributions up to the average industrial wage level. The plan would be fully portable, fully funded, with individual choice of investment (*not* a central fund) and form of benefit. Unisex mortality table should be used to provide annuities under PURS. Given the voluntary

and diverse nature of employer pension plans the Commission concluded that:

- employment pensions alone should not be expected to fill the gap in income replacement between the basic minimum level to the desired adequacy standard;
- it is impossible to achieve portability in a system of individual employer plans.

The PURS would ensure full coverage of employees in those sectors where pension plans are sparse.

- *Greater Regulation of Employer Plans* including:

- earlier vesting and locking-in requirement (ten years' service if PURS is adopted, otherwise five years' service, regardless of age);
- employer to bear the cost of at least 50 percent of the benefit upon vested termination under a contributory defined plan (similar to the Saskatchewan provision);
- transfer rights for employee provided benefits;
- minimum interest credit on employee contributions (1 percent less than chartered bank nonchequing accounts);
- surviving spouse benefits, pre- and postretirement;
- unisex annuity tables for money purchase plans (two Commissioners dissenting);
- limits on types of actuarial funding methods and guidelines for actuarial assumptions;
- more stringent funding rules;
- greater disclosure including, information as to the degree to which benefits are funded;
- revised wind-up rules;
- greater flexibility in retirement ages;
- provision for retirees to elect an increasing participating annuity or an escalating annuity purchased from an insurance company. (No compulsory indexing of vested or current retirement payments proposed).

- *Greater Accountability and Control of Public Service Plans including:*
  - bringing of all public plans under the Pension Benefits Act;
  - full-funding and more frequent actuarial valuations;
  - investment through capital markets;
  - effective cost control through the Management Board of Cabinet;
  - parity with private sector.
  
- *Inflation Tax Credit* (one Commissioner dissenting) which would provide a refundable tax credit for all taxpayers over age 68 equal to Consumers Price Index increases since age 68 applied to retirement income from all sources (except OAS and CPP) such as employer pensions, RRSPs and PURS. Retirement income up to a maximum of twice the level of the maximum CPP and OAS would qualify for this credit. The credit would be partly financed through the elimination of the age related tax exemption and the \$1,000 pension income deduction. CPP and OAS would continue to be fully indexed.

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A tabular presentation of the Commission's Plan for the Future is reproduced from the Report on the following page. In the remainder of the bulletin, brief details of the Commission's recommendations for the various elements are provided.

## **Brief Details of Recommendations**

### **Guaranteed Income Suppléments**

- Adopt a *well-defined* standard linked to minimum wage—but increased by CPI each year for periods when no change in minimum wage occurs. Thus the standard would remain current.
- Standard for single elderly to be about 60 percent of married couple (suggested 1980 levels: \$10,785 a year for a couple both aged 65 or over; \$6,292 for a single person). Greater replacement ratio for the lower-income groups.

## The Royal Commission on the Status of Pensions in Ontario A Plan for the Future

Sources of retirement income	Gross income replacement levels (percent of average industrial wage)	Retirement age	Indexing	Funding	Investment	Regulation
Old Age Security	10-15	65	Fully to CPI	Pay-go	N/A	Federal
Guaranteed minimum income (for those with little or no income from CPP, etc.) through GIS and GAINS		65	Fully to CPI <sup>a</sup>	Pay-go	N/A	Federal and provincial
Canada Pension Plan	25	65	Fully: to AIW pre-retirement, to CPI post-retirement	Pay-go	Guaranteed securities of provincial Crown agencies	Federal and participating provinces
Provincial Universal Retirement System (PURS)	15-20	65	Participating annuity option; Inflation Tax Credit	Fully funded	Private sector, employee control	Provincial
Total Gross Income Replacement	50-60					
Free OHIP and Drug Plan; Ontario tax grants		65	N/A	Pay-go	N/A	Provincial
Employment pension plans (private and public sector)	May or may not be integrated with CPP and PURS; 70% maximum of preretirement earnings	As per plan; option from age 60, actuarially reduced	Participating annuity option or part of pension promise; inflation tax credit	Provisionally to fully funded	Private sector, employer control	Provincial control with federal through taxation
RRSP	Maximum contributions: \$5,500 if no pension plan; \$3,500 if pension plan member	60-71	Participating annuity option; inflation tax credit	Fully funded	Private sector, individual control	Federal through taxation
Other individual arrangements		N/A	N/A	Fully funded	Private sector, individual control	Federal through taxation if applicable

<sup>a</sup> GAINS is not indexed but the guarantee level has been increased periodically with increases to OAS and GIS.

- Base adequacy on actual, not *assumed*, needs—no increases in universal payments or services. Adequacy of income assessed on *available income* basis, that is after-tax plus value of other additional benefits, and including all sources such as Workmen's Compensation, Veteran's and family allowances.
- Maintain age of eligibility as 65 (any future change in concert with all other government programs). Eliminate Spouses' Allowance for under 65—provide benefits for these under the Family Benefits or Canada Assistance Act.
- No extension of Ontario tax credits (other than the Inflation Tax Credit).
- Tax back OAS payments at 100 percent for net taxable income exceeding \$30,000.
- Provide adequate standard through federal GIS eventually, but increase GAINS meantime.
- Finance GAINS on pay-as-you-go basis through the Consolidated Revenue Fund.

### **Canada Pension Plan**

- No change recommended in the level of benefits or covered earnings.
- Full funding rejected in view of:
  - enormously increased contributions (12.53 percent in 1980 reducing to 9.66 percent in 2030);
  - resulting very large fund (\$14.3 billion in 1978 increasing to \$9 trillion in 2030—equivalent to about \$300 billion in current dollars);
  - large amounts available for provincial funding;
  - CPP's prime role not that of an economic tool.
- Pay-as-you-go financing plus contingency fund at the level required to satisfy twice the year's benefit and administrative pay-out, three years hence.
- Current 3.6 percent contribution maintained until contingency fund level achieved. After that provinces required to pay interest (mid-80s) but no repayment of capital except on a call basis.

- Gradual phasing-in of required increases in contribution rates, set six years in advance. Estimated future contribution rates:
  - the current 3.6 percent early 1990s;
  - 5.0 percent thereafter until the turn of the century;
  - rising gradually to 9.4 percent by 2050.
- Change in the investment structure to ensure the receipt of market rates of interests:
  - Provincial obligations replaced in 1986 by 20-year guaranteed negotiable bonds issued for the purposes of investment in fixed assets or refinancing outstanding debt for similar purposes.
  - Interest rates based on average market rates prevailing at the time.
- Resist extension to unpaid workers.
- Adopt the drop-out provision for child-rearing years (enacted but not proclaimed).
- Resist any extension of existing survivor benefits or levels of pension and survivor benefits.
- No credit-splitting during marriage, but retain splitting on marriage breakdown.
- As 65 to be the earliest age for eligibility—no earning test. No reduced or unreduced early retirement provision. No actuarially increased postponed retirement.
- Provide a more effective and less complicated appeals procedure.

### **Provincial Universal Retirement System (PURS)**

- Establish PURS on a mandatory basis for all Ontario employees aged 18 to 64 based on:
  - individual money purchase accounts;
  - immediate vesting and locking in;
  - complete portability.
- Contributions by employer and employees (or wholly by self-employed) to be based on earnings up to average industrial wage.
- Level of contributions to reflect the desired income replacement goal. For example, if replacement goal is 20 percent:

- employee contributions: 1 percent of covered earnings for age 18 to 30; 1½ percent for ages 30-45; 2 percent for ages 45 to 65;
  - employer: 2 percent throughout.
- Range of annuity options between ages 65 and 71, but for an employee with spouse, 60 percent surviving spouse benefit to be provided unless spouse waives the benefit. Spouse's benefit to be provided upon preretirement death.
  - Annuities to be based on unisex rates.
  - Ontario central pension agency to be established to keep records, to provide alternative investment facility and to cooperate with other jurisdictions.
  - Employee to have a choice of financial intermediary (including the central agency). Funds to be invested in same types of investments as now permitted for pension funds *but* foreign investments excluded.
  - Contributions tax-deductible.
  - Contributions by payroll deduction remitted to Revenue Canada or the central agency and thence to financial intermediary.
  - Employers with pension plans including similar provisions as a minimum may opt out of PURS. Integration with PURS allowed.

## **Employment Pension Plans**

### *Termination Benefits*

- Vesting and locking-in to occur after ten years' continuous service (five years if PURS not established), no age requirement.
- Interest credit on employee contributions to be not less than 1 percent below the rates paid by Canadian chartered banks on nonchequing accounts.
- Under a contributory defined benefit plan, employees' contributions accumulated with interest to be utilized to provide no more than 50 percent of vested benefit—excess refunded to the employee. No other commutation (such as the current 25 percent) to be allowed except for small annuities.
- Under a contributory plan, an employee may have the right to transfer one-half of locked-in benefit to his PURS account, a



locked-in RRSP (which the Commission would like established) or to his new employer's plan.

—No compulsory improvement of deferred benefits between termination and retirement date.

### *Survivor Benefits*

#### —Preretirement

- 60 percent of actuarially reduced pension to be paid to surviving spouse on employee's death after fulfilling eligibility for early retirement;
- 60 percent of vested pension to spouse payable from the earlier of the employee's or the spouse's birthday if death occurs after being vested but before qualifying for early retirement.

#### —Postretirement

Primary form of benefit must be at least 60 percent surviving spouse pension unless otherwise jointly rescinded by employee and spouse. The amount of pension may be actuarially reduced to allow such option.

If PURS is adopted, greater flexibility in the form of benefits (e.g. lump sums) be allowed.

### *Integration*

—For existing offset plans, offset for OAS frozen at December 1979 level; for new plans, OAS offset not allowed.

—Offsets must be proportional, should not reduce accrued benefits at any time, and should be properly explained.

—Integration with PURS allowed.

### *Funding*

—Actuarial funding methods restricted to unit credit, entry age level and attained age level methods.

—Actuarial assumptions should comply with guidelines to be established by the Pension Commission of Ontario.

—Capitalized values of fixed income securities in actuarial valuation to be used only under restricted circumstances.

—Triennial valuations to be filed within six months of due date (currently 12 months) with suitable penalties for default.

- No change in amortization periods of five years for experience deficiencies and 15 years for initial unfunded liabilities. However, the “test” valuation rules which allow certain experience deficiencies (especially under final pay plans) over 15 years to be phased out by June 1982.
- Flat benefit plans: funding of plan improvements to be made more stringent.
- Postretirement adjustments to be funded in advance.

#### *Plan Wind-ups*

- Meaningful disclosure to plan members individually that benefits may be reduced if funds are insufficient on wind-up (the Commission believes that the dissatisfaction on plan wind-up arises partly due to lack of understanding).
- No steps should be taken to institute plan termination insurance.
- Persons retired or eligible to retire should receive first priority if assets are insufficient. The Pension Benefits Act should also set out priorities for other classes where the plan document is silent. However, continued funding of unfunded vested or accrued benefits is *not* advocated.
- There should be a statutory lien on employee contributions collected and employer contributions due but not remitted to the pension fund. A protected classification should be created under the federal bankruptcy laws for these contributions upon insolvency.
- Employer contributions under money-purchase plans to be remitted monthly; under defined benefit plans quarterly within 30 days of the end of each quarter.

#### *Disclosure*

- No information about a pension plan which is necessary for individual assessment to be unreasonably withheld.
- Individual annual statement of benefit and contribution data, pension fund statements and addresses of administrator and financial carrier.
- Upon employment termination a detailed statement of entitlements including a summary of fund investments and rates of return.

- Access to plan documents, the most recent annual information return, lists of investments, actuarial valuation and cost certificate and audit reports.

#### *Audit*

- Both the pension plan and the fund should be audited by a chartered accountant annually for multiemployer plans and at least every three years for others, or annually if assets not held by an insurance company or a trust company.

#### *Indexing*

- Employers should not be obliged to provide inflation protection—although employers should be free to provide indexing if desired, provided such adjustments are funded.
- Every plan should provide an option of a participating annuity (increasing based on investment experience of the fund with the employer bearing the mortality risk) or an escalating annuity.

#### *Retirement Age*

- Although the Commission favors flexibility in the choice of retirement age, it takes no position in the current debate on whether the protected age for right to employment should be raised.
- Every plan should provide an option for every member to elect early retirement on an actuarially adjusted basis at any time after age 60.
- Any member continuing to work after normal retirement should be provided an option to postpone commencement of pension on an actuarially increased basis.

#### *Pension Commission of Ontario (PCO)*

- PCO role should be expanded to include the following:
  - to inform and assist individuals including the right to intervene with the employer and to arbitrate disputes;
  - to review the Pension Benefits Act immediately and then periodically, and submit reports to the Minister every five years.

### *Other Matters*

- Multiemployer, union-sponsored and employee-pay-all plans to be brought within the ambit of the Pension Benefits Act. The board of trustees under the multiemployer plans to have the same responsibilities as the employer under single-employer plans.
- Under a contributory pension plan, at least one representative of the active members to be elected to the board or committee administering the plan.
- Pension benefits to remain nonassignable.
- Plan eligibility to be extended to all part-time employees where there is a durable employment relationship. If PURS is not adopted, maximum service eligibility requirements should be two years for those under 35, one year for those over. If PURS is adopted, no employee to be compelled to join a contributory plan.
- Unisex annuity tables should apply to money-purchase plans and RRSPs (two Commissioners dissenting).
- Under the Ontario Family Law Reform Act pensions should be regarded as income in retirement which may be a source of support upon marriage breakdown, but not as a capital asset.
- The Commission found the defined benefit plan wanting in today's circumstances of short-service employees—even though over 90 percent of all plan members in Ontario are covered by such plans. However, the outright abolition of the defined benefit plan is not recommended but a move to the defined contribution design is encouraged.

### **Ontario Public-Sector Plans**

- As a general principle, public-sector plans should be regulated on the same basis as private-sector plans, they should not lead the private-sector plans and effective cost control of public-sector plans must be implemented and maintained.
- The Pension Benefits Act should be amended to bind the Crown and its agencies, and all public sector plans should be amended as necessary to comply with the Act—except that in some cases any initial unfunded liability existing currently need not be amortized, although interest must be paid.

- Ontario should adopt a policy of determining full and true costs of all pensions to recognize and control their costs, to allocate those costs fairly between employer and employees, and to provide the cost information to employers, employees and taxpayers.
- The principle of “matching contributions,” employed in some of the major plans, should be abandoned and contributions should be set to reflect the true costs.
- Funds, where necessary, should be separated from the Consolidated Revenue Fund and all investments should be in the form of marketable securities and reflect market rates of return with some portion invested in the private sector. Book entries should be discontinued.
- All public-sector funds in excess of \$150 million should be actuarially valued, and such valuations filed with the PCO, annually. All other funds should be valued and filed triennially, but their filing dates should be coordinated.
- Inflation adjustment payments, now under separate acts or funds or on an ad hoc basis, should be consolidated with the principal funds and from now on be fully funded in advance, terminal funding should not be adopted. If Ontario is not prepared to change its current approach, the indexing promise (currently linked to CPI, with 8 percent cap) should be changed to limit it to what can be provided by 1 percent employer/employee contributions and each employee being clearly warned that adjustments can be made only up to available funds.
- Responsibility for cost control should be placed with the Management Board of Cabinet. The Treasury should assist by evaluating true and total costs of actual operations and proposals for change, and by reporting these to the public. No public-sector plan should normally continue in a surplus position for more than one valuation period. The Treasury should review the funding of all public-sector plans on a consistent basis at least once every six years.
- If the cost-control authority cannot be given to the Management Board, consideration should be given to changing existing defined benefit plans to money-purchase.
- Ontario should seek parity with private sector in total compensation and pension benefits. It should not lead the way, particularly in the areas of inflation adjustment and unreduced early retirement benefits.

- The terms of reciprocal transfers between public-sector plans should be reviewed and amended to make the terms equitable.
- Early retirement age for unreduced benefits should not be lowered. Earnings test for retired employees who have attained age 65 should be abolished.
- Pensions should in principle be considered appropriate for collective bargaining but no new areas in this respect should be opened at this time.
- A separate and independent plan should be established for all members of the judiciary.

### **Inflation Tax Credit**

(One Commissioner dissenting)

- Protection from inflation to be provided for *all* retired persons, not just the members of employer pension plans. Therefore, a refundable Inflation Tax Credit for residents aged 68 or over be introduced.
- The Inflation Tax Credit would protect from inflation a measure of total retirement income above the government floor programs (CPP, GIS, OAS, GAINS) in step with CPI changes. CPI should continue to be the measure for inflation, and no steps be taken to develop a different index for those over 65.
- An appropriate maximum amount of protection might be twice the total of OAS pension and the maximum CPP pension for the year (in addition to the OAS/ CPP pensions) and include such sources as RRSPs, PURS and employer pension plans.
- To finance inflation protection, all income including Workmen's Compensation payments be made subject to income tax and the present age-related tax deduction as well as the pension income deduction be eliminated.

### **Other Tax Matters**

- Curtail existing tax incentives for cash withdrawal from employment pensions.

- Restrict roll-overs of pension benefits and retiring allowances into RRSPs, so excessive amounts do not receive tax shelter.
- Base exemptions and deductions on actual needs—not to be universal. Income tested exemptions and credits to take account of all income.
- If pension income deduction retained, adopt minimum age to avoid encouraging early retirement.
- Eliminate percentage limitation of earned income on tax-deductible RRSP contributions.
- Permit tax-deductible past service contributions to money-purchase plans.

## **President's Commission on Pension Policy A Summary of the 1981 Final Report\***

### **Retirement Income Goals**

The Commission believes that the replacement of preretirement disposable income from all sources is a desirable retirement income goal.

### **Strengthening Employee Pensions**

#### *Minimum Universal Pension System*

The Commission recommends that a Minimum Universal Pension System (MUPS) be established for all workers. The system should be funded by employer contributions. The Commission further recommends that a 3 percent of payroll contribution be established as a minimum benefit standard. All employees over the age of 25, with one year of service and 1,000 hours of employment with their employer would be participants in the system. Vesting of benefits would be immediate.

Under a MUPS, current pension plans that did not meet the minimum standards would be amended to provide equivalent of what a MUPS would provide. The MUPS benefit would be a supplement to Social Security benefits and could not be integrated with Social Security. The MUPS benefit should be portable. A portability clearinghouse for benefit records should be established in the Social Security Administration.

To help mitigate the costs of a MUPS for employers and employees, it is recommended that the program be phased in over three years. In addition, a special MUPS tax credit for small business should be available. Employers should be able to take a tax credit of 46 percent of their contribution to a qualified plan, up to a limit of 3 percent of payroll.

Employers should be encouraged to maintain the accumulated funds in pension trusts or in arrangements with insurance companies and other financial institutions. However, those employers who do not wish to administer an employee pension plan could send their

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\*Taken from the final report of The President's Commission on Pension Policy, *Coming of Age: Toward A National Retirement Income Policy* (February 1981).



contributions to the portability clearinghouse within the Social Security Administration. These funds would be transferred to a central MUPS portability fund which would be established to invest the funds in the economy. The fund should be administered by an independent Board of Trustees appointed by the President.

#### *Vesting and Portability*

1. For pension benefits above the MUPS minimum the Commission recommends that ERISA's vesting standards should not be changed. However, the Commission urges voluntary changes to shorter vesting schedules, especially for mature plans.
2. The Commission recommends that all cash-outs of pension benefits over \$500 be prohibited unless transferred to an IRA or the plan of a subsequent employer. The Commission strongly urges government and the private sector to take steps to encourage and facilitate the use of the IRA as a portability mechanism.

#### *Integration*

1. The Commission recommends that benefits provided under a MUPS should not be integrated with Social Security. Because the benefits from such a system are intended to provide a minimum supplement to Social Security, it is inappropriate and inconsistent both with the purpose of integration and of such a pension system.
2. The Commission recommends that changes be made to the current integration rules so that the result is consistent with the fulfillment of retirement income goals.
3. The Commission also recommends that integration rules be made less complex.

#### *Spouse Benefits*

**Postretirement Survivor Protection:** Postretirement survivor protection under the pension plan should be mandatory unless there are extenuating circumstances for the couple. Couples may waive the joint and survivor option by jointly signing such a waiver under circumstances where each spouse is a willing and knowledgeable signator.

**Preretirement Survivor Protection:** The 50 percent joint and survivor option should be provided automatically to the survivors of workers who die in the ten-year period to normal retirement age of

the plan. Also, the Commission recommends that both the employee and the spouse would have to agree to opt out of this automatic provision. At earlier ages where benefits are vested, survivor protection should be provided either through the pension plan or through life insurance.

**Protection upon Divorce:** In cases of separation or divorce, the pension entitlement earned during the marriage should be divisible. This recommendation should not be construed to weaken present nonalienation of benefits provision under ERISA.

### *Retirement Ages*

1. The Commission recommends that ERISA should be amended to permit private pension plans, on a voluntary basis, to increase their normal retirement age in tandem with Social Security.

As in the private sector, public employee pension plans should increase their normal retirement age in tandem with Social Security. A retirement age policy that parallels that of Social Security is recommended for all federal retirement programs. Under this recommendation, the current Social Security normal retirement age of 65 would be phased in for new retirees. This age would increase in tandem with increases in the Social Security normal retirement age. Early retirement benefits would be actuarially reduced for new retirees.

The Commission expresses concern about the payment at very young ages of old age pension benefits to public employees in hazardous occupations. In particular, the Commission believes it is inappropriate to use pension plans largely as recruitment, retention and separation devices. The Commission recommends that other methods be found to carry out these functions and that pension programs be used solely to provide retirement income.

### *State and Local Government Plans*

The Commission recommends that, because state and local government employees deserve the same protection as employees in the private sector, a Public Employee Retirement Income Security Act (PERISA) should be enacted covering the same areas of concern as covered by ERISA.

### *Ownership and Control*

1. The Commission believes that concerns relating to the ownership and control of pension fund assets are among the most important

social and economic public policy issues facing the nation in the upcoming decades. This Commission, while it realizes their importance, does not believe that enough is now known about these complex legal and economic issues to enable it to make conclusive recommendations.

In the interim the Commission recommends that Congress and the President continue research and policy development; and to encourage public debate, the Commission further recommends the establishment of a Presidential Commission.

2. In the interim, the Commission recommends that ERISA's prudence standards not be construed so as to narrow normal prudence standards to prevent pension funds from taking into account the broader social interests of the pension plan beneficiaries in making investment decisions.

## **Strengthening Social Security**

### *Financing*

1. To solve the short-run financing problems, the Commission recommends that there should be interfund borrowing and an acceleration of the scheduled payroll tax rate increases.

The Commission recommends the normal retirement age of 65 for Social Security should not be raised for working people who are approaching retirement age. However, to help solve the long-run financing problem, an increase in the normal retirement age to 68 should be phased in over a 12-year period beginning in the year 1990. The Social Security early retirement age, now 62, should be raised to 65, in tandem with the normal retirement age. Disability benefits should be available through the normal retirement age.

### *Universal Social Security*

The Commission believes that individuals who are already retired and workers eligible for immediate retirement should not be affected by any modification of a pension system caused by coordination with Social Security coverage. Social Security should not replace an existing pension system for noncovered workers. Rather, an existing system should be modified to take into account benefits available under Social Security.

The Commission recommends mandatory universal Social Security coverage. Specifically the Commission recommends extending

Social Security coverage to all new workers who otherwise would not be covered. However, the Commission recommends that members of certain religious groups continue to be exempted from mandatory Social Security.

The Commission recommends that action be taken immediately to eliminate benefit gaps and unintended subsidies to workers who have not had substantial Social Security coverage.

The Commission recommends that the current option allowing covered government and nonprofit groups to withdraw from the Social Security program be terminated immediately and those groups be encouraged to elect coverage prior to the effective date of mandatory coverage.

#### *Tax Treatment and Earnings Test*

Contributions to, and benefits from, Social Security should receive the same tax treatment as do those of other retirement programs. At the time of filing, the employee would choose the higher of a tax deduction or a tax credit for the Social Security employee contribution. Social Security benefits would be included in taxable income. As this tax treatment is phased in, the Social Security earnings test should be phased out.

#### *Spouse Benefits*

1. The Commission recommends that earnings sharing be used upon divorce and that inheritance of earnings credits be provided to surviving spouses.
2. The Commission recommends that earnings sharing should not be used for the purpose of disability.

#### *Special Minimum Benefit Under Social Security*

The Commission recommends that the Social Security special minimum benefit be available to long-service workers to enable them to meet the Commission's retirement income goals. This special minimum benefit should be calculated to take into account receipt of employee pensions.

#### *Miscellaneous Benefits*

The Commission recommends that the student benefit, the young parent benefit and the parent benefit should be reexamined and put on a more rational basis.

## **Strengthening Individual Efforts**

### *Individual Savings*

Favorable tax treatment should be extended to employee contributions to pension plans. A refundable tax credit for low- and moderate-income people to encourage voluntary individual retirement savings and employee contributions to plans is recommended. At the time of tax filing, the employee would choose the higher of a tax deduction or a tax credit.

Contributions and benefit limitations for all individuals should be treated more consistently for all types of retirement savings.

The tax treatment of savings specifically for retirement should be the same as the tax treatment of pension plans.

### *Employment of Older Workers*

1. If the Commission recommendation on the tax treatment of Social Security contributions and benefits is adopted, then the Social Security earnings test should be removed. The earnings test limits should be phased out as the Commission's proposal concerning the exclusion of Social Security contributions and inclusion of benefits in taxable income is phased in.
2. Information on alternative work patterns should be encouraged and developed through research and demonstration programs in existing federal employment programs. Job retraining and job redesign for older workers in private industry also should be encouraged.
3. In conjunction with its recommendation to raise the retirement age, the Commission recognizes the problem of long-term unemployment among older workers and the use of early retirement under Social Security to solve this problem. Rather than utilize the Social Security system, consideration should be given to improving unemployment benefits to provide both short-term income maintenance for these workers and to keep them in the labor force.
4. The ADEA has recently been amended to raise the permissible mandatory retirement age from 65 to 70. As yet there is little experience with the impact of this law on specific work forces, management practices and labor costs, but early indications are that any feared adverse effects on younger workers have been minimal. After sufficient experience has been gained, consider-

ation should be given to eliminating mandatory retirement completely.

### *Disability*

1. Disability benefits under the Social Security Disability Insurance program (DI) should be available through the age at which normal retirement benefits are available under Social Security. Therefore, in conjunction with the recommended changes in Social Security retirement ages, the age through which DI is available would move upward from 65 to 68 over the 12-year period beginning in the year 1990.
2. Further study at the federal level is needed to adequately address problems with disability programs. The Commission's work on disability should provide the groundwork for that study. Specifically, the merits of the following options should be the subject of further exploration and debate before specific recommendations are made to reform disability programs:
  - a) a universal disability program;
  - b) a ceiling and floor on replacement ratios for all disability benefits;
  - c) a more effective use of rehabilitation; and job redesign and so forth, to encourage labor force participation;
  - d) an occupational disability program for older workers.

### **Strengthening Public Assistance**

The Commission recommends that federal SSI benefits be set at the poverty line level and the assets test be eliminated.

### **Inflation Protection for Retirement Income**

1. The Commission recommends that the Bureau of Labor Statistics develop a separate cost-of-living index for the retired.
2. The greatest emphasis should be placed on expanding pension coverage rather than providing full inflation protection to some at this time. Therefore, automatic inflation adjustments for employee pensions should be encouraged through tax policy but should not be required at this time.

3. Retirement benefits from federal pension plans should be adjusted for inflation once, rather than twice, a year.
4. Until a new index is developed for the retired, federal pensions should be adjusted on the basis of average federal wage increases or the CPI, whichever is lower.

### **Administration**

The Commission recommends consolidation of administration of all federal retirement systems; consolidation of ERISA administrative functions in one entity; an interdepartmental task force to coordinate executive branch programs dealing with retirement income, including federal plans; and new committees on Retirement Income Security, one in the House and one in the Senate, which would consolidate jurisdiction over all types of retirement income programs, including federal programs.

## **President's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs A Summary of the 1965 Final Report\***

### **Development of Private Retirement Plans**

*Conclusions:* Private retirement plans now cover about 25 million workers, about half of the employees in private nonfarm establishments. They pay almost \$2¾ billion a year in benefits to nearly 2½ million beneficiaries. Their status as a major financial institution is reflected in their accumulated reserves of over \$75 billion, in their annual accumulations of \$6½ billion, and in their annual benefit payments of almost \$2¾ billion a year.

It is estimated that by 1980 the number of employees covered by retirement plans will increase to 42 million, or three out of five employees are then expected to be in private nonfarm establishments. The number of beneficiaries will increase to about 6½ million in 1980. According to these projections, plans will continue to build substantial reserves since the contributions paid into the funds, together with the funds' earnings, will be far in excess of benefit payments. Under the assumed conditions, total contributions, which amounted to nearly \$7 billion in 1964, are expected to rise to about \$11 billion a year by 1980, while benefit payments during the same period will increase to around \$9 billion annually. Total reserves will grow to about \$225 billion by 1980.

### **The Public Interest in Private Retirement Plans**

*Conclusions:* Although the development of private retirement plans has largely been the result of business and labor initiative, public policy has encouraged and protected these plans through tax laws, labor relations statutes, standards of fiduciary obligations of trustees, and more recently through specifically designed legislation requiring public disclosure of various aspects of retirement and welfare plans.

The prevailing tax provisions for private pensions make it possible to provide private pensions at a substantially lower cost than that which would result if no special tax provisions were available for

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\*Taken from the final report of the President's Committee on Corporate Pension Funds and Other Private Retirement Welfare Programs, *Public Policy and Private Pension Programs—A Report to the President on Private Employee Retirement Plans* (January 1965).



pensions. Regardless of how the worker and the employer may share the benefits—in the form of higher pensions or reduced costs—which the special tax provisions for pensions make possible, it is evident that the advantages for both employers and workers are very significant. The loss of revenue to the Federal government as a result of this special tax treatment is estimated to be more than \$1 billion annually.

Several points underline the breadth and depth of the public interest in private retirement plans:

- (1) They represent a major element in the economic security of millions of American workers and their families.
- (2) They are a significant, growing source of economic and financial power.
- (3) They have an important impact on manpower in our economy.
- (4) They have a major, growing significance for Federal taxpayers because the special tax concessions reduce the tax base and put more burden on other tax sources.

### **Relation of Private Plans to the Public Retirement Program**

*Conclusions:* The public program will continue to be the Nation's basic instrument for assuring reasonably adequate retirement income to workers, their widows and dependents.

Private pension plans should continue as a major element in the Nation's total retirement security program. Their strength rests on the supplementation they can provide to the basic public system.

The basic justification for the indirect public subsidy involved in favored tax treatment lies in the social purposes served by private pension plans. In view of these social purposes, public policy should continue to provide appropriate incentives to private plan growth, and by improving the basic soundness and equitable character of such plans, set a firmer foundation for their future development. Because protection will always be far from complete, private pension plans cannot be a substitute for public programs, but public policy can encourage developments which will provide supplementary retirement benefits to a growing proportion of the Nation's workers and will provide greater assurance that the promised benefits will be paid.

Continuing attention will be necessary to assure that the combined benefits available through OASDI and supplementary private pen-

sions, for those receiving them, are reasonably related to wage levels and living standards in the economy.

### **Private Pensions, Labor Mobility, and Manpower Policy**

*Conclusions:* Private pensions, along with seniority and other benefits based on length of service, tend to reduce labor mobility by tying workers to a particular employer. While the effect of private pensions on mobility is significant, it is limited and selective. However, there is cause for concern in the selective impediments to mobility now erected by private pension plans and in the possibility that such plans in the future will not permit a rate of mobility among mature workers sufficient to accommodate a rapid rate of technological change.

Employers should be encouraged to adopt more widely those types of pension plans which do not involve significantly higher costs for older workers, in preference to those types which involve greater differences in cost between new employees in different age groups. However, legislation affecting private pensions is not recommended as a means of minimizing the use of rigid age limits in hiring.

The government should not attempt to regulate compulsory retirement practices, which should be left to private decision. However, employers should be encouraged to adopt flexibly administered systems of retirement. Measures to compel earlier retirement are not desirable or suitable as a general means of dealing with unemployment problems.

### **Vesting**

*Conclusions:* The advantages which vesting brings to the private pension system are the following:

- (1) As a matter of equity and fair treatment, an employee covered by a pension plan is entitled, after a reasonable period of service, to protection of his future retirement benefit against any termination of his employment.
- (2) Vesting also provides special advantages to the employer.
- (3) By making private pension benefits more widely available, vesting strengthens the Nation's program for retirement protection.
- (4) Vesting enhances the mobility of the work force.

The values of vesting extend beyond the interests of the participants in pension plans. Benefits to the entire economy are involved, including the strengthening of economic security for retired workers and the effective operation of the Nation's system of labor markets.

*Recommendations:* A vesting requirement is necessary if private pension plans are to serve the broad social purpose justifying their favored status. The Internal Revenue Code should be amended to require that a private pension plan, in order to qualify for favored tax treatment, must provide some reasonable measure of vesting for the protection of employees. Several suggestions are made regarding the most effective method for implementing this requirement without creating obstacles to the future growth of the private pension system. The Committee suggests a system of graded deferred vesting based solely on service applicable to both single and multiemployer plans. An appropriate transition period should be provided, and special procedures made available to plans whose costs would be increased by more than 10 percent as a result of this recommendation, the recommendation on funding, or a combination of the two.

### **Funding for Financial Solvency**

*Conclusion:* Pension plans without adequate funding may turn out to be empty or only partially fulfilled promises. The minimum standards for funding under present tax law do not assure adequate funding. The setting of standards for adequate funding, therefore, becomes an important public concern.

*Recommendations:* The present minimum standard for funding needs to be strengthened by changes along the following lines:

- (1) As a minimum standard of funding for *stated benefit* plans, the plan should be required to fund fully all current service liabilities and to amortize fully all accrued liabilities over a period that roughly approximates the average work life of employees but not more than 30 years.
- (2) As a minimum standard for funding of *fixed contribution* plans, the contribution commitments of the plan should be realistically related to benefits promised and actually paid.
- (3) The funding process of every qualified plan should be certified at the inception of the plan and periodically thereafter by an actuary with acceptable professional qualifications.

- (4) The funding process should be subject to review by the Internal Revenue Service on the basis of guidelines or ranges of standards with respect to such actuarial assumptions. The guides should be specified by the Internal Revenue Service with the advice and consultation of a public advisory body of actuaries and other interested parties.
- (5) Concurrent with actuarial certification, a determination should be made by a professionally qualified public accountant with respect to the value of pension fund assets.
- (6) An appropriate transition period should be provided, and special procedures made available to plans whose costs would be increased by more than 10 percent as a result of this recommendation, the recommendation on vesting, or a combination of the two.

### **Portability and Insurance**

*Conclusions:* Two proposals are worthy of serious study to help fulfill the long-range promise of the private pension system:

- (1) The possibility of some institutional arrangement for transferring and accumulating private pension credits.
- (2) A system of insurance which, in the event of certain types of termination, would assure plan participants credit for accrued benefits.

### **Inequities Under the Tax Laws**

*Conclusion:* Present laws permit many serious inequities in qualified private retirement plans and in the tax treatment of benefits distributed by such plans.

*Recommendations:*

- (1) The option which qualified retirement plans now have to cover only salaried or clerical employees should be eliminated, unless there is a showing of special circumstances.
- (2) The maximum period for which coverage of any employee can be deferred by a qualified plan should be reduced from five to three years.

- (3) Employees of tax-exempt institutions should be given tax favored treatment for pension benefits earned after the date of the change only where they participate in tax qualified plans.
- (4) An appropriate dollar limitation on contributions to qualified corporate pension plans for any employee or a commensurate limitation on benefits should be required, as to benefits earned after the date of the change, in order to prevent abuse and restrict favored tax treatment to private plans which furnish benefits consistent with the public interest.
- (5) Qualified plans should be permitted to continue to integrate with OASDI, but, as to benefits earned after the date of the change, the employer should be given credit for no more than one-half of the Social Security benefit.
- (6) The present provision treating lump-sum distributions of retirements benefits as long-term capital gains should be replaced, as to benefits earned after the date of the change, by an appropriate averaging device which might take into account the individual's future income status.
- (7) The special tax treatment of distributions of employer securities to employees should be eliminated, with respect to appreciation in value arising after the date of the change.
- (8) Gift and estate taxes should apply to transfers of interests in qualified retirement plans in the same manner as they apply to transfers of similar types of property.
- (9) Deferred profit-sharing plans should be required to provide for employers' contributions in accordance with a predetermined formula.
- (10) The Committee's vesting requirement should also apply to deferred profit-sharing plans designed primarily to provide retirement benefits but in such cases reallocation of forfeitures among the remaining participants would be prohibited. In the case of all other deferred profit-sharing plans, a provision granting immediate vested rights to covered employees should be required.
- (11) An appropriate transition period should be provided and special procedures established for those plans whose costs would be substantially increased by these recommendations.

## **Financial Aspects of Retirement Plans**

*Conclusions:* The total amount of investments held by private retirement funds has increased from \$12 billion at the end of 1950 to over \$75 billion at the end of 1964. A further increase to around \$225 billion is projected by 1980. However, the Committee does not believe there are sufficient grounds for recommending regulation of the size of retirement funds or of their rate of capital accumulation.

By 1964, the noninsured funds were investing half of their new resources in common stocks. This shift has certainly been one of the factors contributing to increases in common stock prices, particularly for the higher grade stocks, although it would be very difficult to estimate the quantitative importance of this single factor.

In view of the wide legitimate differences regarding the most advantageous balance of retirement funds investments, the Committee does not believe it would be desirable on the basis of evidence to date to require conformity to a prescribed rule with respect to the proportion of stocks to other investments.

## **Protecting the Interests of Employees in the Investments of Retirement Funds**

*Conclusions:* Whatever the type of investments made by retirement funds, such investments should be made honestly, conscientiously and prudently; it is important that there be the greatest practicable degree of assurance on these points.

This Committee recognizes the need for additional measures for the protection of the interests of employees, but doubts whether a major problem is the lack of appropriate standards of prudence. On the basis of present evidence, the Committee does not propose the substitution of a new set of statutory standards for the recognized standards of fiducial responsibility, although there appears to be a need for strengthening statutory provisions for assuring compliance with these standards.

Full disclosure of relevant facts is a prerequisite for self-help and for the enforcement of statutory measures for the protection of the individual's rights. It is premature, short of a more extensive test of the effectiveness of the disclosure approach as a means of assuring standards of fiducial responsibility, to make a recommendation for a regulatory agency to act as guardian for the collective interests of employees and their beneficiaries.

*Recommendations:*

- (1) Future investments by retirement funds should be subject to a maximum limitation (perhaps 10 percent) on the portion of a fund's assets to be held in stock or obligations of the employer company or its affiliates regardless of the ability of such investment to meet a fiducial test.
- (2) The Welfare and Pension Plans Disclosure Act should be amended by requiring the disclosure of additional information related to the investment holdings and activities of retirement plans.

**Further Study and Research**

*Conclusion:* The pension and welfare areas deserve greater emphasis in planning of the Federal Government's research and statistical program. Several suggestions are made for further research regarding private retirement plans.

## **Provisions of the Reagan Administration Social Security Proposal\***

### **I. Changes To Encourage Work Between 62-65**

#### *—Change Benefit Computation Point from Age 62 to 65*

The benefit formula treats early retirement the same as waiting until age 65. After 65, there is an annual incentive to continue working. Early retirees at 62 get 80 percent of what they would get at 65.

Proposal would discourage early retirement by assigning zero value to the age 62-64 period, thus reducing benefits in such cases while rewarding those who elect to work until age 65. This returns the program to the formula used before the age of retirement for women was lowered to 62 in 1956.

#### *—Reduce Benefits for Early Retirement*

Workers electing early retirement at 62 now receive benefits equal to 80 percent of what they would receive if they delayed retirement to age 65.

Proposal would reduce early retirement benefits to 55 percent of the maximum, thus strongly encouraging workers to remain in the work force until age 65.

### **II. Change To Reduce Opportunity For “Windfall” Benefits**

#### *—Eliminate “Windfall” Benefits for Noncovered Employment*

The benefit formula now makes it possible for a person, such as a retired federal employee, who enters Social Security-covered employment for only a few years to receive disproportionately high benefits, in some cases exceeding those paid to low-wage earners who have spent a lifetime in covered employment.

Proposal would have formula take pension resources from non-covered employment into account in such cases, thus sharply lowering the Social Security benefit in such cases.

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\*Released by the U. S. Department of Health and Human Services on May 12, 1981.



### **III. Changes To Relate Disability Insurance Closer to Work History and Medical Condition**

#### *—Require “Medical Only” Determination of Disability*

Workers can now qualify for disability benefits on combinations of medical and nonmedical factors, such as age, education and work experience. More than one-third of disability cases age 60 to 65 involve nonmedical factors.

Proposal would limit qualification to medical factors alone thus restoring program to original purposes.

#### *—Increase Waiting Period to Six Months*

Under a 1972 liberalization of the program, the waiting period for disability benefits was reduced from six to five months on the assumption that ample funds would be available.

Proposal would restore the six-month waiting period previously in law. This conforms to the terms of most private disability insurance programs.

#### *—Require Prognosis of 24-Plus Months of Disability*

Workers now seeking disability benefits must show only that disability claimed will exceed 12 months or will result in death. The 12-month test, enacted in 1965, replaced a test of “long-continued and indefinite duration” in prior law.

Proposal would restore the original intent of the law, requiring that the prognosis of disability be of long duration, at least 24 months, a more reasonable definition of disability.

#### *—Increase Requirement for Insured Status to 30 Quarters*

Workers may now qualify for disability benefits even if they have been in the work force only 20 out of the past 40 quarters. Therefore a person could be out of covered employment for five years and still qualify.

Proposal would set the minimum at 30 out of the past 40 quarters, thus more closely tying benefits to the principle that they are replacement for wages recently lost.

#### **IV. Changes To Reduce Welfare Elements**

##### *—Eliminate Children's Benefits in Early-Retirement Cases*

Children under 18 or under 22 if in school are now eligible for benefits on the basis of a retired parent's wage record. Thus a retiree with a child receives a dependent's benefit, whereas a retiree with no children gets only his own benefit.

Proposal would end this inequity in early-retirement cases and thus encourage the worker to continue work until 65.

##### *—Extend Disability Maximum Family Benefit to Retirement and Survivors Cases*

Benefits for families of retired and deceased workers can now actually exceed that worker's net take-home pay.

Proposal would extend the maximum limitation on benefits to families in disability cases enacted in 1980 to retirement and survivor cases. This would return the program closer to its original purpose as a "floor" of protection.

#### **V. Other Amendments for Short-Term**

##### *—Increase Bend Points by 50 Percent Instead of 100 Percent of Wage Increases For 1982-87*

In 1977, the "bend points" (dollar amounts referred to in the weighted benefit formula) were made subject to automatic wage indexing. This change was adopted in legislation intended in part to offset the cost impact of earlier legislation and the faulty benefit computation procedure adopted in the 1972 Amendments. However, benefit levels today remain disproportionately high (by about 10 percent) compared with the pre-1972 levels.

Proposal would restore the traditional relative benefit levels for future beneficiaries by increasing the "bend points" by 50 percent (instead of 100 percent) of increases in average wage earnings for the years 1982-87, after which the 100-percent factor would be restored to the formula.

*—Move Date for Automatic Benefit Increases from June to September and Use 12-Month CPI Average*

Under the 1972 Amendments (as modified in 1974), annual Social Security benefit increases have been automatic each June (payable beginning in July). The increase is based on changes in the Consumer Price Index as measured between the first quarter of the current calendar year and the corresponding quarter of the preceding year, a provision which can unduly inflate or deflate the increase, depending on economic conditions in those quarters.

Proposal would correct the anomaly of having benefit increases initiated on the pre-1976 Federal Fiscal Year basis and change the CPI computation to cover a full year (July-June) period, thus making the measurement a more accurate reflection of economic trends and measuring living costs in a period ending closer to the initiation of benefit increases.

## **VI. Change in Coverage**

*—Extend Coverage to First Six Months of Sick Pay*

Most sick pay is not taxed due to complex exclusion which forces employers to track sick pay on daily, even hourly basis, and leads some to unwittingly break the law.

Proposal would extend tax to all sick pay during first six months of an employee's illness. This would eliminate the administrative burden and would treat sick pay in the same way as vacation pay.

## **VII. Phase Out Retirement Earnings Test By 1986**

Under current law, 1981 Social Security benefits payable to persons aged 65 through 71 are reduced by \$1 for each \$2 of annual earnings in excess of \$5,500, a level which rises each year in relation to average wage earnings. However, benefits are not reduced for those aged 72 and over (70 and over beginning in 1982).

Proposal would phase out the retirement test over a three-year period, permitting \$10,000 in earnings in 1983, \$15,000 in 1984, \$20,000 in 1985 and unlimited earnings thereafter.

## VIII. Reduce Long-Range Social Security Taxes

Assuming enactment of these proposals, and those introduced in the Administration's Budget proposals, it will be possible to lessen the Social Security tax increase now scheduled for 1985 and to actually decrease Social Security taxes below the current level in 1990. (See chart below). Note that while an increase will again become necessary in 2020 due to the aging of the population, the rate will still be lower than the 1990-and-after rate scheduled under current law.

### Social Security Tax Rates Under Proposal

Period	Present Law	Proposal	
		Under Budget Assumptions	Under Worst-Case Assumptions
TAX SCHEDULE			
1981	6.65%	6.65%	6.65%
1982-84	6.70	6.60	6.70
1985	7.05	6.45	6.95
1986-89	7.15	6.45	7.05
1990-2019	7.65	6.45	6.45
2020 and after	7.65	7.55	7.55

**Cost Analysis of Effect of Various Social Security Options**  
 (Positive numbers indicate savings; negative numbers indicate added costs  
 or amounts needed to meet cost of present program)

Item	Short-Range Effect CY 1982-86 <sup>a</sup>		Long-Range Effect <sup>b</sup>	
A. Status of Present System, Deficit	-\$11.0(-110.8)		-1.52% (100)	
Effect of Budget Proposal	35.5	(36.8)	.20	(15)
Status of Program After Budget Proposals Enacted	(-74.0)		-1.32	(87)
B. Proposal				
(1) Cover Sick Pay in First 6 Months	2.6	(2.6)	.02	(1)
(2) Change Computation Points for Average Indexed Monthly Earnings from Age 62 to Age 65	1.3	(1.4)	.39	(26)
(3) Increase Bend Points in Primary Benefit Formula by 50% (instead of 100%) of Wage Increases, 1982-87	4.2	(4.7)	1.30	(86)
(4) Benefit Rate of 55% of Primary Benefit for Retired Workers (and 27½% for Spouses) at Age 62	17.6	(20.3)	.85	(56)
(5) Eliminate Benefits for Children of Retired Workers Aged 62-64	1.9	(2.0)	.02	(1)
(6) Disability Maximum Family Benefit Applicable to Survivor and Retirement Cases	2.9	(3.3)	.10	(7)
(7) Eliminate Windfall Portion of Benefits for Persons with Pensions from Noncovered Employment	.6	(.6)	.10	(7)
(8) Require "Medical Only" Determination of Disability (i.e., exclude vocational factors)	7.7	(9.0)	.06	(4)
(9) Increase Disability Waiting Period from 5 Months to 6 Months	1.4	(1.5)	.03	(2)
(10) Require Disability Prognosis of 24+ Months Duration (instead of 12+ months)	2.8	(3.4)	0.7	(5)

Item	Short-Range Effect CY 1982-86 <sup>a</sup>		Long-Range Effect <sup>b</sup>	
(11) Require 30 QC Out of Last 40 Quarters for Disability Benefits (instead of 20/40)	10.0	(11.5)	.21	(14)
(12) Move Date for Automatic Benefit Increases from June to September (and Use 12-Month Average)	6.3	(27.8)	.14	(9)
(13) Raise Retirement-Test Exemption for Age 65+ to \$10,000 in 1983, \$15,000 in 1984, \$20,000 in 1985, and Eliminate Test in 1986	-6.5	(-7.4)	-.14	(-9)
TOTAL EFFECT	46.4	(75.0) <sup>d</sup>	2.86	(18)

<sup>a</sup>In billions. Figures in parentheses are based on "worst case" assumptions; other figures are based on the expected economic assumptions (those in the President's Budget).

<sup>b</sup>Average-cost over 75-year period, in percentage of taxable payroll. Figure in parentheses is long-range effect of this item as percentage of actuarial deficiency of present program.

<sup>c</sup>Amount necessary to restore financial soundness of program over the long range.

<sup>d</sup>Including effect of additional net income to Hospital Insurance program.

## Estimated Short-Range Effect of Proposal as Compared With Present Law, Fund Ratios at Start of Year <sup>a</sup>

Calendar Year	Expected Economic Conditions		Worst-Case Economic Conditions	
	Present Law	Proposal	Present Law	Proposal
1981	23%	23%	23%	23%
1982	21	22	21	22
1983	18	23	16	22
1984	16	25	6 <sup>b</sup>	19
1985	14	28	<sup>c</sup>	17
1986	16	30	<sup>c</sup>	18
1987	22	35 <sup>d</sup>	<sup>c</sup>	21 <sup>e</sup>

<sup>a</sup>Balance in combined Old-Age and Survivors Insurance Trust Fund, Disability Insurance Trust Fund, and Hospital Insurance Trust Fund at beginning of year as percentage of outgo from trust funds in coming year (i.e., assumes availability of interfund borrowing).

<sup>b</sup>Funds have insufficient balance to pay monthly benefits (actually, this situation would occur several months earlier).

<sup>c</sup>Funds exhausted.

<sup>d</sup>By 1990, the fund ratio would be about 50%.

<sup>e</sup>By 1990, the fund ratio would be about 30%, and by 1995 it would be about 50%.

## Year-by-Year Cost Analysis of Proposal (In billions)

Calendar Year	Proposal	
	Under Expected Economic Assumptions	Under Worst-Case Economic Assumptions
1981	\$ .9	\$ .9
1982	9.1	11.3
1983	11.8	16.2
1984	15.7	21.7
1985	20.5	28.1
1986	23.9	33.6
1981-86	81.9	111.8

## Illustrative Benefits for Workers Retiring at Ages 62 and 65 Under Proposal and Under Present Law <sup>a</sup>

Earnings Category <sup>b</sup>	Present Law	Proposal
<b>Age 62 at Retirement in 1/82</b>		
Low	\$247.60	\$163.90
Average	372.80	246.80
Maximum	469.60	310.50
<b>Age 65 at Retirement in 1/82</b>		
Low	\$355.30	\$355.30
Average	535.40	535.40
Maximum	679.30	679.30
<b>Age 62 at Retirement in 1/87</b>		
Low	\$384.40	\$225.20
Average	580.70	348.30
Maximum	755.60	430.00
<b>Age 65 at Retirement in 1/87</b>		
Low	\$477.10	\$447.40
Average	719.00	691.90
Maximum	942.80	860.30

<sup>a</sup> Includes effect of (1) 55% benefit rate (instead of 80%) for retirement at age 62, (2) age-65 computation point (instead of age 62) for all ages at retirement, and (3) increasing bend points in primary-benefit formula by 50% (instead of 100%) of wage increases in 1982-87. Benefit amounts are for worker only. Worker is assumed to reach exact age shown in January.

<sup>b</sup> "Low earnings" are defined as the Federal Minimum Wage in each past year, and the 1981 Minimum increased by the change in average wages in future years. "Average earnings" are defined as the average wage for indexing purposes in each year. "Maximum earnings" denote the contribution and benefit base in each year.

### *Assumptions:*

- (1) Worker entered covered employment in 1956 and worked steadily thereafter.
- (2) Future earnings (for retirement in 1/87) follow trend under intermediate assumptions in 1980 Trustees Report.



## **Social Security Administration's Universal Social Security Coverage Study Group**

### **A Summary of the 1980 Final Report\***

Although the Social Security program now covers almost all American workers, certain inequities and inadequacies result from the existing pattern of exemptions from the program. The five major issues are as follows:

1. Gaps in insurance protection exist for workers moving between jobs that are covered and jobs that are not covered by Social Security.
2. Gaps in benefit protection exist for workers in noncovered employment.
3. A few workers are exempted from paying into a redistributive program that provides proportionately more generous benefits to low-wage than to high-wage workers.
4. Participation in noncovered employment exempts part of the lifetime earnings of some workers from Social Security taxes. These workers subsequently receive a Social Security benefit—often called a windfall—that is high in proportion to the payroll tax they paid.
5. Some workers who spend most of their careers in noncovered employment also work for a short period in the covered sector without becoming fully insured under Social Security. These individuals receive no retirement benefits from Social Security based on their contributions to the program.

#### *Effects of Mandatory Coverage on Selected Groups*

Pension coverage for several groups of workers now in noncovered employment would be substantially enhanced if their pension plans were coordinated with Social Security. Minority groups having disproportionately large numbers of low-income workers would find the redistributive aspects of Social Security to their advantage. The tilt

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\*Taken from *The Desirability and Feasibility of Social Security Coverage for Employees of Federal State, and Local Governments and Private Nonprofit Organizations*, Report of the Universal Social Security Coverage Study Group (March 1980).

in Social Security benefits would almost certainly increase pensions for low-income wage earners.

Women also would benefit from several aspects of wider Social Security coverage. Approximately 28 percent of women employed by the federal government in April 1978 had annual salaries below \$10,000, compared with 7 percent of male federal employees.

Approximately 1 million federal workers have military service for which they can receive credit under CSRS. However, CSRS benefits are reduced when the veteran reaches age 62 if he or she is eligible for Social Security and if the military service occurred after 1956.

If Social Security coverage were extended to federal workers, military service could still be used to determine both Social Security and CSRS benefits. Then, reducing CSRS benefits at age 62 would no longer be appropriate because the new CSRS formula would automatically coordinate the benefits.

#### *Effects of Mandatory Coverage on the Social Security Program*

The effects of mandatory coverage on the Social Security program would depend on the groups for which Congress enacted coverage. Congress sets Social Security taxes to maintain an approximate balance between revenues and disbursements, plus a modest reserve fund.

If coverage were expanded to all noncovered workers, Social Security disbursements would increase gradually. Initially, these increases would be quite small because the newly covered workers would not be eligible to retire for some time. These increases in disbursements would be more than offset by increases in revenues generated by the expanded coverage. If all currently exempted workers were covered at once, new Social Security revenues would substantially exceed disbursements for the first years.

Because workers and their employers would begin to pay taxes before the workers become eligible for benefits, the short-term effects of coverage are much more positive for the system than are the long-term effects. The short-term effects would be more limited if mandatory coverage were limited to workers hired after the effective date.

The Social Security Administration estimates that in the long-run mandatory coverage would make possible a reduction of 0.5 percent in the Social Security tax rates paid on the total covered payroll. This reduction would constitute savings of approximately \$6 billion a year in current dollars, for currently covered workers.

### *Effects of Mandatory Social Security Coverage on Affected Jurisdictions*

Substantial increases in Social Security revenues could not occur without causing reverberations in previously noncovered systems. Some people have argued that coverage would add to the financial burdens of the affected jurisdictions. However, virtually all employees and employers in the private sector and two-thirds of those in the public sector now participate in the Social Security program and bear the financial burden of the payroll tax.

Any approach that required additional cash outlays from a jurisdiction and its employees would have its sharpest effect on public plans that do not advance-fund. The local jurisdiction that does not advance-fund would bear the combined costs of Social Security and the existing retirement system until employees began to retire under the coordinated system. This financial burden would exist even if the benefit accrual rate for future service of current employees were reduced.

Systems with advance-funding would be in a different position. To the extent that Social Security provides some benefits that overlap with the current plan, the public employee retirement system could be redesigned so that future obligations would accrue at a lower rate. The new, lower rate at which public employee retirement benefits accrued could be immediately reflected in a new, lower contribution rate to the retirement system.

### **Options**

Public policymakers have two principal choices in addressing the problems in the Social Security program: to mandate coverage for some or all workers in noncovered employment or to reduce coverage gaps and undesirable subsidies (windfalls) without mandating coverage.

Extension of Social Security coverage would be the most effective way to resolve the gaps and windfalls issue.

The second approach would be to reduce the problems of insurance gaps and windfalls without requiring Social Security coverage. The option to withdraw from Social Security now available to state and local governments could be eliminated to help prevent the gaps and windfalls problems from worsening.

A third, less practical option would be to increase voluntary coverage incentives.

Another option would be to continue the status quo.

### *Mandatory Coverage*

If Social Security coverage were mandated for federal, state, and local government employees, most current retirement benefit formulas would need revision.

In all approaches, benefits would be based on length of service and final salary.

In the *add-on approach*, the amount of the staff benefit would not be affected by the amount of the Social Security benefit. In the *offset approach*, the staff benefit would be reduced by a variable percentage of the Social Security benefit. In the *step-rate approach*, a given percentage would be applied to salary below a specific amount and a higher percentage to all salary above it.

Each approach could be designed to provide average employees with the same retirement income, including Social Security, that the present noncovered systems provide.

### *Transitions*

The transition method chosen to implement mandatory coverage would determine which employees would be covered and which would be exempted and would determine the time that would be required to implement coverage. The chief transition goals would be equity and administrative efficiency. General transition strategies range from including everyone immediately to including only new employees. The Study Group concentrated on a middle strategy that would exempt some current workers and provide prospective coverage for all others. Given the diversity in career patterns, constructing a transition threshold on a combined age and service criterion might be reasonable. The combination could give workers a reasonable time to accrue Social Security coverage before retirement.

“Hold harmless” provisions could be implemented to protect current employees’ present benefit accrual rates under the new, coordinated pension plan.

### *Alternatives to Mandatory Social Security Coverage*

Alternatives to mandatory Social Security coverage include revising the Social Security benefit formula to reduce windfall benefits and establishing minimum standards or transfer-of-credit plans for

public employee retirement systems to reduce coverage gaps. Reducing windfalls would require changing the way Social Security treats workers in noncovered employment. Credit transfers and minimum standards would require modification of currently noncovered pension plans.

The Study Group analyzed five strategies to reduce windfalls, and chose the following evaluation criteria for assessing alternative strategies: retention of the Social Security tilt, retention of presumed need, no variations in treatment, no spillover effects, administrative simplicity, and prospective application. Using these criteria, the *average replacement* method emerges as most reasonable; workers would receive the same relative benefit that they would receive if all their earnings were covered.

#### *Closing Protection Gaps*

Insurance gaps that result from inadequate public employee retirement system benefits could be reduced if pension plans were required to meet certain minimum standards.

An approach developed by the Office of Personnel Management would rely on credit transfers rather than on minimum standards to fill major gaps in federal workers' survivor, disability, and retirement protection.

### **Federal Employees and Social Security**

Nine of ten civilian jobs in the federal government are not now covered by the Social Security program.

#### *Legality*

Congress can enact legislation that would (1) extend Social Security coverage to federal employees, (2) modify future accrual rates under existing federal pension plans, and (3) restrict Social Security coverage and modifications of benefits for future service to selected groups such as new employees or employees below a certain age. These changes are permissible under the Constitution.

#### *Coordination Goals*

In developing specific options for CSRS-Social Security coordination, the Study Group tried to balance several important and sometimes conflicting objectives:

1. Proposed modifications should not affect the benefits that current Civil Service annuitants receive.
2. Employees eligible for immediate Civil Service retirement should not be affected.
3. There should be no reductions in benefits already accrued and no unreasonable reductions in expected benefits for current employees.
4. Costs to the federal government of a modified CSRS together with the government's contributions to Social Security should approximately equal the government's costs for the current CSRS.
5. The modified CSRS should be as simple to administer as is feasible.
6. Where possible, modifications of CSRS should be consistent with Internal Revenue Service regulations now imposed on private employers concerning integration of pension benefits.

### **State and Local Government Employees and Social Security**

Seven of ten employees of state and local governments are covered by Social Security; virtually all these employees are also covered by state or local plans for public employees. State and local government workers who are not covered by Social Security are generally covered by public employee retirement systems sponsored by their employers.

#### *Public Employee Retirement Systems*

Public employee retirement systems now cover approximately 10 million state and local government employees, protecting them and their survivors against income loss due to retirement, disability, or death. For approximately 72 percent of state and local employees, Social Security is an important addition to this protection. For the remaining 28 percent, however, the public employee retirement system constitutes the only income protection.

Covered and noncovered systems have similar characteristics. Most participants are covered by retirement benefit formulas based on a percentage of pay and years of service, and most receive limited disability and preretirement and postretirement survivor protection

through their pension plans. Limited portability is available, but usually only to other governmental units within the same state. Benefits are adjusted to the cost of living after retirement but the adjustments often are not automatic or are set at a level typically 3 percent—well below the inflation rate of recent years.

Although provisions of covered and noncovered systems are similar, participants in systems covered by Social Security generally have substantially superior protection. Data from the Pension Task Force of the House of Representatives indicated that in 1976, annuitants in covered systems received a combined benefit 20 to 60 percent higher at retirement than did annuitants in noncovered systems. Furthermore, because Social Security is fully indexed, the purchasing power of benefits was also sustained. In all, covered employees pay more to the plan to Social Security than noncovered employees pay.

Employees in six statewide systems—Colorado, Louisiana, Maine, Massachusetts, Ohio, and Nevada—are not covered by Social Security. In addition, several large municipal pension plans and teacher retirement systems are not coordinated with Social Security. In many jurisdictions, safety officer plans remain outside the Social Security system. More than half of all noncovered workers are concentrated in four states—California, Ohio, Illinois, and Massachusetts. However, the effects of mandatory coverage would be felt to some degree by workers in all but eleven states.

### *Legal Issues*

Extending Social Security coverage to state and local government employees would raise competing constitutional claims. Congress may have power to extend coverage under article 1, section 8, of the Constitution, which grants Congress the power to levy taxes, to spend for the general welfare, and to regulate commerce. States might challenge coverage as an encroachment on their sovereignty, which is protected by the 10th Amendment. Congress might override state sovereignty through enforcement of the equal protection clause of the 14th Amendment. How these competing constitutional claims would be resolved is unclear.

### *Costs of Coordinated Formulas*

The cost of any retirement formula and plan composition can be expressed as “entry-age normal cost.” Normal cost is the level percentage of salary needed to fund each employee’s benefit by

retirement date, if contributed annually from time of employment. If this figure is aggregated across employee categories and adjusted for employee resignations, disabilities, and deaths, the result becomes the plan's normal cost. Additional unfunded liabilities can be amortized over a standard period, typically 40 years. By using these standardized cost calculations for all plans, the Study Group estimated the cost of mandatory coverage.

After coverage, normal costs would be lower than the current plan's costs because each plan's formula would be redesigned to take account of Social Security benefits. On average, in the constant-benefit formulas of both groups, normal costs after coverage (as a percentage of payroll) would decline to between one-half and two-thirds their former level. Postcoverage costs would be heavily influenced by special early-retirement supplements for systems in which early retirement is common—especially police and firefighter plans. These normal costs are in addition to the new Social Security payroll taxes assumed by employers and employees. The net effect of lower normal costs combined with scheduled payroll taxes would be an average increase of about 5 percent to 10 percent of payroll in the constant-benefit formulas, or an increase of 33 percent to 62 percent over current normal costs. Cost increases would be even more significant for the "most likely" and "most typical" or "standard" formulas because these formulas are more liberal.

Current public employee retirement protection and new Social Security coverage are not duplicative in several areas. The cost impact of mandatory coverage cannot be ascribed directly to specific provisions. Among the most important factors contributing to the cost increases are strengthening the cost-of-living protection; reducing forfeitures that occur when vested or nonvested employees resign (since part of retirement protection will become fully portable); designing special supplements for retirement before age 62 (especially in police and firefighter plans); and improving health insurance and disability and survivors' benefits.

### *Transition Considerations*

The transition problems associated with mandatory coverage are more challenging at the state and local levels than at the federal level. Elected officials, plan administrators, and employees need considerable time to determine the appropriate design for newly coordinated formulas and to devise approaches for meeting the higher



costs. The Study Group concluded that at least four years would be required for this process.

Two transition approaches were analyzed: coverage of new employees only, and coverage of current workers plus all future employees. Even under the second approach, some exemptions would probably be granted for current employees nearing retirement or meeting certain age and service criteria.

### *Impact of Social Security Coverage on Capital Formation*

Extension of Social Security coverage to state and local government employees would not be expected to disrupt capital formation in the United States. Extension of coverage would reduce the level of contributions now flowing into noncovered state and local plans, but the reductions would be small and would probably occur gradually. Compared with the potential effects of other long-term developments, particularly changes in plan funding and investment strategies, the effects of extending Social Security coverage to all state and local government employees seem relatively small and manageable.

### **Private, Nonprofit Organizations and Social Security Coverage**

Most well-established, private, nonprofit institutions participate voluntarily in the Social Security program. Therefore, as many as nine of every ten positions in these organizations are now covered.

Empirical data on employment in the nonprofit world are hard to obtain and assess, but the Study Group made several conclusions from its investigations.

Mandatory coverage would improve the income protection of noncovered workers and would present no special administrative difficulties for employers. However, because much employment in the nonprofit sector is sporadic, and because considerable nonprofit activity occurs without any contact with the government, it would be hard to enforce mandatory coverage for all nonprofit enterprises. Religious organizations might resist mandatory participation on First Amendment—free exercise of religion—grounds. Secular nonprofit organizations might have similar—freedom of association—grounds for opposition.

## **Perspective on the Feasibility and Desirability of Mandatory Social Security Coverage**

The Study Group was specifically charged with the task of evaluating the “feasibility and desirability” of extending Social Security coverage to currently exempted employees.

The Study Group determined on the basis of legal, administrative, fiscal, and transition criteria that it would be feasible to expand Social Security coverage.

*Legal Criteria.* Extending Social Security coverage to noncovered workers would raise several legal issues, which vary for each of the noncovered groups. If Social Security coverage were extended to civilian employees of the federal government, few legal problems would probably ensue. Congressional power to mandate coverage is clear. How the legal issues would be resolved if Social Security coverage were extended to state and local government employees is less clear. Opponents and proponents of coverage could present competing constitutional claims that would require judicial resolution. If coverage were extended to employees of nonprofit organizations, religious and secular organizations wanting to oppose coverage could also base their legal claims on the Constitution.

*Administrative Criteria.* During the transition period, some added administrative complexity could be expected. The extent of the burden would depend on the approach selected to coordinate staff pension systems. Administrators also would have to choose between two methods as the current pension system was closed and the new one became effective. If only future employees were covered, a dual system would have to be administered. Coverage of only part of the current work force or of future workers only would not require establishment of separate pension trust funds for these systems.

*Fiscal Criteria.* The fiscal implications of extending coverage to federal workers are relatively neutral from the perspective of the consolidated federal budget. Both Social Security and the Civil Service Retirement System are funded within the same budget. The effects are more evident, however, when separate accounts are considered. By covering federal employees, the Social Security program would receive new monies and assume new obligations. However, coverage of federal workers would lead to reduced revenues for CSRS and commensurately reduce pension obligations under the coordinated system. Covering federal employees would mean the

gradual elimination of Social Security windfalls to CSRS annuitants. Coverage would also lead to net gains for the Social Security program as contribution gaps were closed and as higher income public employees were affected by the redistributive aspect of Social Security.

At the state and local levels, expanded Social Security coverage would mean elimination of another \$750 million to \$1 billion in benefit and contribution inequities. Expanded coverage would involve diverting some pension contributions from locally administered pension funds into the Social Security trust funds. Even when the present pension formula was redesigned to reflect Social Security benefits, combined pension costs would generally increase. In the constant-benefit case, for example, the long-term cost increase typically falls between 5 and 10 percent of payroll. When the new costs associated with Social Security coverage are considered in the resulting coordinating plans, however, pension costs generally would not be higher in the affected jurisdictions than in localities already covered by Social Security.

Coverage would mean an additional cost for nonprofit organizations that have not waived their exemptions from Social Security coverage. The cost of Social Security may become prohibitive for short-term, nonprofit organizations established to reach a goal within a specific period. The paid employment that exists in such organizations hardly constitutes full-time career employment. For these groups, some threshold of hours or wages might be established for determining when coverage was required.

*Transition Criteria.* At the federal level, the transition to Social Security coverage would only minimally affect costs, whether the transition included current workers or only future employees. Costs of the new system would be similar to those of the current system. The optimal transition would depend on the trade-offs involved in maintaining current employees' satisfaction with the existing pension system while eliminating problems resulting from lack of coverage.

For state and local pension systems, the transition to coverage would generally be more costly. Most of these systems would have higher ultimate costs when the payroll tax is included; they would need new ways to finance a higher level of pension obligations. Covering current workers would result in a faster transition to the more expensive system than would be the case if coverage were extended to new employees only. Beyond this option, the means available to a pension system to phase in increased costs are contingent on the current plan's funding level. Pay-as-you-go systems

would have to assume Social Security obligations for current workers while paying accrued obligations from operating funds. For systems with some advance-funding, the problem would be less critical.

### *The Desirability of Alternative Solutions*

Opponents of mandatory Social Security coverage have argued that the problems should be resolved by alternative means. No alternative solves all the problems discussed in this report without introducing new problems.

If the windfall reduction options were implemented, the costs of eliminating windfalls would be borne only by the worker; coverage gaps would remain.

If a transfer-of-credit plan were implemented, the employer and employee would share the cost of reducing windfalls and gaps. This plan would raise the costs of pensions for noncovered employment. A two-way credit-transfer plan would be both administratively cumbersome and contrary to established Social Security provisions. Mandatory, one-way credit-transfer plans would introduce inequities for noncovered workers, unless they were coupled with stringent vesting requirements for public employee retirement systems. One-way credit transfers would not necessarily eliminate windfalls.

If minimum standards for public retirement systems were implemented, some of the portability problems and benefit protection gaps could be reduced. This plan would result in higher public retirement system costs.

Implementing either a mandatory transfer-of-credit program or minimum standards would require federal legislation affecting state and local pension systems. This legislation would almost certainly encounter the same legal tests as mandatory Social Security coverage.

### *The Desirability of Expanded Social Security Coverage*

The desirability of expanding Social Security coverage depends on one's perspective. At the public hearings on mandatory coverage held by the Study Group, nearly all the testimony came from individuals receiving public plan annuities, from public employees, or from their representatives. These individuals' pension systems would be covered if Social Security participation were mandated. Their testimony was overwhelmingly negative. Noncovered employees' groups maintain that many of their members already have Social Security coverage through alternative employment and would not receive com-

mensurately larger benefits based on the additional contributions they would have to make if coverage were mandated. Rather than extend coverage, they suggest that any inequitable subsidies being provided by Social Security should be modified.

The position of the approximately 100 million workers engaged in employment covered by Social Security was seldom heard in the hearings.

The desirability and feasibility of coverage are issues requiring political resolution. They must be resolved in a national forum in which all pertinent views are debated. Legislators will have to hear all sides of the arguments, consider the nature of the existing problem, and assess the implications of the alternative solutions.

**Social Security Board of Trustees  
A Summary of the 1981 Annual Reports\***

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\*Prepared by the Social Security Administration and the Health Care Financing Administration, July 6, 1981.

## Highlights

During calendar year 1980, 115 million workers paid Social Security payroll taxes. Monthly Social Security benefits were being paid to 35 million beneficiaries at year-end. About 95 percent of all persons aged 65 or over were protected by Medicare.

The funds held for retirement, survivors, and disability benefits declined by \$3.8 billion during 1980, to about \$26 billion at year-end, while the fund for Medicare Hospital Insurance increased by \$0.5 billion, to about \$14 billion.

The short-range financing of the retirement and survivors benefit program must be strengthened very soon, so that benefits can be paid throughout 1982 and beyond.

Hospital Insurance taxes are set at about the levels needed for that program during the early 1980s, but later on these taxes will be too low if the assumptions underlying the estimates are realized.

In approximately 30 years, the aged population will have grown significantly, both in total number and relative to the number of covered workers. While these numbers cannot be forecast precisely, reasonable estimates can be made based on the population already born. To finance the benefits scheduled over the long-range, much more income to these programs will be needed from taxes unless benefit outlays are substantially reduced.

Action to remedy the short-range financial crisis by lowering the benefit outgo could well carry over to the long-range and solve its problems as well.

## Introduction

Four Social Security programs provide basic financial security to American workers and their families:

- (1) *Old-Age and Survivors Insurance* (OASI) pays monthly cash benefits after a worker retires or dies.
- (2) *Disability Insurance* (DI) pays monthly cash benefits after a worker becomes disabled. (OASI and DI together are referred to as OASDI.)
- (3) *Hospital Insurance* (HI, or Medicare Part A) pays for hospital care of those aged 65 and over and of the long-term disabled.

- (4) *Supplementary Medical Insurance* (SMI, or Medicare Part B) pays for doctor bills and other medical expenses of those aged 65 and over and of the long-term disabled.

These programs are financed essentially on a pay-as-you-go basis. Taxes paid by current workers are used to pay benefits to current beneficiaries. However, Social Security does maintain trust funds that provide small reserves against fluctuations. These trust funds hold all of the income not needed currently to pay benefits and expenses. Social Security funds may not be used for any other purpose.

The Secretaries of Treasury, Labor, and Health and Human Services serve as trustees of the Social Security trust funds. They report annually to the Congress on the condition of each fund and on projected future results.

The 1981 annual reports for the four trust funds are summarized here. Copies of the complete Trustees Report for OASDI can be obtained without charge from the Social Security Administration, Office of Public Inquiries, 4100 Annex, Baltimore, Maryland 21235. The HI and SMI Trustees Reports are available from the Health Care Financing Administration, Office of Public Affairs, Room 313H, Humphrey Building, 200 Independence Avenue, S.W., Washington, D.C. 20201.

Payroll taxes from employees, their employers, and the self-employed go into the trust funds to pay for OASI, DI, and HI. These trust funds pay benefits to current beneficiaries. SMI is financed differently and is discussed separately in Appendix A, so that this summary can focus on the three payroll-tax supported programs.

Table 1 shows the payroll tax rates for employers and employees, as established by law. Taxes at these rates are paid on each worker's earnings up to \$29,700 in 1981. In future years, the Social Security earnings base will rise as average wages increase.

For the self-employed, the OASDI tax rates are about 1½ times the rates for employees, and the HI tax rates are the same as for employees.

It is intended that the income for each program will closely match outgo in most years. When income exceeds outgo, the excess serves to increase the trust funds. When outgo exceeds income, the trust funds are drawn down. Thus, the trust funds serve as a contingency reserve to absorb temporary fluctuations in income and outgo. The trust funds are invested in U.S. government bonds, notes, and other securities, bearing rates of interest similar to those for long-term securities issued to the general public.



**TABLE 1**  
**Payroll Tax Schedule**

Calendar Year	Contribution Rates (Percent of Taxable Earnings) Payable by Employers and Employees, Each			Total
	OASI	DI	HI	
1981	4.70%	0.65%	1.30%	6.65%
1982-84	4.575	0.825	1.30	6.70
1985	4.75	0.95	1.35	7.05
1986-89	4.75	0.95	1.45	7.15
1990 & later	5.10	1.10	1.45	7.65

### Results for 1980

During 1980, 115 million workers contributed to the OASDI and HI programs through payroll taxes. At the end of 1980, 35 million OASDI beneficiaries were receiving monthly benefit payments, and 95 percent of the population over age 65 was covered under HI.

Table 2 presents the cash income, outgo, and changes in assets during 1980 for the three programs, with 1979 data for comparative purposes.

In 1980, income to the three trust funds was \$145.8 billion, while outgo was \$149.1 billion. As a result, the three trust funds together decreased by \$3.3 billion. The OASI and DI Trust Funds dropped by \$3.8 billion, while the HI Trust Fund rose by \$0.5 billion.

Administrative expenses represented about 1.3 percent of benefit payments for OASDI and 2.0 percent for HI—1.5 percent for the three programs combined. This combined expense rate was 1.6 percent in 1979.

Compared to the prior year's figures, income to the three funds in 1980 rose by 13 percent, but outgo was up by 16 percent. During 1980, as in 1979, there were unanticipated negative developments in the economy, including high unemployment and inflation, with prices rising more rapidly than wages. Thus, Social Security cash benefits (which are adjusted for changes in the Consumer Price Index) went up faster than Social Security revenues (which are based on covered payrolls). Medicare Hospital Insurance expenditures also rose faster than revenues because of rapidly increasing health care costs.

**TABLE 2**  
**Results of Financial Operations During 1980**  
 (Billions)

	OASI	DI	HI	Total
Trust Fund Assets on January 1, 1980 ..	\$ 24.7	\$ 5.6	\$13.2	\$ 43.5
Income in 1980:				
Payroll Taxes .....	103.5	13.3	23.8	140.6
Premiums From Participants .....	—	—	*	*
General Fund of Treasury .....	0.5	0.1	0.9	1.5
Interest .....	1.8	0.5	1.1	3.4
Transfer from Railroad Retirement Account .....	—	—	0.2	0.2
Total Income .....	105.8	13.9	26.1	145.8
Outgo in 1980:				
Benefit Payments .....	105.1	15.4	25.1	145.6
Administration, Including Rehabilitation .....	1.2	0.4	0.5	2.1
Transfer to Railroad Retirement Account .....	1.4	*	—	1.4
Total Outgo .....	107.7	15.9	25.6	149.1
Net Change in Trust Fund in 1980 .....	-1.8	-2.0	0.5	-3.3
Trust Fund Assets on December 31, 1980 .....	22.8	3.6	13.7	40.2

**Comparative Results for 1979**

Income in 1979 .....	90.3	15.6	22.8	128.7
Outgo in 1979 .....	93.1	14.2	21.1	128.4
Net Change in Trust Fund in 1979 .....	-2.9	1.4	1.8	0.3

\*Less than \$50 million.

Note: Components may not add to totals due to rounding.

## Actuarial Cost Projections

As required by law, the annual Trustees Reports contain projections on each fund's estimated financial operations and status. The estimates given here are on a calendar-year basis (and are for the programs as they are now structured). They extend over the next 75 years for OASDI and 25 years for HI. The estimated costs after the first few years are presented as percentages of taxable payroll, so that expenditures can be compared directly with the payroll tax rates. A precise prediction of the future is not possible, even in the short range. Both short- and long-range estimates are made using reasonable assumptions to indicate the trend and general range of future costs.

### *Assumptions Used*

Future OASDI income and outgo will depend on mortality, fertility, unemployment, inflation, and other economic and demographic factors. Medicare costs will also depend on how often health care services are used and how much these services cost.

The OASDI and HI cost projections are prepared using five alternative sets of assumptions regarding these economic and demographic factors, referred to as "optimistic," "intermediate-A," "intermediate-B," "pessimistic," and "worst-case" assumptions. Because recent economic performance has been erratic, the economic assumptions now allow for more possible variation than before, including both an A and B set of intermediate economic assumptions, and also a "worst-case" set of short-range economic assumptions.

Intermediate A assumes future economic performance resembling the experience in recent periods of more robust economic growth, such as would result from policies aimed at stimulating growth and lowering inflation; this presentation shows the favorable effect on the trust funds of an improved economy. Intermediate B assumes the adoption of policies that would yield less economic growth. The set of assumptions characterized as "worst-case" covers 1981-86 and is more pessimistic than the other four sets (although even more unfavorable assumptions could be designed). The "worst-case" assumptions were also used to test the adequacy of the short-range financing under the Administration's recent Social Security proposals.

Appendix B shows selected values of several of the assumptions used in the five basic projections.

### *Measures of Actuarial Status*

In analyzing the financial status of the program, several measures of actuarial status are commonly used.

**Fund ratio** is the amount in the trust fund at the beginning of a year expressed as a percentage of that year's expenditures. For example, a fund ratio of 25 percent means that the amount in the fund is one-fourth of annual outgo (or enough to pay benefits for about three months in the absence of any income). At the beginning of 1981, the fund ratios for OASI, DI, and HI were 18, 20, and 46 percent, respectively.

Several factors should be considered in determining appropriate fund ratios, as follows:

- (1) The OASI and DI benefit payments go out early each month, but the income from payroll taxes is spread over the entire month. If the OASI or DI Trust Funds drop to a point where the balance on hand at the beginning of a month is too low to pay the benefits, the benefit checks could not be sent out in a timely manner. In practice, a fund ratio of about 12 to 14 percent would usually mean that this point is near, and that action must be taken very soon to strengthen the financing.
- (2) HI benefit payments do not have this cash-flow pattern, but they do fluctuate noticeably from month to month.
- (3) Payroll-tax receipts to the trust funds also fluctuate during the year (as do other items of income and outgo).
- (4) Unforeseen changes in the economy may cause the trust funds to decrease unexpectedly. Each trust fund should have sufficient assets to avoid the need for hasty action to assure the payment of benefits.

**Year-by-year expenditures as a percentage of taxable payroll** is another useful measure. These percentages can be used to establish tax rate schedules that approximately support pay-as-you-go financing.

**Actuarial balance** is the average difference between the scheduled tax rate and the projected annual outgo over a given period. The actuarial balance is the usual measure of financial status over periods of 25 years or more. The OASDI system is said to be in *close actuarial balance* over the long-range period if the average scheduled tax rates

are between 95 and 105 percent of the average estimated expenditures as a percentage of taxable payroll.

### **Short-Range Financing (1981-85)**

The Trustees emphasize that there is an urgent need to strengthen the financing of the Social Security system in the short-range. Without any changes in current law, the OASI Trust Fund will become unable to pay benefits by late 1982. Even if the three payroll-tax financed trust funds were allowed to borrow from one another, their combined assets would decline significantly during the next five years. In fact, their combined assets would barely suffice under the two more-optimistic sets of assumptions. Under the three less-favorable projections, combined assets of these trust funds would become depleted within a few years.

\* \* \*

Projections over the next five years allow Congress and the Administration to monitor and adjust income to the programs. In this short-range picture, the numbers of persons receiving OASDI benefits can be forecast closely. However, changes in the national economy can have major effects on outgo and income, and are difficult to predict. Past economic downturns that were more severe than anticipated have led to the current financial crisis.

Table 3 indicates year-by-year projections of OASDI fund ratios through 1985, under all four sets of long-range assumptions and under the so-called "worst-case" economic assumptions, which prudently served as the basis for the Administration's recommendations to solve the short-range and long-range financing crisis of the OASDI program.

The OASI Trust Fund would become unable to pay timely benefits by late 1982 under any of the projections. Combining the DI Trust Fund with the OASI Trust Fund would not postpone the latter's exhaustion by more than a few months. Even combining all three trust funds would provide a slim margin at best. Under the three less-favorable projections, the three combined trust funds would become exhausted before the end of 1985.

Chart A shows the projected fund ratios through 1990 for these three funds combined. Even on this basis, which assumes interfund borrowing (which would require legislation), there is a need to

**TABLE 3**  
**Fund Ratios Projected to 1985**

	Fund at January 1 as a Percent of Outgo During Year					
	1980	1981	1982	1983	1984	1985
<b>OASI:</b>						
Optimistic Assumptions . . . . .	23%	18%	14%*	6%*	- 1%*	- 8%*
Intermediate-A Assumptions . . . . .	23	18	13*	5*	- 4*	-13*
Intermediate-B Assumptions . . . . .	23	18	13*	4*	- 5*	-16*
Pessimistic Assumptions . . . . .	23	18	13*	4*	- 9*	-22*
“Worst-Case” Assumptions . . . . .	23	18	13*	2*	-13*	-29*
<b>OASI and DI Combined:</b>						
Optimistic Assumptions . . . . .	25	18	14	9*	6*	4*
Intermediate-A Assumptions . . . . .	25	18	13	8*	3*	- 1*
Intermediate-B Assumptions . . . . .	25	18	13*	7*	2*	- 5*
Pessimistic Assumptions . . . . .	25	18	13*	7*	- 2*	-12*
“Worst-Case” Assumptions . . . . .	25	18	13*	5*	- 7*	-18*
<b>OASI, DI, and HI Combined:</b>						
Optimistic Assumptions . . . . .	29	23	21	20	19	19
Intermediate-A Assumptions . . . . .	29	23	21	18	15	13
Intermediate-B Assumptions . . . . .	29	23	21	18	14	8*
Pessimistic Assumptions . . . . .	29	23	21	17	9*	1*
“Worst-Case” Assumptions . . . . .	29	23	20	15	5*	- 5*

\*Under present law, the program would be unable to pay timely benefits during this year because financing is projected to be inadequate.

strengthen the short-range financing. The combined funds would barely get through the early 1980s under the two more-favorable sets of assumptions. Under the other three less-favorable projections, the combined funds would be used up within a few years. Thus, any reallocation of the tax rates or borrowing among the trust funds would not result in adequate short-range financing under adverse conditions.

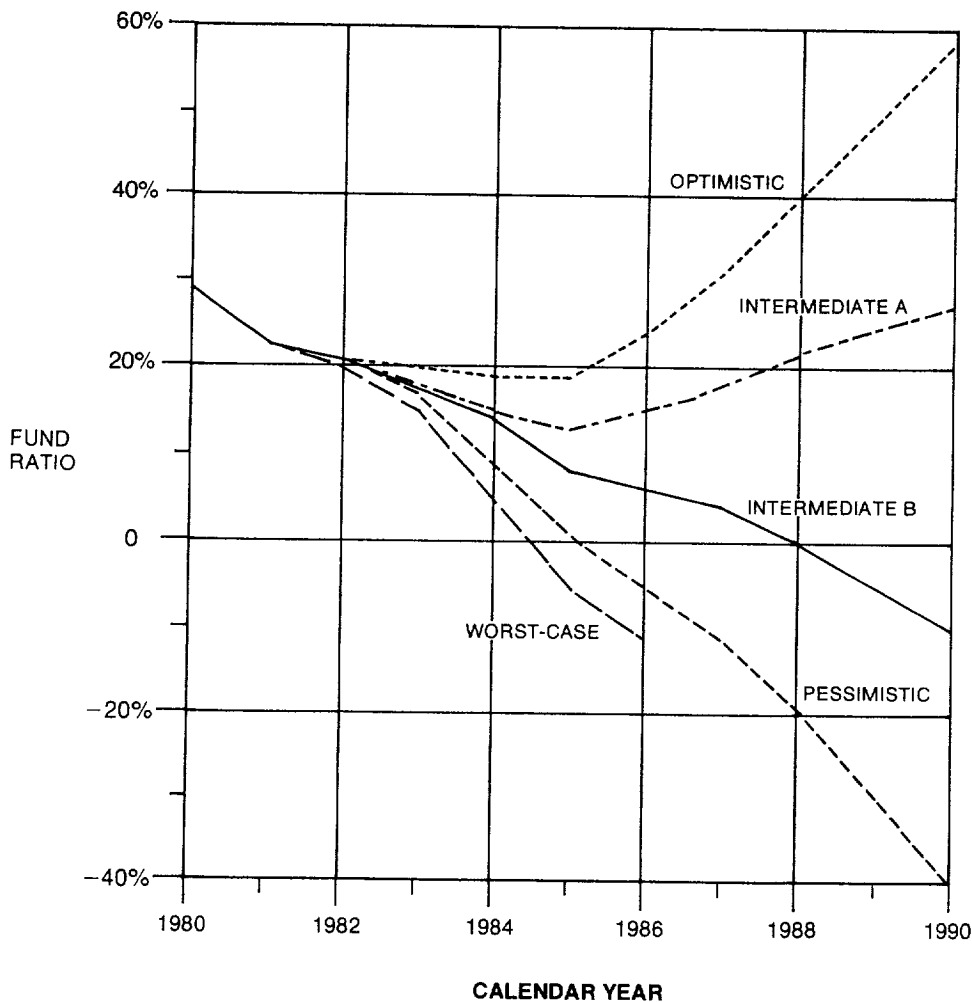
### Long-Range Financing (1981-2055)

Over the next 75 years, the projections indicate a need for substantial changes in the long-range financing of OASDI. Action is urgently needed to solve the financing problems during the 1980s (as discussed earlier). Later on, the outlook for the OASDI Trust Funds improves substantially, after the tax increases that would take effect

during 1985-90, and remains favorable during the first 25-year period. During the following 25 years, however, OASDI tax rates are projected to become inadequate, as expenditures rise (due to a larger beneficiary population), while tax rates remain level under current law. During the final 25 years of the 75-year projection period, there is a substantial deficit projected under all but the most optimistic assumptions. Thus, the long-range financing of OASDI needs to be strengthened.

Chart A

### Estimated Fund Ratios Under Combined OASI, DI, and HI Programs



HI income is projected to cover expenditures during the early 1980s. But later in the 25-year period, HI financing is estimated to deteriorate. Although the HI Trust Fund is not in imminent danger, the Board of Trustees recommends that Congress should investigate ways of strengthening its financing.

\* \* \*

Long-range cost estimates for OASDI over the next 75 years, although sensitive to variations in the assumptions, give the best indication of the trend and general range of the program's cost. HI projections customarily do not go beyond 25 years, because of the high degree of uncertainty about the trend of future hospital costs relative to the rest of the economy.

Several important demographic trends are anticipated in the next 75 years which would sharply raise the proportion of the aged in the population.

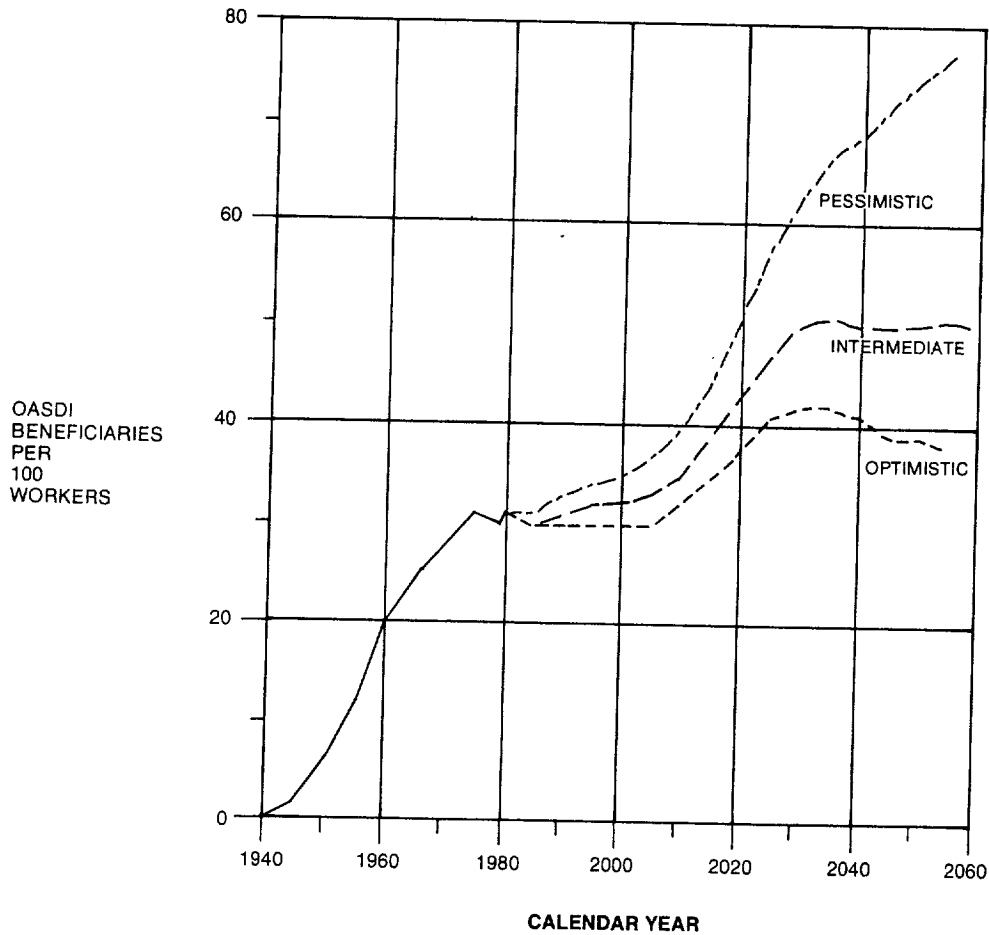
- (1) After the turn of the century, rapid growth is expected in the aged population because of the large number of persons born shortly after World War II.
- (2) Projected improvements in mortality also would increase the numbers of aged persons.
- (3) At the same time, low birthrates would hold down the number of young people.

Chart B shows the long-range trend in the number of OASDI beneficiaries per 100 covered workers, based on the three sets of demographic assumptions. (It is important to note that "beneficiaries" includes not only retired workers, but also disabled workers, spouses, children, and survivor beneficiaries.) This ratio has gone up from zero in 1940 to 31 currently. It is estimated to rise to a range of 40 to 70 by the middle of the next century. Because most of the beneficiaries during the next 75 years have already been born, their numbers are projected mainly from the present population. The numbers of workers involved in these projections, however, depend on future birthrates, which are subject to more variability.

Chart C shows the trend in the estimated annual OASDI outgo as a percentage of taxable payroll under each of the four sets of long-range assumptions during the next 75 years. Also shown for comparative purposes are the scheduled OASDI tax rates. Under each set of assumptions, the estimated outgo as a percentage of taxable



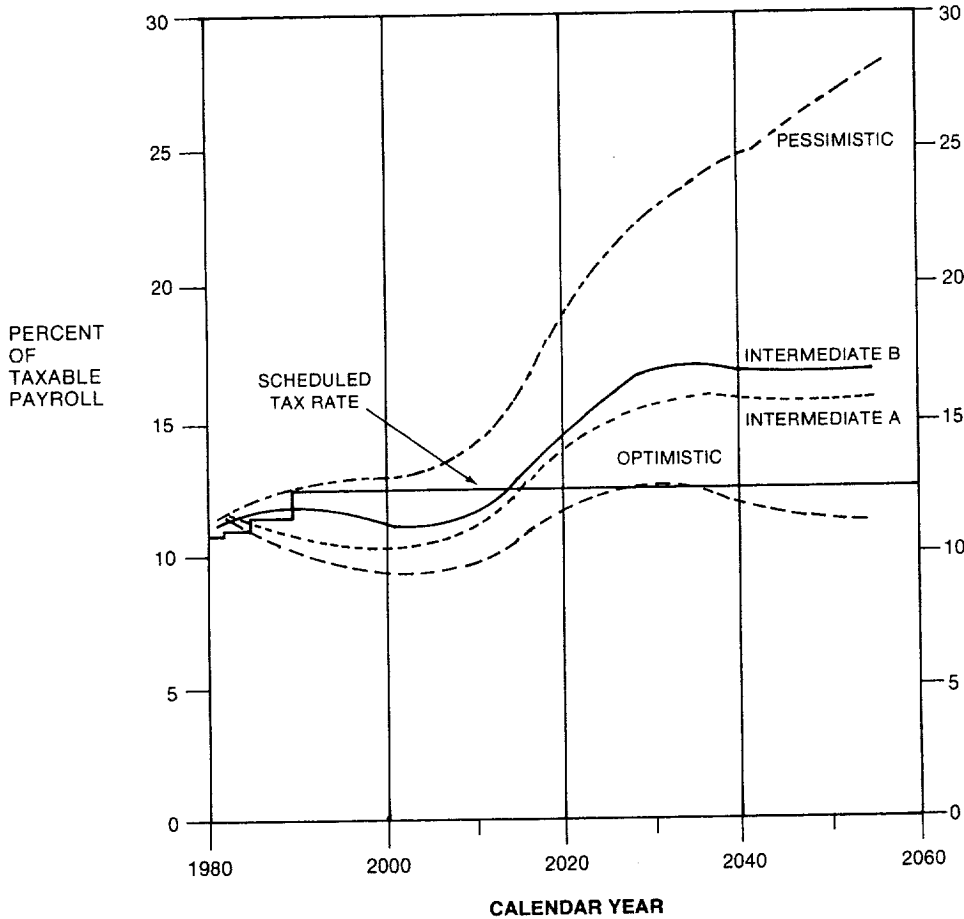
### Number of OASDI Beneficiaries per 100 Workers



payroll increases rapidly after the turn of the century. Under the intermediate and optimistic sets of assumptions, the outgo in relation to taxable payroll peaks around 2030, while under the pessimistic assumptions, the outgo is still increasing at the end of the valuation period. These projections indicate the need for action to restore the OASDI system to financial health over the long-range.

Table 4 compares the estimated average OASDI expenditures in relation to taxable payroll and the tax rates over the next 75 years under the four alternative sets of long-range assumptions. The estimated average annual tax income for the entire 75-year projection

### Estimated OASDI Outgo and Tax Rates 1981-2055



period falls below the estimated average annual outgo for the period by 0.93 percent of taxable payroll under Intermediate A and 1.82 percent under Intermediate B.

Chart D summarizes the projections of HI expenditures as percentages of taxable payroll as compared with the tax rates through the year 2005, based on the four sets of long-range assumptions. HI income scheduled for the early 1980s is sufficient to cover HI expenditures. But the chart shows that this favorable short-range financing picture is projected to begin deteriorating shortly after 1985. The expected net outflows from HI beginning in the late 1980s add to the

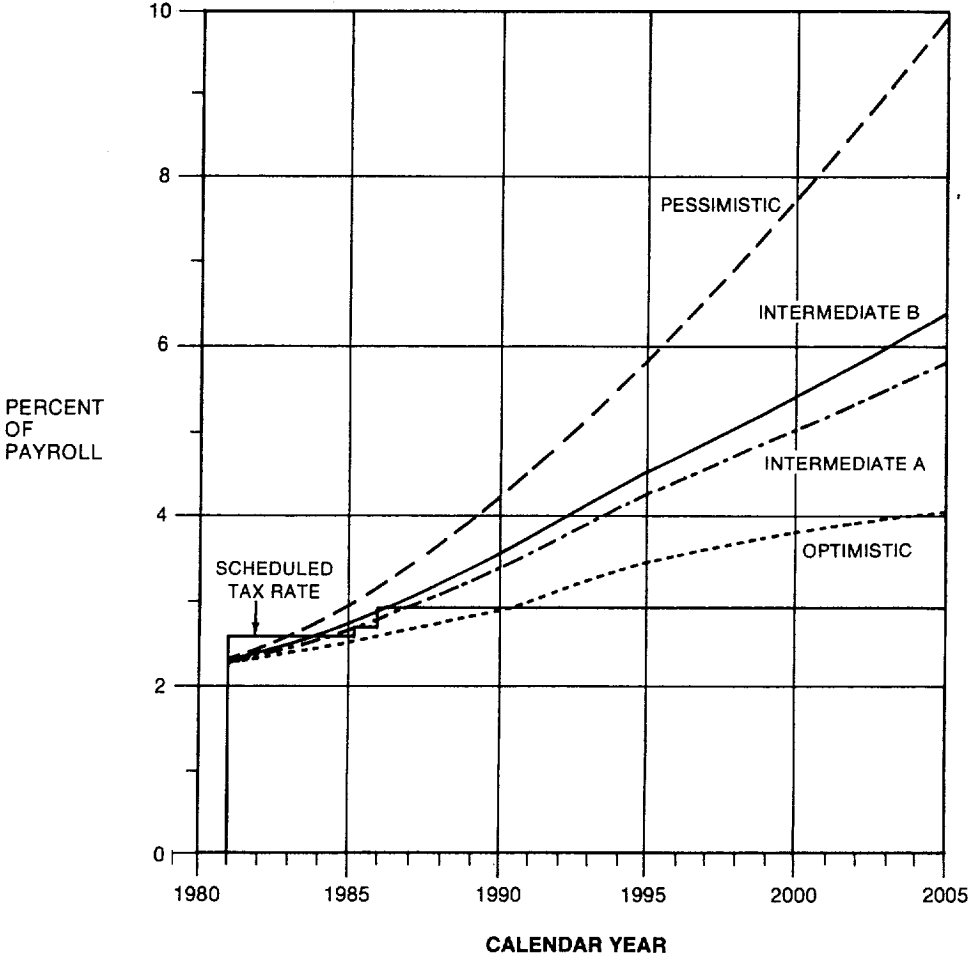
**TABLE 4**  
**Estimated Average OASDI Tax Rates, Expenditures, and**  
**Actuarial Balance**  
 (Percent of Taxable Payroll)

	25-Year Averages			75-Year
	1981-2005	2006-2030	2031-2055	Average 1981-2055
<hr/>				
Average Scheduled Tax Rate (Combined Employer- Employee Rate)	11.94%	12.40%	12.40%	12.25%
<hr/>				
Estimated Average Expenditures:				
Optimistic Assumptions . . . . .	9.99	11.07	11.93	10.99
Intermediate-A Assumptions ..	10.67	13.07	15.79	13.17
Intermediate-B Assumptions ..	11.51	13.87	16.81	14.07
Pessimistic Assumptions . . . . .	12.55	17.50	25.43	18.50
<hr/>				
Difference (Actuarial Balance):				
Optimistic Assumptions . . . . .	1.95	1.33	0.48	1.25
Intermediate-A Assumptions ..	1.27	-0.67	- 3.39	-0.93
Intermediate-B Assumptions ..	0.43	-1.47	- 4.41	-1.82
Pessimistic Assumptions . . . . .	-0.61	-5.10	-13.03	-6.25
<hr/>				

problems already discussed for OASDI, and underscore the need to do more than rely on interfund borrowing to restore the strength of the combined system.

Table 5 shows the actuarial balance for HI over the next 25 years, based on the two sets of intermediate assumptions. This actuarial balance compares the average scheduled HI tax rate and the estimated average cost, both for meeting the HI expenditures and for bringing the HI fund ratio up to a more adequate level over the long-run. For illustrative purposes, a fund ratio of 50 percent has been used here as providing such a level.

### Estimated HI Outgo and Tax Rates 1981-2005



**TABLE 5**  
**HI Actuarial Balance 1981-2005**  
 (Percent of Taxable Payroll)

	Optimistic Assumptions	Intermediate-A Assumptions	Intermediate-B Assumptions	Pessimistic Assumptions
Average Scheduled Payroll Tax Rate (Combined Employer-Employee Rate)	2.84%	2.84%	2.84%	2.84%
Expenditures	3.21	3.94	4.19	5.46
Trust Fund Buildup and Maintenance	<u>0.05</u>	<u>0.08</u>	<u>0.09</u>	<u>0.18</u>
Total Cost of the Program	3.26	4.02	4.28	5.64
Difference (Actuarial Balance)	-0.42	-1.18	-1.44	-2.80

## Economic and Demographic Assumptions

The table below shows selected values of several of the assumptions used in the projections for OASDI and HI in the 1981 Trustees Reports.

Calendar Year	Percent Increase over Previous Year in Average Annual—				Annual Unemployment Rate	Total Fertility Rate <sup>3</sup>
	Real GNP <sup>1</sup>	Wages in Covered Employment	Consumer Price Index	Inpatient Hospital Costs <sup>2</sup>		
Optimistic Assumptions						
1981	1.7%	10.6%	10.7%	15.6%	7.7%	1.9
1985	4.4	6.8	4.1	11.4	5.7	2.0
1995	3.2	4.5	2.0	6.8	4.5	2.1
2005 & later	3.5	4.5	2.0	6.3	4.0	2.4
Intermediate-A Assumptions						
1981	1.1	10.2	11.1	15.6	7.8	1.9
1985	4.2	7.1	4.7	12.9	5.9	1.9
1995	2.8	5.0	3.0	9.1	5.0	2.0
2005 & later	3.1	5.0	3.0	8.4	5.0	2.1
Intermediate-B Assumptions						
1981	1.1	10.2	11.1	15.6	7.8	1.9
1985	2.9	8.1	7.4	14.4	6.8	1.9
1995	2.4	5.5	4.0	10.0	5.4	2.0
2005 & later	2.7	5.5	4.0	9.3	5.0	2.1
Pessimistic Assumptions						
1981	0.7	11.5	12.6	15.6	7.9	1.8
1985	3.0	10.1	9.7	18.8	7.4	1.8
1995	2.3	6.4	5.4	12.9	6.0	1.8
2005 & later	2.2	6.0	5.0	11.9	6.0	1.7
"Worst-Case" Assumptions (1981-86 Only)						
1981	-0.1	10.6	12.8	15.6	8.3	1.8
1985	4.4	10.4	9.7	15.6	8.0	1.8

<sup>1</sup>Gross National Product (the total output of goods and services) expressed in constant dollars. The percentage increase in real GNP is assumed to change after the year 2005. The values for the year 2055 are 3.4, 2.5, 2.1, and 0.9 percent for the optimistic, intermediate-A, intermediate-B, and pessimistic assumptions, respectively.

<sup>2</sup>Includes hospital costs for all patients, not just those covered under HI. Figures shown for "2005 & later" are for 2005.

<sup>3</sup>The number of children who would be born to a woman in her lifetime if she were to experience the age-specific birthrates assumed and were to survive the entire child-bearing period.

## **Summary Comparison of Recommendations by ACSS, NCSS, and PCPP**

### **Social Security Financing**

#### *Advisory Council on Social Security*

Fund HI from earmarked income tax (general revenues). Increase OASDI tax rate.

Use countercyclical general revenues if reserves fall below 25 percent.

Merge OASI and DI funds.

Raise tax rate to 7.25 percent in 2005.

Earnings base level should be set so as to maintain same fraction of aggregate earnings as was covered in 1979.

#### *National Commission on Social Security*

Fund one-half HI from general revenues (with 2.5 percent surtax on income tax). Increase OASDI tax rate (not to exceed combined rate of 18 percent in the future).

Maintain earnings base for 1985 and 1986 at 1984 level and adjust automatically thereafter.

Permit borrowing through 1985 from general revenues if interfund borrowing is insufficient.

Reallocate part of DI tax to OASI.

#### *President's Commission on Pension Policy*

Permit interfund borrowing.

Accelerate payroll tax increases.

### **Coverage**

#### *Advisory Council on Social Security*

Extend coverage to all new federal, state and local and nonprofit organization employees.

Until universal coverage is complete, coordinate Social Security and other systems and preclude termination of state/local coverage agreements.

Count payment of employee tax by employer as taxable wages except for domestics.

Subject tips to Social Security tax.

Subject all earnings of farm workers to Social Security tax if farm operator pays \$2,500 annually for farm labor.

#### *National Commission on Social Security*

Extend coverage to all new federal, state and local and nonprofit organization employees.

Extend HI coverage on a mandatory basis to all governmental employees.

Extend coverage to all governmental employees not now under a retirement system.

Extend coverage to all employees of nonprofit organizations.

Coordinate Social Security and other systems and preclude termination of state/local coverage agreements.

Count sick pay as taxable wages for six months.

Raise earnings requirement for coverage and tax purposes for domestics, casual labor and self-employed.

#### *President's Commission on Pension Policy*

Extend coverage to all new federal, state/local, and nonprofit organization employees.

Preclude termination of state/local coverage agreements.

### **Women's Issues**

#### *Advisory Council on Social Security*

Consider full-scale earnings sharing; i.e., dividing earnings credits equally between spouses in all circumstances.

Divide earnings credits equally between divorced spouses in computing retirement benefits if marriage lasted ten years.



Pay benefits to aged widows/widowers based on combined earnings of spouses.

Consider drop-out years for child care.

*National Commission on Social Security*

Permit child-care credit years for calculating special minimum benefit.

Calculate surviving spouses' benefits on basis of recent wages.

*President's Commission on Pension Policy*

Adopt earnings sharing at divorce and inheritance of credits by surviving spouse.

## **Disability**

*Advisory Council on Social Security*

Liberalize family benefits in DI.

Apply liberalized "vocational factors" in determining disability for older workers 55 to 59.

Adopt a broader definition of disability in SSI than in Social Security disability insurance.

Reduce waiting period to three months.

Do not reduce benefits to disabled widows/widowers under 65.

Extend spouses' benefits to disabled spouses of disabled and retired workers.

*National Commission on Social Security*

Liberalize family benefits in DI.

Make SGA the same as retirement test monthly measure.

*President's Commission on Pension Policy*

Consider a universal disability program.

Consider a ceiling on replacement ratios as a work incentive.

Consider rehabilitation, job redesign, etc. to encourage work.  
Consider an occupational disability program for older workers.

## **SSI**

### *Advisory Council on Social Security*

Increase benefits so that combined Social Security, SSI, state supplementary payments and food stamps reach poverty level.

Index assets limits.

Cash-out food stamps for SSI recipients.

Eliminate assets test on automobile, household goods and personal effects.

Increase \$20 disregard to \$30 and index thereafter.

Consider dependents' benefits under SSI.

Consider changing one-third reduction.

### *National Commission on Social Security*

Increase benefit levels by 25 percent and require states to maintain level of supplementation.

Eliminate food stamp eligibility for SSI recipients.

Eliminate assets test.

Eliminate one-third reduction.

Increase \$20 disregard to \$40 and index thereafter.

### *President's Commission on Pension Policy*

Raise benefit level to poverty level.

Eliminate assets test.

## **Program Administration**

### *Advisory Council on Social Security*

Improve quality and clarity of notices sent to beneficiaries.

Consider federal administration of DI.

*National Commission on Social Security*

Establish independent government agency to administer Social Security, Medicare, SSI, and Medicaid.

Provide additional resources to improve administration.

**Private Pensions**

*Advisory Council on Social Security*

Strengthen private pension.

*National Commission on Social Security*

Employers should not be required to establish pension program.

*President's Commission on Pension Policy*

Establish minimum universal pension system for all workers.

**Benefit Structure**

*Advisory Council on Social Security*

Increase benefits to future long-term, low-wage workers and to high-wage workers.

Scale dropout years to length of service with a maximum of six.

*National Commission on Social Security*

The special minimum benefit should be liberalized.

*President's Commission on Pension Policy*

Adopt earnings sharing upon divorce and inheritance of credits by surviving spouse.

Calculation of special minimum to consider receipt of employee pensions.

## **Retirement Age**

### *Advisory Council on Social Security*

Consider raising retirement age to 68 after year 2000, but do not change entitlement right for those retiring at 62-65.

Consider long-term unemployment benefits for older workers.

### *National Commission on Social Security*

Raise age for full and reduced benefits to 68 and 65, beginning in 2001 with 12-year phase-in.

Institute flexible retirement age plan with incentives for later retirement.

### *President's Commission on Pension Policy*

Raise retirement for full and reduced benefits to 68 and 65, beginning in 1980 with 12-year phase-in.

## **Retirement Test**

### *Advisory Council on Social Security*

Treat retirees under 65 the same as retirees 65 and older, but do not otherwise liberalize retirement test.

### *National Commission on Social Security*

Repeal provision reducing age at which test no longer applies from 72 to 70.

### *President's Commission on Pension Policy*

Retirement test should be removed if proposal to tax benefits is adopted.

## **Cost of Living Increases**

### *Advisory Council on Social Security*

Adjust benefits twice a year whenever prices have increased at least 3 percent.

*National Commission on Social Security*

Automatic benefit increases should be reduced when average wages rise slower than prices with later “catch-up” increases when wages rise faster than prices.

BLS should evaluate special index for Social Security beneficiaries.

*President's Commission on Pension Policy*

BLS should develop special index for the retired.

Endorses 100 percent indexing to changes in prices.

**Tax Policy**

(with respect to income taxes)

*Advisory Council on Social Security*

Tax half of Social Security benefits.

*National Commission on Social Security*

Create income tax credit to mitigate effect of retirement test.

Raise dollar limits on contributions to IRAs.

*President's Commission on Pension Policy*

For tax purposes, Social Security contributions and benefits would be treated in the same way as private pensions.

# **Appendix B**

## **Retirement Income Opportunities in an Aging America: Coverage and Benefit Entitlement\***

### **Executive Summary**

During the last half century, Americans have increasingly enjoyed improvements in their standards of living. Simultaneously significant transformations have taken place in economic and social institutions. As needs have changed the U.S. retirement income system has changed, directly affecting work, leisure and income patterns.

The Reagan Administration's recent proposals to modify Social Security could become the first major benefit cutbacks in the program's history. When the baby boom generation begins to retire twenty-six years from now, additional cutbacks may be necessary. A consensus is growing that employer pensions and private savings should assume an expanded role in providing retirement income security.

#### **The Retirement Income System**

Chapter I of this report provides a summary description of the various retirement income components and discusses their interactive relationships. Each primary component—Social Security, employer sponsored pension plans, personal assets and public welfare programs—has differing goals:

- Social Security is the fundamental program offering retirement income protection to nearly all workers. For most, it is mandatory and financed through automatic payroll taxes. The program's benefit formula is structured to provide all covered workers with "a floor of protection"; thus, it favors lower income workers by providing them with a larger pre-retirement income replacement rate than that given to higher income workers.
- As part of the overall compensation package, employers frequently offer employee pension programs. An employee's length of service and his or her earnings level are often combined factors in determining pension benefit amounts.
- Throughout their lifetimes, individuals accumulate assets based on their desire and ability to provide income security for themselves and their families. Such assets offer protection at times of financial crisis. In retirement years, savings and investments contribute to income security.
- A number of public welfare programs have been created to provide security to those whose retirement income needs are not satisfied by other retirement system components.

\*A report of the Employee Benefit Research Institute, by Sylvester J. Schieber and Patricia M. George and released on July, 1981.

No single retirement income vehicle is able or intended to satisfy all retirement income needs and desires. Public programs attempt to satisfy social needs but cannot fulfill every individual's desires. Employer pension programs are more individually oriented, but they are unable to satisfy broadly defined social goals. Each person's financial circumstances resulting from family wealth and employment and savings patterns directly contribute to accomplishing individual retirement income stability.

There are significant interactions among the various retirement income components. Changes in one component may have countervailing effects on others; thus no one component should be evaluated in isolation. Those concerned with developing retirement income policy must consider the diverse nature and capacity inherent within each income source.

### **Factors Related to Pension Accrual**

Chapter II focuses on employer sponsored pension programs. Since benefit levels in most employer pension programs are based on employees' years of service and earnings, employer pensions cannot provide meaningful retirement income to all workers. Therefore, in assessing the effectiveness of employer pension coverage, a *relevant workforce* is defined. The relevant workforce includes non-agricultural, paid employees, over age 25, who have been in current employment more than one year, and who work more than 1,000 hours annually.

The 25/1/1,000 criteria are used because in developing the 1974 Employee Retirement Income Security Act (ERISA), the Congress determined that these were reasonable requirements for employee pension program participation eligibility. Excluded from the "relevant workforce" are self-employed and agricultural workers. The self-employed are excluded because: (1) generally these individuals are the most qualified to decide whether they should invest their savings in outside retirement income programs or in their own companies; (2) the long-term self-employed frequently accumulate business assets that provide substantial retirement security. It is documented that those who establish successful businesses are among society's most wealthy individuals.<sup>1</sup>

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<sup>1</sup>Peter Diamond and Jerry Hausman, "Individual Savings Behavior," Paper prepared for the National Commission on Social Security (Washington, D.C., 1980), p. 22.

Agricultural workers are excluded from the relevant workforce because farmwork is seasonal and very few hired agricultural workers ever satisfy ERISA's 1,000-hours, one-year employment criteria. In 1979, 71 percent of the 2.6 million hired agricultural employees worked fewer than 150 days in any one job; 59 percent worked fewer than 75 days. More than 37 percent of these workers were under 20 years of age.<sup>2</sup>

In assessing 1979 pension coverage for those in the *relevant workforce*, this report concludes:

- More than 68 percent were employer pension program participants.
- Among participants, more than 80 percent of those who had been in current employment ten or more years were vested in present employer plans.
- Firm age and firm size are important indicators of economic stability; they directly relate to an employer's ability to establish a pension program. Firms with fewer than 25 workers provide jobs to only 19 percent of the relevant workforce, but they accounted for 48 percent of all jobs without pension coverage. Firms with fewer than 100 workers provided 31 percent of relevant workforce jobs but 67 percent of jobs without pension coverage.
- Industry category appears to affect pension availability. For example, the trade and services industries accounted for 39 percent of jobs but 58 percent of jobs without pension coverage in the private sector.
- Employee characteristics such as age, salary level and employment stability affect a worker's ultimate potential to receive pension benefits. Workers earning less than \$10,000 accounted for 28 percent of relevant workforce employment but 44 percent of jobs without pension coverage. Fewer tax incentives and high Social Security replacement rates contribute to this reduced pension coverage pattern for low-income workers.
- Workers who were with their present employers for fewer than five years accounted for 42 percent of jobs but 58 percent of jobs without pension coverage.

## **Trends in Expanding Pension Protection**

Chapter III analyzes private employer pension growth through 1979. Previous analyses have frequently focused on participation rates as the relevant measure of pension expansion. The participation

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<sup>2</sup>Bureau of the Census, *Statistical Abstract of the United States: 1980*, Table 1241, p. 708.



rate seemed to stabilize in the 1970s. Based on this experience, some have concluded that the private pension system has stopped growing. This is incorrect. Although the participation rate grew by 23 percentage points between 1950 and 1979, in absolute numbers participation increased by 263 percent.

The slowing of participation rate increases in the 1970s, occurred for several reasons. During the decade:

—Female labor force participation rates increased by 7.7 percentage points. The baby boom generation entered the workforce. These two factors led to rapid private sector employment increases. For example, in the four years between 1975 and 1979, the nonagricultural workforce grew more than it had in the ten years between 1965 and 1975. Pension programs continued to expand but not as rapidly as the overall workforce.

Employment growth between 1980 and 1985 will slow significantly. This will permit employer pension participation rates to catch up with employment levels.

—ERISA initially contributed to reduced rates in new pension plan formation and increased rates in plan terminations. In 1974, the year before ERISA's implementation, 55,000 net new pension plans were tax-qualified by IRS. However, in 1976 only 3,500 net new plans were created.

—Concurrently Social Security employer and employee payroll taxes were rising dramatically. Social Security and employer pension plans are complementary. Thus increases in Social Security taxes and benefits may have resulted in reducing pension growth.

The private pension system appears to have recovered from the after-shock of ERISA. In 1980 more than 56,000 new pension plans were issued IRS tax qualification letters.

Declining labor force growth, the maturing of baby boom workers, and increasing rates of new plan formation, all suggest that pension participation rates will continue increasing.

## **Prospects for Future Pension Growth**

Chapter IV reviews and analyzes recent, notable forecasts of future private pension growth. The models and the modeling assumptions utilized in developing these forecasts are evaluated. Weaknesses inherent in the assumptions indicate that these forecasts have underestimated potential pension growth.

- The President's Commission on Pension Policy assumed there will be "no increase in plan availability under current policy."<sup>3</sup>
- This assumption is contrary to IRS plan creation data as shown in this report, Table III-9.
- The Pension Commission established arbitrary pension growth limitations that were used in their industry-by-industry forecasts. The model's rapid growth projections, with the arbitrary constraints, predicted 75 percent less pension participation growth between 1979 and 1990 than the same model's projections without the arbitrary constraints.
- A different Pension Commission model developed pension participation forecasts on an individual worker basis. The model stipulated that: "Trends in plan availability are thus controlled primarily through the assumed rate of change in indexed wages."<sup>4</sup> In the model's actual simulation of future pension growth, "the wage rate for estimating coverage was deflated by the rate of increase in average wages."<sup>5</sup> Thus the Commission's forecasts postulated that pension growth was dependent on real wage growth; but they arbitrarily eliminated real wage growth in developing their final forecast, and then concluded that in the future pensions would also not grow.
- Other forecasts *were* developed for the Commission which did assume real wage growth. Under current policies, this "produces an overall increase in coverage in the future."<sup>6</sup> This forecast's results, however, are not publicly available. The Commission's elimination of the effects of wage growth in their pension forecasts is unusual. It is especially peculiar since the Commission, itself, assumed there would be wage growth when they assessed the future impact of their own proposals for policy change.<sup>7</sup>
- To evaluate present coverage rate implications, EBRI developed a series of simulations estimating the likelihood of future pension benefit receipt. At current coverage rates, more than 70 percent of today's young workers (aged 22) can expect to receive employer pension benefits when they retire. While these estimates may seem high, they *are* consistent with forecasts that were prepared for the Pension Commission, which showed 73 percent of current workers aged 25 to 29 can expect to receive pensions.<sup>8</sup>

<sup>3</sup>*Background Analysis of the Potential Effects of Minimum Universal Pension System*, Developed by ICF, Incorporated for the President's Commission on Pension Policy and the Office of Pension and Welfare Benefit Programs (Washington, D.C., 1981), p. 37.

<sup>4</sup>*Ibid.*, Appendix C, p. 23.

<sup>5</sup>*Ibid.*, Appendix C, p. 25.

<sup>6</sup>*Ibid.*

<sup>7</sup>*Ibid.*, p. 36.

<sup>8</sup>*Ibid.*, p. 38.

—Based on questionable assumptions and forecasts, the Pension Commission concluded:

“Commission forecasting models indicate that the proportion of the labor force covered and vested in employee pension plans is not expected to increase significantly under current policies.”<sup>9</sup>

The Commission then went on to develop their major policy recommendations calling for the creation of a mandatory pension program. The Commission’s conclusions and recommendations may have been considerably different if they had used alternative assumptions in their forecasting.

## Retirement Policy Issues

Over the last thirty years voluntary employer pension programs have grown dramatically. In reviewing historical demographic and retirement income program development, the interactions among various retirement system components and differing employer/employee needs and resources, it is apparent that pension coverage patterns have evolved rationally. There is need for further growth, however, especially among some targeted worker groups. Chapter V addresses major policy issues that are relevant to the overall goal of expanding retirement income protection.

Many believe that future Social Security expansion is not possible. Today’s principal policy concerns center on program funding and universal coverage controversies. Proposals for resolving Social Security financing problems and stabilizing employer/employee payroll taxes may result in benefit cutbacks. Such action could, in turn, place additional economic pressures on other retirement income components and on the American people—particularly employers, employees and retirees. Modifications in Social Security’s benefit formula may lead to financial transfers among differing income groups or differing worker generations; or they may require that all members of society expand their individual roles in producing retirement security.

Since voluntary employer programs have demonstrated continuous growth, these programs may absorb some losses resulting from OASDI benefit reductions. Chapter V’s discussion on private employer pension issues focuses on incentives for increasing voluntary retirement income provisions.

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<sup>9</sup>The President’s Commission on Pension Policy, *Coming of Age: Toward a National Retirement Income Policy* (Washington, D.C., 1981), p. 28.

Employers and taxpayers have assumed a large role in providing the American public with retirement income security. However, these two resources are not totally responsible or able to provide everyone with desired retirement income levels. Thus, policy measures should encourage individuals to accept an increased role in preparing for their retirement security.

Many are working toward developing effective retirement income policies that are suitable to the dynamic U.S. economic and social setting. However, additional research is needed before policy alternatives can be intelligently evaluated. The final chapter discusses briefly some principal areas where research gaps exist.

It is a time of economic difficulty requiring budget austerity. An exhaustive, constructive review and reorganization of this nation's priorities is necessary. Retirement security policy changes should be coordinated and consistent with other major policy changes. Additionally policymakers must appreciate that preparing for retirement is a lifetime process. New policies must incorporate sensible transition periods so that individuals and employers can productively respond to new circumstances. Changes permitting reasonable growth within realistic time frames can allay public fears while bolstering the present retirement system's effectiveness.

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